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BUDGET RECONCILIATION RECOMMENDATIONS OF THE COMMITTEE ON FINANCE REGARDING TAX CUTS

AS SUBMITTED TO THE COMMITTEE ON THE BUDGET PURSUANT TO H. CON. RES. 67

COMMITTEE ON FINANCE
UNITED STATES SENATE

WILLIAM V. ROTH, JR., *Chairman*

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PREFACE

H. Con. Res. 67 sets forth the congressional budget for the United States Government for fiscal years 1996, 1997, 1998, 1999, 2000, 2001, and 2002. The resolution instructs Senate and House committees to develop legislation that achieves the levels of deficit reduction established by the resolution.

In addition, the resolution instructs the Committee on Finance to cut taxes if the Congressional Budget Office certifies that the legislative recommendations from all Senate committees would balance the total budget by fiscal year 2002.

These budget reconciliation recommendations of the various committees are submitted to the Committees on the Budget and assembled into a bill which is considered by each House.

H. Con. Res. 67 instructs the Committee on Finance to report, not more than five days after the Congressional Budget Office certification, changes in laws within its jurisdiction necessary to reduce revenues by not more than $50,000,000,000 in fiscal year 2002 and $245,000,000,000 for the period of fiscal years 1996 through 2002.

On October 18, 1995, the Congressional Budget Office certified that, upon review of the legislative recommendations submitted to the Senate Committee on the Budget by 11 Senate committees, enactment of the reconciliation legislation would produce a budget surplus of $10,000,000,000 in 2002.

On October 19, 1995, the Committee on Finance approved legislative recommendations to cut taxes by $42,440,000,000 in fiscal year 2002 and $223,990,000,000 for the period of fiscal years 1996 through 2002 by a vote of 11–9.

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A. Child Tax Credit for Children Under Age 18 (sec. 12001 of the bill and new sec. 23 of the Code)

Present Law

Present law does not provide tax credits based solely on the taxpayer's number of dependent children. Taxpayers with dependent children, however, generally are able to claim a personal exemption for each of these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is $2,500 for 1995, and is adjusted annually for inflation. In 1995, the amount of personal exemptions is phased out for taxpayers with AGI in excess of $114,700 for single taxpayers, $143,350 for heads of household, and $172,050 for married couples filing joint returns. These phaseout thresholds are adjusted annually for inflation.

In general, in order for a taxpayer to claim an individual as a dependent, the individual must (1) be a member of the taxpayer's household for the entire taxable year or be related to the taxpayer, (2) receive more than half of his total support from the taxpayer, (3) be a citizen, national, or resident of the United States or a resident of Canada or Mexico, (4) not file a joint return with his spouse, and (5) have gross income that is less than the exemption amount. This gross income test does not apply to a child of the taxpayer who is (1) under the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins or (2) a student under the age of 24 at the close of such calendar year.

Reasons for Change

The Committee believes that the individual income tax structure does not reduce tax liability by enough to reflect a family's reduced ability to pay taxes as family size increases. In part, this is because over the last 50 years the value of the dependent personal exemption has declined in real terms by over one-third. The Committee believes that a tax credit for families with dependent children will reduce the individual income tax burden of those families, will better recognize the financial responsibilities of raising dependent children, and will promote family values.

Explanation of Provision

In general

The bill provides taxpayers with a maximum nonrefundable tax credit of $500 for each qualifying child under the age of 18 (as of the close of the calendar year in which the taxpayer's taxable year begins). The amount of the credit is not indexed for inflation.

To be a qualifying child, an individual has to satisfy a relationship test and a dependency test. An individual satisfies the relationship test if the individual is a son or daughter of the taxpayer, a descendant of a son or daughter of the taxpayer, a stepson or stepdaughter of the taxpayer, or an adopted child of the taxpayer. An adopted child includes a child who is legally adopted or who is placed with the taxpayer by an authorized placement agency for adoption by the taxpayer. A foster child also satisfies the relationship test if, for the taxpayer's entire taxable year, the foster child (1) is a member of the taxpayer's household and (2) has as his principal place of abode the home of the taxpayer.

An individual satisfies the dependency test if the individual is a dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency deduction. For this purpose, the term "dependent" does not include an individual who is a resident of a country contiguous to the United States unless (1) that individual is an adopted child of a taxpayer who is a U.S. citizen or national and (2) for the taxpayer's entire taxable year, the individual is a member of the taxpayer's household and has as his principal place of abode the home of the taxpayer.

Except in the case of a taxable year closed by reason of the taxpayer's death, the credit is not allowable in the case of a taxable year covering a period of less than 12 months.

Income phaseout

For taxpayers with AGI in excess of certain thresholds, the allowable child credit is reduced by $25 for each $1,000 of AGI (or fraction thereof) in excess of the threshold. Thus, the size of the phaseout range is proportional to the number of qualifying children. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

B. Marriage Penalty Relief: Increase in Standard Deduction for Joint Returns (sec. 12002 of the bill and sec. 63(c) of the Code)

Present Law

Marriage penalty

A married couple generally is treated as one tax unit that must pay tax on the unit's total taxable income. Although married couples may elect to file separate returns, the rate schedules and provisions are structured so that filing separate returns usually results in a higher tax than filing joint returns. Other rate schedules apply to single persons and to single heads of household.

A "marriage penalty" exists when the sum of the tax liabilities of two unmarried individuals filing their own tax returns (either single or head of household returns) is less than their tax liability under a joint return (if the two individuals were to marry). A "marriage bonus" exists when the sum of the tax liabilities of the individuals is greater than their combined tax liability under a joint return.

While the size of any marriage penalty or bonus under present law depends upon the individuals' incomes, number of dependents, and itemized deductions, as a general rule married couples whose earnings are split more evenly than 70–30 suffer a marriage penalty. Married couples whose earnings are largely attributable to one spouse generally receive a marriage bonus.

Under present law, the size of the standard deduction and the tax bracket breakpoints follow certain customary ratios across filing statuses. The standard deduction and tax bracket breakpoints for single filers are roughly 60 percent of those for joint filers. The standard deduction and tax bracket breakpoints for head of household filers are about 83 percent of those for joint filers. With these ratios, unmarried individuals have standard deductions whose sum exceeds the standard deduction they would receive as a married couple filing a joint return. Thus, their taxable income as joint filers may exceed the sum of their taxable incomes as unmarried individuals. Furthermore, because of the way the tax bracket breakpoints are structured, as joint filers they may have some of their taxable income pushed into a higher marginal tax bracket than when they were not married.

The rate changes in the Revenue Reconciliation Act of 1993 exacerbated the already existing marriage penalty because the new tax bracket breakpoints did not provide the customary ratios across filing statuses. For the 36-percent tax bracket, the breakpoint for single filers and for head of household filers are 82 percent and 91 percent, respectively, of the breakpoint for joint filers. For the 39.6-percent tax bracket, the tax bracket breakpoint is $250,000 regardless of filing status.

Standard deduction

Taxpayers who do not itemize deductions may choose the standard deduction. The size of the standard deduction varies according to filing status and is indexed for inflation. For 1995, the size of the standard deduction is as follows:

Filing status	*Standard deduction*
Married, joint return	$6,550
Head of household return	5,750
Single return	3,900
Married, separate return	3,275

For 1996, the size of the standard deduction is projected to be as follows:

Filing status	*Standard deduction*
Married, joint return	$6,700
Head of household return	5,900
Single return	4,000
Married, separate return	3,350

Taxpayers may claim an additional standard deduction if they are blind or aged 65 or older. For 1995, the amount of the additional standard deduction is $750 ($900 if the taxpayer is unmarried and not a surviving spouse). These amounts are indexed for inflation.

The total amount of standard deductions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income.

Reasons for Change

Any attempt to eliminate the marriage penalty involves the balancing of several competing principles, including equal tax treatment of married couples with equal incomes and the determination of equitable relative tax burdens of single individuals and married couples with equal incomes. The Committee is concerned about the inequity of the marriage penalty and the potential work disincentive it causes. The Committee believes that relief from the marriage penalty is needed because marriage penalties in the tax laws undermine respect for the family and may discourage family formation.

The Committee believes that substantial reduction of the marriage penalty can be achieved through a simple approach—an increase in the standard deduction for joint filers. The fact that the standard deduction and the tax bracket breakpoints for joint filers are not twice the respective amounts for single filers introduces a marriage penalty into the heart of the individual income tax rate structure.

By the year 2005, the provision is designed to increase the standard deduction for joint filers to twice that of single filers, eliminating the standard deduction as a source of marriage penalty in the individual income tax for taxpayers without dependents. Providing the marriage penalty relief through an increase in the standard deduction also targets the relief to moderate-income taxpayers, who are less likely to itemize deductions. For example, in 1992, according to information from the Statistics of Income Division of the Internal Revenue Service, about 85 percent of joint returns with AGI under $30,000 and 60 percent of joint returns with AGI under $75,000 chose the standard deduction.

Explanation of Provision

The bill increases the standard deduction for married taxpayers filing a joint return according to the following schedule:

For taxable years beginning in calendar year:	The standard deduction would be—
1996	$6,800
1997	7,150
1998	7,500
1999	7,950
2000	8,200
2001	8,600
2002	9,100
2003	9,500
2004	9,950
2005	10,800

For calendar years after 2005, the amount is indexed for inflation.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

C. Tax Credit for Adoption Expenses; Exclusion for Certain Adoption Expenses (sec. 12003 of the bill and new sec. 24 of the Code)

Present Law

Present law does not provide a tax credit for adoption expenses. Also, present law does not provide an exclusion from gross income for employer-provided adoption assistance. The Federal Adoption Assistance program (a Federal outlay program) provides financial assistance for the adoption of certain special needs children. In general, a special needs child is defined as a child who (1) according to a State determination, could not or should not be returned to the home of the natural parents and (2) on account of a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical condition, or physical, mental or emotional handicap), could not reasonably be expected to be adopted unless adoption assistance is provided. Specifically, the program provides assistance for adoption expenses for those special needs children receiving Federally assisted adoption assistance payments as well as special needs children in private and State-funded programs. The maximum Federal reimbursement is $1,000 per special needs child. Reimbursable expenses include those nonrecurring costs directly associated with the adoption process such as legal costs, social service review, and transportation costs.

Reasons for Change

The Committee believes that the financial costs of the adoption process should not be a barrier to adoptions. Further, employers should be allowed to help their employees meet these expenses. Therefore, the Committee believes that the tax benefits described below will help offset financial burdens associated with the adoption process.

Explanation of Provision

Tax credit

The bill provides taxpayers with a maximum credit against income tax liability of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. Any unused adoption credit will be carried forward by the taxpayer for up to five years. Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys' fees and other expenses that are directly related to the legal and final adoption of an eligible child. An eligible child is an individual (1) who has not attained age 18 as of the time of the adoption, or (2) who is physically or mentally incapable of caring for himself or herself. No credit is allowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, or (3) in connection with the adoption of a child of the taxpayer's spouse. The credit is phased out ratably for taxpayers with taxable income above $60,000, and is fully phased out at $100,000 of taxable income.

The $5,000 limit is a per child limit, not an annual limitation. For example, if a taxpayer incurs $3,000 of qualified adoption expenses in year one and $3,000 of qualified adoption expenses in year two, then the taxpayer will receive a $3,000 credit in year one and a $2,000 credit in year two.

To avoid a double benefit, the bill denies the credit to taxpayers to the extent the taxpayer may use otherwise qualified adoption expenses as the basis of another credit or deduction. Also the credit is not allowed for any expenses for which a grant is received under any Federal, State, or local program. Finally, the credit is not allowed for any expense to the extent the expense is reimbursed under an adoption assistance program and that reimbursement is excluded from gross income

The bill provides that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from each other for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Further, the bill provides that an individual legally separated from his spouse under a decree of divorce or separate maintenance is not considered married for purposes of this provision.

Exclusion from income

The bill provides a maximum $5,000 exclusion from the gross income of an employee for amounts paid by the employer. The $5,000 limit is a per child limit, not an annual limitation. These amounts must be in connection with an adoption of an eligible child (as described above) by an employee if such amounts are furnished pursuant to an adoption assistance program. An adoption reimbursement program operated under section 1052 of title 10 of the U.S. Code (relating to the armed forces) or section 514 of title 14 of the U.S. Code (relating to members of the Coast Guard) is treated as an adoption assistance program for these purposes. An adoption assistance program is a nondiscriminatory plan of an employer under which the employer provides employees with adoption assistance. Also, not more than 5 percent of the benefits under the program for any year can benefit more than 5 percent owners of the employer or their spouses or dependents. An adoption assistance program does not have to be funded. Adoption assistance is a qualified benefit under a cafeteria plan. The exclusion is phased out ratably for taxpayers with taxable income (determined without regard to the exclusion) above $60,000 and is fully phased out at $100,000 of taxable income (determined without regard to the exclusion). No credit is allowed for adoption expenses paid as reimbursed under an adoption assistance program that are excluded from gross income.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

D. Tax Credit for Interest on Student Loans (sec. 12004 of the bill and new sec. 24A of the Code)

Present Law

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest generally is 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.

Reasons for Change

The Committee believes that allowing a credit for interest paid on a student loan will encourage individuals to pursue postsecondary education. America's productivity and ability to compete in global markets will be enhanced if America's workforce is better educated. The Committee recognizes the increasing cost of postsecondary education and the increasing need of many Americans to finance those costs. By allowing a credit, the Committee intends that individuals can take advantage of this benefit regardless of whether they itemize their deductions.

Explanation of Provision

In general

The bill allows individuals who have paid interest on qualified education loans a nonrefundable credit against income tax liability generally equal to 20 percent of such interest. The maximum credit allowed is $500 ($1,000 in the case of a taxpayer paying interest on loans for two or more students). Unused amounts of credit cannot be carried forward or backward to other taxable years.

A qualified education loan generally is any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer or the taxpayer's spouse or dependents in attending (1) higher education institutions and certain area vocational education schools (i.e., eligible educational institutions defined in Code section 135(c)(3)) or (2) 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. Indebtedness incurred by a student from borrowing from a related party is not treated as a qualified education loan.

The qualified higher education expenses have to be paid or incurred (1) within a reasonable period of time before or after the indebtedness is incurred and (2) while the individual using the loan proceeds is at least a half-time student. Indebtedness that is used to refinance any indebtedness described in the previous sentence also is treated as a qualified education loan.

Qualified higher education expenses are the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses). At the time the expenses are incurred, the student has to be the taxpayer or the taxpayer's spouse or dependent.

Income phaseout range for credit

The credit is phased out ratably over the following modified adjusted gross income (modified AGI) ranges: joint filers ($60,000–$75,000) and unmarried individuals ($40,000–$55,000). The beginning of the phaseout ranges (but not the size of the phaseout range) is indexed for inflation for taxable years beginning after 1996. Modified AGI is defined as the taxpayer's AGI (1) increased by the amount otherwise excluded from gross income under Code sections 135, 911, 931, or 933 (relating to educational savings bonds and to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively) and (2) calculated after the inclusion of Social Security benefits in income, the deduction for contributions to individual retirement arrangements, and the limitation on passive losses.

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 is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. For purposes of counting the 60 months, any qualified education loan and all refinancing (that is treated as a qualified education loan) of such loan is treated as a single loan.

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.

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.

Couples who are married at the end of the taxable year have to file a joint return to claim the credit unless they lived apart for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for a dependent child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. An individual legally separated from his spouse under a decree of divorce or separate maintenance is not considered married for purposes of this provision.

Information reporting on student loan interest

Any person in a trade or business or any governmental agency who receives $600 or more in qualified education loan interest from an individual during a calendar year is required to file an information report on such interest to the IRS and to the payor. In the case of interest received by any person on behalf of another person, generally only the first person receiving the interest is required to file the information reports.

Effective Date

The provision is effective for payments of interest due after December 31, 1995, on any qualified education loan. Thus, in the case of already existing qualified education loans used to pay the qualified higher education expenses of the taxpayer or the taxpayer's spouse, interest payments will qualify for the credit to the extent that the 60-month period has not expired.

Subtitle B. Savings and Investment Incentives

A. Provisions Relating to Individual Retirement Arrangements (secs. 12101–12104, 12111, and 12121 of the bill and sec. 408 and new sec. 408A of the Code)

Present Law

In general

Under certain circumstances, an individual is allowed a deduction for contributions (within limits) to an individual retirement account or an individual retirement annuity (an "IRA"). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA. No deduction is permitted with respect to IRA contributions made after an individual attains age 70½.

Deductible IRA contributions

Under present law, the maximum deductible contribution that can be made to an IRA generally is the lesser of $2,000 or 100 percent of an individual's compensation (earned income in the case of self-employed individuals). The maximum IRA deduction limit is increased to $2,250 if the individual is married, files a joint return, and has a spouse that has no compensation (or elects to be treated as having no compensation). The $2,250 contribution may be allocated in any manner between IRAs for each spouse, as long as no more than $2,000 is contributed for either spouse. A contribution to an IRA is treated as made for a taxable year if made by April 15 of the following year.

A single individual is permitted to make the maximum deductible IRA contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has adjusted gross income ("AGI") of less than $25,000. A married taxpayer filing a joint return is permitted to make the maximum deductible IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married couple) is an active participant in an employer-sponsored retirement plan, the maximum IRA deduction is phased out over certain AGI levels. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Nondeductible IRA contributions

Individuals may make nondeductible IRA contributions to the extent they are not permitted to make deductible contributions. An individual may also elect to make nondeductible contributions in lieu of deductible contributions. Thus, any individual may make nondeductible contributions up to the excess of (1) the lesser of $2,000 or 100 percent of compensation over (2) the IRA deduction claimed by the individual. An individual making nondeductible contributions is required to report the amount of such contributions on his or her tax return. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions are not subject to income tax until withdrawn.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than amounts that represent nondeductible contributions) are taxable.

To discourage IRA withdrawals for nonretirement purposes, IRA withdrawals before age 59½, death, or disability are generally subject to an additional 10-percent tax. The 10-percent additional tax does not apply to withdrawals that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the individual or the joint lives (or joint life expectancies) of the individual and the individual's designated beneficiary.

Reasons for Change

The Committee is concerned about the national savings rate, and believes that individuals should be encouraged to save. The Committee believes that the ability to make deductible contributions to an IRA is a significant savings incentive. However, this incentive is not available to all taxpayers under present law. Further, the present-law income thresholds for IRA deductions are not indexed for inflation so that fewer Americans will be eligible to make a deductible IRA contribution each year, and the amount of the maximum contribution is declining in real terms over time. The Committee believes it is appropriate to encourage individual saving and that deductible IRAs should be available to more individuals.

In addition, the Committee believes that some individuals would be more likely to save if funds set aside in a tax-favored account could be withdrawn without tax after a reasonable holding period for retirement or certain special purposes. Some taxpayers may find such a vehicle more suitable for their savings needs.

The Committee believes that providing an incentive to save for certain special purposes is appropriate. The Committee believes that many Americans may have difficulty saving enough to ensure that their children will be able to afford a college education or to purchase a home. The ability to obtain a college education is an important factor in ensuring that the United States remains competitive with other nations. Home ownership is a fundamental part of the American dream. Large medical expenses can often deplete personal savings.

The Committee believes that the present-law rules relating to deductible IRAs penalize American homemakers. The Committee believes that IRA contributions should be permitted for both spouses even though only one spouse works and that an individual should not be precluded from making a deductible IRA contribution merely because his or her spouse participates in an employer-sponsored retirement plan.

Finally, the Committee believes that IRAs should not be precluded from investing in coins and bullion.

Explanation of Provision

In general

The bill phases up the income limits on the deductibility of traditional IRA contributions and modifies the definition of active participant. The bill indexes the $2,000 limit on deductible IRA contributions for inflation. In addition, the bill permits nondeductible contributions to a new IRA Plus. The limits on contributions to traditional IRAs and IRA Plus are coordinated, so that no more than $2,000 could be contributed per year to an individual's IRAs.

In general, an IRA Plus is subject to the same rules as IRAs. However, withdrawals from an IRA Plus are not includible in income (or subject to the 10-percent early withdrawal tax) if attributable to contributions that have been held in the IRA Plus for at least 5 years and are either (1) made after the individual attains age 59½, or (2) made for a special purpose or on account of death or disability or in the form of an annuity. Other withdrawals are taxable (to the extent of earnings on contributions).

The bill allows penalty-free withdrawals from deductible IRAs to the extent used for certain special purposes. Special purposes are the purchase of a first home (up to $10,000), certain education expenses, catastrophic medical expenses, and withdrawals by individuals who have received unemployment compensation for at least 12 weeks.

Expansion of deductible IRAs

The bill provides that a person is not considered an active participant for purposes of the IRA rules merely because his or her spouse is an active participant in an employer-sponsored retirement plan.

Beginning in 1996, for single individuals, the bill phases up the income limits on deductible IRA contributions in $5,000 increments until the phaseout range is $85,000 to $95,000 (in 2007). Also beginning in 1996, for married couples, the deduction is phased out over a $20,000 income range (rather than $10,000) and the phaseout range is increased in $5,000 increments until the phaseout range is $100,000 to $120,000 (in 2007) After these new ranges are reached, the income limits are indexed for inflation in $5,000 increments.

Thus, under the bill, the phase-out ranges are as follows:

Year	Singles	Married couples
1996	$30,000–$40,000	$45,000–$65,000
1997	$35,000–$45,000	$ 50,000–$70,000
1998	$40,000–$50,000	$ 55,000–$75,000
1999	$45,000–$55,000	$60,000–$80,000
2000	$50,000–$60,000	$65,000–$85,000
2001	$55,000–$65,000	$70,000–$90,000
2002	$60,000–$70,000	$75,000–$95,000
2003	$65,000–$75,000	$80,000–$100,000
2004	$70,000–$80,000	$85,000–$105,000
2005	$75,000–$85,000	$90,000–$110,000
2006	$80,000–$90,000	$95,000–$115,000
2007	$85,000–$95,000	$100,000–$120,000
2008 and later	income thresholds indexed for inflation in $5,000 increments	

Spousal IRAs

The bill permits annual contributions of up to $2,000 for each spouse in a married couple.

Inflation adjustment for IRA deduction limit

Under the bill, the $2,000 limit on contributions that can be made to an IRA is indexed for inflation in $500 increments.

IRA investments in coins and metals

The bill permits IRAs to acquire certain coins or bullion, as long as they are in the physical possession of the IRA trustee. Coins that can be held by an IRA are any coin certified by a recognized grading service and traded on a nationally recognized electronic network or listed by a recognized wholesale reporting service and which is (or was at any time) legal tender in the country of issuance or issued under the laws of any State. Under the bill, IRAs could hold gold, silver, platinum, or palladium bullion.

IRA Plus

In general

The bill replaces present-law nondeductible IRAs with new IRA Plus to which individuals can make nondeductible contributions. Generally, IRA Plus are subject to the same rules applicable to deductible IRAs.[1] However, a number of special rules would apply.

Contributions

Contributions to an IRA Plus are nondeductible. IRA Plus contributions may be made by any taxpayer, regardless of the taxpayer's income. The amount of nondeductible contributions to an IRA Plus that can be made for any taxable year are coordinated with the limits for deductible IRAs, so that the maximum permitted contribution to an IRA Plus is reduced by any deductible IRA contribution for the year.

Taxation of distributions

The taxation of withdrawals from an IRA Plus depends on how long the contributions have been in the IRA Plus, the age of the individual, and the purpose of the withdrawal.[2] Withdrawals of amounts attributable to contributions that have been in the IRA Plus for less than 5 years are includible in income (to the extent of earnings). The 10-percent early withdrawal tax also applies to the amount includible, unless the distribution is on account of death or disability or is in the form of an annuity. Withdrawals made after 5 years and before the individual is age 59½ are excludable from income (and not subject to the 10-percent tax) if the withdrawal is made for a special purpose, on account of death or disability, or in the form of an annuity; otherwise, such withdrawals are includible in income (to the extent of earnings) and subject

[1] For example, under present law, the rules requiring capitalization of certain policy acquisition expenses (sec. 848) do not apply to contracts entered into with IRAs. This exception applies to IRA Plus as well as deductible IRAs.

[2] In some cases, the minimum required distribution rules may require distributions from an IRA Plus to begin before the expiration of the 5-year holding period. The 10-percent tax would not apply to such minimum required distributions.

to the 10-percent tax (on earnings). Withdrawals after 5 years and after age 59½ are not includible in income (or subject to the 10-percent tax), regardless of the purpose of the withdrawal.

In determining whether amounts are includible in income under the 5-year rule, distributions are treated as having been made first from the earliest contributions (and earnings attributable to such contributions) remaining in the account at the time of distribution and then from other contributions (and earnings) in the order made. Thus, distributions are deemed to occur under a first-in, first-out (FIFO) method. Any portion of a distribution allocated to a contribution and earnings are allocated first to the earnings on the contribution and then to the contribution. Earnings are allocated to contributions in the manner prescribed by the Secretary of the Treasury. It is intended that any reasonable method can be used to allocate earnings. For purposes of the 5-year rule, all contributions for a taxable year are treated as made on January 1 of that year.

As an example of the operation of the 5-year rule, assume that an individual makes a $2,000 contribution to an IRA Plus on January 1, 1996, and a $2,000 contribution on January 1, 1997. Assume that earnings on the contributions are 10 percent per year. On July 1, 2001, the IRA Plus balance is $6,456, with $3,382 of the balance attributable to the contribution made on January 1, 1996, and $3,074 attributable to the contribution made on January 1, 1997. If the individual withdraws $3,000 on July 1, 2001, for a special purpose, the entire amount is attributable to the contribution made on January 1, 1996. Because the $2,000 contribution made on January 1, 1996, satisfies the 5-year requirement, the entire $3,000 withdrawal is not included in income. After the withdrawal, the account balance is $3,456, $382 ($3,382–$3,000) of which is attributable to the January 1, 1996, contribution.

Assume that the taxpayer withdraws an additional $3,000 on August 1, 2001, for a special purpose and that no additional earnings have been credited to the account at that time. $382 is attributable to the January 1, 1996, contribution and, therefore, is not includible in income. The remaining $2,618 is attributable to the $2,000 contribution made January 1, 1997, which does not satisfy the 5-year requirement. The taxpayer is deemed to withdraw earnings on the January 1, 1997, contribution first; thus, $1,074 is attributed to earnings on the January 1, 1997, contribution and that amount is includible in the taxpayer's income and subject to the 10-percent additional tax on early withdrawals. $1,544 is a return of the January 1, 1997, contribution that is not includible in gross income. The remaining $456 in the IRA Plus is attributable to the January 1, 1997, contribution (but not to earnings, which have all been withdrawn).

Rollovers

Tax-free rollovers from an IRA Plus to another IRA Plus are permitted. For purposes of the 5-year rule, the IRA Plus to which amounts are rolled over are treated as having held the amounts during any period during which such contributions were held in the IRA Plus to which the contributions were first made.

The bill permits amounts withdrawn from present-law IRAs to be rolled over into an IRA Plus. The amount rolled over is includible in gross income in the year the withdrawal is made, except that amounts rolled over to an IRA Plus before January 1, 1998, are includible in income ratably over a 4-year period. The 10-percent early withdrawal tax does not apply to amounts rolled over from an IRA to an IRA Plus.

Special purpose withdrawals

In general

As described above, withdrawals from an IRA Plus after 5 years and before age 59½ are excludable from income (and not subject to the 10-percent early withdrawal tax) if the distribution is for a special purpose. In addition, the bill provides exceptions to the early withdrawal tax in the case of special purpose distributions from deductible IRAs. In general, special purposes are (1) qualified first-time homebuyer distributions that do not exceed $10,000, (2) qualified higher education distributions, (3) distributions used for extraordinary medical expenses, or (4) distributions made to certain unemployed individuals.

Withdrawals by first-time homebuyers

Under the bill, qualified first-time homebuyer distributions are withdrawals of up to $10,000 during the individual's lifetime that are used within 60 days to pay costs (including reasonable settlement, financing, or other closing costs) of acquiring, constructing, or reconstructing the principal residence of a first-time homebuyer who is the individual, the individual's spouse, or a child, grandchild, or ancestor of the individual or individual's spouse. A first-time homebuyer is an individual who has not had an ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which the withdrawal relates. The bill requires that the spouse of the individual also meet this requirement as of the date the contract is entered into or construction commences. The date of acquisition is the date the individual enters into a binding contract to purchase a principal residence or begins construction or reconstruction of such a residence. Principal residence is defined as under the provisions relating to the rollover of gain on the sale of a principal residence.

Under the bill, any amount withdrawn for the purchase of a principal residence is required to be used within 60 days of the date of withdrawal. The 10-percent additional income tax on early withdrawals is imposed with respect to any amount not so used. If the 60-day rule cannot be satisfied due to a delay in the acquisition of the residence, the taxpayer may recontribute all or part of the amount withdrawn to the IRA prior to the end of the 60-day period without adverse tax consequences. Any amount recontributed is treated as a rollover contribution without regard to the limitations on the frequency of IRA-to-IRA rollovers.

Withdrawals for education expenses

Qualified higher education expenses are defined as tuition, fees, books, supplies, and equipment required for courses at an eligible educational institution. Amounts withdrawn are available for use for the education of the individual or the individual's spouse, or a child, grandchild, or ancestor of the individual or the individual's spouse.

The amount that can be considered qualified higher education expenses is reduced by any amount that is excludable from the taxable income of the taxpayer under the provisions relating to education savings bonds.

Financially devastating medical expenses

Withdrawals for the medical expenses of the individual, his or her spouse or dependents, and any child, grandchild, or ancestor of the individual or the individual's spouse, whether or not a dependent of the individual for income tax purposes, is a special purpose withdrawal to the extent such medical expenses exceed 7.5 percent of adjusted gross income.

Distributions to unemployed individuals

Withdrawals by an individual who has received unemployment compensation for at least 12 consecutive weeks under any Federal or State unemployment compensation law is a special purpose distribution.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

B. Establish SIMPLE Retirement Plans (secs. 12131–12132 of the bill and secs. 401(k) and 408(p) of the Code)

Present Law

Present law does not contain rules relating to SIMPLE retirement plans. However, present law does provide a number of ways in which individuals can save for retirement on a tax-favored basis. These include employer-sponsored retirement plans that meet the requirements of the Internal Revenue Code (a "qualified plan") and individual retirement arrangements ("IRAs"). Employees can earn significant retirement benefits under employer-sponsored retirement plans. However, in order to receive tax-favored treatment, such plans must comply with a variety of rules, including complex nondiscrimination and administrative rules (including top-heavy rules). Such plans are also subject to requirements under the labor law provisions of the Employee Retirement Income Security Act of 1974 ("ERISA").

IRAs are not subject to the same rules as qualified plans, but the amount that can be contributed in any year is significantly less. The maximum deductible IRA contribution for a year is limited to $2,000.

Distributions from IRAs and employer-sponsored retirement plans are generally taxable when made. In addition, distributions prior to age 59½ generally are subject to an additional 10-percent early withdrawal tax.

Under one type of qualified plan, employees can elect to reduce their taxable compensation and have nontaxable contributions made to the plan. Such contributions are called elective deferrals, and the plans which allow such contributions are called qualified cash or deferred arrangements (or "401(k) plans"). The maximum annual amount of elective deferrals that can be made by an individual is $9,240 for 1995. This dollar limit is indexed for inflation in $500 increments. A special nondiscrimination test applies to elective deferrals.

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.

An employer may make contributions based on an employee's elective contributions. Such contributions are called matching contributions, and are subject to a special nondiscrimination test similar to the special nondiscrimination test applicable to elective deferrals.

Reasons for Change

Retirement plan coverage is lower among small employers than it is among medium and large employers. The Committee believes that one of the reasons small employers do not establish tax-qualified retirement plans is the complex rules relating to such plans and the cost of complying with such rules. The Committee believes it is appropriate to encourage small employers to adopt retirement plans by providing a simplified retirement plan that is not subject to the complex rules applicable to tax-qualified plans.

Among the rules applicable to tax-qualified plans are nondiscrimination rules that help to ensure that plans cover a broad range of employees, not just an employer's highly compensated employees. The Committee believes that the goal of the nondiscrimination rules, broad pension coverage, is an important one. Unfortunately, the complicated nature of these rules may prevent small employers from establishing any plan. The Committee believes that the purposes of the nondiscrimination rules will be served in the case of small employers if all full-time employees are given the opportunity to participate in the plan, the employer is required to match employee contributions, and there are limits on the total contributions that can be made.

The Committee believes that employees should be encouraged to save for retirement, and thus believes a penalty should be imposed on amounts withdrawn within a short period after the retirement plan is adopted.

Explanation of Provision

In general

The bill creates a simplified retirement plan for small business called the savings incentive match plan for employees ("SIMPLE") retirement plan. SIMPLE plans can be adopted by employers with 100 or fewer employees who do not maintain another employer-sponsored retirement plan. A SIMPLE plan can be either an IRA for each employee or part of a qualified cash or deferred arrangement ("401(k) plan"). If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified plans (including the top-heavy rules) and is not subject to the labor law provisions of ERISA. In addition, simplified reporting requirements apply. Within limits, contributions to a SIMPLE plan are not taxable until withdrawn.

A SIMPLE plan can also be adopted as part of a 401(k) plan. In that case, the plan does not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified plan rules continue to apply.

SIMPLE retirement plans in IRA form

In general

A SIMPLE retirement plan allows employees to make elective contributions to an IRA. Employee contributions have to be expressed as a percentage of the employee's compensation, and cannot exceed $6,000 per year. The $6,000 dollar limit is indexed for inflation in $500 increments.

The employer generally is required to match employee elective contributions on a dollar-for-dollar basis up to 3 percent of the employee's compensation. Under a special rule, the employer can elect a lower percentage matching contribution for all employees (but not less than 1 percent of each employee's compensation). In order for the employer to lower the matching percentage, the employer must notify employees of the applicable match within a reasonable time before the 60-day election period for the year (described below). In addition, a lower percentage cannot be elected for more than 2 out of any 5 years. No contributions other than employee elective contributions and employer matching contributions can be made to a SIMPLE account.

Only employers who normally employ 100 or fewer employees on any day during the year and who do not currently maintain a qualified plan can establish SIMPLE retirement accounts for their employees.

Each employee of the employer who received at least $5,000 in compensation from the employer during each of the 2 preceding years and who is reasonably expected to receive at least $5,000 in compensation during the year must be eligible to participate in the SIMPLE plan. Nonresident aliens and employees covered under a collective bargaining agreement do not have to be eligible to participate in the SIMPLE plan. Self-employed individuals can participate in a SIMPLE plan.

All contributions to an employee's SIMPLE account must be fully vested.

Distributions from a SIMPLE plan generally are taxed as under the rules relating to IRAs, except that an increased early withdrawal tax (25 percent) applies to distributions within the first 2 years the SIMPLE is established.

Tax treatment of SIMPLE accounts, contributions, and distributions

Contributions to a SIMPLE account generally are deductible by the employer. In the case of matching contributions, the employer is allowed a deduction for a year only if the contributions are made by the due date (including extensions) for the employer's tax return. Contributions to a SIMPLE account are excludable from the employee's income. SIMPLE accounts, like IRAs, are not subject to tax. Distributions from a SIMPLE retirement account generally are taxed under the rules applicable to IRAs. Thus, they are includible in income when withdrawn. Tax-free rollovers can be made from one SIMPLE account to another. To the extent an employee is no longer participating in a SIMPLE plan (e.g., the employee has terminated employment), the employee's SIMPLE account shall be treated as an IRA.

Early withdrawals from a SIMPLE account generally are subject to the 10-percent early withdrawal tax applicable to IRAs. However, withdrawals of contributions during the 2-year period beginning on the date the employee first participated in the SIMPLE account are subject to a 25-percent early withdrawal tax (rather than 10 percent).

Administrative requirements

Each eligible employee can elect, within the 60-day period before the beginning of the year, to participate in the SIMPLE plan (i.e., to make elective deferrals), and to modify any previous elections regarding the amount of contributions. An employer is required to contribute employees' contributions to the employee's SIMPLE account within 30 days after the end of the month to which the contributions relate. Employees must be allowed to terminate participation in the SIMPLE plan at any time during the year (i.e., to stop making contributions). The plan could provide that an employee that terminates participation could not resume participation until the following year. A plan can permit (but is not required to permit) an individual to make other changes to his or her salary reduction contribution election during the year (e.g., reduce contributions).

No fee can be imposed on the employee with respect to the employee's initial investment decision with respect to any contributions. This rule is not intended to preclude the imposition of a reasonable fee based on the rate of return on assets held in a SIMPLE account.

Reporting requirements

Trustee requirements.—The trustee of a SIMPLE account is required each year to prepare, and provide to the employer maintaining the SIMPLE plan, a summary description containing the following basic information about the plan: the name and address of the employer and the trustee; the requirements for eligibility; the benefits provided under the plan; the time and method of making salary reduction elections; and the procedures for and effects of, withdrawals from the SIMPLE account. At least once a year, the trustee also is required to furnish an account statement to each individual maintaining a SIMPLE account. In addition, the trustee is required to file an annual report with the Secretary. A trustee who fails to provide any of such reports or descriptions is subject to a penalty of $50 per day until such failure is corrected, unless the failure is due to reasonable cause.

Employer reports.—The employer maintaining a SIMPLE plan is required to notify each employee of the employee's opportunity to make salary reduction contributions under the plan immediately before the employee becomes eligible to make such election. This notice must include a copy of the summary description prepared by the trustee. An employer who fails to provide such notice is subject to a penalty of $50 per day on which such failure continues, unless the failure is due to reasonable cause.

Definitions

For purposes of the rules relating to SIMPLE plans, compensation is compensation required to be reported by the employer on Form W–2, plus any elective deferrals of the employee. In the case of a self-employed individual, compensation is net earnings from self-employment. "Employer" includes the employer and related employers. Related employers include trades or businesses under common control (whether incorporated or not), controlled groups of corporations, and affiliated service groups. In addition, the leased employee rules apply.

For purpose of the rule prohibiting an employer from establishing a SIMPLE plan, if the employer has another qualified plan, an employer is treated as maintaining a qualified plan if the employer (or a predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, with respect to service in the period beginning with the year the SIMPLE plan became effective and ending with the year for which the determination is being made. A qualified plan includes a qualified retirement plan, a qualified annuity plan, a governmental plan, a tax-sheltered annuity, and a simplified employee pension.

SIMPLE 401(k) plans

In general, under the bill, a cash or deferred arrangement (i.e., 401(k) plan), is deemed to satisfy the special nondiscrimination tests applicable to employee elective deferrals and employer matching contributions if the plan satisfies the contribution requirements applicable to SIMPLE plans. In addition, the plan is not subject to the top-heavy rules for any year for which this safe harbor is satisfied. The plan is subject to the other qualified plan rules.

The safe harbor is satisfied if, for the year, the employer does not maintain another qualified plan and (1) employee's elective deferrals are limited to no more than $6,000, (2) the employer matches employees' elective deferrals up to 3 percent of compensation, and (3) no other contributions are made to the arrangement. Contributions under the safe harbor must be 100 percent vested. The employer cannot reduce the matching percentage below 3 percent of compensation.

Effective Date

The provision relating to SIMPLE plans is effective for years beginning after December 31, 1995.

C. Capital Gains Provisions

1. 50-percent capital gains deduction for individuals (sec. 12141 of the bill and new sec. 1202 of the Code)

Present Law

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of capital assets, the net capital gain is taxed at the same rate as ordinary income, except that individuals are subject to a maximum marginal rate of 28 percent of the net capital gain. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss 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 US. publications. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances that would have been available under the straight-line method.

Prior to the enactment of the Tax Reform Act of 1986, individuals were allowed a deduction equal to 60 percent of net capital gain. The deduction resulted in a maximum effective tax rate of 20 percent on such gains.

Capital losses are generally deductible in full against capital gains. In addition, individuals may deduct capital losses against up to $3,000 of ordinary income in each year. Capital losses in excess of the amount deductible are carried forward indefinitely. Prior to the Tax Reform Act of 1986, individuals were required to use two dollars of long-term capital loss to offset each dollar of ordinary income.

Reasons for Change

The Committee believes it is important that tax policy be conducive to economic growth. Economic growth cannot occur without saving, investment, and the willingness of individuals to take risks.

The greater the pool of savings, the greater the monies available for business investment. It is through such investment that the United States' economy can increase output and productivity. It is through increases in productivity that workers earn higher real wages. Hence, greater saving is necessary for all Americans to benefit through a higher standard of living.

The Committee believes that, by reducing the effective tax rates on capital gains, American households will respond by increasing saving. The Committee believes it is important to encourage risk taking and believes a reduction in the taxation of capital gains will have that effect. The Committee also believes that a reduction in the taxation of capital gains will improve the efficiency of the capital markets, because the taxation of capital gains upon realization encourages investors who have accrued past gains to keep their monies "locked in" to such investment even when better investment opportunities present themselves. A reduction in the taxation of capital gains should reduce this "lock in" effect.

Explanation of Provision

The bill allows individuals a deduction equal to 50 percent of net capital gain for the taxable year. The bill repeals the present-law maximum 28-percent rate. Thus, under the bill, the effective rate under the regular tax on the net capital gain of an individual in the highest (i.e., 39.6 percent) marginal rate bracket is 19.8 percent. One-half of the capital gains deduction is a minimum tax preference.

Collectibles are excluded from net capital gain. A maximum rate of 28 percent applies to the net gain of an individual from the sale or exchange of collectibles held for more than one year.

The bill reinstates the rule in effect prior to the 1986 Tax Reform Act that required two dollars of the long-term capital loss of an individual to offset one dollar of ordinary income. The $3,000 limitation on the deduction of capital losses against ordinary income continues to apply.

Effective Date

The provision generally applies to taxable years ending after October 13, 1995.

For a taxpayer's taxable year that includes October 14, 1995, the 50-percent capital gains deduction applies to the lesser of (1) the net capital gain for the taxable year, or (2) the net capital gain determined by taking into account gain or loss properly taken into account for the portion of the taxable year after October 13, 1995. Any net capital gain not eligible for the 50-percent capital gains deduction is subject to the present-law maximum rate of 28 percent. This generally has the effect of applying the 50-percent deduction to capital assets sold or exchanged (or installment payments received) on or after October 14, 1995, and subjecting any remaining net capital gain to a maximum rate of 28 percent.

In the case of gain taken into account by a pass-through entity (i.e., a RIC, a REIT, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date for applying the rule in the preceding paragraph.

The capital loss rule applies to taxable years beginning after December 31, 1995. However, the amendments made by the provision do not apply to the carryover of capital losses sustained in taxable years beginning before January 1, 1996.[3]

2. Small business stock (secs. 12142 and 12143 of the bill and secs. 1045 and 1203 of the Code)

Present Law

The Revenue Reconciliation Act of 1993 provided individuals a 50-percent exclusion for the sale of certain small business stock acquired at original issue and held for at least five years. One-half of the excluded gain is a minimum tax preference.

The amount of gain eligible for the 50-percent exclusion by an individual with respect to any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) $10 million.

In order to qualify as a small business, when the stock is issued, the gross assets of the corporation may not exceed $50 million. The corporation also must meet an active trade or business requirement.

Reasons for Change

The Committee believes it is important to maintain a larger exclusion for stock in small, start-up enterprises. Such enterprises are inherently risky and may not have easy access to the capital necessary to launch a new venture. The Committee believes that it is important to foster such entrepreneurial activities and believes targeted reduction in capital gains taxation will help provide access to needed capital.

The Committee also understands that the present law restrictions on working capital may often be inappropriate in the context of a venture start up enterprise.

Explanation of Provision

The taxable portion of the gain from the sale of small business stock is eligible for the individual capital gains deduction added by section 12141 of the bill. Thus, only 25 percent of the gain of an individual from a qualified sale of small business stock generally is subject to tax. The effective rate under the regular tax on the gain of an individual in the highest (i.e., 39.6 percent) marginal rate bracket is 9.9 percent.

The bill increases the size of an eligible corporation from gross assets of $50 million to gross assets of $100 million. The bill also repeals the limitation on the amount of gain an individual can exclude with respect to the stock of any corporation.

The bill provides that certain working capital must be expended within five years (rather than two years) in order to be treated as used in the active conduct of a trade or business. No limit on the

[3] Section 1212(b)(3), prior to its repeal by section 1002(a) of the Tax Reform Act of 1984, provided a similar rule for the carryover of capital losses sustained in taxable years beginning before January 1, 1970. See Treas. Reg secs. 1.1211–1(b)(3) and 1.1212–1(b)(4) and prior IRS Form 4798.

percent of the corporation's assets that are working capital is imposed.

The bill provides that if the corporation establishes a business purpose for a redemption of its stock, that redemption is disregarded in determining whether other newly issued stock could qualify as eligible stock.

The bill allows an individual to roll over gain from the sale or exchange of small business stock otherwise qualifying for the exclusion where the individual uses the proceeds to purchase other qualifying small business stock within 60 days of the sale of the original stock. If the individual sells the replacement stock, the gain attributable to the original stock is eligible for the small business stock exclusion and the capital gain deduction, and any remaining gain is eligible for the capital gain deduction if held more than one year and the small business exclusion if held for at least five years. In addition, any gain that otherwise would be recognized from the sale of the replacement stock can be rolled over to other small business stock purchased within 60 days.

Effective Date

The increase in the size of corporations whose stock is eligible for the exclusion applies to stock issued after the date of the enactment of the proposal. The remaining provisions apply to stock issued after August 10, 1993 (the original effective date of the small business stock provision).

3. 28-percent corporate alternative tax for capital gains (sec. 12151 of the bill and sec. 1201 of the Code)

Present Law

Under present law, the net capital gain of a corporation is taxed at the same rate as ordinary income, and subject to tax at graduated rates up to 35 percent. Prior to the Tax Reform Act of 1986, the net capital gain of a corporation was subject to a maximum effective tax rate of 28 percent.

Reasons for Change

The Committee observes that net business saving has not increased significantly from its levels of a decade ago. The Committee believes that a lower rate of tax on capital gains at the corporate level will promote economic growth, create new jobs, and encourage investment, saving and risk-taking.

Explanation of Provision

The bill provides an alternative tax of 28 percent on the net capital gain of a corporation if that rate is less than the corporation's regular tax rate.

The bill also provides an alternative rate of 21 percent on the gain from the sale or exchange of qualified small business stock (other than stock of a subsidiary corporation) held more than five years.

Effective Date

The provision generally applies to taxable years ending after October 13, 1995. The 28- percent rate applies to the lesser of (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after October 13, 1995.

The small business stock provision applies to stock issued after date of enactment.

In the case of gain taken into account by a corporation from a pass-through entity (i.e., a RIC, 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 for applying the rule in the preceding paragraph.

D. Alternative Minimum Tax (AMT) Reform

1. Provide relief for depreciation deductions (sec. 12161 of the bill and sec. 56 of the Code)

Present Law

Alternative minimum tax, in general

Present law imposes an alternative minimum tax ("AMT") on an individual or a corporation to the extent the taxpayer's tentative minimum tax exceeds its regular tax liability. The individual minimum tax is imposed at graduated rates of 26 and 28 percent on alternative minimum taxable income in excess of a phased-out exemption amount; the corporate minimum tax is imposed at a rate of 20 percent on alternative minimum taxable income in excess of a phased-out $40,000 exemption amount. Alternative minimum taxable income ("AMTI") is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Depreciation under the AMT

Individuals and corporations must adjust their regular tax depreciation deductions in computing their AMTI. Under the AMT, depreciation on property placed in service after 1986 must be computed by using the class lives prescribed by the alternative depreciation system of section 168(g) and either (1) the straight-line method in the case of property subject to the straight-line method under the regular tax or (2) the 150-percent declining balance method in the case of other property. Under the regular tax, depreciation on such property generally is determined using shorter recovery periods and more accelerated recovery methods. The depreciable lives for some property is the same under both the regular tax and the AMT. For example, automobiles, light general purpose trucks, computers and other qualified technological equipment, and semi-conductor manufacturing equipment have 5-year lives under both the regular tax and the AMT; however, such property has a slower recovery method under the AMT (the 150-percent declining balance method) than it does under the regular tax (the 200-percent declining balance method). Similarly, other property (generally, longer-lived personal property and real property) have the same recovery methods under the regular tax and the AMT, but have longer depreciable lives under the AMT.

In the case of a corporation, in addition to the regular set of adjustments and preferences used in calculating AMTI, there is a second set of adjustments known as the "adjusted current earnings" adjustment. The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings ("ACE") of a corporation exceeds its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction).[4] The determination of ACE generally follows the rules for the determination of corporate earnings and profits. For property placed in service before 1994, depreciation under ACE generally is determined using the straight-line method and the class life determined under the alternative depreciation system.[5] Pursuant to a provision contained in the Omnibus Budget Reconciliation Act of 1993, an ACE depreciation adjustment is not required with respect to property placed in service after 1993.

Reasons for Change

The Committee believes that requiring AMT depreciation to be calculated by using depreciation methods that are slower than the regular tax depreciation methods may present a disincentive to the investment in certain tangible personal property.

Explanation of Provision

For purposes of the individual and corporate AMTs, the bill conforms the AMT depreciation method to the regular tax method. Thus, property that is recovered using the 200-percent declining balance method for regular tax purposes (generally, shorter-lived tangible personal property) will use that method under the AMT. The bill does not change the class lives applicable to any property for AMT purposes.

Effective Date

The provision is effective for property placed in service after December 31, 1995.

2. Allow corporations to take certain minimum tax credits against the minimum tax (sec. 12161 of the bill and sec. 53 of the Code)

Present Law

As described above, present law imposes an alternative minimum tax ("AMT") on an individual or a corporation to the extent the taxpayer's tentative minimum tax exceeds its regular tax liability.

If a taxpayer is subject to the AMT in one year, such amount of tax is allowed as a credit ("AMT credit") in a subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its

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[4] If ACE is less than AMTI, the ACE adjustment may reduce AMTI to the extent of prior-year positive ACE adjustments.

[5] Similar rules apply for purposes of computing corporate earnings and profits under sec. 312(k).

tentative minimum tax in such subsequent year. If the taxpayer is an individual, the AMT credit is allowed to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature (e.g., the adjustment for depreciation). The AMT credit has an unlimited carryforward but cannot be carried back.

Reasons for Change

The Committee believes that the corporate AMT originally was designed to act as a prepayment of tax that would be refunded by way of a credit mechanism when the timing adjustments that gave rise to the AMT reversed themselves and the corporation became subject to the regular tax. However, under present law, the realization of the AMT credit may be postponed to the extent a corporation makes new investments that generate new AMT adjustments and preferences or has preference items that are permanent in nature. In these cases, the value of the AMT credit is diminished by the time value of money and the corporation may have a disincentive to make additional investments that give rise to AMT adjustments and preferences. The Committee provides a mechanism to allow the use of AMT credits, the value of which had been substantially diminished under present law.

Explanation of Provision

The bill allows a corporation with certain AMT credits to offset a portion of its tentative minimum tax in excess of its regular tax. The portion so allowed would be the least of: (1) the amount of the taxpayer's long-term minimum tax credit; (2) 50 percent of the taxpayer's tentative minimum tax; or (3) the amount by which the taxpayer's tentative minimum tax exceeds it regular tax for the year.

Under the bill, an AMT credit will be a long-term minimum tax credit if the credit is attributable to the adjusted net minimum tax of the taxpayer for a taxable year that began after 1986 and ended before the fifth taxable year immediately preceding the taxable year for which the determination is being made. In determining the amount of its long-term minimum tax credit, a corporation will be deemed to use its oldest AMT credits first, whether such usage is (or was) under the present-law provision that allows the use of AMT credits against the regular tax or is under the bill. Thus, for example, a calendar year corporation's long-term minimum tax credit for 1996 will be the amount of its aggregate adjusted net minimum tax for taxable years beginning after 1986 and before 1991, reduced by the amount of the AMT credit used before 1996. If a corporation carries back a loss or credit to a taxable year that causes the corporation to create or increase its adjusted net minimum tax for such year, such amount of AMT will be allocable to the year to which the loss or credit is carried back, not the year in which the loss or credit arose.

The use of AMT credits under the bill does not affect the present-law ability of a corporation to generate AMT credits in the year the provision of the bill is used. Likewise, the bill does not affect (1) the present-law provision that allows a taxpayer to offset the excess of its regular tax over its tentative minimum tax with AMT credits (no matter when such credits originated) or (2) the determination of a corporation's alternative minimum taxable income or its tentative minimum tax (e.g., the 90-percent limitations on the use of net operating losses and foreign tax credits would continue to apply as under present law and the bill is applied after the application of these limitations).

The following examples illustrate the provision:

Example 1.—Assume that calendar year corporation X is liable for a minimum tax of $1,000 in each of the years 1990 through 1994. Corporation X was not subject to the minimum tax before 1990. In 1995, X's regular tax exceeds its tentative minimum tax ("TMT") by $200. Under present law, X is allowed to offset its regular tax with an AMT credit of $200 in 1995. Further assume that in 1996, the TMT of X is $1,000 and its regular tax is $400.

Under the bill, for 1996, X is allowed to offset its TMT of $1,000 with a credit of $500, computed as the least of:

(1) $800, i.e., its long-term minimum tax credit, i.e., its unused AMT credits from 1990;

(2) $500, i.e., one-half of its $1,000 TMT; or

(3) $600, i.e., the excess of its $1,000 TMT over its $400 regular tax.

X will generate an AMT credit of $600 in 1996, i.e., the difference between its TMT of $1,000 and its regular tax is $400.

X's long-term minimum tax credit for 1997 will be $1,300, i.e., X's AMT credit of $1,000 from 1990, reduced by $200 used in 1995 and further reduced by $500 used in 1996, plus X's AMT credit of $1,000 from 1991.

Example 2.—Assume the same facts as in Example 1, except that X has a regular tax of $600 in 1996 (rather than $400). Under the bill, for 1996, X is allowed to offset its TMT of $1,000 with an AMT credit of $400, computed as the least of:

(1) $800, i.e., its unused AMT credits from 1990;

(2) $500, i.e., one-half of its $1,000 TMT; or

(3) $400, i.e., the excess of its $1,000 TMT over its $600 regular tax.

X will generate an AMT credit of $400 in 1996, i.e., the difference between its TMT of $1,000 and its regular tax is $600.

X's long-term minimum tax credit for 1997 will be $1,400, i.e., X's AMT credit of $1,000 from 1990, reduced by $200 used in 1995 and further reduced by $400 used in 1996, plus X's AMT credit of $1,000 from 1991.

Example 3.—Assume the same facts as in Example 1, except that X's minimum tax liability in each of the years 1990 through 1994 was $500 (rather than $1,000 in each year). Under the bill, for 1996, X is allowed to offset its TMT of $1,000 with an AMT credit of $300, computed as the least of:

(1) $300, i.e., the unused AMT credit from 1990;

(2) $500, i.e., one-half of its $1,000 TMT; or

(3) $600, i.e., the excess of its $1,000 TMT over its $400 regular tax.

X will generate an AMT credit of $600 in 1996, i.e., the difference between its TMT of $1,000 and its regular tax is $400.

X's long-term minimum tax credit for 1997 will be $500, i.e., X's AMT credit of $500 from 1990, reduced by $200 used in 1995 and further reduced by $300 used in 1996, plus X's AMT credit of $500 from 1991.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

Subtitle C. Health Care-Related Provisions

A. Treatment of Long-Term Care Insurance (secs. 12201–12204 and 12211–12212 of the bill and secs. 106, 125, 213, 807(d)(3), 1035, 4980B, 6050R and 7702B of the Code, and sec. 1882 of the Social Security Act)

Present Law

In general

Present law generally does not provide explicit rules relating to the tax treatment of long-term care insurance contracts or long-term care services. Thus, the treatment of long-term care contracts and services is unclear. Present law does provide rules relating to medical expenses and accident or health insurance.

Itemized deduction for medical expenses

In determining taxable income for Federal income tax purposes, a taxpayer is allowed an itemized deduction for unreimbursed expenses that are paid by the taxpayer during the taxable year for medical care of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer, to the extent that such expenses exceed 7.5 percent of the adjusted gross income of the taxpayer for such year (sec. 213). For this purpose, expenses paid for medical care generally are defined as amounts paid: (1) for the diagnosis, cure, mitigation, treatment, or prevention of disease (including prescription medicines or drugs and insulin), or for the purpose of affecting any structure or function of the body (other than cosmetic surgery not related to disease, deformity, or accident); (2) for transportation primarily for, and essential to, medical care referred to in (1); or (3) for insurance (including Part B Medicare premiums) covering medical care referred to in (1) and (2).

Exclusion for amounts received under accident or health insurance

Amounts received by a taxpayer under accident or health insurance for personal injuries or sickness generally are excluded from gross income to the extent that the amounts received are not attributable to medical expenses that were allowed as a deduction for a prior taxable year (sec. 104).

Treatment of accident or health plans maintained by employers

Contributions of an employer to an accident or health plan that provides compensation (through insurance or otherwise) to an employee for personal injuries or sickness of the employee, the employee's spouse, or a dependent of the employee, are excluded from the gross income of the employee (sec. 106). In addition, amounts received by an employee under such a plan generally are excluded from gross income to the extent that the amounts received are paid, directly or indirectly, to reimburse the employee for expenses for the medical care of the employee, the employee's spouse, or a dependent of the employee (sec. 105). For this purpose, expenses incurred for medical care are defined in the same manner as under the rules regarding the deduction for medical expenses.

A cafeteria plan is an employer-sponsored arrangement under which employees can elect among cash and certain employer-provided qualified benefits. No amount is included in the gross income of a participant in a cafeteria plan merely because the participant has the opportunity to make such an election (sec. 125). Employer-provided accident or health coverage is one of the benefits that may be offered under a cafeteria plan.

A flexible spending arrangement (FSA) is an arrangement under which an employee is reimbursed for medical expenses or other nontaxable employer-provided benefits, such as dependent care, and under which the maximum amount of reimbursement that is reasonably available to a participant for a period of coverage is not substantially in excess of the total premium (including both employee-paid and employer-paid portions of the premium) for such participant's coverage. Under proposed Treasury regulations, a maximum amount of reimbursement is not substantially in excess of the total premium if such maximum amount is less than 500 percent of the premium. An FSA may be part of a cafeteria plan or provided by an employer outside a cafeteria plan. FSAs are commonly used to reimburse employees for medical expenses not covered by insurance. If certain requirements are satisfied[6], amounts reimbursed for nontaxable benefits from an FSA are excludable from income.

Health care continuation rules

The health care continuation rules require that an employer must provide qualified beneficiaries the opportunity to continue to participate for a specified period in the employer's health plan after the occurrence of certain events (such as termination of employment) that would have terminated such participation (sec. 4980B). Individuals electing continuation coverage can be required to pay for such coverage.

Life insurance company reserve rules

In general, life insurance companies are allowed a deduction for a net increase in reserves and must take into income any net decreases in reserves (sec. 807(a) and (b)). Present law prescribes a tax reserve method based on the nature of the contract. For noncancellable accident and health insurance contracts, the prescribed method is a two-year full preliminary term method (sec. 807(d)(3)(A)(iii)). Long-term care insurance reserves are treated like noncancellable accident and health insurance for this purpose and, therefore, are determined under the two-year full preliminary term method. In no event is the tax reserve for any contract as of any time permitted to exceed the amount which would be taken into account in determining statutory reserves as set forth on the annual statement (sec 807(d)(1)).

[6] These requirements include a requirement that a health FSA can only provide reimbursement for medical expenses (as defined in sec. 213) and cannot provide reimbursement for premium payments for other health coverage and that the maximum amount of reimbursement under a health FSA must be available at all times during the period of coverage.

The amount of any adjustment, whether an increase or a reduction in income, that is attributable to a change in the basis for determining reserves (or for determining any other item referred to in sec. 807(c)) is generally spread over a 10-year period (sec. 807(f)).

Reasons for Change

The Committee desires to provide an incentive for individuals to take financial responsibility for their long-term health care. The bill therefore provides generally for the treatment of long-term care services and eligible long-term care premiums as medical expenses for purposes of the itemized deduction for medical expenses, and the exclusion (subject to dollar limits) from income of certain amounts paid under long-term care insurance contracts and long-term care riders to life insurance contracts that meet the bill's requirements.

Under National Association of Insurance Commissioners (NAIC) Long-Term Care Insurance Model Act and Regulations, which have been adopted by some States, long-term care insurance reserves are calculated under a one-year full preliminary term method, while a two-year full preliminary term method is required for Federal income tax purposes. Because of this inconsistency, in some cases life insurance companies are required to establish reserves for long-term care insurance contracts earlier for State regulatory purposes than they do for Federal tax purposes. In addition, some life insurance companies have voluntarily complied with the NAIC model act and regulations. The bill therefore modifies the reserve method applicable to long-term care insurance contracts under the life insurance company tax rules so that this disparity is eliminated with respect to contracts issued after the effective date.

The bill includes Medicare duplication rules because the Committee believes that these rules are needed to permit the sale of tax-favored long-term care insurance contracts that the bill is designed to foster (as well as other contracts). Current interpretations of existing Medicare duplication rules may curtail sale of these contracts; thus, the bill's changes to these rules are integral to the purpose of the provision.

Explanation of Provision

Tax treatment and definition of long-term care insurance contracts and qualified long-term care services

In general

A long-term care insurance contract is treated as an accident and health insurance contract. A plan of an employer providing coverage under a long-term care insurance contract generally is treated as an accident and health plan; however, coverage under a long-term care insurance contract is not excludable by an employee if provided through a cafeteria plan, and expenses for long-term care services cannot be reimbursed under an FSA.[7] Amounts (other

[7] The bill does not otherwise modify the requirements relating to FSAs. An FSA is defined (as under proposed regulations) as a benefit program providing employees with coverage under which specified incurred expenses may be reimbursed (subject to maximums and other reasonable conditions), and the maximum amount of reimbursement that is reasonably available to a participant is less than 500 percent of the value of the coverage.

than policyholder dividends or premium refunds) received under a long-term care insurance contract generally are excludable as amounts received for personal injuries or sickness (subject to a dollar cap on per diem policies). A contract does not fail to be treated as a long-term care insurance contract solely because it provides for payments on a per diem or other periodic basis without regard to expenses during the period. If the aggregate payments under all per diem contracts issued by the same insurer with respect to any one insured exceed $150 per day, then the excess is not excludable. A payor of long-term care benefits is required to report the amount of such benefits.[8] The $150 limit is indexed.

Premiums for long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses.[9] Similarly, expenses for qualified long-term care services are treated as medical expenses for purposes of the itemized deduction. The $150 limitation does not apply with respect to the deduction of long-term care premiums or expenses as medical expenses.

Definition of long-term care insurance contract

A long-term care insurance contract is defined as any insurance contract that provides only coverage of qualified long-term care services and that meets other requirements. The other requirements are that (1) premiums are level annual payments over the life of the contract (or 20 years, if shorter), (2) refunds (other than refunds on death of the insured or complete surrender or cancellation of the contract) and dividends under the contract may be used only to reduce future premiums or increase future benefits, (3) the contract prohibits borrowing, assignment, or pledging, (4) the contract generally does not pay or reimburse expenses reimbursable under Medicare (except where Medicare is a secondary payor). The bill provides that no provision of law shall be considered or applied so as to prohibit the offering of a long-term care contract on the basis that it coordinates its benefits with those provided under Medicare.

Medicare duplication rules

In addition, the bill provides for coordination with insurance duplication rules under Medicare. Under these rules, as amended by the bill, it is unlawful to sell a health insurance policy (other than a Medicare supplemental policy) to an individual entitled to benefits under part A or B of Medicare with the knowledge that such policy duplicates health benefits to which the individual is otherwise entitled. This anti-duplication rule does not apply to: (1) a health insurance policy providing benefits without regard to other health benefit coverage of the individual; or (2) a policy or rider providing benefits only for long-term care, nursing home care,

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[8] A payor of long-term care benefits is required to report to the IRS the aggregate amount of such benefits paid to any individual during any calendar year, and the name, address and taxpayer identification number of such individual. A copy of the report must be provided to the payee by January 31 following the year of payment, showing the name of the payor and the aggregate amount of benefits paid to the individual during the calendar year. Failure to file the report or provide the copy to the payee is subject to the generally applicable penalties for failure to file similar information reports.

[9] Similarly, within certain limits, in the case of a rider to a life insurance contract, charges against the life insurance contract's cash surrender value that are includible in income are treated as medical expenses (provided the rider constitutes a long-term care insurance contract).

home health care or community based care, or a combination of these. States may not impose additional requirements regarding Medicare duplication on such contracts.

In addition, the bill provides that it is unlawful to sell or issue a Medicare supplemental policy to an individual entitled to benefits under part A or B of Medicare, with the knowledge that the policy duplicates benefits under another Medicare supplemental policy of the individual. Criminal and civil penalties (up to 5 years in jail, or a fine of up to $25,000) apply for failure to comply with these rules, but these penalties waived for policies to which the anti-duplication rules do not apply.

The bill provides that any lawsuit in Federal or State court, relating to these insurance duplication rules under Medicare, cannot be brought or continued if it: (1) was filed after November 5, 1990; (2) includes a cause of action arising prior to date of enactment of the bill; (3) relates to these rules in connection with the sale, issuance or renewal of any health insurance policy; and (4) relates to any health insurance policy, to which the anti-duplication rule does *not* apply, or that was sold before November 5, 1990.

Definition of qualified long-term care services

Qualified long-term care services mean necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, rehabilitative and maintenance (including personal care) services, that are required by a functionally impaired individual. Such services are required to be provided pursuant to a plan of care prescribed by a licensed health care practitioner, and to have as their primary purpose the provision of needed assistance with one or more activities of daily living, or substantial supervision to protect from threats to health and safety due to substantial cognitive impairment.

A functionally impaired individual means one who has been certified within the previous 12 months by a licensed health care practitioner as (1) being unable to perform (without substantial assistance) at least 2 activities of daily living, or (2) requiring substantial supervision to protect such individual from threats to health and safety due to substantial cognitive impairment. Activities of daily living are eating, toileting, transferring, bathing, dressing and continence.

A licensed health care practitioner is defined as a physician (as defined in sec. 1861(r)(1) of the Social Security Act), registered professional nurse, qualified community care case manager, or other qualified individual who meets such requirements as may be prescribed by the Secretary of the Treasury, provided such person is not a relative of the individual receiving care. A qualified community care case manager means an individual or entity with experience in assessing individuals to determine functional and cognitive impairment, and with experience in providing case management services and preparing individual care plans, and that meets requirements prescribed by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services.

Itemized deduction for medical expenses

Unreimbursed expenses for qualified long-term care services provided to the taxpayer or the taxpayer's spouse or dependent are treated as medical expenses for purposes of the itemized deduction for medical expenses (subject to the present-law floor of 7.5 percent of adjusted gross income). Amounts received under a long-term care insurance contract (regardless of whether the contract reimburses expenses or pays benefits on a per diem or other basis) are treated as reimbursement for expenses for this purpose. A deduction is also provided for premiums for insurance covering otherwise deductible expenses for medical care that is provided under a long-term care insurance contract.

Long-term care riders on life insurance contracts

In the case of long-term care insurance coverage provided by a rider on a life insurance contract, the requirements applicable to long-term care insurance contracts applies as if the portion of the contract providing such coverage were a separate contract. The term "portion" means only the terms and benefits that are in addition to the terms and benefits under the life insurance contract without regard to long-term care coverage. The guideline premium limitation applicable under section 7702(c)(2) is increased by the sum of charges (but not premium payments) against the life insurance contract's cash surrender value, the imposition of which reduces premiums paid for the contract (within the meaning of sec. 7702(f)(1)). In addition, it is anticipated that Treasury regulations will provide for appropriate reduction in premiums paid (within the meaning of sec. 7702(f)(1)) to reflect the payment of benefits under the rider that reduce the cash surrender value of the life insurance contract. A similar rule should apply in the case of a contract governed by section 101(f) and in the case of the payments under a rider that are excludable under section 101(g) of the Code (as added by this bill).

Life insurance company reserves

In determining reserves for insurance company tax purposes, the bill provides that the Federal income tax reserve method applicable for a long-term care insurance contract issued after December 31, 1995, is the method prescribed by the National Association of Insurance Commissioners (or, if no reserve method has been so prescribed, a method consistent with the tax reserve method for life insurance, annuity or noncancellable accident and health insurance contracts, whichever is most appropriate). The method currently prescribed by the NAIC for long-term care insurance contracts is the one-year full preliminary term method. As under present law, however, in no event may the tax reserve for a contract as of any time exceed the amount which would be taken into account with respect to the contract as of such time in determining statutory reserves.

Health care continuation rules

The health care continuation rules do not apply to coverage under a long-term care insurance contract.

Consumer protection provisions

Under the proposal, long-term care insurance contracts, and issuers of contracts, are required to satisfy certain provisions of the long-term care insurance model Act and model regulations promulgated by the National Association of Insurance Commissioners (as adopted as of January 1993). The policy requirements relate to disclosure, nonforfeitability, guaranteed renewal or noncancellability, prohibitions on limitations and exclusions, extension of benefits, continuation or conversion of coverage, discontinuance and replacement of policies, unintentional lapse, post-claims underwriting, minimum standards, inflation protection, preexisting conditions, and prior hospitalization. The proposal also provides disclosure and nonforfeiture requirements. The nonforfeiture provision gives consumers the option of selecting reduced paid-up insurance, extended term insurance, or a shortened benefit period in the event a policyholder who elects a nonforfeiture provision is unable to continue to pay premiums. The requirements for issuers of long-term care insurance contracts relate to application forms, reporting requirements, marketing, appropriateness of purchase, format, delivering a shopper's guide, right to return, outline of coverage, group plans, policy summary, monthly reports on accelerated death benefits, and incontestability period. A tax is imposed equal to $100 per policy per day for failure to satisfy these requirements.

Nothing in the proposal prevents a State from establishing, implementing or continuing standards related to the protection of policyholders of long-term care insurance policies, if such standards are not inconsistent with standards established under the proposal.

Effective Date

The provision relating to treatment of long-term care insurance or plans apply to contracts issued after December 31, 1995. The provisions relating to treatment of qualified long-term care services as medical care apply to taxable years beginning after December 31, 1995. The bill provides that no inference is intended as to the tax treatment of long-term care insurance and services prior to the effective date.

A contract providing for payment or reimbursement of services similar to qualified long-term care services, that is issued on or before December 31, 1995, may be exchanged for a long-term care insurance contract tax-free until June 30, 1997. Taxable gain is recognized to the extent money or other property is received in the exchange.

The issuance or conformance of a rider to a life insurance contract providing long-term care insurance coverage is not treated as a modification or a material change for purposes of applying present-law rules relating to flexible premium contracts and the definition of life insurance contracts and modified endowment contracts.

The change in treatment of reserves for long-term care insurance contracts are effective for contracts issued after December 31, 1995.

The provision relating to the reporting of long-term care benefits is effective for benefits paid after December 31, 1995. Thus, the initial year in which reports will be filed with the IRS and copies provided to the payee will be 1997, with respect to long-term care benefits paid in 1996.

The provisions relating to coordination with insurance duplication rules under Medicare are effective as if included with the Omnibus Budget Reconciliation Act of 1990, on November 5, 1990.

The provision relating to consumer protections applies to contracts issued after December 31, 1995 with respect to policy requirements, and to actions taken after December 31, 1995 with respect to actions by insurers.

B. Treatment of Accelerated Death Benefits Under Life Insurance Contracts (secs. 12221–12222 of the bill and secs. 101(g) and 818(g) of the Code)

Present Law

Treatment of amounts received under a life insurance contract

If a contract meets the definition of a life insurance contract, gross income does not include insurance proceeds that are paid pursuant to the contract by reason of the death of the insured (sec. 101(a)). In addition, the undistributed investment income ("inside buildup") earned on premiums credited under the contract is not subject to current taxation to the owner of the contract. The exclusion under section 101 applies regardless of whether the death benefits are paid as a lump sum or otherwise.

Amounts received under a life insurance contract (other than a modified endowment contract) prior to the death of the insured are includible in the gross income of the recipient to the extent that the amount received constitutes cash value in excess of the taxpayer's investment in the contract (generally, the investment in the contract is the aggregate amount of premiums paid less amounts previously received that were excluded from gross income).

If a contract fails to be treated as a life insurance contract under section 7702(a), inside buildup on the contract is generally subject to tax (sec. 7702(g)).

Requirements for a life insurance contract

To qualify as a life insurance contract for Federal income tax purposes, a contract must be a life insurance contract under the applicable State or foreign law and must satisfy either of two alternative tests: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement (sec. 7702(a)). A contract satisfies the cash value accumulation test if the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract. A contract satisfies the guideline premium and cash value corridor tests if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and if the death benefit under the contract is not less than a varying statutory percentage of the cash surrender value of the contract.

Proposed regulations on accelerated death benefits

The Treasury Department has issued proposed regulations[10] under which certain "qualified accelerated death benefits" paid by reason of the terminal illness of an insured would be treated as paid by reason of the death of the insured, and therefore would qualify for exclusion under section 101. In addition, the proposed regulations would permit an insurance contract that includes a qualified accelerated death benefit rider to qualify as a life insurance contract under section 7702. Thus, the proposed regulations provide that including this benefit would not cause an insurance contract to fail to meet the definition of a life insurance contract.

Under the proposed regulations, a benefit would qualify as a qualified accelerated death benefit only if it meets three requirements. First, the accelerated death benefit can be payable only if the insured becomes terminally ill. Second, the amount of the benefit must equal or exceed the present value of the reduction in the death benefit otherwise payable.[11] Third, the cash surrender value and the death benefit payable under the policy must be reduced proportionately as a result of the accelerated death benefit.

For purposes of the proposed regulations, an insured would be treated as terminally ill if he or she has an illness that, despite appropriate medical care, the insurer reasonably expects to result in death within twelve months from the payment of the accelerated death benefit. The proposed regulations would not apply to viatical settlements.

Reasons for Change

The Committee wishes to extend the present-law rule permitting an exclusion from income for amounts paid under a life insurance contract by reason of the death of the insured to accelerated death benefits paid with respect to certain terminally ill insured individuals. In addition, in the case of a terminally ill insured individual, the Committee believes that this exclusion from income should be extended to certain sales or assignments of all or a portion of a life insurance contract to a viatical settlement provider. The Committee believes that the exclusion should be permitted if the amount is received within twelve months before the insured individual's reasonably expected death, because a longer period could become speculative and not realistically related to the time of the individual's death. The Committee also believes that protection of policyholders warrants limitations on the method and maximum rate of discount permitted. In the case of viatical settlement arrangements, similar policyholder protection concerns apply, and the bill consequently refers to provisions of model legislation and regulations covering viatical settlements which are designed to protect policyholders and limit discount rates.

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[10] Prop. Treas. Reg. Secs. 1.101–8, 1.7702–0, 1.7702–2, and 1.7702A–1 (December 15, 1992).

[11] For purposes of determining the present value under the proposed regulations, the maximum permissible discount rate would be the greater of (1) the applicable Federal rate that applies under the discounting rules for property and casualty insurance loss reserves, and (2) the interest rate applicable to policy loans under the contract. Also, the present value would be determined assuming that the death benefit would have been paid twelve months after payment of the accelerated death benefit.

Explanation of Provision

In general

The bill provides an exclusion from gross income as an amount paid by reason of the death of an insured for (1) amounts received under a life insurance contract, and (2) amounts received for the sale or assignment of a life insurance contract to a qualified viatical settlement provider, provided that the insured under the life insurance contract is terminally ill.

A terminally ill individual is defined as one who has been certified by a physician [12] as having an illness or physical condition that reasonably is expected to result in death within 12 months of the date of certification.

The provision does not apply in the case of an amount paid to any taxpayer other than the insured, if such taxpayer has an insurable interest by reason of the insured being a director, officer or employee of the taxpayer, or by reason of the insured being financially interested in any trade or business carried on by the taxpayer.

Amounts received under a life insurance contract

The exclusion for amounts received under a life insurance contract is available only if two requirements are met. First, under a present value test, the amount received must equal or exceed the present value of the reduction in the death benefit otherwise payable under the life insurance contract. Second, under a ratio test, the payment of the amount must not reduce the cash surrender value of the contract proportionately more than the death benefit payable under the contract. In other words, the percentage derived by dividing the cash surrender value of the contract immediately after the distribution by the cash surrender value of the contract immediately before the distribution must equal or exceed the percentage derived by dividing the death benefit payable immediately after the distribution by the death benefit payable immediately before the distribution. The amount received includes a series of payments.

For purposes of the present value test, the present value of the reduction in the death benefit is determined by reference to a maximum permissible discount rate, and by assuming that the death benefit would have been paid on the date that is 12 months from the date of the physician's certification. The maximum permissible discount rate is the highest of the following three interest rates: (1) the 90-day Treasury bill yield (as most recently published); (2) Moody's Corporate Bond Yield Average-Monthly Average Corporates (or any successor rate) for the month ending two months before the date the rate is determined; or (3) the rate used to determine cash surrender values under the contract during the applicable period plus 1 percent per annum. It is intended that the

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[12] A physician is defined for these purposes as in section 1861(r)(1) of the Social Security Act, which provides that a physician means a doctor of medicine or osteopathy legally authorized to practice medicine and surgery by the State in which he performs such function or action (including a physician within the meaning of section 1101(a)(7) of that Act). Section 1101(a)(7) of that Act provides that the term physician includes osteopathic practitioners within the scope of their practice as defined by State law.

rate be determined as of the date (or dates) that the payment is made.

For example, assume that an insured is certified as being terminally ill on January 1, 1996. Assume also that the maximum permissible discount rate is 10 percent and that the cash surrender value of the contract is $100,000 and the death benefit payable is $500,000. Finally, assume that an accelerated death benefit is paid on July 1, 1996 which reduces the death benefit payable under the contract by $200,000 (i.e., from $500,000 to $300,000). Under these facts, the applicable discount period would be six months (i.e., the period between July 1, 1996, and January 1, 1997)[13] and thus, the amount of the accelerated death benefit paid must equal or exceed $190,280 (i.e., the $200,000 reduction in the death benefit payable discounted at 10 percent for six months). In addition, the cash surrender value of the contract after distribution of the accelerated death benefit must equal or exceed $60,000.

If the accelerated death benefit under the contract is paid in connection with a lien against the death benefit rather than an actual reduction in the death benefit on a discounted basis, then the amount of the lien, and interest charges with respect to any amount in connection with the lien, are taken into account as follows, so as to achieve parity between use of the lien method and use of a discounted payment. First, for purposes of applying the present value test and the ratio test (described above), the amount of the lien is treated as a reduction in the death benefit and in the cash surrender value. Any interest charges, with respect to any amount in connection with the lien, that could encumber the cash surrender value or the death benefit in the future are also treated as a reduction in the cash surrender value or the death benefit at the time of the accelerated benefit payment. Second, any interest rate applicable with respect to any amount in connection with the lien cannot exceed the maximum permissible discount rate that applies under the present value test (described above). Thus, such interest cannot exceed the amount of the discount that would have been permitted had the accelerated benefit been paid on a discounted basis instead of by use of a lien, and the lien cannot encumber the cash surrender value proportionately more than it encumbers the death benefit.

For life insurance company tax purposes, the bill provides that a life insurance contract is treated as including a reference to a qualified accelerated death benefit rider to a life insurance contract. A qualified accelerated death benefit rider is any rider on a life insurance contract that provides for a distribution to an individual upon becoming a terminally ill individual (as defined by the bill).

Viatical settlements

The bill provides an exclusion for the amount paid for the sale or assignment to a viatical settlement provider of a life insurance contract on the life of an insured individual who is terminally ill. A viatical settlement provider is any person that is regularly engaged in the trade or business of purchasing or taking assignments

[13] January 1, 1997 is the date 12 months after the date of the physician's certification.

of life insurance contracts on the lives of terminally ill individuals and either (1) is licensed for such purposes in the State in which the insured resides, or (2) if the person is not required to be licensed by that State, meets the requirements of sections 8 and 9 of the Viatical Settlements Model Act issued by the National Association of Insurance Commissioners (NAIC) (relating to disclosure requirements and general rules for a viatical settlement contract). In addition, any such sale or assignment of a life insurance contract is required to satisfy the requirements of the section of the Viatical Settlements Model Regulation issued by the NAIC relating to standards for evaluation of reasonable payments, including discount rates.

Effective Date

The provision applies to amounts received after December 31, 1995. The discount rules applicable to payments under life insurance contracts do not apply to any amount received before July 1, 1996. The provision treating a qualified accelerated death benefit rider as life insurance for life insurance company tax purposes takes effect on January 1, 1996. The issuance of a qualified accelerated death benefit rider to a life insurance contract, or the addition of any provision required to conform an accelerated death benefit rider to these provisions, would not be treated as a modification or material change of the contract for purposes of the definition of a life insurance contract and a modified endowment contract (and would not affect the issue date of any contract under section 101(f)).

C. Medical Savings Accounts (secs. 12231-12233 of the bill and secs. 106 and 125 and new secs. 224 and 7705 of the Code)

Present Law

Under present law, the tax treatment of health insurance expenses depends on whether the individual is an employee or self employed, and whether the individual is covered under an employer-sponsored health plan. Employer contributions to a health plan for coverage for the employee and the employee's spouse and dependents is excludable from the employee's income. In addition, employers generally can deduct, as an employee compensation expense, the full cost of any health insurance coverage provided for their employees. The exclusion and deduction are generally also available in the case of owners of subchapter C corporations who are also employees.

Self-employed individuals are entitled to a deduction for 30 percent of the amount paid for health insurance for a self-employed individual and the individual's spouse and dependents. The 30-percent deduction is also available to more than 2-percent shareholders of subchapter S corporations. The 30-percent deduction is available with respect to self insurance, as well as commercial insurance. Of course, the self-insured plan must in fact be insurance (e.g., there must be appropriate risk shifting) and not merely a reimbursement arrangement.

Individuals who itemize their tax deductions may deduct unreimbursed medical expenses (including expenses for medical insurance) paid during the year to the extent that the total of such expenses exceeds 7.5 percent of the individual's adjusted gross income ("AGI"). Medical expenses include the expenses of the individual and his or her spouse or dependents.

Reasons for Change

The fact that Americans with low-deductible health insurance have few incentives to lower their health costs or benefit from staying well are major factors affecting health care cost growth. One approach to providing incentives for Americans to be more cost conscious purchasers of medical services is to make available alternatives to low-deductible insurance such as medical savings accounts ("MSAs"). MSAs will give people more control over their health care dollars. Because MSAs afford people the opportunity to save unspent MSA funds for future health and long-term care needs, the Committee believes that people will be more careful in their purchase of health care services.

Explanation of Provision

In general

In general, the bill permits individuals who are covered by a high-deductible health plan to maintain a medical savings account ("MSA"). Only one MSA can be maintained per family. Within limits, contributions to a MSA are deductible if made by the individual, or alternatively, are excludable from an employee's income if made by the employer. An individual cannot make contributions to a MSA if the individual is eligible for employer-subsidized health care (or to receive employer contributions to a MSA). A self-employed individual is not treated as his or her own employer for purposes of this rule. Income earned on amounts held in a MSA are not currently includible in income. Withdrawals from a MSA are excludable from income if used for medical expenses for the individual and his or her spouse or dependents.

Contributions to MSAs

The bill extends the present-law tax treatment for medical expenses to MSA contributions (within certain limits). Thus, an individual can deduct MSA contributions to the extent the contributions, together with other medical expenses for the year, exceed 7½ percent of AGI. Self-employed individuals can deduct 30 percent of MSA contributions. Employer contributions to a MSA are excludable from income for income and employment tax purposes. An individual is not eligible to make contributions to a MSA if the individual is eligible to receive employer-subsidized health care (or to receive employer contributions to a MSA).

The maximum annual amount of contributions that can be taken into account for purposes of the deductions for individual contributions or the exclusion for employer contributions is limited to the lesser of (1) the deductible under the high deductible health plan, and (2) \$2,000 (\$4,000 in the case of family coverage). The dollar limits are indexed for medical inflation after 1996 (rounded to the nearest multiple of $50).

This maximum contribution limit is determined separately for each month based on the individual's status as of the first day of the month, including: (1) whether the individual is eligible to make MSA contributions, (2) whether the high-deductible health plan covers only the individual or also a spouse and dependents, and (3) the amount of the deductible under the plan. The maximum annual contribution is the sum of the monthly contribution limits.

A high deductible plan is a plan with an annual deductible of at least $1,500 in the case of individual coverage and, in the case of coverage of more than one person, a limit on the aggregate deductibles for all persons covered of at least $3,000. These dollar amounts are indexed for medical inflation after 1996 (rounded to the nearest multiple of $50).

Contributions to a MSA for a taxable year can be made until the due date for filing the individual's tax return for the year (determined without regard to extensions).

The bill does not expressly limit the timing of employer contributions. Thus, for example, an employer could make monthly contributions or a single annual contribution to a MSA. Employer contributions made through a cafeteria plan are not excludable from income.

Definition and tax treatment of MSAs

In general, a MSA is a trust (or a custodial account) created exclusively for the benefit of the beneficiaries of the trust that meets requirements similar to those applicable to individual retirement arrangements ("IRAs").[14] The trustee of a MSA can be a bank, insurance company,[15] or other person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with applicable requirements.

Earnings in amounts in a MSA are not currently taxed.

Distributions from a MSA

Distributions from a MSA that are used to pay the unreimbursed qualified medical expenses of the individual or the individual's spouse or dependents are not taxable. Qualified medical expenses are generally defined as under the rules relating to the itemized deduction for medical expenses (as modified by the bill), and thus include amounts expended for qualified long-term care services. Qualified medical expenses do not include any insurance premiums (including premiums for the high-deductible health plan), except for premiums for long-term care insurance, health care continuation coverage for certain individuals who have lost employer-provided health coverage, and coverage while the individual is receiv-

[14] For example, MSA contributions (other than amounts rolled over from another MSA) must be in cash, no MSA assets can be invested in life insurance contracts, MSA assets cannot be commingled with other property except in a common trust fund or common investment fund, and an account holder's interest in a MSA must be nonforfeitable. In addition, if an account holder engages in a prohibited transaction with respect to a MSA or pledges assets in a MSA, rules similar to those for IRAs apply, and any amounts treated as distributed to the account holder under those rules are treated as not used for qualified medical expenses.

[15] The acquisition expenses of an insurance company relating to the establishment of a MSA would not be subject to the rules relating to the capitalization of policy acquisition expenses.

ing unemployment compensation. Qualified medical expenses paid with distributions from a MSA that are excludable from gross income cannot be taken into account for purposes of the itemized deduction for medical expenses. Amounts do not fail to be qualified medical expenses merely because the amounts are not paid directly to medical providers, but rather are reimbursements to the individual for medical expenses paid during the year.

Distributions for purposes other than qualified medical expenses are taxable to the extent not attributable to nondeductible contributions. An additional tax of 10 percent of the taxable amount also applies unless the distribution is made after the individual attains the age of 59½, dies, or becomes disabled.

If certain events occur, a MSA ceases to be a MSA. This can happen if an individual engages in a prohibited transaction during a taxable year. In addition, a MSA ceases to be treated as a MSA unless the individual remains in a high-deductible health plan for at least two years after the MSA is established. This two-year rule does not apply to an individual who does not remain in a high-deductible health plan because of the termination of employment. If a MSA ceases to be treated as a MSA, the individual is treated as taking the account balance as a distribution for purposes other than qualified medical expenses.

Rollovers from one MSA to another MSA are permitted without income inclusion if made within 60 days of distribution. Once a rollover is made, another rollover cannot be made for at least a one-year period.

The bill includes a correction mechanism so that if contributions for a year (whether made by the individual or the employer) exceed the deduction limit for the year, the excess contribution can be withdrawn tax free. In order for tax-free treatment to apply, the excess contributions must be withdrawn before the due date (including extensions) for filing the individual's tax return for the year and be accompanied by the amount of income attributable to such contribution.

Upon the death of the individual, a MSA is not subject to estate tax. Income tax treatment of a MSA depends on who is the individual's beneficiary. If the beneficiary is the surviving spouse, then the spouse may continue the MSA as his or her own. Thus, new contributions can be made by the spouse (or the spouse's employer) if the spouse is in a high deductible plan. Tax-free distributions can be made from the account for the benefit of the spouse and his or her dependents (and any subsequent spouse).

If the beneficiary is not the surviving spouse, then the MSA balance is included in the income of the beneficiary in the year of death (to the extent not attributable to nondeductible contributions). If the individual does not designate a beneficiary, then the MSA account balance is includible in the individual's income for the year of death.

Effective Date

The provision is effective with respect to taxable years beginning after December 31, 1995.

D. Increase Dollar Limits for Burial Insurance (sec. 12241 of the bill and sec. 7702(e) of the Code)

Present Law

To qualify as a life insurance contract for Federal income tax purposes, a contract must be a life insurance contract under the applicable State or foreign law and must satisfy either of two alternative tests: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement (sec. 7702). A contract satisfies the cash value accumulation test if the cash surrender value of the contact may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract. A contract satisfies the guideline premium and cash value corridor tests if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and if the death benefit under the contract is not less than a varying statutory percentage of the cash surrender value of the contract. Under these rules, the death benefit is generally deemed not to increase (sec. 7702(e)(1)(A)).

Special rules apply with respect to a contract that is purchased to cover payment of burial expenses or in connection with prearranged funeral expenses. For such a contract, death benefit increases may be taken into account in applying the cash value accumulation test if the contract (1) has an initial death benefit of $5,000 or less and a maximum death benefit of $25,000 or less, and (2) provides for a fixed predetermined annual increase not to exceed 10 percent of the initial death benefit or 8 percent of the death benefit at the end of the preceding year (sec. 7702(e)(2)(C)).

Reasons for Change

The Committee believes that the amount of the dollar limits with respect to insurance covering payment of burial expenses or prearranged funeral expenses should be adjusted to reflect increasing costs in the economy, including the cost of burials and funerals.

Explanation of Provision

The provision increases the dollar limits applicable in the case of an insurance contract to cover payment of burial expenses or in connection with prearranged funeral expenses. For such a contract, death benefit increases may be taken into account in applying the cash value accumulation test if the contract has an initial death benefit of $7,000 or less and a maximum death benefit of $30,000 or less (and other requirements of present law are met). In addition, these dollar limits are to be adjusted annually, after 1995, for inflation in accordance with the consumer price index.

Effective Date

The provision is effective for contracts entered into after December 31, 1995.

E. Health Insurance Organizations Eligible for Benefits of Section 833 (sec. 12242 of the bill and sec. 833 of the Code)

Present Law

An organization described in section 501(c)(3) or (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance (sec. 501(m)). Special rules apply to certain eligible health insurance organizations. Eligible health insurance organizations are (1) Blue Cross or Blue Shield organizations existing on August 16, 1986, which have not experienced a material change in structure or operations since that date, and (2) other organizations that meet certain community-service-related requirements and substantially all of whose activities involve the providing of health insurance (sec. 833). Section 833 provides that eligible organizations are generally treated as stock property and casualty insurance companies.

Section 833 provides a special deduction for eligible organizations, equal to 25 percent of the claims and expenses incurred during the year, less the adjusted surplus at the beginning of the year. This deduction is calculated by computing surplus, taxable income, claims incurred, expenses incurred, tax-exempt income, net operating loss carryovers, and other items attributable to health business. The deduction may not exceed taxable income attributable to health business for the year (calculated without regard to this deduction).

In addition, section 833 eliminates, for eligible organizations, the 20-percent reduction in unearned premium reserves that applies generally to all property and casualty insurance companies.

Reasons for Change

The Committee believes fairness dictates that the special rules benefitting Blue Cross and Blue Shield organizations under section 833 should apply to certain organizations that became taxable by reason of the same provision of the Tax Reform Act of 1986 that made Blue Cross and Blue Shield organizations taxable, if such organizations are not Blue Cross or Blue Shield organizations, but otherwise meet the eligibility requirements.

Explanation of Provision

The bill applies the special rules under section 833 to the same extent they are provided to certain existing Blue Cross or Blue Shield organizations, in the case of any organization that (1) is not a Blue Cross or Blue Shield organization existing on August 16, 1986, and (2) otherwise meets the requirements of section 833(c)(2) (including the requirement of no material change in operations or structure since August 16, 1986). Under the provision, an organization qualifies for this treatment only if (1) it is not a health maintenance organization, and (2) it is organized under and governed by State laws which are specifically and exclusively applicable to not-for-profit health insurance or health service type organizations.

Effective Date

The provision is effective for taxable years ending after October 13, 1995.

Subtitle D. Estate and Gift Tax Reform

A. Reduction in Estate Tax for Qualified Family-Owned Businesses (sec. 12301 of the bill and new sec. 2033A of the Code)

Present Law

Application of the estate and gift tax

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.[16] Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million (Code sec. 2001(c)).

The amount of gift tax payable for any calendar year generally is determined by applying the tax rates (from the unified rate schedule) to the cumulative lifetime taxable transfers made by the taxpayer, and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period. A taxpayer may exclude $10,000 of gifts made to any one donee during a calendar year (sec. 2503).

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable transfers made by the taxpayer during his lifetime or at death and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at $192,800 (sec. 2010), which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased-out by a 5-percent surtax imposed upon cumulative taxable transfers over $10 million and not exceeding $21,040,000 (sec. 2001(c)(2)).[17]

The unified credit originally was enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted $175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of $47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an effective exemption of $225,000 in 1982 to an effective exemption of $600,000 in 1987. The unified credit has not been increased since 1987.

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[16] Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

[17] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her average transfer tax rate will be 55 percent under present law.

Special use valuation of farms and other closely-held businesses

Generally, for Federal transfer tax purposes, the value of property is its fair market value. Under section 2032A, an executor may elect for estate tax purposes to value certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current use value, rather than its highest and best use value. The maximum reduction in the value of such real property resulting from an election under section 2032A is $750,000.

If, after the special use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent's death (15 years for decedents dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special use valuation.

Installment payment of estate tax attributable to closely-held businesses

Under section 6166, an executor generally may elect to pay the Federal estate tax attributable to an interest in a closely-held business in installments over, at most, a 14-year period. To qualify for the election, the business must be an active trade or business and the value of the decedent's interest in the closely-held business must exceed 35 percent of the decedent's adjusted gross estate.

If an election is made, the estate pays only interest for the first four years, followed by up to 10 annual installments of principal and interest. Interest is generally imposed at the rate applicable to underpayments of tax under section 6621 (i.e., the Federal short-term rate plus 3 percentage points). Under section 6601(j), however, a special 4-percent interest rate applies to the amount of deferred estate tax attributable to the first $1,000,000 in value of the closely-held business. The maximum amount that may be subject to the four-percent rate is the lower of (1) $345,800 (i.e., the amount of estate tax on the first $1,000,000), less the amount of allowable unified credit, or (2) the amount of estate tax attributable to the closely-held business that is being paid in installments pursuant to section 6166.

Reasons for Change

The Committee believes that a reduction in estate taxes for qualified family-owned businesses will protect and preserve family farms and other family-owned enterprises, and prevent the liquidation of such enterprises in order to pay estate taxes. The Committee further believes that the protection of family enterprises will preserve jobs and strengthen the communities in which such enterprises are located.

Explanation of Provision

Overview

The bill provides special estate tax treatment for qualified "family-owned business interests" if such interests comprise more than 50 percent of a decedent's estate. Subject to the requirements set forth below, the bill excludes the first $1.5 million of value in qualified family-owned business interests from the decedent's estate, and also excludes from the estate 50 percent of the value of qualified family-owned business interests between $1.5 million and $5 million. Thus, the total amount of exclusion available per decedent for qualified family-owned business interests is equal to $3.25 million (i.e., $1.5 million plus 50 percent of $3.5 million).

This new exclusion for qualified family-owned business interests is provided in addition to the unified credit (which presently effectively exempts $600,000 of taxable transfers from the estate and gift tax, and will be increased to an effective exemption of $750,000 of taxable transfers under other provisions of the bill) and the special-use provisions of section 2032A (which permit the exclusion of up to $750,000 in value of a qualifying farm or other closely-held business from a decedent's estate).

Qualified family-owned business interests

For purposes of the bill, a qualified family-owned business interest is defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if ownership of the trade or business is held at least 50 percent by one family, 70 percent by two families, or 90 percent by three families, as long as the decedent's family owns at least 30 percent of the trade or business. Under the provision, members of an individual's family are defined using the same definition as is used for the special-use valuation rules of section 2032A, and thus include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants. For purposes of applying the ownership tests in the case of a corporation, the decedent and members of the decedent's family are required to own the requisite percentage of the total combined voting power of all classes of stock entitled to vote *and* the requisite percentage of the total value of all shares of all classes of stock of the corporation. In the case of a partnership, the decedent and members of the decedent's family are required to own the requisite percentage of the capital interest, and the requisite percentage of the profits interest, in the partnership.

In the case of a trade or business that owns an interest in another trade or business (i.e., "tiered entities"), special look-through rules apply. Each trade or business owned (directly or indirectly) by the decedent and members of the decedent's family is separately tested to determine whether that trade or business meets the requirements of a qualified family-owned business interest. In applying these tests, any interest that a trade or business owns in another trade or business is disregarded in determining whether the first trade or business is a qualified family-owned business interest. The value of any qualified family-owned business interest held by an entity is treated as being proportionately owned by or for the entity's partners, shareholders, or beneficiaries. In the case of a multi-tiered entity, such rules are sequentially applied to look through each separate tier of the entity.

For example, if a holding company owns interests in two other companies, each of the three entities will be separately tested under the qualified family-owned business interest rules. In determining whether the holding company is a qualified family-owned business interest, its ownership interest in the other two companies is disregarded. Even if the holding company itself does not qualify as a family-owned business interest, the other two companies still may qualify if the direct and indirect interests held by the decedent and his or her family members satisfy the requisite ownership percentages and other requirements of a qualified family-owned business interest. If either (or both) of the lower-tier entities qualify, the value of the qualified family-owned business interests owned by the holding company are treated as proportionately owned by the holding company's shareholders.

An interest in a trade or business does not qualify if the business's (or a related entity's) stock or securities were publicly-traded at any time within three years of the decedent's death. An interest in a trade or business also does not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent's death was personal holding company income (as defined in section 543). This personal holding company restriction does not apply to banks or domestic building and loan associations.

The value of a trade or business qualifying as a family-owned business interest is reduced to the extent the business holds passive assets or excess cash or marketable securities. Under the bill, the value of qualified family-owned business interests does not include any cash or marketable securities in excess of the reasonably expected day-to-day working capital needs of the trade or business. For this purpose, it is intended that day-to-day working capital needs be determined based on a historical average of the business's working capital needs in the past, using an analysis similar to that set forth in *Bardahl Mfg. Corp.*, 24 T.C.M. 1030 (1965). It is further intended that accumulations for capital acquisitions not be considered "working capital" for this purpose. The value of the qualified family-owned business interests also does not include certain other passive assets. For this purpose, passive assets include any assets that (a) produce dividends, interest, rents, royalties, annuities and certain other types of passive income (as described in sec. 543(a)); (b) are an interest in a trust, partnership or REMIC (as described in sec. 954(c)(1)(B)(ii)); (c) produce no income (as described in sec. 954(c)(1)(B)(iii)); (d) give rise to income from commodities transactions or foreign currency gains (as described in sec. 954(c)(1)(C) and (D)); or (e) produce income equivalent to interest (as described in sec. 954(c)(1)(E)). In the case of a regular dealer in property, such property is not considered to produce passive income under these rules, and thus, is not considered to be a passive asset.

Qualifying estates

A decedent's estate qualifies for the special treatment only if the decedent was a U.S. citizen or resident at the time of death, and the aggregate value of the decedent's qualified family-owned business interests that are passed to qualified heirs exceeds 50 percent of the decedent's adjusted gross estate (the "50-percent liquidity test"). For this purpose, qualified heirs include any individual who has been actively employed by the trade or business for at least 10 years prior to the date of the decedent's death, and members of the decedent's family. If a qualified heir is not a citizen of the United States, any qualified family-owned business interest acquired by that heir must be held in a trust meeting requirements similar to those imposed on qualified domestic trusts (under present-law sec. 2056A(a)), or through certain other security arrangements that meet the satisfaction of the Secretary. The 50-percent liquidity test generally is applied by adding all transfers of qualified family-owned business interests made by the decedent to qualified heirs at the time of the decedent's death, plus certain lifetime gifts of qualified family-owned business interests made to members of the decedent's family, and comparing this total to the decedent's adjusted gross estate. To the extent that a decedent held qualified family-owned business interests in more than one trade or business, all such interests are aggregated for purposes of applying the 50-percent liquidity test.

The 50-percent liquidity test is calculated using a ratio, the numerator and denominator of which are described below.

The numerator is determined by aggregating the value of all qualified family-owned business interests that are includible in the decedent's gross estate and are passed from the decedent to a qualified heir, plus any lifetime transfers of qualified business interests that are made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family and were not otherwise includible in the decedent's gross estate. For this purpose, qualified business interests transferred to members of the decedent's family during the decedent's lifetime are valued as of the date of such transfer. This amount is then reduced by all indebtedness of the estate, except for the following: (a) indebtedness on a qualified residence of the decedent (determined in accordance with the requirements for deductibility of mortgage interest set forth in section 163(h)(3)); (b) indebtedness incurred to pay the educational or medical expenses of the decedent, the decedent's spouse or the decedent's dependents; (c) other indebtedness of up to $10,000.

The denominator is equal to the decedent's gross estate, reduced by any indebtedness of the estate, and increased by the amount of the following transfers, to the extent not already included in the decedent's gross estate: (a) any lifetime transfers of qualified business interests that were made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family, plus (b) any other transfers from the decedent to the decedent's spouse that were made within 10 years of the date of the decedent's death, plus (c) any other transfers made by the decedent within three years of the decedent's death, except non-taxable transfers made to members of the decedent's family. The Secretary of Treasury is granted authority to disregard de minimis gifts. In determining the amount of gifts made by the decedent, any gift that the donor and the donor's spouse elected to have treated as a split gift (pursuant to sec. 2513) is treated as made one-half by each spouse for purposes of this provision.

Participation requirements

To qualify for the beneficial treatment provided under the bill, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, each qualified heir (or a member of the qualified heir's family) is required to materially participate in the trade or business for at least five years of any 8-year period within ten years following the decedent's death. For this purpose, "material participation" is defined as under present-law section 2032A (special use valuation) and the regulations promulgated thereunder. Under such regulations, no one factor is determinative of the presence of material participation and the uniqueness of the particular industry (e.g., timber, farming, manufacturing, etc.) must be considered. Physical work and participation in management decisions are the principal factors to be considered. For example, an individual generally is considered to be materially participating in the business if he or she personally manages the business fully, regardless of the number of hours worked, as long as any necessary functions are performed.

If a qualified heir rents qualifying property to a member of the qualified heir's family on a net cash basis, and that family member materially participates in the business, the material participation requirement will be considered to have been met with respect to the qualified heir for purposes of this provision.

Recapture provisions

The benefit of the exclusions for qualified family-owned business interests are subject to recapture if, within 10 years of the decedent's death and before the qualified heir's death, one of the following "recapture events" occurs: (1) the qualified heir ceases to meet the material participation requirements (i.e., if neither the qualified heir nor any member of his or her family has materially participated in the trade or business for at least five years of any 8-year period); (2) the qualified heir disposes of any portion of his or her interest in the family-owned business, other than by a disposition to a member of the qualified heir's family or through a conservation contribution under section 170(h); (3) the principal place of business of the trade or business ceases to be located in the United States; or (4) the qualified heir loses U.S. citizenship. A qualified heir who loses U.S. citizenship may avoid such recapture by placing the qualified family-owned business assets into a trust meeting requirements similar to a qualified domestic trust (as described in present law section 2056A(a)), or through certain other security arrangements.

If one of the above recapture events occurs, an additional tax is imposed on the date of such event. As under section 2032A, each qualified heir is personally liable for the portion of the recapture tax that is imposed with respect to his or her interest in the qualified family-owned business. Thus, for example, if a brother and sister inherit a qualified family-owned business from their father, and only the sister materially participates in the business, her participation will cause both her and her brother to meet the material participation test. If she ceases to materially participate in the business within 10 years after her father's death (and the brother still does not materially participate), the sister and brother would both be liable for the recapture tax; that is, each would be liable for the recapture tax attributable to his or her interest.

The portion of the reduction in estate taxes that is recaptured would be dependent upon the number of years that the qualified heir (or members of the qualified heir's family) materially participated in the trade or business after the decedent's death. If the qualified heir (or his or her family members) materially participated in the trade or business after the decedent's death for less than six years, 100 percent of the reduction in estate taxes attributable to that heir's interest is recaptured; if the participation was for at least six years but less than seven years, 80 percent of the reduction in estate taxes is recaptured; if the participation was for at least seven years but less than eight years, 60 percent is recaptured; if the participation was for at least eight years but less than nine years, 40 percent is recaptured; and if the participation was for at least nine years but less than ten years, 20 percent of the reduction in estates taxes is recaptured. In general, there is no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. As under present-law section 2032A, however, the 10-year recapture period may be extended for a period of up to two years if the qualified heir does not begin to use the property for a period of up to two years after the decedent's death.

If a recapture event occurs with respect to any qualified family-owned business interest (or portion thereof), the amount of reduction in estate taxes attributable to that interest is determined on a proportionate basis. For example, if the decedent's estate included $15 million in qualified family-owned business interests and $5 million of such interests received beneficial treatment under this proposal, one-third of the value of the interest disposed of is deemed to have received the benefits provided under this proposal.

Effective Date

The provision is effective with respect to the estates of decedents dying after December 31, 1995.

B. Increase Estate and Gift Tax Unified Credit (sec. 12032 of the bill and sec. 2010 of the Code)

Present Law

Application of the estate and gift tax

A gift tax is imposed on lifetime transfers by gift and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.[18] Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million.

The amount of gift tax payable for any calendar year generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative lifetime taxable transfers made by the taxpayer and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period. A taxpayer may exclude $10,000 of gifts made to any one donee during a calendar year (sec. 2503).

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable lifetime and deathtime transfers made by the taxpayer and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at $192,800, which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased out by a five-percent surtax imposed upon cumulative taxable transfers over $10 million and not exceeding $21,040,000.[19]

The unified credit was originally enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted $175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of $47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an effective exemption of $225,000 in 1982 to an effective exemption of $600,000 in 1987. The unified credit has not been increased since 1987.

Reasons for Change

The Committee believes that increasing the amount of the estate and gift tax unified credit will encourage saving and promote capital formation and entrepreneurial activity.

Explanation of Provision

The bill increases the present-law unified credit over a six-year period beginning in 1996, from an effective exemption of $600,000 to an effective exemption of $750,000. The increase is phased in as follows:

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[18] Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

[19] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her effective transfer tax rate will be 55 percent under present law.

Decedents dying and gifts made in:	Effective exemption
1996	$625,000
1997	$650,000
1998	$675,000
1999	$700,000
2000	$725,000
2001 and thereafter	$750,000

Conforming amendments to reflect the increased unified credit are made (1) to the 5-percent surtax to conform the phase out of the increased unified credit and graduated rates, (2) to the general filing requirements for an estate tax return under section 6018(a), and (3) to the amount of the unified credit allowed under section 2102(c)(3) with respect to nonresident aliens with U.S. situs property who are residents of certain treaty countries.

Effective Date

The provision applies to the estates of decedents dying, and gifts made, after December 31, 1995.

C. Reduction in Estate Tax for Certain Land Subject to Permanent Conservation Easement (sec. 12303 of the bill and sec. 2031 of the Code)

Present Law

Application of the estate and gift tax

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.[20] Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million (Code sec. 2001(c)).

The amount of gift tax payable for any calendar year generally is determined by applying the tax rates (from the unified rate schedule) to the cumulative lifetime taxable transfers made by the taxpayer, and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period. A taxpayer may exclude $10,000 of gifts made to any one donee during a calendar year (sec. 2503).

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable transfers made by the taxpayer during his lifetime or at death and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been

[20] Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

fixed at $192,800 (sec. 2010), which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased-out by a 5-percent surtax imposed upon cumulative taxable transfers over $10 million and not exceeding $21,040,000 (sec. 2001(c)(2)).[21]

The unified credit originally was enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted $175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of $47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an effective exemption of $225,000 in 1982 to an effective exemption of $600,000 in 1987. The unified credit has not been increased since 1987.

Special use valuation of farms and other closely-held businesses

Generally, for Federal transfer tax purposes, the value of property is its fair market value. Under section 2032A, an executor may elect for estate tax purposes to value certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current use value, rather than its highest and best use value. The maximum reduction in the value of such real property resulting from an election under section 2032A is $750,000.

If, after the special use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special use valuation.

Conservation easements

A deduction is allowed for estate and gift tax purposes for a contribution of a qualified real property interest to a charity (or other qualified organization) exclusively for conservation purposes (secs. 2055(f), 2522(d)). For this purpose, a qualified real property interest means the entire interest of the transferor in real property (other than certain mineral interests), a remainder interest in real property, or a perpetual restriction on the use of real property (sec. 170(h)). A "conservation purpose" is (1) preservation of land for outdoor recreation by, or the education of, the general public, (2) preservation of natural habitat, (3) preservation of open space for scenic enjoyment of the general public or pursuant to a governmental conservation policy, and (4) preservation of historically important land or certified historic structures. Also, a contribution will be treated as "exclusively for conservation purposes" only if the conservation purpose is protected in perpetuity.[22]

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[21] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her average transfer tax rate will be 55 percent under present law.

[22] A member of the transferor's family includes: (1) his or her ancestors; (2) his or her spouse; (3) a lineal descendant of the decedent, the decedent's spouse or the decedent's parents; and (4) the spouse of any of the foregoing lineal descendants.

Reasons for Change

The Committee believes that a reduction in estate taxes for land subject to a qualified conservation easement will ease existing pressures to develop or sell off open spaces in order to raise funds to pay estate taxes, and will thereby help to preserve environmentally significant land.

Explanation of Provision

Reduction in estate taxes for certain land subject to permanent conservation easement

The bill provides that an executor may elect to exclude from the taxable estate 50 percent of the value of any land subject to a qualified conservation easement that meets the following requirements: (1) the land must be located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area; (2) the land must have been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of section 170(h)) of a qualified real property interest (as generally defined in section 170(h)(2)(C)) had been granted by the transferor or a member of his or her family. For purposes of the bill, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose. To the extent that the value of such land is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis (i.e., the basis is not stepped-up to its fair market value at death). Debt-financed property is not eligible for the exclusion.

The exclusion amount is calculated based on the value of the property after the conservation easement has been placed on the property. The exclusion from estate taxes does not extend to the value of any development rights retained by the decedent or donor, although payment for estate taxes on retained development rights may be deferred for up to two years, or until the disposition of the property, whichever is earlier. For this purpose, retained development rights are any rights retained to use the land for any commercial purpose which is not subordinate to and directly supportive of farming purposes, as defined in section 6420 (e.g., tree farming, ranching, viticulture, and the raising of other agricultural or horticultural commodities).

Maximum benefit allowed

The 50-percent exclusion from estate taxes for land subject to a qualified conservation easement (described above) may only be taken to the extent that the value of such land, plus the value of qualified family-owned business interests that qualify for the reduction in estate taxes (described in Part A., above), does not exceed $5 million. The executor of an estate holding land subject to a qualified conservation easement and/or qualified family-owned business interests is required to designate which of the two benefits is being claimed with respect to each property on which a benefit is claimed. To the extent that the aggregate value of such property exceeds $5 million, such excess is taxed at the regular estate tax rates.

If the value of the conservation easement is less than 30 percent of (a) the value of the land without the easement, reduced by (b) the value of any retained development rights, then the exclusion percentage is reduced. The reduction in the exclusion percentage is equal to two percentage points for each point that the above ratio falls below 30 percent. Thus, for example, if the value of the easement is 25 percent of the value of the land before the easement less the value of the retained development rights, the exclusion percentage would be 40 percent (i.e., the 50 percent amount would be reduced by twice the difference between 30 percent and 25 percent). Under this calculation, if the value of the easement is 5 percent or less of the value of the land before the easement less the value of the retained development rights, the exclusion percentage would be equal to zero.

Treatment of land subject to a conservation easement for purposes of special-use valuation

The bill provides that the granting of a qualified conservation easement (as defined above) is not treated as a disposition triggering the recapture provisions of section 2032A. In addition, the Committee intends that the existence of a qualified conservation easement will not prevent such property from subsequently qualifying for special-use valuation treatment under section 2032A.

Effective Date

The provision applies to decedents dying after December 31, 1995.

D. Modification of Generation-Skipping Transfer Tax for Transfers to Individuals with Deceased Parents (sec. 12304 of the bill and sec. 2651 of the Code)

Present Law

A generation-skipping transfer tax ("GST" tax) generally is imposed on transfers, either directly or through a trust or similar arrangement, to a skip person (i.e., a beneficiary in more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations and taxable distributions. For this purpose, a direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person (sec. 2612(c)(1)). A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person (sec. 2612(a)). A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or a direct skip)(sec. 2612(b)).

Direct skips are subject to a lower effective rate of GST tax than taxable terminations and distributions since the GST tax on direct skips is paid by the transferor (sec. 2603(a)(3)) and, therefore, the tax base for a direct skip is tax exclusive (like the Federal gift tax), while the GST tax on taxable terminations and distributions is paid by the trust or beneficiary (secs. 2603(a)(1) & (2)) and, therefore, the tax base on taxable terminations and distributions is tax inclusive (like the Federal estate tax).

Under the "predeceased parent exception," a direct skip transfer to a transferor's grandchild is not subject to the GST tax if the child of the transferor who was the grandchild's parent is deceased at the time of the transfer (sec. 2612(c)(2)). This "predeceased parent exception" to the GST tax is not applicable to (1) transfers to collateral heirs (e.g., grand nieces or grandnephews), or (2) taxable terminations or taxable distributions.

Reasons for Change

The Committee believes that a transfer to a collateral relative whose parent is dead should qualify for the predeceased parent exception in cases where the transferor decedent has no lineal heirs, because no motive or opportunity to avoid transfer tax exists. For similar reasons, the Committee believes that transfers to trusts should be permitted to qualify for the predeceased parent exclusion where the parent of the beneficiary is dead at the time that the transfer is first subject to estate or gift tax.

Explanation of Provision

The bill extends the predeceased parent exception to transfers to collateral heirs, provided that the decedent has no living lineal descendants at the time of the transfer. For example, the exception applies to a transfer made by an individual (with no living lineal heirs) to a grandniece where the transferor's nephew or niece who is the parent of the grandniece is deceased at the time of the transfer.

In addition, the bill extends the predeceased parent exception (as modified by the change in the preceding paragraph) to taxable terminations and taxable distributions, provided that the parent of the relevant beneficiary was dead at the earliest time that the transfer (from which the beneficiary's interest in the property was established) was subject to estate or gift tax. For example, where a trust was established to pay an annuity to a charity for a term for years with a remainder interest granted to a grandson, the termination of the term for years is not a taxable termination subject to the GST tax if the grandson's parent (who is the son or daughter of the transferor) was deceased at the time the trust was created and the transfer creating the trust was subject to estate or gift tax.

Effective Date

The provision is effective for generation skipping transfers occurring after December 31, 1994.

E. Estate Tax Recapture From Cash Leases of Specially-Valued Property (sec. 12305 of the bill and sec. 2032A of the Code)

Present Law

A Federal estate tax is imposed on the value of property passing at death. Generally, such property is included in the decedent's estate at its fair market value. Under section 2032A, the executor may elect to value certain "qualified real property" used in farming or other qualifying trade or business at its current use value rather than its highest and best use. If, after the special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special-use valuation (sec. 2032A(c)).

Some courts have held that cash rental of specially-valued property after the death of the decedent is not a qualified use and, therefore, results in the imposition of the additional estate tax under section 2032A(c). See *Martin v. Commissioner*, 783 F.2d 81 (7th Cir. 1986) (cash lease to unrelated party); *Williamson v. Commissioner*, 93 T.C. 242 (1989), *aff'd*, 974 F.2d 1525 (9th Cir. 1992) (cash lease to family member); *Fisher v. Commissioner*, 65 T.C.M. 2284 (1993) (cash lease to family member).

With respect to a decedent's surviving spouse, a special rule provides that the surviving spouse will not be treated as failing to use the property in a qualified use solely because the spouse rents the property to a member of the spouse's family on a net cash basis. (sec. 2032A(b)(5)). Under section 2032A, members of an individual's family include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants.

Reasons for Change

The Committee believes that cash leasing of farmland among family members is consistent with the purposes of the special-use valuation rules, which are intended to prevent family farms (and other qualifying businesses) from being liquidated to pay estate taxes in cases where members of the decedent's family continue to participate in the business.

Explanation of Provision

The bill provides that the cash lease of specially-valued real property by a lineal descendant of the decedent to a member of the lineal descendant's family, who continues to operate the farm or closely held business, does not cause the qualified use of such property to cease for purposes of imposing the additional estate tax under section 2032A(c). No inference is intended as to whether the cash lease of specially-valued real property is a qualified use of such property under present law.

Effective Date

The provision is effective for cash rentals after December 31, 1995.

Subtitle E. Expiring Tax Provisions

A. Extensions Through February 28, 1997

1. Work opportunity tax credit (sec. 12401 of the bill and sec. 51 of the Code)

Prior Law

General rules

Prior to January 1, 1995, the targeted jobs tax credit was available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The credit generally was equal to 40 percent of qualified first-year wages. Qualified first-year wages consisted of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. For a vocational rehabilitation referral, however, the period began the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan.

No more than $6,000 of wages during the first year of employment were permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual was $2,400.

With respect to economically disadvantaged summer youth employees, the credit was equal to 40 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,200.

The deduction for wages was reduced by the amount of the credit.

Certification of members of targeted groups

In general, an individual was not treated as a member of a targeted group unless certification that the individual was a member of such a group was received or requested in writing by the employer from the designated local agency on or before the day on which the individual began work for the employer. In the case of a certification of an economically disadvantaged youth participating in a cooperative education program, this requirement was satisfied if the certification was requested or received from the participating school on or before the day on which the individual began work for the employer. The "designated local agency" was the State employment security agency.

If a certification was incorrect because it was based on false information provided as to the employee's membership in a targeted group, the certification was revoked. Wages paid after the revocation notice was received by the employer were not treated as qualified wages.

The U.S. Employment Service, in consultation with the Internal Revenue Service, was directed to take whatever steps necessary to keep employers informed of the availability of the credit.

Targeted groups eligible for the credit

The nine groups eligible for the credit were either recipients of payments under means-tested transfer programs, economically disadvantaged (as measured by family income), or disabled individuals.

(1) Vocational rehabilitation referrals

Vocational rehabilitation referrals were those individuals who had a physical or mental disability that constituted a substantial handicap to employment and who had been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973, or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification was provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee had met the above conditions.

(2) Economically disadvantaged youths

Economically disadvantaged youths were individuals certified by the designated local employment agency as (1) members of economically disadvantaged families and (2) at least age 18 but not age 23 on the date they were hired by the employer. An individual was determined to be a member of an economically disadvantaged family if, during the six months immediately preceding the earlier of the month in which the determination occurred or the month in which the hiring date occurred, the individual's family income was, on an annual basis, not more than 70 percent of the Bureau of Labor Statistics' lower living standard. A determination that an individual was a member of an economically disadvantaged family was valid for 45 days from the date on which the determination was made.

Except as otherwise noted below, a determination of whether an individual was a member of an economically disadvantaged family was made on the same basis and was subject to the same 45-day limitation, where required in connection with the four other targeted groups that excluded individuals who were not economically disadvantaged.

(3) Economically disadvantaged Vietnam-era veterans

The third targeted group was Vietnam-era veterans certified by the designated local employment agency as members of economically disadvantaged families. For these purposes, a Vietnam-era veteran was an individual who had served on active duty (other than for training) in the Armed Forces for more than 180 days, or who had been discharged or released from active duty in the Armed Forces for a service-connected disability, but in either case, the active duty must have taken place after August 4, 1964, and before May 8, 1975. However, any individual who had served for a period of more than 90 days during which the individual was on active duty (other than for training) was not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule was intended to prevent employers who hired current members of the armed services (or those departed from service within the last 60-days) from receiving the credit.

(4) SSI recipients

The fourth targeted group was individuals receiving either Supplemental Security Income ("SSI") under Title XVI of the Social Security Act or State supplements described in section 1616 of that Act or section 212 of P.L. 93–66. To be an eligible employee, the individual must have received SSI payments during at least a one-month period ending during the 60-day period that ended on the date the individual was hired by the employer. The designated local agency was to issue the certification after a determination by the agency making the payments that these conditions had been fulfilled.

(5) General assistance recipients

General assistance recipients were individuals who received general assistance for a period of not less than 30 days if that period ended within the 60-day period ending on the date the individual was hired by the employer. General assistance programs were State and local programs that provided individuals with money payments, vouchers, or scrip based on need. These programs were referred to by a wide variety of names, including home relief, poor relief, temporary relief, and direct relief. Because of the wide variety of such programs, Congress provided that a recipient was an eligible employee only after the program had been designated by the Secretary of the Treasury as a program that provided money payments, vouchers, or scrip to needy individuals. Certification was performed by the designated local agency.

(6) Economically disadvantaged former convicts

The sixth targeted group included any individual who was certified by the designated local employment agency as (1) having at some time been convicted of a felony under State or Federal law, (2) being a member of an economically disadvantaged family, and (3) having been hired within five years of the later of release from prison or date of conviction.

(7) Economically disadvantaged cooperative education students

The seventh targeted group was youths who (1) actively participated in qualified cooperative education programs, (2) had attained age 16 but had not attained age 20, (3) had not graduated from high school or vocational school, and (4) were members of economically disadvantaged families. The definitions of a qualified cooperative education program and a qualified school were similar to those used in the Vocational Education Act of 1963. Thus, a qualified cooperative education program meant a program of vocational education for individuals who, through written cooperative arrangements between a qualified school and one or more employers, received instruction, including required academic instruction, by alternation of study in school with a job in any occupational field, but only if these two experiences were planned and supervised by the school and the employer so that each experience contributed to the student's education and employability.

For this purpose, a qualified school was (1) a specialized high school used exclusively or principally for the provision of vocational education to individuals who were available for study in preparation for entering the labor market, (2) the department of a high school used exclusively or principally for providing vocational education to individuals who were available for study in preparation for entering the labor market, or (3) a technical or vocational school used exclusively or principally for the provision of vocational education to individuals who had completed or left high school and who were available for study in preparation for entering the labor market. In order for a nonpublic school to be a qualified school, it must have been exempt from income tax under section 501(a) of the Code.

The certification was performed by the school participating in the cooperative education program. After initial certification, an individual remained a member of the targeted group only while meeting the program participation, age, and degree status requirements of (a), (b), and (c), above.

(8) AFDC recipients

The eighth targeted group included any individual who was certified by the designated local employment agency as being eligible for Aid to Families with Dependent Children ("AFDC") and as having continually received such aid during the 90 days before being hired by the employer.

(9) Economically disadvantaged summer youth employees

The ninth targeted group included youths who performed services during any 90-day period between May 1 and September 15 of a given year and who were certified by the designated local agency as (1) being 16 or 17 years of age on the hiring date and (2) a member of an economically disadvantaged family. A youth must not have been an employee of the employer prior to that 90-day period. With respect to any particular employer, an employee could qualify only one time for this summer youth credit. If, after the end of the 90-day period, the employer continued to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages took into account wages paid to the youth while a qualified summer youth employee.

Definition of wages

In general, wages eligible for the credit were defined by reference to the definition of wages under the Federal Unemployment Tax Act (FUTA) in section 3306(b) of the Code, except that the dollar limits did not apply. Because wages paid to economically disadvantaged cooperative education students and to certain agricultural and railroad employees were not FUTA wages, special rules were provided for these wages.

Wages were taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee were for services in the employer's trade or business. The test as to whether more than one-half of an employee's wages were for services in a trade or business was applied to each separate employer without treating related employers as a single employer.

Other rules

In order to prevent taxpayers from eliminating all tax liability by reason of the credit, the amount of the credit could not exceed 90 percent of the taxpayer's income tax liability. Furthermore, the credit was allowed only after certain other nonrefundable credits had been taken. If, after applying these other credits, 90 percent of an employer's remaining tax liability for the year was less than the targeted jobs tax credit, the excess credit could be carried back three years and carried forward 15 years.

All employees of all corporations that were members of a controlled group of corporations were to be treated as if they were employees of the same corporation for purposes of determining the years of employment of any employee and wages for any employee up to $6,000. Generally, under the controlled group rules, the credit allowed the group was the same as if the group were a single company. A comparable rule was provided in the case of partnerships, sole proprietorships, and other trades or businesses (whether or not incorporated) that were under common control, so that all employees of such organizations generally were to be treated as if they were employed by a single person. The amount of targeted jobs tax credit allowable to each member of the controlled group was its proportionate share of the wages giving rise to the credit.

No credit was available for the hiring of certain related individuals (primarily dependents or owners of the taxpayer). The credit was also not available for wages paid to an individual who was employed by the employer at any time during which the individual was not a certified member of a targeted group.

No credit was available for wages paid by an employer to an individual for services that were the same as, or substantially similar to, those services performed by employees participating in, or affected by, a strike or lockout during the period of such strike or lockout. This rule applied to wages paid to individuals whose principal place of employment was a plant or facility where there was a strike or lockout.

No credit was allowed for wages paid unless the eligible individual was either (1) employed by the employer for at least 90 days (14 days in the case of economically disadvantaged summer youth employees) or (2) had completed at least 120 hours (20 hours for summer youth) of services performed for the employer.

Reasons for Change

While the prior-law targeted jobs tax credit was the subject of some criticism, the Committee believes that a tax credit mechanism can provide an important incentive for employers to undertake the expense of providing jobs and training to economically disadvantaged individuals, many of whom are underskilled and/or undereducated. The bill creates a new program whose design will focus on individuals with poor workplace attachments, streamline administrative burdens, promote longer-term employment, and thereby reduce costs relative to the prior-law program. The Committee intends that this short-term program will provide the Congress and the Treasury and Labor Departments an opportunity to assess fully the operation and effectiveness of the new credit as a hiring incentive.

Explanation of Provision

General rules

The bill replaces the targeted jobs tax credit with the "work opportunity tax credit." The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of six targeted groups. The credit generally is equal to 35 percent of qualified wages. Qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer. For a vocational rehabilitation referral, however, the period will begin on the day the individual begins work for the employer on or after the beginning of the individual's vocational rehabilitation plan as under prior law.

Generally, no more than $6,000 of wages during the first year of employment is permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual is $2,100. With respect to qualified summer youth employees, the maximum credit is 35 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,050.

The deduction for wages is reduced by the amount of the credit.

Certification of members of targeted groups

In general, an individual is not be treated as a member of a targeted group unless: (1) on or before the day the individual begins work for the employer, the employer received in writing a certification from the designated local agency that the individual is a member of a specific targeted group, or (2) on or before the day the individual is offered work with the employer, a pre-screening notice is completed with respect to that individual by the employer and within 14 days after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. The pre-screening notice will contain the information provided to the employer by the individual that forms the basis of the employer's belief that the individual is a member of a targeted group.

If a certification is incorrect because it is based on false information provided as to the individual's membership in a targeted group, the certification will be revoked. No credit will be allowed on wages paid after receipt by the employer of the revocation notice.

If a designated local agency rejects a certification request it will have to provide a written explanation of the basis of the rejection.

Targeted groups eligible for the credit

(1) *Families receiving cash welfare benefits*

An eligible recipient is an individual certified as receiving cash welfare benefits under part A of title IV of the Social Security Act for a period of at least nine months part of which is during the 9-month period ending on the hiring date. For these purposes, each member of the family receiving such assistance is treated as receiving such assistance and therefore is treated as an eligible recipient.

(2) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law, (2) being a member of a family that had an income during the six months before the earlier of the date of determination or the hiring date which on an annual basis is 70 percent or less of the Bureau of Labor Statistics lower living standard, and (3) having a hiring date within one year of release from prison or date of conviction.

(3) High-risk-youth

A high-risk youth is an individual certified as being at least 18 but not 25 on the hiring date and as having a principal place of abode within an empowerment zone or enterprise community (as defined under Subchapter U of the Internal Revenue Code). Qualified wages will not include wages paid or incurred for services performed after the individual moves outside an empowerment zone or enterprise community.

(4) Vocational rehabilitation referral

Vocational rehabilitation referrals are those individuals who have a physical or mental disability that constitutes a substantial handicap to employment and who have been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973 or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(5) Qualified summer youth employee

Qualified summer youth employees are individuals: (1) who perform services during any 90-day period between May 1 and September 15, (2) who are certified by the designated local agency as being 16 or 17 years of age on the hiring date, (3) who have not been an employee of that employer before, and (4) who are certified by the designated local agency as having a principal place of abode within an empowerment zone or enterprise community (as defined under Subchapter U of the Internal Revenue Code). As with high-risk youths, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone or enterprise community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages will take into account wages paid to the youth while a qualified summer youth employee.

(6) Qualified Veteran

A qualified veteran is a veteran who is a member of a family certified as receiving assistance under: (1) part A of title IV of the Social Security Act for a period of at least nine months part of which is during the 12-month period ending on the hiring date, or (2) a food stamp program under the Food Stamp Act of 1977 for a period of at least three months part of which is during the 12-month period ending on the hiring date.

Further, a qualified veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

Definition of wages and other rules

In general, wages eligible for the credit are defined by reference to the definition of wages under the Federal Unemployment Tax Act ("FUTA") in section 3306(b) of the Code, except that the dollar limits do not apply.

Wages are taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. The test as to whether more than one-half of an employee's wages are for services in a trade or business are applied to each separate employer without treating related employers as a single employer.

In order to prevent taxpayers from eliminating all tax liability by reason of the credit, the amount of the credit may not exceed 90 percent of the taxpayer's income tax liability. Furthermore, the credit is allowed only after certain other nonrefundable credits had been taken. If, after applying these other credits, 90 percent of an employer's remaining tax liability for the year is less than the targeted jobs tax credit, the excess credit can be carried back three years and carried forward 15 years.

All employees of all corporations that are members of a controlled group of corporations are treated as if they were employees of the same corporation for purposes of determining the years of employment of any employee and wages for any employee up to $6,000. Generally, under the controlled group rules, the credit allowed the group is the same as if the group were a single company. A comparable rule is provided in the case of partnerships, sole proprietorships, and other trades or businesses (whether or not incorporated) that are under common control, so that all employees of such organizations generally are treated as if they was employed by a single person. The amount of the credit allowable to each member of the controlled group is its proportionate share of the wages giving rise to the credit.

No credit is available for the hiring of certain related individuals (primarily dependents or owners of the taxpayer). The credit is also not be available for wages paid to an individual who is employed by the employer at any time during which the individual is not a certified member of a targeted group.

No credit is available for wages paid by an employer to an individual for services that are the same as, or substantially similar to, those services performed by employees participating in, or affected by, a strike or lockout during the period of such strike or lockout. This rule applies to wages paid to individuals whose principal place of employment is a plant or facility where there is a strike or lockout.

Minimum employment period

No credit is allowed for wages paid unless the eligible individual is employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 400 hours (120 hours in the case of a qualified summer youth employee).

Business awareness program

The Secretary of Labor shall establish a program to encourage small businesses to work with the designated local agencies to identify eligible individuals for inclusion in the credit program. The Secretary of Labor and heads of other Federal agencies also are directed to simplify credit procedures to encourage participation.

Effective Date

The credit is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 1996, and before March 1, 1997.

2. Employer-provided educational assistance (sec. 12402 of the bill and sec. 127 of the Code)

Present and Prior Law

For taxable years beginning after December 31, 1994, an employee must include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to an employee, unless the cost of such assistance qualifies as a deductible job-related expense of the employee. Amounts expended for education qualify as deductible job-related expenses if the education (1) maintains or improves skills required for the employee's current job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continued employment in the employee's current job (Treas. Reg. sec. 1.162–5(a)). Such expenses (if not reimbursed by the employer) are deductible only to the extent that, when aggregated with other miscellaneous itemized deductions, they exceed 2 percent of the taxpayer's adjusted gross income. No deduction (or exclusion) is allowed for expenses incurred to qualify for a new trade or business.

For taxable years beginning before January 1, 1995, an employee's gross income and wages did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements. This exclusion, which expired for taxable years beginning after December 31, 1994, was limited to $5,250 of educational assistance with respect to an individual during a calendar year. The exclusion applied whether or not the education was job related.

Reasons for Change

The Committee believes that the exclusion for employer-provided educational assistance should be extended because it provides needed assistance to workers and aids U.S. competitiveness by encouraging a better-educated work force.

Explanation of Provision

The bill extends the exclusion for educational assistance for taxable years beginning after December 31, 1994, and before March 1, 1997. In the case of a taxable year beginning in 1997, the maximum amount that can be excluded is one-sixth of $5,250 or $875, and only amounts paid by the employer before March 1, 1997, are taken into account.

Effective Date

The provision is effective with respect to taxable years beginning after December 31, 1994, and before January 1, 1998.

3. Research and experimentation tax credit (sec. 12403 of the bill and sec. 41 of the Code)

Present and Prior Law

General rule

Prior to July 1, 1995, section 41 of the Internal Revenue Code provided for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceeded its base amount for that year. The research tax credit expired and does not apply to amounts paid or incurred after June 30, 1995.

A 20-percent research tax credit also applied to the *excess* of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) *over* (2) the sum of (a) the greater of two minimum basic 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. This separate credit computation is commonly referred to as the "university basic research credit" (see sec. 41(e)).

Computation of allowable credit

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. 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 (so-called "start-up firms") are assigned a fixed-base percentage of 3 percent.[23]

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, research expenditures and gross receipts of the taxpayer are aggregated with research expenditures and gross receipts of certain related persons for purposes of computing any allowable credit (sec. 41(f)(1)). Special rules apply for computing the credit when a major portion of a business changes hands, under which qualified research expenditures and gross receipts for periods prior to the change or ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage (sec. 41(f)(3)).

Eligible expenditures

Qualified research expenditures eligible for the research tax credit consist of: (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses").

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 (described below) but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must pertain to functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors (sec. 41(d)(3)). In addition, research does not qualify for the credit if conducted after the beginning of commercial production of the business component, if related to the adaptation of an existing business com-

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[23] The Omnibus Budget Reconciliation Act of 1993 included a special rule designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm (i.e., any taxpayer that did not have gross receipts in at least three years during the 1984–1988 period) will be assigned a fixed-base percentage of 3 percent for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. In the event that the research credit is extended beyond the scheduled June 30, 1995 expiration date, a start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenditures will be a phased-in ratio based on its actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage will be its actual ratio of qualified research expenditures to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993 (sec. 41(c)(3)(B)).

ponent to a particular customer's requirements, if related to the duplication of an existing business component from a physical examination of the component itself or certain other information, or if related to certain efficiency surveys, market research or development, or routine quality control (sec. 41(d)(4)).

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).

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized. However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year. Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

Reasons for Change

Businesses may not find it profitable to invest in some research activities because of the difficulty in capturing the full benefits from the research. Costly technological advances made by one firm are often cheaply copied by its competitors. A research tax credit can help to promote investment in research, so that research activities undertaken approach the optimal level for the overall economy. Therefore, the Committee believes that, in order to encourage research activities, it is appropriate to reinstate the research tax credit and to modify the definition of start-up firms.

Explanation of Provision

The research tax credit (including the university basic research credit) is extended for the period July 1, 1995, through February 28, 1997.

In addition, the bill expands the definition of "start-up firms" under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983.[24]

Effective Date

The provision is effective for expenditures paid or incurred during the period July 1, 1995, through February 28, 1997. The modi-

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[24] In applying the start-up firm rules, the test is whether a taxpayer, in fact, both incurred research expenses (which under the present-law rules would be qualified research expenses) and had gross receipts in a particular year, not whether the taxpayer claimed a research tax credit that year.

fication to the definition of start-up firms applies to taxable years ending on or after July 1, 1995.

4. Exclusion for employer-provided group legal services; tax exemption for qualified group legal services organizations (sec. 12404 of the bill and secs. 120 and 501(c)(20) of the Code)

Prior Law

Under prior law, employees were not subject to income or employment tax on amounts contributed by an employer to a qualified group legal services plan. The exclusion did not apply to the extent that the value of insurance against legal costs incurred by the individual (or spouse or dependents) provided under the plan exceeded $70. The exclusion for group legal services benefits expired after June 30, 1992.

In addition, prior law provided tax-exempt status for an organization the exclusive function of which was to provide legal services or indemnification against the cost of legal services provided through a qualified group legal services plan. The tax exemption for such an organization expired for taxable years beginning after June 30, 1992.

Reasons for Change

The Committee believes that the exclusion for employer-provided group legal services should be reinstated for a temporary period. The Committee believes that the exclusion enables more workers to have access to legal advice.

Explanation of Provision

The bill extends the exclusion from income for contributions to employer-provided group legal services plans and the exemption from tax for certain group legal services organizations from January 1, 1996, through February 28, 1997. The exclusion is available with respect to contributions to employer-provided group legal services plans through February 28, 1997, but the limit on the value of insurance provided under the plan for taxable years beginning in 1997 is one-sixth of $70 or $12.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995, and before February 28, 1997.

5. Orphan drug tax credit (sec. 12405 of the bill and sec. 28 and new sec. 45C of the Code)

Present and Prior Law

Prior to January 1, 1995, a 50-percent nonrefundable tax credit was allowed for qualified clinical testing expenses incurred in testing of certain drugs for rare diseases or conditions, 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. A rare disease or condition is defined as one that (1) affects less than 200,000 persons in the United States or (2) affects more than 200,000 persons, but for which 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).

Under prior law, the orphan drug tax credit could be claimed by a taxpayer only to the extent that its regular tax liability for the year the credit was earned exceeded its tentative minimum tax for that year, after regular tax was reduced by nonrefundable personal credits and the foreign tax credit.[25] Unused credits could not be carried back or carried forward to reduce taxes in other years.

The orphan drug tax credit expired after December 31, 1994.

Reasons for Change

The Committee believes that it is appropriate to reinstate the orphan drug tax credit.

Explanation of Provision

The orphan drug tax credit is extended for the period January 1, 1995, through February 28, 1997.

In addition, the bill allows taxpayers to carry back unused credits to three years preceding the year the credit is earned and to carry forward unused credits to 15 years following the year the credit is earned.

Effective Date

The provision is effective for qualified clinical testing expenses incurred during the period January 1, 1995, through February 28, 1997. The provision allowing for the carry back and carry forward of unused credits applies to taxable years ending after December 31, 1994, except that credits may not be carried back to a taxable year beginning before January 1, 1995.

6. Contributions of appreciated stock to private foundations (sec. 12406 of the bill and sec. 170(e)(5) of the Code)

Present and Prior 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.[26] However, in the case of a charitable contribution of short-term gain, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis in the property. In the case

[25] To the extent that the orphan drug tax credit could not be used by reason of the minimum tax limitation, the taxpayer's minimum tax credit was increased (sec. 53(d)(1)(B)(iii)).

[26] 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)).

of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose.[27]

In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property. However, under a special rule contained in section 170(e)(5), taxpayers were allowed a deduction equal to the fair market value of "qualified appreciated stock" contributed to a private foundation prior to January 1, 1995. Qualified appreciated stock was defined as publicly traded stock which is capital gain property. The fair-market-value deduction for qualified appreciated stock donations applied only to the extent that total donations made by the donor to private foundations of stock in a particular corporation did not exceed 10 percent of the outstanding stock of that corporation. For this purpose, an individual was treated as making all contributions that were made by any member of the individual's family. This special rule contained in section 170(e)(5) expired after December 31, 1994.

Reasons for Change

The Committee believes that, to encourage donations to charitable private foundations, it is appropriate to reinstate the special rule that allowed a fair market value deduction for certain gifts of appreciated stock to private foundations.

Explanation of Provision

The bill extends the special rule contained in section 170(e)(5) for contributions of qualified appreciated stock made to private foundations for contributions made during the period January 1, 1995, through February 28, 1997.[28]

Effective Date

The provision is effective for contributions of qualified appreciated stock to private foundations made during the period January 1, 1995, through February 28, 1997.

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[27] As part of the Omnibus Budget Reconciliation Act of 1993, Congress eliminated the treatment of contributions of appreciated property (real, personal, and intangible) as a tax preference for alternative minimum tax (AMT) purposes. Thus, if a taxpayer makes a gift to charity of property (other than short-term gain, inventory, or other ordinary income property, or 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 the same fair-market-value deduction for both regular tax and AMT purposes (subject to present-law percentage limitations).

[28] If, during this period, a taxpayer contributes qualified appreciate stock as defined in section 170(e)(5) and the amount of such contribution exceeds the percentage limitation under section 170(b)(1)(D), the excess may be carried over to succeeding taxable years. See, e.g., LTR 9444029, LTR 9424020.

7. Transportation fuels tax exemption for fuels used in commercial aviation (sec. 12407 of the bill and secs. 4081–4083, 4091–4093, 6421, and 6427 of the Code)

Present Law

A 4.3-cents-per-gallon deficit reduction excise tax is imposed on fuel used in most transportation modes. Fuels subject to the tax include gasoline (including gasoline blended with alcohol, "gasohol"), diesel fuel, special motor fuels, propane, compressed natural gas, aviation fuels (jet fuel and gasoline), and any other motor fuel used in shipping in the inland waterway system. The transportation modes subject to tax include highway, rail, air, inland waterway, and motorboats and other recreational boats. Fuel consumed before October 1, 1995, in commercial aviation, defined as the air transportation of persons or property for hire, was exempt from this tax.

Revenues from this transportation fuels tax are deposited in the General Fund of the Treasury. This tax is separate from, and in addition to, any user-based excise taxes imposed on the same fuels to fund the Highway Trust Fund, the Airport and Airway Trust Fund, the Leaking Underground Storage Tank Trust Fund, the Inland Waterways Trust Fund, or the Aquatic Resources Trust Fund.

Reasons for Change

A major rationale for granting commercial aviation a temporary exemption from the transportation fuels tax in 1993 was the then existing poor economic condition of the aviation industry. The economic condition of that industry has improved significantly since 1993; however, its recovery is not complete. Further, several questions have arisen regarding the relative excise tax burdens of different transportation modes and the Federal benefits received by payors of certain of those taxes. As a result, the Committee believes that an additional temporary extension of the commercial aviation exemption, accompanied by a request that the Treasury Department study these burden/benefit issues, is appropriate.

Explanation of Provision

The present exemption for commercial aviation fuels is extended through February 28, 1997. Thereafter, the full 4.3-cents-per-gallon tax will be imposed.

The Committee also intends that the Treasury Department, in consultation with the Transportation Department, study the relative excise tax burdens of various modes of transportation (including rail, which pays a deficit reduction fuel tax rate in excess of that paid by other transportation modes) and the benefits derived from Federal expenditures related to those taxes by each such mode. The results of this study should to be submitted to the House Committee on Ways and Means and the Senate Committee on Finance no later than June 30, 1996.

Effective Date

The provision generally is effective after September 30, 1995.

Under present law, this excise tax is imposed on transactions occurring after September 30, 1995, and the floor stocks tax imposed by the Omnibus Budget Reconciliation Act of 1993 was imposed on October 1, 1995. Because the provision defers this imposition for 17 months, retroactive to October 1, 1995, it provides refunds for any such taxes paid before enactment upon adequate documentation that tax-paid fuel was purchased and that the benefit of the refunds accrue to ultimate users of the fuel. The Committee further wishes to express its desire that the Internal Revenue Service consider waiving the semimonthly deposit requirements for this tax during the period beginning on October 1, 1995, and ending on the date on which 1995 budget reconciliation process is completed.

Appropriate floor stocks taxes will be imposed on March 1, 1997.

B. Superfund and Oil Spill Liability Taxes

1. Extend Superfund excise taxes and corporate environmental income tax (sec. 12411 of the bill and secs. 59A, 4611, 4661, and 4671 of the Code)

Present Law

Four different Superfund taxes are imposed under present law. These are:

(1) An excise tax on petroleum, imposed at a rate of 9.7 cents per barrel, on domestic or imported crude oil or refined products;

(2) An excise tax on listed hazardous chemicals, imposed at a rate that varies from $0.22 to $4.87 per ton;

(3) An excise tax on imported substances that use as materials in their manufacture or production one or more of the hazardous chemicals subject to the excise tax described in (2), above; and

(4) A corporate environmental income tax equal to 0.12 percent of the amount of modified alternative minimum taxable income of a corporation that exceeds $2 million.

Modified alternative minimum taxable income is defined as a corporation's alternative minimum taxable income, but determined without regard to the alternative tax net operating loss deduction and the deduction for the corporate environmental income tax (sec. 59A).

Amounts equivalent to the revenues from these taxes are dedicated to the Hazardous Substance Superfund Trust Fund ("Superfund Trust Fund"), established in the Trust Fund Code of the Internal Revenue Code. Amounts in the Superfund Trust Fund generally are available for expenditures incurred in connection with releases or threats of releases of hazardous substances into the environment under specified provisions of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (as amended).

The Superfund taxes are scheduled to expire after December 31, 1995. However, the taxes would have terminated earlier if either (1) the unobligated balance in the Superfund Trust Fund exceeded $3.5 billion on December 31, 1994, and the Treasury Department estimated that the unobligated balance would exceed $3.5 billion at the end of 1995 (assuming no Superfund taxes had been imposed during 1995), or (2) the Treasury Department had estimated that more than $11.97 billion of revenues from these taxes would have been credited into the Superfund Trust Fund before January 1, 1996.

Reasons for Change

The Committee believes that the Superfund taxes should be extended at this time to ensure a continuing, stable source of revenue for the Superfund Trust Fund. The Committee is aware, however, that upcoming Superfund program reauthorization legislation may involve new, Budget Act direct spending, or its tax equivalent, and believes that a shorter, two-year, extension of the corporate environmental income tax is appropriate to preserve the remainder of that revenue source as a budgetary offset for any such spending or tax proposal.

Explanation of Provision

The present-law Superfund excise taxes on petroleum, chemicals, and imported substances are extended through September 30, 2002. The corporate environmental income tax is extended for taxable years beginning before January 1, 1998.

The provisions terminating the Superfund taxes if either the unobligated balance in the Superfund exceeds $3.5 billion before a specified date or if aggregate tax collections exceed $11.97 billion are repealed.

Effective Date

The provision is effective on enactment.

2. Reinstate Oil Spill Liability Trust Fund excise tax (sec. 12412 of the bill and sec. 4611 of the Code)

Present Law

A 5-cents-per-barrel excise tax was imposed on crude oil received at United States refineries and refined petroleum products imported into the United States before January 1, 1995. Revenues from this tax were dedicated to the Oil Spill Liability Trust Fund ("Oil Spill Trust Fund"). In addition to the January 1, 1995 expiration date, imposition of this tax was suspended during any calendar quarter (before 1995) when the unobligated balance of the Oil Spill Trust Fund, as of the close of the preceding quarter, exceeded $1 billion.

Reasons for Change

The Committee is aware that potential future oil spill occurrences and damage levels are unpredictable, and believes that measures should be taken to ensure continued full funding of the Oil Spill Liability Trust Fund in the event that monies in that Trust Fund are needed for future cleanup activities.

Explanation of Provision

The 5-cents-per-barrel excise tax is reimposed during the period January 1, 1996, through September 30, 2002. The $1 billion unobligated balance limit on the Oil Spill Trust Fund is retained.

Effective Date

The provision is effective after December 31, 1995.

C. Other Fuels Tax Provisions

1. Extend expired ethanol blender refund provision (sec. 12421 of the bill and sec. 6427 of the Code)

Present Law

A 54-cents-per-gallon blender income tax credit is provided for ethanol used as a motor fuel. This credit applies to ethanol which is blended with gasoline ("gasohol").

Gasoline is subject to an 18.4-cents-per-gallon excise tax. As an alternative to claiming the income tax credit gasohol blenders may claim the benefit of the ethanol income tax credit against their gasoline excise tax liability. The benefit may be claimed against excise tax liability in either of two ways: (1) by purchasing gasoline destined for blending with ethanol at a reduced excise tax rate, or (2) before October 1, 1995, by claiming expedited refunds of excise tax paid on gasoline purchased at the full 18.4-cents-per-gallon rate after that gasoline is blended with ethanol. In general, the gasoline (including gasohol) excise tax provisions associated with the Highway Trust Fund expire after September 30, 1999.

Reasons for Change

The September 30, 1995, expiration of the ethanol blender refund provision resulted from a 1993 drafting error. The Committee believes that correction of this error, along with a provision for interest on refunds delayed by the error, is appropriate.

Explanation of Provision

The bill conforms the expiration date for the excise tax expedited refund provision for gasohol blenders that expired after September 30, 1995, to that for gasoline tax provisions generally. Thus, these refunds will be permitted through September 30, 1999.

For refund claims that could have been filed during the period beginning on October 8, 1995, and ending on the date of enactment, but for expiration of the refund provision after September 30, 1995, interest will accrue from the date which is the later of (1) November 1, 1995, or (2) 20 days after the claim could have been filed under the law as in effect on September 30, 1995.

Effective Date

The provision is effective on enactment.

2. Extend tax credit for producing fuel from a nonconventional source (sec. 12422 of the bill and sec. 29 of the Code)

Present Law

Certain fuels produced from "nonconventional sources" and sold to unrelated parties are eligible for an income tax credit equal to $3 (generally adjusted for inflation) per barrel or BTU barrel of oil equivalent (sec. 29) (referred to as the "section 29 credit"). Qualified fuels must be produced within the United States. Qualified fuels include:

—(1) oil produced from shale and tar sands;

—(2) gas produced from geopressured brine, Devonian shale, coal seams, tight formations ("tight sands"), or biomass; and

—(3) liquid, gaseous, or solid synthetic fuels produced from coal (including lignite).

In general, the credit is available only with respect to fuels produced from wells drilled or facilities placed in service after December 31, 1979, and before January 1, 1993. An exception extends the January 1, 1993, expiration date for facilities producing gas from biomass and synthetic fuel from coal if the facility producing the fuel is place in service before January 1, 1997, pursuant to a binding written contract in effect before January 1, 1996.

The credit may be claimed for qualified fuels produced and sold before January 1, 2003 (in the case of nonconventional sources subject to the January 1, 1993 expiration date) or January 1, 2008 (in the case of biomass gas and synthetic fuel facilities eligible for the extension period).

Reasons for Change

The Committee believes that a short-term extension of the section 29 credit is appropriate to allow projects currently under development to be placed in service in a more orderly manner than is possible under the present-law scheduled expiration.

Explanation of Provision

The placed-in-service (and binding contract) dates for facilities producing synthetic fuels from coal and gas from biomass is extended for one year. The present sunset on production qualifying for the credit is not changed. Under the proposal, fuel produced from a facility placed in service before January 1, 1998, pursuant to a binding contract entered into before January 1, 1997, will be eligible for the tax credit if produced before January 1, 2008.

Effective Date

The provision is effective upon enactment.

D. Diesel Dyeing Provisions

1. Exempt Alaska from diesel dyeing requirement while Alaska is exempt from Clean Air Act dyeing requirements (sec. 12431 of the bill and sec. 4081 of the Code)

Present Law

An excise tax totaling 24.4 cents per gallon is imposed on diesel fuel. In the case of diesel fuel used in highway transportation, 20 cents per gallon is dedicated to the Highway Trust Fund. Revenues equal to 0.1 cent per gallon of the diesel fuel tax are dedicated to the Leaking Underground Storage Trust Fund. The remaining portion of this tax is imposed on transportation generally and is retained in the General Fund.

The diesel fuel tax is imposed on removal of the fuel from a pipeline or barge terminal facility (i.e., at the "terminal rack"). Present law provides that tax is imposed on all diesel fuel removed from terminal facilities unless the fuel is destined for a nontaxable use and is indelibly dyed pursuant to Treasury Department regulations.

In general, the diesel fuel tax does not apply to non-transportation uses of the fuel. Off-highway business uses are included within this non-transportation use exemption. This exemption includes use on a farm for farming purposes and as fuel powering off-highway equipment (e.g., oil drilling equipment). Use as heating oil also is exempt. (Most fuel commonly referred to as heating oil is diesel fuel.) The tax also does not apply to fuel used by State and local governments, to exported fuels, and to fuel used in commercial shipping.

A similar dyeing regime exists for diesel fuel under the Clean Air Act. That Act prohibits the use on highways of diesel fuel with a sulphur content exceeding prescribed levels. This "high sulphur" diesel fuel is required to be dyed by the EPA. The State of Alaska generally was exempted from the Clean Air Act, but not the excise tax, dyeing regime for three years.

Reasons for Change

Most diesel fuel sold in rural areas of Alaska is sold for nontaxable, off-highway uses. Due to this fact and the Clean Air Act provision exempting those areas from that Act's dyeing requirement, the Committee believes that tax compliance in those areas can be achieved without dyeing diesel fuel destined for nontaxable uses.

Explanation of Provision

Diesel fuel sold in the State of Alaska will be exempt from the diesel dyeing requirement during the period when that State is exempt from the Clean Air Act dyeing requirements. Thus, dyed diesel fuel may be used in taxable uses without penalties being imposed (subject to a certification procedure to be established by the Treasury Department).

Effective Date

The provision is effective as if included in the Omnibus Budget Reconciliation Act of 1993.

2. Suspend imposition of diesel fuel tax on recreational motorboats (sec. 12432 of the bill and sec. 4081 of the Code)

Present Law

An excise tax totaling 24.4 cents per gallon is imposed on diesel fuel. The Omnibus Budget Reconciliation Act of 1993 extended this tax to diesel fuel used in recreational motorboats, effective through December 31, 1999. The tax on diesel fuel used in motorboats was enacted as a revenue offset for repeal of the luxury excise tax on certain boats.

The diesel fuel tax is imposed on removal of the fuel from a pipeline or barge terminal facility (i.e., at the "terminal rack"). Present law provides that tax is imposed on all diesel fuel removed from terminal facilities unless the fuel is destined for a nontaxable use *and* is indelibly dyed pursuant to Treasury Department regulations. If fuel on which tax is paid at the terminal rack (i.e., undyed diesel fuel) ultimately is used in a nontaxable use, a refund is allowed. Depending on the aggregate amount of tax to be refunded, this refund may be claimed either by a direct filing with the Internal Revenue Service or as a credit against income tax.

Dyed diesel fuel (fuel on which no tax is paid) may not be used in a taxable use. Present law imposes a penalty equal to the greater of $10 per gallon or $1,000 on persons found to be violating this prohibition.

Reasons for Change

The Committee understands that market conditions in the marine industry have produced shortages of diesel fuel for recreational boat use in some areas. This is alleged to have occurred because some marinas primarily serve commercial vessels that burn nontaxable, dyed diesel fuel, and have resisted installing supplemental fuel tanks for the taxable, undyed diesel fuel required for recreational boats. The Committee believes, therefore, that a temporary suspension of this tax is appropriate to allow review of possible alternative collection regimes, and to allow marinas to adapt to the requirements of the present-law rules, if satisfactory alternatives are not found.

Description of Provision

No tax will be imposed on diesel fuel used in recreational motorboats during the period January 1, 1996, through February 28, 1997.

This exemption will temporarily address current supply problems. In an attempt to find a permanent solution that protects tax collection and avoids supply disruptions, the Committee intends that the Treasury Department study possible alternatives to the current collection regime for motorboat diesel fuel that will provide comparable compliance with the law, and to report to the Commit-

tee on Ways and Means and the Committee on Finance no later than June 30, 1996.

Effective Date

The provision is effective after December 31, 1995.

E. Expatriation Tax Provisions (secs. 12441 and 12442 of the bill and secs 102, 877, 2107, 2501, and 7701 of the Code)

Present Law

a. Taxation of United States citizens, residents, and nonresidents

Individual income taxation

Income taxation of U.S. citizens and residents

In general.—A United States citizen generally is subject to the U.S. individual income tax on his or her worldwide taxable income. All income earned by a U.S. citizen, from sources inside and outside the United States, is taxable, whether or not the individual lives within the United States. A non-U.S. citizen who resides in the United States generally is taxed in the same manner as a U.S. citizen if the individual meets the definition of a "resident alien," described below.

The taxable income of a U.S. citizen or resident is equal to the taxpayer's total income less certain exclusions, exemptions, and deductions. The appropriate tax rates are then applied to a taxpayer's taxable income to determine his or her individual income tax liability. A taxpayer may reduce his or her income tax liability by any applicable tax credits. When an individual disposes of property, any gain or loss on the disposition is determined by reference to the taxpayer's cost basis in the property, regardless of whether the property was acquired during the period in which the taxpayer was a citizen or resident of the United States.

If a U.S. citizen or resident earns income from sources outside the United States, and that income is subject to foreign income taxes, the individual generally is permitted a foreign tax credit against his or her U.S. income tax liability to the extent of foreign income taxes paid on that income.[29] In addition, a United States citizen who lives and works in a foreign country generally is permitted to exclude up to $70,000 of annual compensation from being subject to U.S. income taxes, and is permitted an exclusion or deduction for certain housing expenses.[30]

Resident aliens.—In general, a non-U.S. citizen is considered a resident of the United States if the individual (1) has entered the United States as a lawful permanent U.S. resident (the "green card test"); or (2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for a substantial period of time—183 or more days during

[29] See sections 901–907.
[30] Section 911.

a 3-year period weighted toward the present year (the "substantial presence test").[31]

If an individual is present in the United States for fewer than 183 days during the calendar year, and if the individual establishes that he or she has a closer connection with a foreign country than with the United States and has a tax home in that country for the year, the individual generally is not subject to U.S. tax as a resident on account of the substantial presence test. If an individual is present for as many as 183 days during a calendar year, this closer connections/tax home exception is not available. An alien who has an application pending to change his or her status to permanent resident or who has taken other steps to apply for status as a lawful permanent U.S. resident is not eligible for the closer connections/tax home exception.

For purposes of applying the substantial presence test, any days that an individual is present as an "exempt individual" are not counted. Exempt individuals include certain foreign government-related individuals, teachers, trainees, students, and professional athletes temporarily in the United States to compete in charitable sports events. In addition, the substantial presence test does not count days of presence of an individual who is physically unable to leave the United States because of a medical condition that arose while he or she was present in the United States, if the individual can establish to the satisfaction of the Secretary of the Treasury that he or she qualifies for this special medical exception.

In some circumstances, an individual who meets the definition of a U.S. resident (as described above) could also be defined as a resident of another country under the internal laws of that country. In order to avoid the double taxation of such individuals, most income tax treaties include a set of "tie-breaker" rules to determine the individual's country of residence for income tax purposes. In general, a dual resident is deemed to be a resident of the country in which such person has a permanent home. If the individual has a permanent home available in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer (i.e., the "center of vital interests.") If the country in which such individual has his or her center of vital interests cannot be determined, or if such individual does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both countries or in neither country, he or she is deemed to be a resident of the country of which he or she is a citizen. If each country considers the person to be its citizen or if he or she is a citizen of neither country, the competent authorities of the countries are to settle the question of residence by mutual agreement.

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[31] The definitions of resident and nonresident aliens are set forth in section 7701(b). The substantial presence test will compare 183 days to the sum of (1) the days present during the current calendar year, (2) one-third of the days present during the preceding calendar year, and (3) one-sixth of the days present during the second preceding calendar year. Presence for 122 days (or more) per year over the 3-year period would constitute substantial presence under the test.

Income taxation of nonresident aliens

Non-U.S. citizens who do not meet the definition of "resident aliens" are considered to be nonresident aliens for tax purposes. Nonresident aliens are subject to U.S. tax only to the extent their income is from U.S. sources or is effectively connected with the conduct of a trade or business within the United States. Bilateral income tax treaties may modify the U.S. taxation of a nonresident alien.

A nonresident alien is taxed at regular graduated rates on net profits derived from a U.S. business.[32] Nonresident aliens also are taxed at a flat rate of 30 percent on certain types of passive income derived from U.S. sources, although a lower rate may be provided by treaty (e.g., dividends are frequently taxed at a reduced rate of 15 percent). Such passive income includes interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits and income. There is no U.S. tax imposed, however, on interest earned by nonresident aliens with respect to deposits with U.S. banks and certain types of portfolio debt investments.[33] Gains on the sale of stocks or securities issued by U.S. persons generally are *not* taxable to a nonresident alien because they are considered to be foreign source income.[34]

Nonresident aliens are subject to U.S. income taxation on any gain recognized on the disposition of an interest in U.S. real property.[35] Such gains generally are subject to tax at the same rates that apply to similar income received by U.S. persons. If a U.S. real property interest is acquired from a foreign person, the purchaser generally is required to withhold 10 percent of the amount realized (gross sales price). Alternatively, either party may request that the Internal Revenue Service ("IRS") determine the transferor's maximum tax liability and issue a certificate prescribing a reduced amount of withholding (not to exceed the transferor's maximum tax liability).[36]

Estate and gift taxation

The United States imposes a gift tax on any transfer of property by gift made by a U.S. citizen or resident,[37] whether made directly or indirectly and whether made in trust or otherwise. Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. No gift tax is imposed, how-

[32] Section 871.

[33] See sections 871(h) and 871(i)(3).

[34] Section 865(a).

[35] Sections 897, 1445, 6039C, and 6652(f), known as the Foreign Investment in Real Property Tax Act ("FIRPTA"). Under the FIRPTA provisions, tax is imposed on gains from the disposition of an interest (other than an interest solely as a creditor) in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the U.S. Virgin Islands. Also included in the definition of a U.S. real property interest is any interest (other than an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes that the corporation was not a U.S. real property holding corporation ("USRPHC") at any time during the five-year period ending on the date of the disposition of the interest (sec. 897(c)(1)(A)(ii)). A USRPHC is any corporation, the fair market value of whose U.S. real property interests equals or exceeds 50 percent of the sum of the fair market values of (1) its U.S. real property interests, (2) its interests in foreign real property, plus (3) any other of its assets which are used or held for use in a trade or business (sec. 897(c)(2)).

[36] Section 1445.

[37] Section 2501.

ever, on gifts made by nonresident aliens of intangible property having a situs within the United States (e.g., stocks and bonds).[38]

The United States also imposes an estate tax on the worldwide "gross estate" of any person who was a citizen or resident of the United States at the time of death, and on certain property belonging to a nonresident of the United States that is located in the United States at the time of death.[39]

Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a U.S. citizen or resident during his or her lifetime and at death. Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million.[40] A unified credit of $192,800 is available with respect to taxable transfers by gift and at death. The unified credit effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax.

Residency for purposes of estate and gift taxation is determined under different rules than those applicable for income tax purposes. In general, an individual is considered to be a resident of the United States for estate and gift tax purposes if the individual is "domiciled" in the United States. An individual is domiciled in the United States if the individual (a) is living in the United States and has the intention to remain in the United States indefinitely; or (b) has lived in the United States with such an intention and has not formed the intention to remain indefinitely in another country. In the case of a U.S. citizen who resided in a U.S. possession at the time of death, if the individual acquired U.S. citizenship solely on account of his or her birth or residence in a U.S. possession, that individual is not treated as a U.S. citizen or resident for estate tax purposes.[41]

In addition to the estate and gift taxes, a separate transfer tax is imposed on certain "generation-skipping" transfers.

Special tax rules with respect to the movement of persons into or out of the United States

Individuals who relinquish U.S. citizenship with a principal purpose of avoiding U.S. tax

An individual who relinquishes his or her U.S. citizenship with a principal purpose of avoiding U.S. taxes is subject to an alternative method of income taxation for 10 years after expatriation under section 877.[42] Under this provision, if the Treasury Department establishes that it is reasonable to believe that the expatriate's loss of U.S. citizenship would, but for the application of this provision, result in a substantial reduction in U.S. tax based on the

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[38] Section 2501(a)(2).

[39] Sections 2001, 2031, 2101, and 2103.

[40] Section 2001(c).

[41] Section 2209.

[42] Treasury regulations provide that an individual's citizenship status is governed by the provisions of the Immigration and Nationality Act, specifically referring to the "rules governing loss of citizenship [set forth in] sections 349 to 357, inclusive, of such Act (8 U.S.C. 1481–1489)." Treas. Reg. section 1.1–1(c). Under the Immigration and Nationality Act, an individual is generally considered to lose U.S. citizenship on the date that an expatriating act is committed. The present-law rules governing the loss of citizenship, and a description of the types of expatriating acts that lead to a loss of citizenship, are discussed more fully below.

expatriate's probable income for the taxable year, then the expatriate has the burden of proving that the loss of citizenship did not have as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. Section 877 does *not* apply to resident aliens who terminate their U.S. residency.

The alternative method modifies the rules generally applicable to the taxation of nonresident aliens in two ways. First, the expatriate is subject to tax on his or her U.S. source income at the rates applicable to U.S. citizens rather than the rates applicable to other nonresident aliens. (Unlike U.S. citizens, however, individuals subject to section 877 are not taxed on any foreign source income.) Second, the scope of items treated as U.S. source income for section 877 purposes is broader than those items generally considered to be U.S. source income under the Code. For example, gains on the sale of personal property located in the United States, and gains on the sale or exchange of stocks and securities issued by U.S. persons, generally are not considered to be U.S. source income under the Code. However, if an individual is subject to the alternative taxing method of section 877, such gains are treated as U.S. source income with respect to that individual. The alternative method applies only if it results in a higher U.S. tax liability than would otherwise be determined if the individual were taxed as a nonresident alien.

Because section 877 alters the sourcing rules generally used to determine the country having primary taxing jurisdiction over certain items of income, there is an increased potential for such items to be subject to double taxation. For example, a former U.S. citizen subject to the section 877 rules may have capital gains derived from stock in a U.S. corporation. Under section 877, such gains are treated as U.S. source income, and are, therefore, subject to U.S. tax. Under the internal laws of the individual's new country of residence, however, that country may provide that all capital gains realized by a resident of that country are subject to taxation in that country, and thus the individual's gain from the sale of U.S. stock also would be taxable in his or her country of residence. If the individual's new country of residence has an income tax treaty with the United States, the treaty may provide for the amelioration of this potential double tax.

Similar rules apply in the context of estate and gift taxation if the transferor relinquished U.S. citizenship with a principal purpose of avoiding U.S. taxes within the 10-year period ending on the date of the transfer. A special rule is applied to the estate tax treatment of any decedent who relinquished his or her U.S. citizenship within 10 years of death, if the decedent's loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive.[43] Once the Secretary of the Treasury establishes a reasonable belief that the expatriate's loss of U.S. citizenship would result in a substantial reduction in estate, inheritance, legacy and succession taxes, the burden of proving that one of the principal purposes of the loss of U.S. citizenship was *not* avoidance of U.S. income or estate tax is on the executor of the decedent's estate.

In general, the estates of individuals who have relinquished U.S. citizenship are taxed in accordance with the rules generally appli-

[43] Section 2107.

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cable to the estates of nonresident aliens (i.e., the gross estate includes all U.S.-situs property held by the decedent at death, is subject to U.S. estate tax at the rates generally applicable to the estates of U.S. citizens, and is allowed a unified credit of $13,000, as well as credits for State death taxes, gift taxes, and prior transfers). However, a special rule provides that the individual's gross estate also includes his or her pro-rata share of any U.S.-situs property held through a foreign corporation in which the decedent had a 10-percent or greater voting interest, provided that the decedent and related parties together owned more than 50 percent of the voting power of the corporation. Similarly, gifts of intangible property having a situs within the United States (e.g., stocks and bonds) made by a nonresident alien who relinquished his or her U.S. citizenship within the 10-year period ending on the date of transfer are subject to U.S. gift tax, if the loss of U.S. citizenship had as one of its principal purposes a tax avoidance motive.[44]

Aliens having a break in residency status

A special rule applies in the case of an individual who has been treated as a resident of the United States for at least three consecutive years, if the individual becomes a nonresident but regains residency status within a three-year period.[45] In such cases, the individual is subject to U.S. tax for all intermediate years under the section 877 rules described above (i.e., the individual is taxed in the same manner as a U.S. citizen who renounced U.S. citizenship with a principal purpose of avoiding U.S. taxes). The special rule for a break in residency status applies regardless of the subjective intent of the individual.

b. Requirements for United States citizenship, immigration, and visas

United States citizenship

An individual may acquire U.S. citizenship in one of three ways: (1) being born within the geographical boundaries of the United States; (2) being born outside the United States to at least one U.S. citizen parent (as long as that parent had previously been resident in the United States for a requisite period of time); or (3) through the naturalization process. All U.S. citizens are required to pay U.S. income taxes on their worldwide income. The State Department estimates that there are approximately 3 million U.S. citizens living abroad, although thousands of these individuals may not even know that they are U.S. citizens.

A U.S. citizen may voluntarily give up his or her U.S. citizenship at any time by performing one of the following acts ("expatriating acts") with the intention of relinquishing U.S. nationality: (1) becoming naturalized in another country; (2) formally declaring allegiance to another country; (3) serving in a foreign army; (4) serving in certain types of foreign government employment; (5) making a formal renunciation of nationality before a U.S. diplomatic or consular officer in a foreign country; (6) making a formal renunciation of nationality in the United States during a time of war; or (7) com-

[44] Section 2501(a)(3).
[45] Section 7701(b)(10).

mitting an act of treason.[46] An individual who wishes formally to renounce citizenship (item (5), above) must execute an Oath of Renunciation before a consular officer, and the individual's loss of citizenship is effective on the date the oath is executed. In all other cases, the loss of citizenship is effective on the date that the expatriating act is committed, even though the loss may not be documented until a later date. The State Department generally documents loss in such cases when the individual acknowledges to a consular officer that the act was taken with the requisite intent. In all cases, the consular officer abroad submits a certificate of loss of nationality ("CLN") to the State Department in Washington, D.C. for approval.[47] Upon approval, a copy of the CLN is issued to the affected individual.

Before a CLN is issued, the State Department reviews the individual's files to confirm that: (1) the individual was a U.S. citizen; (2) an expatriating act was committed; (3) the act was undertaken voluntarily; and (4) the individual had the intent of relinquishing citizenship when the expatriating act was committed. If the expatriating act involved an action of a foreign government (for example, if the individual was naturalized in a foreign country or joined a foreign army), the State Department will not issue a CLN until it has obtained an official statement from the foreign government confirming the expatriating act. If a CLN is not issued because the State Department does not believe that an expatriating act has occurred (for example, if the requisite intent appears to be lacking), the issue is likely to be resolved through litigation. Whenever the loss of U.S. nationality is put in issue, the burden of proof is on the person or party claiming that a loss of citizenship has occurred to establish, by a preponderance of the evidence, that the loss occurred.[48] Similarly, if a CLN has been issued, but the State Department later discovers that such issuance was improper (for example, because fraudulent documentation was submitted, or the requisite intent appears to be lacking), the State Department could initiate proceedings to revoke the CLN. If the recipient is unable to establish beyond a preponderance of the evidence that citizenship was lost on the date claimed, the CLN would be revoked. To the extent that the IRS believes a CLN was improperly issued, the IRS could present such evidence to the State Department and request that revocation proceedings be commenced. If it is determined that the individual has indeed committed an expatriating act, the date for loss of citizenship will be the date of the expatriating act.

A child under the age of 18 cannot lose U.S. citizenship by naturalizing in a foreign state or by taking an oath of allegiance to a foreign state. A child under 18 can, however, lose U.S. citizenship by serving in a foreign military or by formally renouncing citizenship, but such individuals may regain their citizenship by asserting a claim of citizenship before reaching the age of eighteen years and six months.

A naturalized U.S. citizen can have his or her citizenship involuntarily revoked if a U.S. court determines that the certificate of

[46] 8 U.S.C. section 1481.
[47] 8 U.S.C. section 1501.
[48] 8 U.S.C. section 1481(b).

naturalization was illegally procured, or was procured by concealment of a material fact or by willful misrepresentation. In such cases, the individual's certificate of naturalization is cancelled, effective as of the original date of the certificate; in other words, it is as if the individual were never a U.S. citizen at all.

United States immigration and visas

In general, a non-U.S. citizen who enters the United States is required to obtain a visa.[49] An immigrant visa (also known as a "green card") is issued to an individual who intends to relocate to the United States permanently. Various types of nonimmigrant visas are issued to individuals who come to the United States on a temporary basis and intend to return home after a certain period of time. The type of nonimmigrant visa issued to such individuals is dependent upon the purpose of the visit and its duration. An individual holding a nonimmigrant visa is prohibited from engaging in activities that are inconsistent with the purpose of the visa (for example, an individual holding a tourist visa is not permitted to obtain employment in the United States).

Foreign business people and investors often obtain "E" visas to come into the United States. Generally, an "E" visa is initially granted for a one-year period, but it can be routinely extended for additional two-year periods. There is no overall limit on the amount of time an individual may retain an "E" visa. There are two types of "E" visas: an "E–1" visa, for "treaty traders" and an "E–2" visa, for "treaty investors."

Relinquishment of green cards

There are several ways in which a green card can be relinquished. First, an individual who wishes to terminate his or her permanent residency may simply return his or her green card to the INS. Second, an individual may be involuntarily deported from the United States (through a judicial or administrative proceeding), and the green card must be relinquished at that time. Third, a green card holder who leaves the United States and attempts to reenter more than a year later may have his or her green card taken away by the INS border examiner, although the individual may appeal to an immigration judge to have the green card reinstated. A green-card holder may permanently leave the United States without relinquishing his or her green card, although such individuals would continue to be taxed as U.S. residents.[50]

Reasons for Change

The Committee has been informed that a small number of very wealthy individuals each year relinquish their U.S. citizenship for the purpose of avoiding U.S. income, estate, and gift taxes. By so

[49] Under the Visa Waiver Pilot Program, nationals of most European countries are not required to obtain a visa to enter the United States if they are coming as tourists and staying a maximum of 90 days. Also, citizens of Canada, Mexico, and certain islands in close proximity to the United States do not need visas to enter the United States, although other types of travel documents may be required.

[50] Section 7701(b)(6)(B) provides that an individual who has obtained the status of residing permanently in the United States as an immigrant (i.e., an individual who has obtained a green card) will continue to be taxed as a lawful permanent resident of the United States until such status is revoked, or is administratively or judicially determined to have been abandoned.

doing, such individuals reduce their annual U.S. income tax liability and eliminate their eventual U.S. estate tax liability.

The Committee recognizes that citizens of the United States have a basic right not only physically to leave the United States to live elsewhere, but also to relinquish their U.S. citizenship. The Committee does not believe that the Internal Revenue Code should be used to stop U.S. citizens from expatriating; however, the Committee also does not believe that the Code should provide a tax incentive for expatriating.

The Committee is concerned that present law, which bases the application of the alternative method of taxation under section 877 on proof of a tax-avoidance purpose, is difficult to administer. In addition, the Committee is concerned that the alternative method can be avoided by postponing the realization of U.S. source income for 10 years. The Committee believes that section 877 is largely ineffective in taxing U.S. citizens who expatriate with a principal purpose to avoid tax.

The Committee believes that the alternative tax system of section 877 should be replaced by a tax regime applicable to wealthy expatriates that does not rely on establishing a tax-avoidance motive. Because U.S. citizens who retain their citizenship are subject to income tax on accrued appreciation when they dispose of their assets, as well as estate tax on the full value of assets that are held until death, the Committee believes it fair and equitable to tax expatriates on the appreciation in their assets when they relinquish their U.S. citizenship. The Committee believes that an exception from the expatriation tax should be provided for individuals whose income and net worth are relatively modest.

Explanation of Provision

In general

The bill replaces the present-law expatriation income tax rules with rules that generally subject certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who relinquish their U.S. residency to tax on the net unrealized gain in their property as if such property were sold for fair market value on the expatriation date. The bill also imposes information reporting obligations on U.S. citizens who relinquish their citizenship and long-term residents whose U.S. residency is terminated.

Individuals covered

The bill applies the expatriation tax to certain U.S. citizens and long-term residents who terminate their U.S. citizenship or residency. For this purpose, a long-term resident is any individual who was a lawful permanent resident of the United States for at least 8 out of the 15 taxable years ending with the year in which the termination of residency occurs. In applying this 8-year test, an individual is not considered to be a lawful permanent resident of the United States for any year in which the individual is taxed as a resident of another country under a treaty tie-breaker rule. An individual's U.S. residency is considered to be terminated when either the individual ceases to be a lawful permanent resident pursuant to section 7701(b)(6) (i.e., the individual loses his or her green-card status) or the individual is treated as a resident of another country under a tie-breaker provision of a tax treaty (and the individual does not elect to waive the benefits of such treaty).

The expatriation tax under the bill applies only to individuals whose average income tax liability or net worth exceeds specified levels. U.S. citizens who lose their citizenship and long-term residents who terminate U.S. residency are subject to the expatriation tax if they meet either of the following tests: (1) the individual's average annual U.S. Federal income tax liability for the 5 taxable years ending before the date of such loss or termination is greater than $100,000, or (2) the individual's net worth as of the date of such loss or termination is $500,000 or more. The dollar amount thresholds contained in these tests are indexed for inflation in the case of a loss of citizenship or termination of residency occurring in any calendar year after 1996.

Exceptions from the expatriation tax under the bill are provided for individuals in two situations. The first exception applies to an individual who was born with citizenship both in the United States and in another country, provided that (1) as of the date of relinquishment of U.S. citizenship the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual was a resident of the United States for no more than 8 out of the 15 taxable years ending with the year in which the relinquishment of U.S. citizenship occurred. The second exception applies to a U.S. citizen who relinquishes citizenship before reaching age 18½, provided that the individual was a resident of the United States for no more than 5 taxable years before such relinquishment.

Deemed sale of property upon expatriation

Under the bill, individuals who are subject to the expatriation tax generally are treated as having sold all of their property at fair market value immediately prior to the relinquishment of citizenship or termination of residency. Gain or loss from the deemed sale of property is recognized at that time, generally without regard to provisions of the Code that would otherwise provide nonrecognition treatment. The net gain, if any, on the deemed sale of all such property is subject to U.S. tax at such time to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom expatriate).

The deemed sale rule of the bill generally applies to all property interests held by the individual on the date of relinquishment of citizenship or termination of residency, provided that the gain on such property interest would be includible in the individual's gross income if such property interest were sold for its fair market value on such date. Special rules apply in the case of trust interests (see "Interests in trusts", below). U.S. real property interests, which remain subject to U.S. taxing jurisdiction in the hands of nonresident aliens, generally are excepted from the bill. An exception also applies to interests in qualified retirement plans and, subject to a limit of $500,000, interests in certain foreign pension plans as prescribed by regulations. The Secretary of the Treasury is authorized to issue regulations exempting other property interests as appropriate. For example, an exclusion may be provided for an interest in a nonqualified compensation plan of a U.S. employer, where payments from such plan to the individual following expatriation would continue to be subject to U.S. withholding tax.

Under the bill, an individual who is subject to the expatriation tax is required to pay a tentative tax equal to the amount of tax that would be due for a hypothetical short tax year ending on the date the individual relinquished citizenship or terminated residency. Thus, the tentative tax is based on all the income, gain, deductions, loss and credits of the individual for the year through such date, including amounts realized from the deemed sale of property. The tentative tax is due on the 90th day after the date of relinquishment of citizenship or termination of residency.

Deferral of payment of tax

Under the bill, an individual is permitted to elect to defer payment of the expatriation tax with respect to the deemed sale of any property. Under this election, the expatriation tax with respect to a particular property, plus interest thereon, is due when the property is subsequently disposed of. For this purpose, except as provided in regulations, the disposition of property in a nonrecognition transaction constitutes a disposition. In addition, if an individual holds property until his or her death, the individual is treated as having disposed of the property immediately before death. In order to elect deferral of the expatriation tax, the individual is required to provide adequate security to ensure that the deferred expatriation tax and interest ultimately will be paid. A bond in the amount of the deferred tax and interest constitutes adequate security. Other security mechanisms are also permitted provided that the individual establishes to the satisfaction of the Secretary of the Treasury that the security is adequate. In the event that the security provided with respect to a particular property subsequently becomes inadequate and the individual fails to correct such situation, the deferred expatriation tax and interest with respect to such property will become due. As a further condition to making this election, the individual is required to consent to the waiver of any treaty rights that would preclude the collection of the expatriation tax.

Interests in trusts

In general

Under the bill, special rules apply to trust interests held by the individual at the time of relinquishment of citizenship or termination of residency. The treatment of trust interests depends upon whether the trust is a qualified trust. For this purpose, a "qualified trust" is a trust that is organized under and governed by U.S. law and that is required by its instruments to have at least one U.S. trustee.

Constructive ownership rules apply to a trust beneficiary that is a corporation, partnership, trust or estate. In such cases, the shareholders, partners or beneficiaries of the entity are deemed to be the direct beneficiaries of the trust for purposes of applying these provisions. In addition, an individual who holds (or who is treated as holding) a trust interest at the time of relinquishment of citizenship or termination of residency is required to disclose on his or her tax return the methodology used to determine his or her interest in the trust, and whether such individual knows (or has reason to know) that any other beneficiary of the trust uses a different method.

Nonqualified trusts

If an individual holds an interest in a trust that is not a qualified trust, a special rule applies for purposes of determining the amount of the expatriation tax due with respect to such trust interest. The individual's interest in the trust is treated as a separate trust consisting of the trust assets allocable to such interest. Such separate trust is treated as having sold its assets as of the date of relinquishment of citizenship or termination of residency and having distributed all proceeds to the individual, and the individual is treated as having recontributed such proceeds to the trust. The individual is subject to the expatriation tax with respect to any net income or gain arising from the deemed distribution from the trust. The election to defer payment is available for the expatriation tax attributable to a nonqualified trust interest.

A beneficiary's interest in a nonqualified trust is determined on the basis of all facts and circumstances. These include the terms of the trust instrument itself, any letter of wishes or similar document, historical patterns of trust distributions, and the role of any trust protector or similar advisor.

Qualified trusts

If the individual has an interest in a qualified trust, a different set of rules applies. Under these rules, the amount of unrealized gain allocable to the individual's trust interest is calculated at the time of expatriation. In determining this amount, all contingencies and discretionary interests are assumed to be resolved in the individual's favor (i.e., the individual is allocated the maximum amount that he or she potentially could receive under the terms of the trust instrument). The expatriation tax imposed on such gains generally is collected when the individual receives distributions from the trust, or, if earlier, upon the individual's death. Interest is charged for the period between the date of expatriation and the date on which the tax is paid.

If an individual has an interest in a qualified trust, the individual is subject to expatriation tax upon the receipt of any distribution from the trust. Such distributions may also be subject to U.S. income tax. For any distribution from a qualified trust made to an individual after he or she has expatriated, expatriation tax is imposed in an amount equal to the amount of the distribution multiplied by the highest tax rate generally applicable to trusts and estates, but in no event will the tax imposed exceed the deferred tax amount with respect to such trust interest. The "deferred tax amount" would be equal to (1) the tax calculated with respect to the unrealized gain allocable to the trust interest at the time of expatriation, (2) increased by interest thereon, and (3) reduced by the tax imposed under this provision with respect to prior trust distributions to the individual.

If an individual's interest in a trust is vested as of the expatriation date (e.g., if the individual's interest in the trust is non-contingent and non-discretionary), the gain allocable to the individual's trust interest is determined based on the trust assets allocable to his or her trust interest. If the individual's interest in the trust is not vested as of the expatriation date (e.g., if the individual's trust interest is a contingent or discretionary interest), the gain allocable to his or her trust interest is determined based on all of the trust assets that could be allocable to his or her trust interest, determined by resolving all contingencies and discretionary powers in the individual's favor. In the case where more than one trust beneficiary is subject to the expatriation tax with respect to trust interests that are not vested, the rules are intended to apply so that the same unrealized gain with respect to assets in the trust is not taxed to both individuals.

If the individual disposes of his or her trust interest, the trust ceases to be a qualified trust, or the individual dies, expatriation tax is imposed as of such date. The amount of such tax equal to the lesser of (1) the tax calculated under the rules for nonqualified trust interests applied as of such date or (2) the deferred tax amount with respect to the trust interest as of such date.

If the individual agrees to waive any treaty rights that would preclude collection of the tax, the tax is imposed under this provision with respect to distributions from a qualified trust to the individual deducted and withheld from distributions. If the individual does not agree to such a waiver of treaty rights, the tax with respect to distributions to the individual is imposed on the trust, the trustee is personally liable therefor, and any other beneficiary of the trust has a right of contribution against such individual with respect to such tax. Similarly, in the case of the tax imposed in connection with an individual's disposition of a trust interest, the individual's death while holding a trust interest or the individual's holding of an interest in a trust that ceases to be qualified, the tax is imposed on the trust, the trustee is personally liable therefor, and any other beneficiary of the trust has a right of contribution against such individual with respect to such tax.

Election to be treated as a U.S. citizen

Under the bill, an individual is permitted to make an irrevocable election to continue to be taxed as a U.S. citizen with respect to all property that otherwise is covered by the expatriation tax. This election is an "all-or-nothing" election; an individual is *not* permitted to elect this treatment for some property but not other property. The election, if made, applies to all property that would be subject to the expatriation tax and to any property the basis of which is determined by reference to such property. Under this election, the individual continues to pay U.S. income taxes at the rates applicable to U.S. citizens following expatriation on any income generated by the property and on any gain realized on the disposition of the property, as well as any excise tax imposed with respect to the property (see, e.g., sec. 1491). In addition, the property continues to be subject to U.S. gift, estate, and generation-skipping transfer taxes. However, the amount of any transfer tax so imposed is limited to the amount of income tax that would have been due if the property had been sold for its fair market value immediately before the transfer or death. The $600,000 exclusion provided with respect to the expatriation tax under the bill is available to reduce the tax imposed by reason of this election. In order to make this election, the taxpayer is required to waive any treaty rights that would preclude the collection of the tax. The individual is also required to provide security to ensure payment of the tax under this election in such form, manner, and amount as the Secretary of the Treasury requires.

Date of relinquishment of citizenship

Under the bill, an individual is treated as having relinquished U.S. citizenship on the date that the individual first makes known to a U.S. government or consular officer his or her intention to relinquish U.S. citizenship. Thus, a U.S. citizen who relinquishes citizenship by formally renouncing his or her U.S. nationality before a diplomatic or consular officer of the United States is treated as having relinquished citizenship on that date, provided that the renunciation is later confirmed by the issuance of a CLN. A U.S. citizen who furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act with the requisite interest to relinquish his or her citizenship is treated as having relinquished his or her citizenship on the date the statement is so furnished (regardless of when the expatriating act was performed), provided that the voluntary relinquishment is later confirmed by the issuance of a CLN. If neither of these circumstances exist, the individual is treated as having relinquished citizenship on the date a CLN is issued or a certificate of naturalization is cancelled. The date of relinquishment of citizenship determined under the bill applies for all tax purposes.

Effect on present-law expatriation provisions

Under the bill, the present-law income tax provisions with respect to U.S. citizens who expatriate with a principal purpose of avoiding tax (sec. 877) and certain aliens who have a break in residency status (sec. 7701(b)(10)) do apply to U.S. citizens who are treated as relinquishing their citizenship on or after February 6, 1995 or to long-term U.S. residents who terminate their residency on or after such date. The special estate and gift tax provisions with respect to individuals who expatriate with a principal purpose of avoiding tax (secs. 2107 and 2501(a)(3)), however, continue to apply; a credit against the tax imposed solely by reason of such special provisions is allowed for the expatriation tax imposed with respect to the same property.

Treatment of gifts and inheritances from an expatriate

Under the bill, the exclusion from income provided in section 102 does not apply to the value of any property received by gift or inheritance from an individual who was subject to the expatriation tax (i.e., an individual who relinquished citizenship or terminated residency and to whom the expatriation tax was applicable). Accordingly, a U.S. taxpayer who receives a gift or inheritance from such an individual is required to include the value of such gift or inheritance in gross income and is subject to U.S. income tax on such amount.

Required information reporting and sharing

Under the bill, an individual who relinquishes citizenship or terminates residency is required to provide a statement which includes the individual's social security number, forwarding foreign address, new country of residence and citizenship and, in the case of individuals with a net worth of at least $500,000, a balance sheet. In the case of a former citizen, such statement is due not later than the date the individual's citizenship is treated as relinquished and is to be provided to the State Department (or other government entity involved in the administration of such relinquishment). The entity to which the statement is to be provided by former citizens is required to provide to the Secretary of the Treasury copies of all statements received and the names of individuals who refuse to provide such statements. In the case of a former long-term resident, the statement is provided to the Secretary of the Treasury with the individual's tax return for the year in which the individual's U.S. residency is terminated. An individual's failure to provide the statement required under this provision results in the imposition of a penalty for each year the failure continues equal to the greater of (1) 5 percent of the individual's expatriation tax liability for such year or (2) $1,000.

The bill requires the State Department to provide the Secretary of the Treasury with a copy of each CLN approved by the State Department. Similarly, the bill requires the agency administering the immigration laws to provide the Secretary of the Treasury with the name of each individual whose status as a lawful permanent resident has been revoked or has been determined to have been abandoned.

Further, the bill requires the Secretary of the Treasury to publish in the Federal Register the names of all former U.S. citizens with respect to whom it receives the required statements or whose names it receives under the foregoing information-sharing provisions.

Effective Date

The provision is effective for U.S. citizens whose date of relinquishment of citizenship (as determined under the bill, see "Date of relinquishment of citizenship" above) occurs on or after February 6, 1995. Similarly, the provision is effective for long-term residents who terminate their U.S. residency on or after February 6, 1995.

U.S. citizens who committed an expatriating act with the requisite intent to relinquish their U.S. citizenship prior to February 6, 1995, but whose date of relinquishment of citizenship (as determined under the bill) does not occur until after such date, are subject to the expatriation tax under the bill as of date of relinquishment of citizenship. However, the individual is not subject retroactively to worldwide tax as a U.S. citizen for the period after he or she committed the expatriating act (and therefore ceased being a U.S. citizen for tax purposes under present law). Such an individual continues to be subject to the expatriation tax imposed by present-law section 877 until the individual's date of relinquishment of citizenship (at which time the individual would be subject to the expatriation tax of the bill). The rules described in this paragraph do not apply to an individual who committed an expatriating act prior to February 6, 1995, but did not do so with the requisite intent to relinquish his or her U.S. citizenship.

The tentative tax is not required to be paid, and the reporting requirements would not be required to be met, until 90 days after the date of enactment. Such provisions apply to all individuals whose date of relinquishment of U.S. citizenship or termination of U.S. residency occurs on or after February 6, 1995.

Subtitle F. Taxpayer Bill of Rights 2 Provisions

A. Expansion of Authority to Abate Interest (sec. 12501 of the bill and sec. 6404 of the Code)

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.

Reasons for Change

The Committee believes that it is appropriate to expand the authority to abate interest to include delays caused by managerial acts of the IRS.

Explanation of Provision

The bill permits the IRS to abate interest with respect to any unreasonable error or delay resulting from managerial acts as well as ministerial acts. This would include extensive delays resulting from managerial acts such as: the loss of records by the IRS, IRS personnel transfers, extended illnesses, extended personnel training, or extended leave. On the other hand, interest would not be abated for delays resulting from general administrative decisions. For example, the taxpayer could not claim that the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system resulted in an unreasonable delay in the Service's action on the taxpayer's tax return, and so the interest on any subsequent deficiency should be waived.

Effective Date

The provision applies to interest accruing with respect to deficiencies or payments for taxable years beginning after the date of enactment.

B. Review of IRS Failure to Abate Interest (sec. 12502 of the bill and sec. 6404 of the Code)

Present Law

Federal courts generally do not have the jurisdiction to review the IRS's failure to abate interest.

Reasons for Change

The Committee believes that it is appropriate for the Tax Court to have jurisdiction to review IRS's failure to abate interest with respect to certain taxpayers.

Explanation of Provision

The bill grants the Tax Court jurisdiction to determine whether the IRS's failure to abate interest for an eligible taxpayer was an abuse of discretion. The action must be brought within six months after the date of the Secretary's final determination not to abate interest. An eligible taxpayer must meet the net worth and size requirements imposed with respect to awards of attorney's fees. No inference is intended as to whether under present law any court has jurisdiction to review IRS's failure to abate interest.

Effective Date

The provision applies to requests for abatement after the date of enactment.

C. Joint Return May Be Made After Separate Returns Without Full Payment of Tax (sec. 12503 of the bill and sec. 6013 of the Code)

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.

Reasons for Change

Not all taxpayers are able to pay the full amount owed on their returns by the filing deadline. In such circumstances, the IRS encourages the taxpayer to pay the tax as soon as possible or enter into an installment agreement. However, 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 from reducing their tax liability by filing jointly if they are unable to pay the entire amount of the joint return liability. This rule may be unfair to taxpayers experiencing financial difficulties.

Explanation of Provision

The 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.

D. Modifications in Certain Levy Exemption Amounts (sec. 12504 of the bill and sec. 6334 of the Code)

Present Law

Property exempt from levy includes personal property with a value of up to $1,650 as well as books and tools with a value up to $1,100.

Reasons for Change

The Committee believes that these amounts should be increased and indexed for inflation.

Explanation of Provision

The bill increases the exemption amount to $2,500 for personal property and to $1,250 for books and tools. These amounts are indexed for inflation commencing January 1, 1996.

Effective Date

The provision is effective with respect to levies issued after December 31, 1995.

E. Offers-in-compromise (sec. 12505 of the bill and sec. 7122 of the Code)

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.

Reasons for Change

The Committee believes that the $500 threshold amount requiring a written opinion from the IRS Chief Counsel slows the approval process for most offers-in-compromise and is unnecessarily low.

Explanation of Provision

The bill increases from $500 to $50,000 the amount requiring a written opinion from the Office of Chief Counsel. 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.

F. Award of Litigation Costs Permitted in Declaratory Judgment Proceedings (sec. 12506 of the bill and sec. 7430 of the Code)

Present Law

Section 7430(b)(3) denies any reimbursement for attorney's fees in all declaratory judgment actions, except those actions related to the revocation of an organization's qualification under section 501(c)(3) (relating to tax-exempt status).

Reasons for Change

It is appropriate to treat declaratory judgment proceedings similar to other tax proceedings, with respect to eligibility for attorney's fees.

Explanation of Provision

The bill eliminates the present-law restrictions on awarding attorney's fees in all declaratory judgment proceedings.

Effective Date

The provision applies to proceedings commenced after the date of enactment.

G. Court Discretion to Reduce Award for Litigation Costs for Failure to Exhaust Administrative Remedies (sec. 12507 of the bill and sec. 7433 of the Code)

Present Law

A taxpayer suing the United States for civil damages for unauthorized collection activities must exhaust administrative remedies to be eligible for an award.

Reasons for Change

There may be circumstances in which it is inappropriate to require a taxpayer to exhaust administrative remedies.

Explanation of Provision

The bill permits (but does not require) a court to reduce an award if the taxpayer has not exhausted administrative remedies.

Effective Date

The provision is effective for proceedings commenced after the date of enactment.

H. Enrolled Agents Included as Third-party Recordkeepers (sec. 12508 of the bill and sec. 7609 of the Code)

Present Law

Section 7609 contains special procedures that the IRS must follow before it issues a third- party summons. A third-party summons is a summons issued to a third-party recordkeeper compelling the recordkeeper to provide information with respect to the taxpayer. An example of this would be a summons served on a stock brokerage house to provide data on the securities trading of the taxpayer-client.

If a third-party summons is served on a third-party recordkeeper listed in section 7609(a)(3), then the taxpayer must receive notice of the summons and have an opportunity to challenge the summons in court. Otherwise the taxpayer has no statutory right to receive notice of the summons and accordingly the taxpayer will not have the opportunity to challenge it in court.

Section 7609(a)(3) lists attorneys and accountants as third-party recordkeepers, but it does not list "enrolled agents", who are authorized to practice before the IRS.

Reasons for Change

Because enrolled agents are authorized to practice before the IRS in a similar manner to attorneys and accountants, they should be accorded the same status as third-party recordkeepers as are attorneys and accountants.

Explanation of Provision

The bill includes enrolled agents as third-party recordkeepers.

Effective Date

The provision applies to summonses issued after the date of enactment.

I. Safeguards Relating to Designated Summonses (sec. 12509 of the bill and sec. 6503 of the Code)

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 may 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.[51]

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 sum-

[51] 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).

mons relating to the same tax return that is issued within 30 days after the designated summons is issued.

Reasons for Change

The Committee recognizes that issuance of a designated summons is a serious step in the examination of a tax return, given the fact that litigation over the summons would suspend the running of the period for assessing additional tax against the taxpayer under audit. The Committee believes that it is important to place some restrictions on the taxpayers to whom IRS can issue a designated summons.

Explanation of Provision

The bill limits the use of a designated summons to corporations (or to any other person to whom the corporation has transferred records) that are being examined as part of the Coordinated Examination Program (CEP) or its successor. CEP audits cover about 1,600 of the largest corporate taxpayers. If a corporation moves between CEP and non-CEP audit categories, only the tax years covered by the CEP may be the subject of a designated summons. The bill does not affect Code section 6038A(e)(1), which relates to a U.S. reporting corporation that acts merely as the agent of the foreign related party by receiving summonses on behalf of the foreign party.

Effective Date

The provision applies to summonses issued after date of enactment.

J. Annual Reminders to Taxpayers With Outstanding Delinquent Accounts (sec. 12510 of the bill and new sec. 7524 of the Code)

Present Law

There is no statutory requirement in the Code that the IRS send annual reminders to persons who have outstanding tax liabilities.

Reasons for Change

Numerous taxpayers become delinquent in paying their tax liability. The delinquencies may occur because the person did not make enough payments through payroll withholding or quarterly estimated payments or because of an adjustment following an audit.

The IRS generally pursues larger tax deficiencies first, and then it pursues small deficiencies. Because of the limited amount of IRS resources to work collection cases, cases with smaller deficiencies may not be addressed for years. In the meantime, the taxpayer may come to believe that the apparent lack of IRS collection activity means that it has abandoned its claim against the taxpayer. The taxpayer may be surprised when the IRS resumes collection action years later, when the 10-year statute of limitations on collections is close to expiring.

Explanation of Provision

The bill requires the IRS to send taxpayers an annual reminder of their outstanding tax liabilities. The fact that a taxpayer did not receive a timely, annual reminder notice does not affect the tax liability.

Effective Date

The provision requires the IRS to send annual reminder notices beginning in 1996.

Subtitle G. Casualty and Involuntary Conversion Provisions

A. Modify Basis Adjustment Rules Under Section 1033 (sec. 12601 of the bill and sec. 1033 of the Code)

Present Law

Under section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified replacement period of time. The replacement property may be acquired directly or by acquiring control of a corporation (generally, 80 percent of the stock of the corporation) that owns replacement property. The taxpayer's basis in the replacement property generally is the same as the taxpayer's basis in the converted property, decreased by the amount of any money or loss recognized on the conversion, and increased by the amount of any gain recognized on the conversion. In cases in which a taxpayer purchases stock as replacement property, the taxpayer generally reduces the basis of the stock, but does not reduce the basis of the underlying assets. Thus, the reduction in the basis of the stock generally does not result in reduced depreciation deductions where the corporation holds depreciable property, and may result in the taxpayer having more aggregate depreciable basis after the acquisition of replacement property than before the involuntary conversion.

Reasons for Change

The Committee believes that if a taxpayer elects to defer the recognition of gain with respect to property that is involuntarily converted, the taxpayer should have the same adjusted basis in the acquired property that is similar or related in service or use to the converted property, regardless of whether such property is acquired directly or indirectly through the acquisition of stock of a corporation.

Explanation of Provision

The bill provides that where the taxpayer satisfies the replacement property requirement of section 1033 by acquiring stock in a corporation, the corporation generally will reduce its adjusted bases in its assets by the amount by which the taxpayer reduces its basis in the stock. The corporation's adjusted bases in its assets will not be reduced, in the aggregate, below the taxpayer's basis in its stock (determined after the appropriate basis adjustment for the stock). In addition, the basis of any individual asset will not be reduced below zero. The basis reduction first is applied to: (1) property that is similar or related in service or use to the converted property, then (2) to other depreciable property, then (3) to other property.

The application of these rules can be demonstrated by the following examples:

Example 1.—Assume that a taxpayer owned a commercial building with an adjusted basis of $100,000 that was involuntarily converted, causing the taxpayer to receive $1 million in insurance proceeds. Further assume that the taxpayer acquires, as replacement property, all of the stock of a corporation, the sole asset of the corporation is a building with a value and an adjusted basis of $1 million. Under the bill, for section 1033 to apply, the taxpayer would reduce its basis in the stock to $100,000 (as under present law) and the corporation would reduce its adjusted basis in the building to $100,000.

Example 2.—Assume the same facts as in Example 1, except that on the date of acquisition, the corporation has an adjusted basis of $100,000 (rather than $1 million) in the building. Under the bill, the taxpayer reduces its basis in the stock to $100,000 (as under present law) and the corporation is not required to reduce its adjusted basis in the building.

Effective Date

The provision applies to involuntary conversions occurring after September 13, 1995.

B. Modify the Exception to the Related Party Rule of Section 1033 for Individuals to Only Provide an Exception for De Minimis Amounts (sec. 12602 of the bill and sec. 1033 of the Code)

Present Law

Under section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified replacement period of time. Pursuant to a provision of H.R. 831, as passed by the Congress and signed by the President on April 11, 1995 (P.L. 104–7), subchapter C corporations (and certain partnerships with corporate partners) are not entitled to defer gain under section 1033 if the replacement property or stock is purchased from a related person. A person is treated as related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1). An exception to this related party rule provides that a taxpayer could purchase replacement property or stock from a related person and defer gain under section 1033 to the extent the related person acquired the replacement property or stock from an unrelated person within the replacement period.

Reasons for Change

The Committee believes that, except for de minimis cases, individuals should be subject to the same rules with respect to the acquisition of replacement property from a related person as are other taxpayers.

Explanation of Provision

The bill expands the present-law denial of the application of section 1033 to any other taxpayer (including an individual) that acquires replacement property from a related party (as defined by secs. 267(b) and 707(b)(1)) unless the taxpayer has aggregate realized gain of $100,000 or less for the taxable year with respect to converted property with aggregate realized gains. In the case of a partnership (or S corporation), the annual $100,000 limitation applies to both the partnership (or S corporation) and each partner (or shareholder).

Effective Date

The provision applies to involuntary conversions occurring after September 13, 1995.

C. Treatment of Certain Crop Insurance Proceeds and Disaster Assistance Payments (sec. 12603 of the bill and sec. 451 of the Code)

Present Law

A taxpayer engaged in a farming business generally may use the cash receipts and disbursements method of accounting ("cash method") to report taxable income. A cash method taxpayer generally recognizes income in the taxable year in which cash is received, regardless of when the economic events that give rise to such income occur. Under a special rule (sec. 451(d) of the Internal Revenue Code), in the case of insurance proceeds received as a result of destruction or damage to crops, a cash method taxpayer may elect to defer the income recognition of the proceeds until the taxable year following the year of the destruction or damage, if the taxpayer establishes that under his practice, income from such crops would have been reported in a following taxable year.

Reasons for Change

The Committee is aware of situations where cash-method farmers have received crop insurance proceeds or disaster assistance payments in the taxable year after the close of year in which the crops were destroyed. The income from such crop normally would have been reported in the year of the destruction. The receipt of these payments in the subsequent year along with the recognition of the income from crops harvested or sold in that year will result in a "bunching" of income. This bunching of income may result in the loss of itemized deductions in the year of the disaster, a higher marginal income tax rate in the subsequent year, and the loss of several AGI-based deductions and exemptions in the subsequent year. The Committee believes that it is appropriate to allow taxpayers to accelerate the recognition of insurance and disaster assistance payments in these and similar cases so that taxpayers may more closely replicate the tax effects that would have occurred had the destroyed crop been sold in the normal course of business.

Explanation of Provision

The bill amends the special rule of section 451(d) to allow a cash method taxpayer to elect to accelerate (or defer) the recognition of certain disaster-related payments if the taxpayer establishes that, under the taxpayer's practice, income from the crops lost in the disaster would have been reported in a prior (or the subsequent) taxable year. These elections are available with respect to payments of: (1) insurance proceeds received on account of destruction or damage to crops or (2) disaster assistance received under any Federal law as a result of destruction or damage to crops caused by drought, flood, or other natural disaster, or the inability to plant crops because of such a disaster. A taxpayer is not allowed to accelerate the recognition of a disaster-related payment if the taxable year to which the taxpayer could properly accelerate such income under the bill is closed by the statute of limitations.

Thus, for example, the provision allows a calendar-year, cash-method taxpayer who has received disaster assistance payments in 1997 relating to the destruction of crops by a flood in 1996 to elect to treat such payments as received in 1996, so long as the taxpayer establishes that, under the taxpayer's practice, income from such crops would have been reported in 1996 and taxable year 1996 is not closed by the statute of limitations.

Effective Date

The provision is effective for payments received after December 31, 1992, as a result of destruction or damage occurring after such date.

D. Application of Involuntary Conversion Rules to Property Damaged as a Result of Presidentially Declared Disasters (sec. 12604 of the bill and sec. 1033 of the Code)

Present Law

Under present law, a taxpayer may elect not to recognize gain with respect to property that is involuntarily converted if the taxpayer acquires within an applicable period property similar or related in service or use. The applicable period generally begins with the date of the disposition of the converted property and generally ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. If the taxpayer does not replace the converted property with property similar or related in service or use, then gain generally is recognized.

Reasons for Change

The property damage in a Presidentially declared disaster may be so great that businesses are forced to suspend operations for a substantial time. During that hiatus, valuable markets and customers may be lost. If this suspension causes the business to fail, and the owners of the business wish to reinvest their capital in a new business venture, the involuntary conversion rules will force them to recognize gain when they buy replacement property that is needed for the new business but not similar to that used in the failed business. This provision will offer relief to such businesses by allowing them to reinvest their funds in any tangible business property without being forced to recognize gain. No such deferral of gain is available, however, if the taxpayer decides not to reinvest in tangible business property.

Explanation of Provision

For purposes of the involuntary conversion rules, the bill treats any tangible property acquired and held for productive use in a business as similar or related in service or use to Presidentially declared disaster area property. Presidentially declared disaster area property is property that (1) was held for investment or for productive use in a business and (2) was involuntarily converted as a result of a disaster that resulted in a subsequent determination by the President that assistance by the Federal Government was warranted under the Disaster Relief and Emergency Assistance Act.

Effective Date

The provision is effective for disasters for which a Presidential declaration is made after December 31, 1994, in taxable years ending after that date.

Subtitle H. Exempt Organizations And Charitable Reforms

A. Common Investment Fund for Private Foundations (sec. 12701 of the bill and new sec. 501(n) of the Code)

Present Law

Code section 501(c)(3) requires that an organization be organized and operated exclusively for a charitable or other 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) funds contributed by the members in stocks and securities, and to collect income from such investments and turn over such income, less expenses, to the members.

Reasons for Change

The Committee believes it is appropriate to extend to tax-exempt private foundations and community foundations the present-law rules that permit educational institutions to form tax-exempt cooperative service organizations to provide for collective investment of their assets.

Explanation of Provision

Under the bill, a cooperative service organization comprised solely of members that are tax-exempt private foundations and community foundations[52] is 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) it is organized[53] and controlled by its members, but no one member by itself controls the organization or any other member; (4) the members are permitted to dismiss any of the organization's investment advisors, if (following reasonable notice) members holding a majority of interest in the account managed by such advisor vote to remove such advisor; and (5) the organization is organized and operated solely to hold, commingle, and collectively invest and reinvest (including arranging for investment services by independent contractors) funds contributed by the members in stocks and securities, and to collect income from such investments and turn over

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[52] 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). See Treas. Reg. sec. 1.170A-9(e)(10).

The Committee expects that members will present the organization with verification of their status as tax-exempt private or community foundations at the time they become members (i.e., when they make an initial investment). The Committee intends that a reasonable time period (such as 60 days) should be allowed for withdrawal by a member that subsequently ceases to qualify as a tax-exempt private or community foundation.

[53] The Committee intends that an organization in existence at the time of enactment will meet the requirement that it be "organized" by members if its initial board of directors or trustees are officers of private or community foundations that become members of the organization within a reasonable period after enactment of the bill.

such income, less expenses, to the members.[54] To qualify for tax-exempt status under present-law section 501(c)(3), a cooperative service organization described in the provision also must satisfy the other applicable requirements of that section (e.g., prohibition of private inurement, political activities, and substantial lobbying).

A cooperative service organization meeting the criteria of the proposal will 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.[55] 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 will be 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.[56]

Effective Date

The provision is effective for taxable years ending after December 31, 1995.

B. Exclusion From UBIT for Certain Corporate Sponsorship Payments (sec. 12702 of the bill and sec. 513 of the Code)

Present Law

Although generally exempt from Federal income tax, tax-exempt organizations are subject to the unrelated business income tax ("UBIT") on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511–514). Contributions or gifts received by tax-exempt organizations generally are not subject to the UBIT. However, present-law section 513(c) provides that an activity (such as advertising) does not lose its identity as a separate trade or business merely because it is carried on within a larger complex of other endeavors.[57] If a tax-exempt organization receives sponsorship payments in connection with an event or other activity, the solicitation and receipt of such sponsorship payments may be treated as a separate activity. The Internal Revenue Service (IRS) has taken the position that, under some circumstances, such sponsorship payments are subject to the UBIT.[58]

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[54] The Committee intends that an organization will satisfy the requirement that it collectively invest and reinvest funds solely in "stocks and securities" if its investment portfolio consists solely of stocks and securities, and ordinary and routine investments held in connection with a stock and securities portfolio.

[55] The bill provides that the present-law expenditure responsibility requirements of section 4945(d)(4)(B) will not apply to grants made by private foundations to a cooperative service organization and that such grants will be deemed to be qualifying distributions for purposes of 4942.

[56] Each member's allocable share of the organization's expenses are passed through to the member for purposes of determining the deductions allowed by section 4940(c)(3) in computing the member's net investment income.

[57] See *United States v. American College of Physicians*, 475 U.S. 834 (1986)(holding that activity of selling advertising in medical journal was not substantially related to the organization's exempt purposes and, as a separate business under section 513(c), was subject to tax).

[58] See Prop.Treas. Reg. sec. 1.513–4 (issued January 19, 1993, EE–74–92, IRB 1993–7, 71). These proposed regulations generally exclude from the UBIT financial arrangements under which the tax-exempt organization provides so-called "institutional" or "good will" advertising to a sponsor (i.e., arrangements under which a sponsor's name, logo, or product line is acknowledged by the tax-exempt organization). However, specific product advertising (e.g., "comparative

Reasons for Change

In order to clarify the uncertainty regarding the treatment of corporate sponsorship payments for UBIT purposes, the Committee believes that it is appropriate to distinguish sponsorship payments for which the donor receives no substantial return benefit other than the use or acknowledgement of the donor's name or logo (which are not subject to the UBIT) from payments made in exchange for advertising (which are subject to the UBIT).

Explanation of Provision

Under the bill, qualified sponsorship payments received by a tax-exempt organization (or State college or university described in section 511(a)(2)(B)) are exempt from the UBIT.

The bill defines "qualified sponsorship payments" as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities.[59] Such a use or acknowledgment does *not* include advertising of such person's products or services—meaning qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use such products or services. Thus, for example, if, in return for receiving a sponsorship payment, an organization promises to use the sponsor's name or logo in acknowledging the sponsor's support for an educational or fundraising event conducted by the organization, such payment would not be subject to the UBIT. In contrast, if the organization provides advertising of a sponsor's products, the payment made to the organization by the sponsor in order to receive such advertising would be subject to the UBIT (provided that the other, present-law requirements for UBIT liability are satisfied).

The bill specifically provides that a qualified sponsorship payment does not include any payment where the amount of such payment is contingent, by contract or otherwise, upon the level of attendance at an event, broadcast ratings, or other factors indicating the degree of public exposure to an activity. However, the fact that a sponsorship payment is contingent upon an event actually taking place or being broadcast, in and of itself, does not cause the payment to fail to be a qualified sponsorship payment. Moreover, mere distribution or display of a sponsor's products by the sponsor or the tax-exempt organization to the general public at a sponsored event, whether for free or for remuneration, is considered to be "use or acknowledgment" of the sponsor's product lines (as opposed to advertising), and thus will not affect the determination of whether a payment made by the sponsor is a qualified sponsorship payment.

The bill does not apply to the sale of advertising or acknowledgements in tax-exempt organization periodicals. For this purpose, the term "periodical" means regularly scheduled and printed material

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or qualitative descriptions of the sponsor's products") provided by a tax-exempt organization on behalf of a sponsor is not shielded from the UBIT under the proposed regulations.

[59] In determining whether a payment is a qualified sponsorship payment, it is irrelevant whether the sponsored activity is related or unrelated to the organization's exempt purpose.

that is not related to and primarily distributed in connection with a specific sponsored event. For example, the provision does not apply to payments that lead to acknowledgements in a monthly journal, but does apply if a sponsor receives an acknowledgement in a program or brochure distributed at a sponsored event.

The bill specifically provides that, to the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, such portion of the payment will be treated as a separate payment. Thus, if a sponsorship payment made to a tax-exempt organization entitles the sponsor to both product advertising *and* use or acknowledgment of the sponsor's name or logo by the organization, then the UBIT would not apply to the amount of such payment that exceeds the fair market value of the product advertising provided to the sponsor. Moreover, the provision of facilities, services or other privileges by an exempt organization to a sponsor or the sponsor's designees (e.g., complimentary tickets, pro-am playing sports in golf tournaments, or receptions for major donors) in connection with a sponsorship payment will not affect the determination of whether the payment is a qualified sponsorship payment. Rather, the provision of such goods or services will be evaluated as a separate transaction in determining whether the organization has unrelated business taxable income from the event. In general, if such services or facilities do not constitute a substantial return benefit or if the provision of such services or facilities is a related business activity, then the payments attributable to such services or facilities will not be subject to the UBIT.

The exemption provided by the bill is in addition to other present-law exceptions from the UBIT (e.g., the exceptions for activities substantially all the work for which is performed by volunteers and for activities not regularly carried on). No inference is intended as to whether any sponsorship payment received prior to 1996 was subject to the UBIT.[60]

Effective Date

The provision applies to qualified sponsorship payments solicited or received after December 31, 1995.

[60] The Committee expects that, under present-law UBIT rules (see Rev. Rul. 81-178-2 C.B. 135), royalty income derived from licensing trademarks, emblems, and designations of a qualified amateur sports organization described in section 501(j)(2) (e.g., the U.S. Olympic Committee), as well as income received by such organizations from broadcasting, filming, and videotaping sports competitions and related events, will be treated as exempt from the UBIT. This exemption from the UBIT should not be affected by the fact that an amateur sports organization undertakes legal or other actions to protect the exclusivity of a licensing arrangement, or to prevent third parties from improperly using the organization's trademarks or representing that such parties are an official sponsor of the organization or its competitive events. In addition, if the organization provides incidental benefits related to the sports competition (e.g., preferred seating) to a licensee in connection with a licensing arrangement, the provision of such incidental benefits should be treated as an activity separate from the licensing activity to determine whether there is any UBIT liability.

C. Treatment of Dues Paid to Agricultural or Horticultural Organizations (sec. 12703 of the bill and sec. 512 of the Code)

Present Law

Tax-exempt organizations generally are subject to the unrelated business income tax ("UBIT") on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511–514). Dues payments made to a membership organization generally are not subject to the UBIT. However, several courts have held that, with respect to postal labor organizations, dues payments were subject to the UBIT when received from individuals who were not postal workers but who became "associate" members for the purpose of obtaining health insurance available to members of the organization. See *National League of Postmasters of the United States v. Commissioner*, No. 8032–93, T.C. Memo (May 11, 1995); *American Postal Workers Union, AFL–CIO v. United States*, 925 F.2d 480 (D.C. Cir. 1991); *National Association of Postal Supervisors v. United States*, 944 F.2d 859 (Fed. Cir. 1991).

In Rev. Proc. 95–21 (issued March 23, 1995), the IRS set forth its position regarding when associate member dues payments received by an organization described in section 501(c)(5) will be treated as subject to the UBIT. The IRS stated that dues payments from associate members will not be treated as subject to UBIT unless, for the relevant period, "the associate member category has been formed or availed of for the principal purpose of producing unrelated business income." Thus, under Rev. Proc. 95–21, the focus of the inquiry is upon the organization's purposes in forming the associate member category (and whether the purposes of that category of membership are substantially related to the organization's exempt purposes other than through the production of income), rather than upon the motive of the individuals who join as associate members.

Reasons for Change

In order to reduce uncertainty and legal disputes involving the UBIT treatment of certain associate member dues, the Committee believes that it is appropriate to provide a special rule exempting from the UBIT annual dues not exceeding $100 paid to a tax-exempt agricultural or horticultural organization.

Explanation of Provision

Under the bill, if an agricultural or horticultural organization described in section 501(c)(5) requires annual dues not exceeding $100 to be paid in order to be a member of such organization, then in no event will any portion of such dues be subject to the UBIT by reason of any benefits or privileges to which members of such organization are entitled. For taxable years beginning after 1995, the $100 amount will be indexed for inflation. The term "dues" is defined as "any payment required to be made in order to be recognized by the organization as a member of the organization."[61] Thus, if a person is recognized as a member of an organization by virtue of having paid annual dues for his or her membership, then any subsequent payments made by that person during the year to purchase another membership in the same organization would not be within the scope of the provision.

Effective Date

The provision applies to taxable years beginning after December 31, 1994.

D. Repeal Tax Credit for Contributions to Special Community Development Corporations (sec. 12704 of the bill)

Present Law

Taxpayers are entitled to claim a tax credit for qualified contributions made to one of 20 non-profit community development corporations (CDCs) selected by the Secretary of Housing and Urban Development (HUD) to provide assistance in economically distressed areas. A qualified contribution means a transfer of cash to a selected CDC (made in the form of an equity investment or loan) which is made available for use by the CDC for at least 10 years to provide employment and business opportunities to low-income residents who live in an area where (1) the unemployment rate is not less than the national unemployment rate and (2) the median family income does not exceed 80 percent of the median gross income of residents of the jurisdiction of the local government which includes such area.[62]

If a taxpayer makes a qualified contribution, the credit may be claimed by the taxpayer for each taxable year during the 10-year period beginning with the taxable year during which the contribution was made. The credit that may be claimed for each year is equal to 5 percent of the amount of the contribution to the CDC. Thus, during the 10-year credit period, the taxpayer may claim aggregate credit amounts totalling 50 percent of his or her contribution. The aggregate amount of contributions that may be designated by any one CDC as eligible for the credit may not exceed $2 million. (Consequently, a total amount of $40 million in contributions will be eligible for the credit with respect to all 20 selected CDCs—and the maximum credit amounts will total $20 million over the 10-year credit period.)

On June 30, 1994, the Secretary of HUD announced the 20 CDCs selected to receive contributions that qualify the for the credit. The eligible CDCs are located in the following areas: (1) Atlanta, (2) Baltimore, (3) Boston, (4) Chicago, (5) Cleveland, (6) Dallas, (7)

[61] No inference is intended regarding the UBIT treatment of any dues payment not governed by the provision.

[62] The contribution to the CDC must be available for use by the CDC for at least ten years, but need not meet the requirements of a "contribution or gift" for purposes of section 170. In other words, a contribution eligible for the credit may be made in the form of a 10-year loan (or other long-term investment), the principal of which is to be returned to the taxpayer after the 10-year period. However, in the case of a donation of cash made by a taxpayer to an eligible CDC, the taxpayer is allowed to claim a charitable contribution deduction (subject to present-law rules under section 170), in addition to the special credit for qualified contributions to a selected CDC.

Washington D.C., (8) Los Angeles, (9) Memphis, (10) Miami, (11) Brooklyn, (12) Newark, (13) Watsonville, Ca., (14) London, Ky., (15) Wiscasset, Maine, (16) Greenville, Miss., (17) Mayville, N.Y., (18) Barnesboro, Pa., (19) San Antonio, Texas, and (20) Christiansburg, Va.

Reasons for Change

The Committee believes that it is not appropriate to provide more favorable tax treatment to a few nonprofit organizations (selected by HUD) than is provided to other nonprofits that are in existence, or will be created, to provide comparable employment and business opportunities in economically distressed areas.

Explanation of Provision

The bill repeals the special tax credit for qualified contributions to selected community development corporations.

Effective Date

The provision is effective for contributions made after the date of enactment (other than a contribution made pursuant to a legally enforceable agreement to make such contribution, if such agreement is in effect on the date of enactment).

E. Required Notices to Charitable Beneficiaries of Charitable Remainder Trusts (sec. 12705 of the bill and sec. 6034A, 6036, and 6652 of the Code)

Present Law

Subject to certain limitations, an estate generally is allowed a deduction for transfers of property to charitable organizations, the United States, or a State or local government (sec. 2055(a)). Where a remainder interest is transferred to the charity in trust, however, a deduction is permitted only if the interest passes to the charitable remainderman through a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund (sec. 2055(e)).

In order for the estate to take the deduction authorized by section 2055, the Treasury regulations require that the executor submit a copy of the transfer instrument with the estate tax return and stipulate that no actions have been filed or are (according to the executor's information and belief) contemplated to contest the decedent's will in a manner affecting the charitable deduction claimed.

A qualifying charitable remainder trust is generally exempt from tax unless it has unrelated business taxable income. The fiduciary of a qualifying charitable remainder trust must file an annual information return and a tax return unless all net income is required to be distributed currently to the beneficiaries. A charitable remainderman generally may inspect any such returns upon written request to the Internal Revenue Service (sec. 6103). The Code generally does not require the executor and trust fiduciaries to provide any information directly to the charitable remainderman.

Reasons for Change

The Committee understands that a charitable remainder interest in a trust can be created without the knowledge of the charitable organization that is to receive the remainder interest. Because the creation of the remainder gives the charitable organization a financial interest in the trust, the Committee believes it is appropriate that the charitable organization be notified of the existence of such a remainder interest.

Explanation of Provision

The bill requires an executor claiming a charitable deduction on the estate tax return for certain qualified remainder interests to provide to the beneficiary of such a remainder interest notification that the remainder interest has been created. Such notice would be provided to the beneficiary within three months of the due date (or any extension thereof) for filing the estate tax return. This notification requirement does not apply in the case of a contingent remainder interest.

The bill further requires the fiduciary of certain trusts with a charitable remainder interest to notify annually the beneficiary of such a remainder interest that the remainder interest exists. The bill provides exceptions to this annual notification requirement if the Secretary determines it is not necessary for the efficient administration of tax law; if the fiduciary has previously provided notification; if the beneficiary relieves the fiduciary of the requirement; or if, as provided under State law, the fiduciary provides annual accounting to the beneficiary of the remainder interest. The annual notification requirement does not apply in the case of a contingent remainder interest.

For the purpose of both the notification requirement upon claiming a charitable deduction against the estate tax and the annual notification requirement, a charitable remainder interest would not be deemed to be contingent if, pursuant to existing Treasury regulations (Treas. reg. secs. 1.664–2(a)(6)(iv) and 1.664–3(a)(6)(iv)), the trust's governing instrument provides that if an organization to which the trust is to transfer the remainder is not a qualified charitable organization at the time the remainder is to be transferred, then alternative charitable organizations are to receive the remainder.

Effective Date

The provision with respect to notification relating to charitable interests claimed on estate tax returns is effective for decedents dying after the date of enactment. The annual notification requirement is effective for taxable years beginning after December 31, 1995.

F. Treat Qualified Football Coaches Plan as Multiemployer Pension Plan for Purposes of the Internal Revenue Code (sec. 12706 of the bill and sec. 3(37) of ERISA)

Present Law

Under present law, a tax-qualified pension plan (including a qualified cash or deferred arrangement) must be maintained for the exclusive benefit of the employees and their beneficiaries covered under the plan.

The American Football Coaches Association ("AFCA") is a tax-exempt organization described in section 501(c)(6) of the Code. The members of the AFCA include college coaches, athletic directors, and high school coaches. The participating members of the AFCA are not employees of the organization. The AFCA maintains a cash or deferred arrangement (i.e., a "401(k) plan") on behalf of participating members.

The Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by the Continuing Appropriations for Fiscal Year 1988, provides that, for purposes of the labor law provisions of ERISA, a qualified football coaches plan generally is treated as a multiemployer plan and may include a qualified cash or deferred arrangement. Under ERISA, a qualified football coaches plan is defined as any defined contribution plan established and maintained by an organization described in Code section 501(c)(6), the membership of which consists entirely of individuals who primarily coach football as full-time employees of 4-year colleges or universities, if the organization was in existence on September 18, 1986. This definition is generally intended to apply to the AFCA.

However, the Omnibus Budget Reconciliation Act of 1987 provided that certain provisions of ERISA are not applicable in interpreting the Internal Revenue Code, except to the extent specifically provided in the Code or as determined by the Secretary of the Treasury.

The Internal Revenue Service determined that the cash or deferred arrangement maintained by the AFCA is not a qualified cash or deferred arrangement under the Internal Revenue Code. In making this determination, the IRS also observed that the AFCA plan may also violate a number of provisions of the Code. For example, the Code requires that a qualified plan be maintained for the benefit of employees, but the coaches are not employees of the AFCA.

Reasons for Change

The Congress intended in 1987 that a cash or deferred arrangement of the AFCA be treated as a qualified plan. This qualified plan status was inadvertently altered by other legislation also enacted in 1978. The Committee believes it is appropriate to impose a small charge for reinstatement of a qualified football coaches plan to reflect the administrative costs to the Federal government.

Explanation of Provision

A correction to the Continuing Appropriations for Fiscal Year 1988 provides that a qualified football coaches plan (as defined in

ERISA) is eligible to maintain a qualified cash or deferred arrangement under the Internal Revenue Code on behalf of the football coaches belonging to the AFCA. In order for the plan to be reinstated as a qualified football coaches plan, a $25,000 excise tax is imposed on the plan.

Effective Date

The provision generally is effective as if included in the Continuing Appropriations for Fiscal Year 1988 (i.e., years beginning after December 22, 1987). The excise tax is required to be paid in the first plan year beginning after the date of enactment.

Subtitle I.—Corporate and Other Reforms And Miscellaneous Provisions

1. Reform the tax treatment of certain corporate stock redemptions and other extraordinary dividends (sec. 12801 of the bill and sec. 1059 of the Code)

Present Law

A corporate shareholder generally can deduct at least 70 percent of a dividend received from another corporation. This dividends received deduction is 80 percent if the corporate shareholder owns at least 20 percent of the distributing corporation and generally 100 percent if the shareholder owns at least 80 percent of the distributing corporation.

Section 1059 of the Code requires a corporate shareholder that receives an "extraordinary dividend" to reduce the basis of the stock with respect to which the dividend was paid by the nontaxed portion of the dividend. Whether a dividend is "extraordinary" is determined, among other things, by reference to the size of the dividend in relation to the adjusted basis of the shareholder's stock. Also, a dividend resulting from a non pro rata redemption or a partial liquidation is an extraordinary dividend. If the reduction in basis of stock exceeds the basis in the stock with respect to which an extraordinary dividend is paid, the excess is taxed as gain on the sale or disposition of such stock, but not until that time (sec. 1059(a)(2)).

In general, a distribution in redemption of stock is treated as a dividend, rather than as a sale of the stock, if it is essentially equivalent to a dividend (sec. 302). A redemption of the stock of a shareholder generally is essentially equivalent to a dividend if it does not result in a meaningful reduction in the shareholder's proportionate interest in the distributing corporation. Section 302(b) also contains several specific tests (e.g., a substantial reduction computation and a termination test) to identify redemptions that are not essentially equivalent to dividends. The determination whether a redemption is essentially equivalent to a dividend includes reference to the constructive ownership rules of section 318, including the option attribution rules of section 318(a)(4).

Reasons for Change

The Committee is concerned that corporate taxpayers are attempting to dispose of stock of other corporations in transactions structured as redemptions, where the redeemed corporate shareholder apparently expects to take the position that the transaction qualifies for the dividends received deduction. Thus, the redeemed corporate shareholder attempts to exclude from income a substantial portion of the amount received. In some cases, it appears that the taxpayers' interpretations of the option attribution rules of section 318(a)(4) are important to the taxpayers' contentions that their interests in the distributing corporations are not meaningfully reduced.

Even in the absence of options, the Committee is concerned that the present law rules dealing with extraordinary dividends permit inappropriate deferral of gain recognition when the portion of the distribution that is excluded due to the dividends received deduction exceeds the basis of the stock with respect to which the extraordinary dividend is received.

Explanation of Provision

Under the bill, except as provided in regulations, a corporate shareholder will recognize gain immediately with respect to any redemption treated as a dividend (in whole or in part) when the nontaxed portion of the dividend exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership.[63]

In addition, the bill requires immediate gain recognition whenever the basis of stock with respect to which any extraordinary dividend was received is reduced below zero.

Reorganizations or other exchanges involving amounts that are treated as dividends under section 356(a)(2) of the Code are treated as redemptions for purposes of applying the rules relating to redemptions under section 1059(e). For example, if a recapitalization or other transaction that involves a dividend under section 356 has the effect of a non pro rata redemption or is treated as a dividend due to options being counted as stock, the rules of section 1059 apply. Redemptions of shares (or other extraordinary dividends on shares) held by a partnership will be subject to section 1059 to the extent there are corporate partners (e.g., appropriate adjustments to the basis of the shares held by the partnership and to the basis of the corporate partner's partnership interest will be required).

Finally, under continuing section 1059(g) of present law, the Treasury Department is authorized to issue regulations where necessary to carry out the purposes and prevent the avoidance of the bill.

Effective Date

The provision is generally effective for distributions after May 3, 1995, unless made pursuant to the terms of a written binding contract in effect on that date. However, in applying the new gain recognition rules to any distribution that is not a partial liquidation, a non pro rata redemption, or a redemption that is treated as a dividend by reason of options, September 13, 1995 is substituted for May 3, 1995 in applying the transition rules.

No inference is intended regarding the tax treatment under present law of any transaction within the scope of the bill, including transactions utilizing options.

2. Registration of confidential corporate tax shelters (sec. 12802 of the bill and secs. 6111 and 6707(a) of the Code)

Present Law

An organizer of a tax shelter is required to register the shelter with the Internal Revenue Service (IRS) (sec. 6111). If the principal organizer does not do so, the duty may fall upon any other partici-

[63] Thus, for example, where a portion of such a distribution would not have been treated as a dividend due to insufficient earnings and profits, the rule applies to the portion treated as a dividend.

pant in the organization of the shelter or any person participating in its sale or management. The shelter's identification number must be furnished to each investor who purchases or acquires an interest in the shelter. Failure to furnish this number to the tax shelter investors will subject the organizer to a $100 penalty for each such failure (sec. 6707(b)).

A penalty may be imposed against an organizer who fails without reasonable cause to timely register the shelter or who provides false or incomplete information with respect to it. The penalty is the greater of one percent of the aggregate amount invested in the shelter or $500. Any person claiming any tax benefit with respect to a shelter must report its registration number on her return. Failure to do so without reasonable cause will subject that person to a $250 penalty (sec. 6707(b)(2)).

A person who organizes or sells an interest in a tax shelter subject to the registration rule or in any other potentially abusive plan or arrangement must maintain a list of the investors (sec. 6112). A $50 penalty may be assessed for each name omitted from the list. The maximum penalty per year is $100,000 (sec. 6708).

For this purpose, a tax shelter is defined as any investment that meets two requirements. First, the investment must be (1) required to be registered under a Federal or state law regulating securities, (2) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or state agency regulating the offering or sale of securities, or (3) a substantial investment. Second, it must be reasonable to infer that the ratio of deductions and 350% of credits to investment for any investor (i.e., the tax shelter ratio) may be greater than two to one as of the close of any of the first five years ending after the date on which the investment is offered for sale. An investment that meets these requirements will be considered a tax shelter regardless of whether it is marketed or customarily designated as a tax shelter (sec. 6111(c)(1)).

Reasons for Change

The Committee believes that requiring registration of corporate tax shelters will result in the IRS obtaining useful information at an early date regarding various forms of tax shelter transactions engaged in by corporate participants. This will allow the IRS to make better informed judgments regarding the audit of corporate tax returns and to monitor whether legislation or regulations are necessary regarding the type of transaction being registered.

Explanation of Provision

The bill requires a promoter of a corporate tax shelter to register the shelter with the Secretary. Registration is required not later than the next business day after the day when the tax shelter is first offered to potential users. If the promoter is not a U.S. person, or if a required registration is not otherwise made, then any U.S. participant is required to register the shelter. An exception to this special rule provides that registration is not required if the U.S. participant notifies the promoter in writing not later than the seventh day after discussions began that the U.S. participant will not participate in the shelter and the U.S. person does not in fact participate in the shelter.

A corporate tax shelter is any investment, plan, arrangement or transaction (1) a significant purpose of the structure of which is tax avoidance or evasion by a corporate participant, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoters may receive total fees in excess of $100,000.

A transaction is offered under conditions of confidentiality if: (a) an offeree (or any person acting on its behalf) has an understanding or agreement with or for the benefit of any promoter to restrict or limit its disclosure of the transaction or any significant tax features of the transaction; or (b) the promoter claims, knows or has reason to know (or the promoter causes another person to claim or otherwise knows or has reason to know that a party other than the potential offeree claims) that the transaction (or one or more aspects of its structure) is proprietary to the promoter or any party other than the offeree, or is otherwise protected from disclosure or use. The promoter includes specified related parties.

Registration will require the submission of information identifying and describing the tax shelter and the tax benefits of the tax shelter, as well as such other information as the Treasury Department may require.

Tax shelter promoters are required to maintain lists of those who have signed confidentiality agreements, or otherwise have been subjected to nondisclosure requirements, with respect to particular tax shelters. In addition, promoters must retain lists of those paying fees with respect to plans or arrangements that have previously been registered (even though the particular party may not have been subject to confidentiality restrictions).

All registrations will be treated as taxpayer information under the provisions of section 6103 and will therefore not be subject to any public disclosure.

The penalty for failing to timely register a corporate tax shelter is the greater of $10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration (i.e., this part of the penalty does not apply to fee payments with respect to offerings after late registration). A similar penalty is applicable to actual participants in any corporate tax shelter who were required to register the tax shelter but did not. With respect to participants, however, the 50-percent penalty is based only on fees paid by that participant. Intentional disregard of the requirement to register by either a promoter or a participant increases the 50-percent penalty to 75 percent of the applicable fees.

Effective Date

The provision applies to any tax shelter offered to potential participants after the date of enactment. No filings are due, however, until the Treasury Department issues guidance with respect to the filing requirements.

3. Disallow interest deduction for corporate-owned life insurance policy loans (sec. 12803 of the bill and sec. 264 of the Code)

Present Law

No Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract ("inside buildup").[64] Further, an exclusion from Federal income tax is provided for amounts received under a life insurance contract paid by reason of the death of the insured (sec. 101(a)). The policyholder may borrow with respect to the life insurance contract without affecting these exclusions, subject to certain limitations.

The limitations on borrowing with respect to a life insurance contract under present law provide that no deduction is allowed for any interest paid or accrued on any indebtedness with respect to one or more life insurance policies owned by the taxpayer covering the life of any individual who (1) is an officer or employee of, or (2) is financially interested in, any trade or business carried on by the taxpayer to the extent that the aggregate amount of such debt with respect to policies covering the individual exceeds $50,000 (sec. 264(a)(4)).

Further, no deduction is allowed for any amount paid or accrued on debt incurred or continued to purchase or carry a life insurance, endowment or annuity contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of the contract.[65] An exception to the latter rule is provided, permitting deductibility of interest on bona fide debt that is part of such a plan, if no part of 4 of the annual premiums due during the first 7 years is paid by means of debt (the "4-out-of-7 rule") (sec. 264(c)(1)). Provided the transaction gives rise to debt for Federal income tax purposes, and provided the 4-out-of-7 rule is met,[66] a company may under present law borrow up to $50,000 per employee, officer, or financially interested person to purchase or carry a life insurance contract covering such a person, and is not precluded under section 264 from deducting the interest on the debt, even though the earnings inside the life

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[64] This favorable tax treatment is available only if a life insurance contract meets certain requirements designed to limit the investment character of the contract (sec. 7702). Distributions from a life insurance contract (other than a modified endowment contract) that are made prior to the death of the insured generally are includible in income, to the extent that the amounts distributed exceed the taxpayer's basis in the contract; such distributions generally are treated first as a tax-free recovery of basis, and then as income (sec. 72(e)). In the case of a modified endowment contract, however, in general, distributions are treated as income first, loans are treated as distributions (i.e., income rather than basis recovery first), and an additional ten percent tax is imposed on the income portion of distributions made before age 59½ and in certain other circumstances (secs. 72(e) and (v)). A modified endowment contract is a life insurance contract that does not meet a statutory "7-pay" test, i.e., generally is funded more rapidly than seven annual level premiums (sec. 7702A).

[65] The statute provides that the $50,000 limitation applies only with respect to contracts purchased after June 20, 1986. However, additional limitations are imposed on the deductibility of interest with respect to single premium contracts (sec. 264(a)(2)), and on the deductibility of premiums paid on a life insurance contract covering the life of any officer or employee or person financially interested in a trade or business of the taxpayer when the taxpayer is directly or indirectly a beneficiary under the contract (sec. 264(a)(1)).

[66] Interest deductions are disallowed if any of the disallowance rules of section 264(a)(2)–(4) apply. The disallowance rule of section 264(a)(3) is not applicable if one of the exceptions of section 264(c), such as the 4-out-of-7 rule (sec. 264(c)(1)) is satisfied. In addition to the specific disallowance rules of section 264, generally applicable principles of tax law apply.

insurance contract (inside buildup) are tax-free, and in fact the taxpayer has full use of the borrowed funds.

Reasons for Change

Considerable publicity has been focused on the magnitude of business borrowings with respect to life insurance and the scale of the tax benefits. In a recent article describing corporate-owned life insurance ("COLI"), it was stated, "COLIs can net big bucks. After 40 years, a COLI program that pays a $10,000 annual premium on each of 5,000 employees will produce about $450 million in death benefits and $300 million in tax benefits—netting the company $230 million."[67]

A company that sets up a COLI program typically purchases life insurance on the lives of its employees, in many cases thousands or tens of thousands of employees.[68] The company, not the employee or his family, receives all or most of the proceeds on the employee's death. The company borrows against the value of the life insurance policies at an interest rate just above the rate at which inside buildup is credited under the policy. The interest that the company pays on policy loans from the insurer is credited under the policy and increases the tax-free inside buildup. At the same time, the company deducts the interest it pays. The company shows a positive return on the COLI program, because the after-tax interest it pays on the policy loan is less than the interest income being credited under the policy. In addition, tax-free death benefits that the company receives on the death of insured employees subsidize future years' premiums. The company is able to increase the value of its life insurance contract while using funds borrowed under the insurance contract for other purposes.[69] Large COLI programs could be viewed as the economic equivalent of a tax-free savings account owned by the company into which it pays itself tax-deductible interest.

The Committee believes that these types of transactions are an inappropriate use of the tax rules and achieve a result that was never contemplated by Congress. When the $50,000 limitation of present law was enacted, it was not anticipated that it would lead to a trend in the purchase of insurance products covering hundreds, thousands or even hundreds of thousands of employees of a business organization in order to maximize the tax arbitrage of deducting interest that is credited, tax-free, to the organization's own insurance contract.

In addition, the Committee feels that it is not appropriate to permit a deduction for interest that is funding the increase in value of an asset of which the taxpayer is the ultimate beneficiary, as recipient of the proceeds upon the insured person's death. Interest

[67] Solov, Diane, "Companies Profit By Insurance," *St. Paul Pioneer Press*, p. 2E, March 20, 1995. See also Lee Sheppard, "'Janitor' Insurance as a Tax Shelter," *Tax Notes*, p. 1526, September 25, 1995.

[68] In some cases, state law provides that an employer continues to have an insurable interest in former employees even after the termination of their employment. Thus, this life insurance coverage may be continued after an employee terminates employment with an employer, creating an ever-increasing pool of lives.

[69] Companies sometimes use the funds borrowed under the life insurance contracts for tax-advantaged funding of expenses such as retiree health benefits and nuclear decommissioning expenses, even though Congress has already provided special tax benefits specifically for funding these expenses.

paid by the taxpayer on a loan under a life insurance policy can be viewed as funding the inside buildup of the policy. The taxpayer is indirectly paying the interest to itself, through the increase in value of the policy of which the taxpayer is the beneficiary.

A general principle of accurate income measurement under an income tax system provides that expenses, such as interest, are not deducted from income if they are costs of accretions to wealth that are not included in income. The Committee notes that numerous provisions of the tax law limit the deductibility of interest (as well as other expenses) relating to income that is not subject to tax. For example, interest incurred or continued to purchase or carry tax-exempt bonds is not deductible (sec. 265(a)(2)). As a further example, proration rules apply to insurance companies and financial institutions such as banks, designed to limit deductions funded by tax-exempt income (secs. 805(a)(4), 832(b)(5)(B), and 265(b)). Personal interest of individuals is not deductible (secs. 163(h))[70]. The absence of any such limitation under present law with respect to companies' borrowings under life insurance contracts creates a significant tax incentive under present law for companies to purchase life insurance contracts rather than investing in other assets. To be consistent with the principle of accurate income measurement, and to limit the economic distortion induced by present law, it is appropriate to limit the deductibility of interest on debt that relates to the earning of inside buildup.

Therefore, the provision generally disallows any deduction for interest on borrowing by businesses with respect to life insurance, endowment and annuity products covering persons in whom the taxpayer has an insurable interest, subject to a phase-in of the disallowance rule. The Committee believes, however, that it is appropriate to provide an exception (retaining the $50,000 ceiling of present law) for borrowing with respect to life insurance covering a limited number of key persons, to the extent that the interest rate on such borrowing does not exceed a market rate of interest. The bill does not limit the ability of business taxpayers to insure key persons, but deductible interest on borrowing is permitted on no more than 25 such persons, because the Committee does not want borrowing on life insurance policies to be used as a tax shelter. In addition, the Committee believes it is appropriate to continue the grandfather provided when the $50,000 limit was imposed in 1986, subject to a market interest rate cap.

Explanation of Provision

Under the bill, subject to an exception for key person insurance, no deduction is allowed for interest paid or accrued on any indebtedness with respect to one or more life insurance policies or annuity or endowment contracts owned by the taxpayer covering any individual who is (1) an officer or employee of, or (2) financially interested in any trade or business carried on by the taxpayer, regard-

[70] Congress has specifically permitted a deduction for home mortgage interest. In providing the home mortgage interest deduction, Congress noted that encouraging home ownership is an important policy goal. Borrowing under a life insurance policy, by contrast, conflicts with a policy goal to encourage the purchase of life insurance so that breadwinners provide after their death for their dependents, because the proceeds of life insurance are reduced by the amount of any loans outstanding at the time of the insured person's death. Interest on a loan to purchase a life insurance policy is nondeductible personal interest of an individual.

less of the aggregate amount of debt with respect to policies or contracts covering the individual.[71]

An exception is provided retaining present law for interest on indebtedness with respect to life insurance policies covering up to 25 key persons. A key person is an individual who is either an officer or a 20-percent owner of the taxpayer. The number of individuals that can be treated as key persons may not exceed the greater of (1) five individuals, or (2) the lesser of 5 percent of the total number of officers and employees of the taxpayer, or 25 individuals. It is intended that employees be full-time employees, for this purpose. A 20-percent owner is an individual who directly owns 20 percent or more of the total combined voting power of the corporation. If the taxpayer is not a corporation, a 20-percent owner is an individual who directly owns 20 percent or more of the capital or profits interest of the taxpayer. It is not intended that indirect ownership interests be attributed to an individual for this purpose. For determining who is a 20-percent owner, all members of a controlled group are treated as one taxpayer. The 25-person limit may be allocated among members of the controlled group as provided in regulations. In the absence of such guidance, the 25-person limit is to be allocated among members of a group in a reasonable manner. Interest paid or accrued on debt with respect to a life insurance contract covering a key person is deductible only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average-Monthly Average Corporates for each month interest is paid or accrued.

In promulgating regulations or other guidance under the provision, it is anticipated that the Treasury Department will take into account the purpose of the provision to eliminate the deduction for interest on borrowing by businesses with respect to life insurance, endowment and annuity products covering persons in whom the taxpayer has an insurable interest. For example, it is not intended that a taxpayer should be able to circumvent the purpose of the provision by borrowing under a life insurance, endowment or annuity contract with respect to a director who is not also an officer of the taxpayer.

Effective Date

With respect to debt incurred after December 31, 1995, no deduction is allowed for interest paid or accrued after December 31, 1995, except with respect to policies that satisfy the key person exception. In addition, as described below, a grandfather rule is provided with respect to certain interest on contracts purchased on or before June 20, 1986.

With respect to debt incurred on or before December 31, 1995, any otherwise deductible interest paid or accrued after October 13, 1995, and before January 1, 2001, is allowed to the extent the rate of interest does not exceed the lesser of (1) the borrowing rate specified in the contract as of October 13, 1995, or (2) a percentage of Moody's Corporate Bond Yield Average-Monthly Average

[71] The provision disallows the deduction for interest even if the deduction would not be disallowed under any other rule. Thus, for example, if a deduction would not be disallowed under section 264(a)(3) because the 4-out-of-7 rule is met, this provision nevertheless disallows the deduction.

Corporates for each month the interest is paid or accrued. For interest paid or accrued after October 13, 1995, and before January 1, 1997, the percentage of the Moody's rate is 100 percent; for interest paid or accrued in 1997, the percentage is 95 percent; for 1998, the percentage is 90 percent; for 1999, the percentage is 85 percent; for 2000, the percentage is 80 percent; and for 2001 and thereafter, the percentage is 0 percent.

Any increase in the amount of debt under the policy on or after December 31, 1995 is treated as debt incurred on or after that date, and interest on the increased amount of debt is not allowed as a deduction under the phase-in of the interest disallowance rule described in the previous paragraph. Only interest that would have been allowed as a deduction but for the amendment made by the bill is allowed under the phase-in. Thus, for example, debt that is otherwise qualified debt under a life insurance policy cannot exceed the $50,000 limit of present-law section 264(a)(4), in order for interest on the debt to be allowed as a deduction under the phase-in. As another example, interest on debt that is disallowed as a deduction under present-law section 264(a)(3) because the 4-out-of-7 rule is not satisfied (and none of the other sec. 264(c) exceptions are satisfied) is not allowed under the phase-in.

Any amount included in income during 1996, 1997, 1998, 1999, 2000 or 2001, that is received under a contract described in the proposal on the complete surrender, redemption or maturity of the contract or in full discharge of the obligation under the contract that is in the nature of a refund of the consideration paid for the contract, is includable ratably over the first four taxable years beginning with the taxable year the amount would otherwise have been includable. Utilization of this 4-year income-spreading rule does not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of failure to meet the 4-out-of-7 rule. Similarly, utilization of this 4-year income-spreading rule does not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of causing the contract to be treated as a single premium contract within the meaning of section 264(b)(1) (i.e., a contract in which substantially all of the premiums are paid within 4 years after the date of purchase). In addition, the lapse of a contract after October 13, 1995, due to nonpayment of premiums, does not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of causing the contract to be treated as a single premium contract within the meaning of section 264(b)(1) or by reason of failure to meet the 4-out-of-7 rule.

In the case of an insurance company, the unamortized balance of policy expenses attributable to a contract with respect to which the 4-year income-spreading treatment is allowed to the policyholder is deductible in the year in which the transaction giving rise to income-spreading occurs.

The provision generally does not apply to interest on debt with respect to contracts purchased on or before June 20, 1986 (thus continuing the effective date provision of the $50,000 limitation enacted in the 1986 Act), except that interest on such contracts paid or accrued after October 13, 1995, is allowable only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield

Average-Monthly Average Corporates for the month the interest is paid or accrued.

Under the proposal, there is no inference as to the tax treatment of interest paid or accrued under present law.

4. Phase-out preferential tax deferral for certain large farm corporations required to use accrual accounting (sec. 12804 of the bill and sec. 447 of the Code)

Present Law

A corporation (or a partnership with a corporate partner) engaged in the trade or business of farming must use an accrual method of accounting for such activities unless such corporation (or partnership), for each prior taxable year beginning after December 31, 1975, did not have gross receipts exceeding $1 million. If a farm corporation is required to change its method of accounting, the section 481 adjustment resulting from such change is included in gross income ratably over a 10-year period, beginning with the year of change. This rule does not apply to a family farm corporation.

A provision of the Revenue Act of 1987 ("1987 Act") requires a family corporation (or a partnership with a family corporation as a partner) to use an accrual method of accounting for its farming business unless, for each prior taxable year beginning after December 31, 1985, such corporation (and any predecessor corporation) did not have gross receipts exceeding $25 million. A family corporation is one where 50 percent or more of the stock of the corporation is held by one (or in some limited cases, two or three) families.

A family farm corporation that must change to an accrual method of accounting as a result of the 1987 Act provision is to establish a suspense account in lieu of including the entire amount of the section 481 adjustment in gross income. The initial balance of the suspense account equals the lesser of (1) the section 481 adjustment otherwise required for the year of change, or (2) the section 481 adjustment computed as if the change in method of accounting had occurred as of the beginning of the taxable year preceding the year of change.

The amount of the suspense account is required to be included in gross income if the corporation ceases to be a family corporation. In addition, if the gross receipts of the corporation attributable to farming for any taxable year decline to an amount below the lesser of (1) the gross receipts attributable to farming for the last taxable year for which an accrual method of accounting was not required, or (2) the gross receipts attributable to farming for the most recent taxable year for which a portion of the suspense account was required to be included in income, a portion of the suspense account is required to be included in gross income.

Reasons for Change

The Committee believes that an accrual method of accounting more accurately measures the economic income of a corporation than does the cash receipts and disbursements method and that changes from one method of accounting to another should be taken into account under section 481. However, the Committee believes that it may be appropriate for a family farm corporation to retain the use of the cash method of accounting until such corporation reaches a certain size. At that time, the corporation should be subject to tax accounting rules to which other corporations are so subject. In addition, the Committee believes that the present-law suspense account provision applicable to large family farm corporations may effectively provide an exclusion for, rather than a deferral of, amounts otherwise properly taken into account under section 481 upon the required change in the method of accounting for such corporations.

Explanation of Provision

The bill repeals the ability of a family farm corporation to establish a suspense account when it is required to change to an accrual method of accounting. Thus, under the bill, any family farm corporation required to change to an accrual method of accounting would include in gross income the section 481 adjustment applicable to the change ratably over a 10-year period beginning with the year of change. In addition, any taxpayer with an existing suspense account is required to include the account in gross income ratably over a 20-year period beginning in the first taxable year beginning after September 13, 1995, subject to the present-law requirements to include all or a portion of the account in income more rapidly in certain circumstances.

Effective Date

The provision is effective for taxable years ending after September 13, 1995.

5. Phaseout of section 936 credit (sec. 12805 of the bill and sec. 936 of the Code)

Present Law

Certain domestic corporations with business operations in the U.S. possessions (including, for this purpose, Puerto Rico and the U.S. Virgin Islands) may elect the section 936 credit which generally eliminates the U.S. tax on certain income related to their operations in the possessions. In contrast to the foreign tax credit, the possessions tax credit is a "tax sparing" credit. That is, the credit is granted whether or not the electing corporation pays income tax to the possession. Income exempt from U.S. tax under this provision falls into two broad categories: (1) possession business income, which is derived from the active conduct of a trade or business within a U.S. possession or from the sale or exchange of substantially all of the assets that were used in such a trade or business; and (2) qualified possession source investment income ("QPSII"), which is attributable to the investment in the possession or in certain Caribbean Basin countries of funds derived from the active conduct of a possession business.

In order to qualify for the section 936 credit for a taxable year, a domestic corporation must satisfy two conditions (sec.936(a)(2)). First, the corporation must derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation must derive at least 75 percent of its gross income for that same period from the active conduct of a possession business.

A domestic corporation that has elected the section 936 credit and that satisfies these two conditions for a taxable year generally is entitled to a credit equal to the U.S. tax attributable to the sum of the taxpayer's possession business income and its QPSII. However, the amount of the credit attributable to possession business income is subject to the limitations enacted by the Omnibus Budget Reconciliation Act of 1993 ("1993 Act") (Code sec. 936(a)(4)). Under the economic activity limit, the amount of the credit with respect to such income cannot exceed the sum of a portion of the taxpayer's wage and fringe benefit expenses and depreciation allowances (plus, in certain cases, possession income taxes). In the alternative, the taxpayer may elect to apply a limit equal to the applicable percentage of the credit that would otherwise be allowable with respect to possession business income; the applicable percentage is phased down, beginning at 60 percent for 1994 and reaching 40 percent for 1998 and thereafter. The amount of the section 936 credit attributable to QPSII is not subject to these limitations.

Reasons for Change

The tax benefits provided by section 936 are enjoyed by only the relatively small number of U.S. corporations that operate in the possessions. The Committee is concerned that the high cost of these tax benefits is borne by all U.S. taxpayers. In light of current budget constraints, the Committee believes that the continuation of the tax exemption provided to corporations under section 936 is no longer appropriate. However, the Committee believes that an appropriate transition period should be provided for corporations with existing operations in the possessions.

Explanation of Provision

Under the bill, the section 936 credit generally is eliminated for taxable years beginning after December 31, 1995. However, under the transition rules described below, the section 936 credit continues to apply, subject to limitations, for taxable years beginning after such date to certain corporations that have existing operations in a possession. A special transition rule applies to the section 936 credit with respect to operations in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

For taxable years beginning after December 31, 1995, the section 936 credit with respect to operations in a possession applies only to a corporation that qualifies as an existing credit claimant (as defined below) with respect to such possession. A corporation that is an existing credit claimant with respect to a possession is subject to the limitations described below in determining the section 936 credit with respect to operations in that possession for taxable years beginning after December 31, 1995. Separate limitations apply in computing the section 936 credit attributable to possession business income and the section 936 credit attributable to QPSII for taxable years beginning after December 31, 1995. The applicable limitation with respect to the section 936 credit attributable to possession business income depends upon whether the corporation is using the economic activity limit or the applicable percentage limit provided under the 1993 Act for computing the credit attributable to possession business income.

For corporations that are existing credit claimants and that use the economic activity limit enacted by the 1993 Act, the section 936 credit attributable to possession business income (determined under the economic activity limit) continues to be determined as under present law through the corporation's taxable year beginning in 2001. For taxable years beginning in 2002 and thereafter, the section 936 credit attributable to possession business income (determined under the economic activity limit) is eliminated.

For corporations that are existing credit claimants and that elected to use the applicable percentage limit and not to use the economic activity limit, the section 936 credit attributable to possession business income continues to be determined as under present law through the corporation's taxable year beginning in 1998. For taxable years beginning during 1999, the section 936 credit attributable to possession business income (determined under the applicable percentage limitation) that is allowed under the bill is limited to 75 percent of the amount that would otherwise be allowed. For taxable years beginning during 2000, the section 936 credit attributable to possession business income (determined under the applicable percentage limit) that is allowed under the bill is limited to 50 percent of the amount that would otherwise be allowed. For taxable years beginning during 2001, the section 936 credit attributable to possession business income (determined under the applicable percentage limit) that is allowed under the bill is limited to 25 percent of the amount that would otherwise be allowed. For taxable years beginning in 2002 and thereafter, the section 936 credit attributable to possession business income (determined under the applicable percentage limit) is eliminated.

A corporation that had elected to use the applicable percentage limit is permitted to revoke that election under present law. Under the bill, such a revocation must be made not later than with respect to the first taxable year beginning after December 31, 1996; such revocation, if made, applies to such taxable year and to all subsequent taxable years. Accordingly, a corporation that had an election in effect to use the applicable percentage limit could revoke such election effective for its taxable year beginning in 1997 and thereafter; such corporation would continue to use the applicable percentage limit for its taxable year beginning in 1996 and would use the economic activity limit for its taxable year beginning in 1997 and thereafter.

For taxable years beginning after December 31, 1995, and before January 1, 2001, the section 936 credit attributable to QPSII applies only to income derived from a qualifying asset (provided such income would otherwise qualify as QPSII under present law). For this purpose, a qualifying asset is an asset held by the corporation on October 13, 1995, or an asset that was purchased through the rollover of the proceeds of such an asset or its successor assets. For taxable years beginning after December 31, 1995, income that is not derived from a qualifying asset is not eligible for the section 936 credit attributable to QPSII. For taxable years beginning after December 31, 1995, and before January 1, 2001, income that would otherwise qualify as QPSII and that is derived by a corporation that is an existing credit claimant from a qualifying asset is eligible for the section 936 credit attributable to QPSII through the date that such asset, if distributed, would be eligible for the maximum reduction in local taxes (as determined under local law in effect on October 13, 1995). The section 936 credit attributable to QPSII is eliminated for taxable years beginning after December 31, 2000.

A corporation is an existing credit claimant with respect to a possession if (1) the corporation is engaged in the active conduct of a trade or business within the possession on October 13, 1995, and (2) the corporation has elected the benefits of section 936 pursuant to an election which is in effect for its taxable year that includes October 13, 1995. A corporation that adds a substantial new line of business with respect to a trade or business conducted in a possession after October 13, 1995, ceases to be an existing credit claimant with respect to such possession as of the beginning of the taxable year during which such new line of business is added.

For purposes of these rules, a corporation is treated as engaged in the active conduct of a trade or business within a possession on October 13, 1995, if such corporation is engaged in the active conduct of such trade or business before January 1, 1996, and such corporation has in effect on October 13, 1995, a binding contract for the acquisition of assets to be used in, or the sale of property to be produced in, such trade or business. For example, if a corporation has in effect on October 13, 1995, binding contracts for the lease of a facility and the purchase of machinery to be used in a manufacturing business in a possession and if the corporation begins actively conducting that manufacturing business in the possession before January 1, 1996, that corporation is an existing credit claimant with respect to the possession. A change in the ownership of a corporation will not affect its status as an existing credit claimant with respect to a possession.

In determining whether a corporation has added a substantial new line of business, the Committee intends that principles similar to those reflected in Treas. Reg. section 1.7704–2(d) (relating to the transition rules for existing publicly traded partnerships) will apply. For example, a corporation that modifies its current production methods, expands existing facilities, or adds new facilities to support the production of its current product lines and products within the same four-digit Industry Number Standard Industrial Classification Code (Industry SIC Code) will not be considered to have added a substantial new line of business. In this regard, the Committee believes the fact that a business which is added is assigned a different four-digit Industry SIC Code than is assigned to an existing business of the corporation will not automatically cause the corporation to be considered to have added a new line of business. For example, a pharmaceutical corporation that begins manufacturing a new drug will not be considered to have added a new line of business. Moreover, a pharmaceutical corporation that begins to manufacture a complete product from the bulk active chemical through the finished dosage form, a process that may be assigned two separate four-digit Industry SIC Codes, will not be considered to have added a new line of business even though it was previously engaged in activities that involved only a portion of the entire manufacturing process.

A special transition rule applies to the section 936 credit with respect to operations in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands. For any taxable year beginning after December 31, 1995, a corporation that is not an existing credit claimant with respect to one of these possessions for such year is not entitled to the section 936 credit with respect to operations in such possession. For any taxable year beginning after December 31, 1995, and before January 1, 2006, a corporation that is an existing credit claimant with respect to one of these possessions for such year continues to determine its section 936 credit with respect to operations in such possession as under present law. For taxable years beginning in 2006 and thereafter, the section 936 credit with respect to operations in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands is eliminated.

Effective Date

The provision is effective on the date of enactment.

6. Corporate accounting—reform of income forecast method (sec. 12806 of the bill and sec. 167 of the Code)

Present Law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through allowances for depreciation or amortization. Tangible property generally is depreciated under a modified Accelerated Cost Recovery System ("MACRS") of section 168, which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Intangible property generally is amortized under section 197, which applies a 15-year recovery period and the straight-line method to the cost of applicable property.

Treatment of film, video tape, and similar property

MACRS does not apply to certain property, including any motion picture film, video tape, or sound recording or to other any property if the taxpayer elects to exclude such property from MACRS and the taxpayer applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197 does not apply to certain intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be recovered under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost of such property may be depreciated under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property.

The "income forecast" method is an allowable method for calculating depreciation under section 167 for certain property. Under the income forecast method, the depreciation deduction for a taxable year for a property is determined by multiplying the cost of the property[72] (less estimated salvage value) by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income to be derived from the property during its useful life. The income forecast method has been held to be applicable for computing depreciation deductions for motion picture films, television films and taped shows, books, patents, master sound recordings and video games.[73] The total forecasted or estimated income to be derived from a property is to be based on the conditions known to exist at the end of the period for which depreciation is claimed. This estimate can be revised upward or downward at the end of a subsequent taxable period based on additional information that becomes available after the last prior estimate. These revisions, however, do not affect the amount of depreciation claimed in a prior taxable year.

In the case of a film, income to be taken into account under the income forecast method means income from the film less the expense of distributing the film, including estimated income from foreign distribution or other exploitation of the film.[74] In the case of a motion picture released for theatrical exhibition, income does not include estimated income from future television exhibition of the film (unless an arrangement for domestic television exhibition has been entered into before the film has been depreciated to its reasonable salvage value). In the case of a series or a motion picture produced for television exhibition, income does not include estimated income from domestic syndication of the series or the film (unless an arrangement for syndication has been entered into before the series or film has been depreciated to its reasonable salvage value).[75] The Internal Revenue Service also has ruled that income does not include net merchandising revenue received from the exploitation of film characters.[76]

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[72] In *Transamerica Corp. v. U.S.*, 999 F.2d 1362, (9th Cir. 1993), the Ninth Circuit overturned the District Court and held that for purposes of applying the income forecast method to a film, the "cost of a film" includes "participation" and "residual" payments (i.e., payments to producers, writers, directors, actors, guilds, and others based on a percentage of the profits from the film) even though these payments were contingent on the occurrence of future events. It is unclear to what extent, if any, the *Transamerica* decision applies to amounts incurred after the enactment of the economic performance rules of Code section 461(h), as contained in the Deficit Reduction Act of 1984.

[73] See, e.g., Rev. Rul. 60–358, 1960–2 C.B. 68; Rev. Rul. 64–273, 1964–2 C.B. 62; Rev. Rul 79–285, 1979–2 C.B. 91; and Rev. Rul. 89–62, 1989–1 C.B. 78. Conversely, the courts have held that certain tangible personal property was not of a character to which the income forecast method was applicable. See, e.g., *ABC Rentals of San Antonio v. Comm.*, 68 TCM 1362 (1994) (consumer durable property subject to short-term, "rent-to-own" leases not eligible) and *Carland, Inc. v. Comm.*, 90 T.C. 505 (1988), aff'd on this issue, 909 F.2d 1101 (8th Cir. 1990) (railroad rolling stock subject to a lease not eligible).

[74] Rev. Rul. 60–358, 1960–2 C.B. 68.

[75] Rev. Proc. 71–29, 1971–2 C.B. 568.

[76] Private letter ruling 7918012, January 24, 1979. Private letter rulings do no have precedential authority and may not be relied upon by any taxpayer other than the taxpayer receiving the ruling but are some indication of IRS administrative practice.

Reasons for Change

The Committee believes that, in theory, the income forecast method is an appropriate method for matching the capitalized cost of certain property with the income produced by such property. However, the Committee believes that the application of the income forecast method under present law does not meet the theoretical objective of the method. In addition, the committee recognizes that the reliance of the operation of the income forecast method upon estimated income may result in a mismatch between income and depreciation deductions when future income is over- or under-estimated. The Committee bill attempts to address these issues.

Explanation of Provision

The bill makes several amendments to the income forecast method of determining depreciation deductions.

Determination of estimated income

First, the bill provides that estimated income to be taken into account under the income forecast method includes all income earned in connection with the property before the close of the tenth taxable year following the taxable year the property was placed in service. This 11-year rule also will apply for purposes of the look-back method described below.

In the case of a film, television show, or similar property, such income includes, but would not necessarily be limited to, income from foreign and domestic theatrical, television, and other releases and syndications; video tape releases, sales, rentals, and syndications; and the exploitation of film or program characters, prints, scripts, and scores. Income from the exploitation of characters is expected to be limited to income from licensing and similar agreements with third parties and sales of tangible property incorporating such characters. Pursuant to a special rule, if a taxpayer produces a television series and initially does not anticipate syndicating the episodes from the series, the forecasted income for the episodes of the first three years of the series need not take into account any future syndication fees (unless the taxpayer has an arrangement to syndicate such episodes during such period). This syndication rule also will apply for purposes of the look-back method described below.

Determination of income forecast property costs

The cost of property subject to depreciation only includes amounts that satisfy the economic performance standard of section 461(h).[77] For this purpose, if the taxpayer incurs a noncontingent liability to acquire property subject to the income forecast method from another person, economic performance will be deemed to occur with respect to such noncontingent liability when the property is provided to the taxpayer. In addition, it is expected that the recurring item exception of section 461(h)(3) will apply in appropriate cases. Any costs that are taken into account after the property is

[77] No inference is intended as to the proper application of section 461(h) to the income forecast method under present law.

placed in service are treated as a separate piece of property to the extent (1) such amounts are significant and are expected to give rise to a significant increase in the income from the property that was not included in the estimated income from the property, or (2) such costs are incurred more than 10 years after the property was placed in service. To the extent costs are incurred more than 10 years after the property was placed in service and give rise to a separate piece of property for which no income is generated, such costs may be written off and deducted. For example, assume a taxpayer places property subject to the income forecast method in service during a taxable year and all income from the property is generated in the following four-year period. If the taxpayer incurs additional costs with respect to that property more than 10 years later (e.g., a payment pursuant to a contingent compensation arrangement to a person that produced the property), such costs may be deducted in the year incurred provided no more income is generated with respect to such costs or the original property.

Any costs that are not recovered by the end of the tenth taxable year after the property was placed in service may be taken into account as depreciation in such year.

Look-back method

Finally, taxpayers that claim depreciation deductions under the income forecast method are required to pay (or would receive) interest based on the recalculation of deprecation under a "look-back" method.[78] The "look-back" method is applied in any "recomputation year" by (1) comparing depreciation deductions that had been claimed in prior periods to depreciation deductions that would have been claimed had the taxpayer used actual, rather than estimated, total income from the property; (2) determining the hypothetical overpayment or underpayment of tax based on this recalculated depreciation; and (3) applying the overpayment rate of section 6621 of the Code.

Except as provided in regulations, a "recomputation year" would be the third and tenth taxable year after the taxable year the property was placed in service unless the actual income from the property for each taxable year ending with or before the close of such years was within 10 percent of the estimated income from the property for such years. The Secretary of the Treasury has the authority to allow a taxpayer to delay the initial application of the look-back method where the taxpayer may be expected to have significant income from the property after the third taxable year after the taxable year the property was placed in service (e.g., the Treasury Secretary may exercise such authority where the depreciable life of the property is expected to be longer than three years).

In applying the look-back method, any cost that is taken into account after the property was placed in service may be taken into account by discounting (using the Federal mid-term rate determined under sec. 1274(d) as of the time the costs were taken into account) such cost to its value as of the date the property was placed in service. Property with an adjusted basis of $100,000 or

[78] The "look-back" method of the provision resembles the look-back method applicable to long-term contracts accounted for under the percentage-of-completion method of present-law sec. 460.

less when the property was placed in service is not subject to the look-back method. The provision provides a simplified look-back method for pass-through entities.

Effective Date

The provision is effective for property placed in service after September 13, 1995, unless placed in service pursuant to a binding written contract in effect before such date and all times thereafter.

7. Permit corporate pension transfers to fund employee benefits (sec. 12807 of the bill and sec. 420 of the Code)

Present Law

Pension plan funding

Present law imposes minimum funding requirements on employers sponsoring a defined benefit pension plan which are designed to provide at least a certain level of benefit security by requiring the employer to make certain minimum contributions to the plan.

Within limits, an employer is permitted to make contributions in excess of the minimum funding requirements. Making contributions in excess of those required by the minimum funding requirements, as well as other factors, such as greater investment returns than assumed for funding purposes, can contribute to overfunding of pension plans.

Contributions to a plan are no longer deductible by the employer when plan assets reach a certain level, called the full-funding limit. Contributions in excess of the full-funding limit are also subject to a 10-percent excise tax. A plan has reached the full-funding limit if the level of plan assets exceeds the lesser of (1) 150 percent of current liability, or (2) the accrued liability under the plan. In general terms, "current liability" is the amount of plan assets needed to fund all current accrued benefits under the plan to date (vested and nonvested). Current liability is determined using a statutorily prescribed interest rate assumption—the interest rate used must be between 90 and 110 percent of the four-year weighted average 30-year Treasury rate. As under the general minimum funding rules, other actuarial assumptions used to calculate current liability are required to be reasonable. Accrued liability is generally the amount of assets required to fund the plan under the actuarial funding method used by the plan.

Transfers of excess pension assets

Under present law, defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Any assets that revert to the employer upon such termination are includible in the gross income of the employer and subject to an excise tax. The rate of the excise tax generally is 20 percent, and is increased to 50 percent unless the employer maintains a replacement plan or makes certain benefit increases in connection with the plan termination. Upon plan termination, the accrued benefits of all plan participants are required to be 100-percent vested.

The Omnibus Budget Reconciliation Act of 1990 included a provision under which employers could transfer excess assets in an overfunded pension plan to pay certain retiree health liabilities. Provided certain requirements are satisfied, such a transfer does not affect a plan's tax-qualified status and is not a prohibited transaction. Further, the assets transferred are not includible in the gross income of the employer and are not subject to the excise tax on reversions. The employer is not entitled to deduct retiree health benefits paid with transferred assets.

A transfer must satisfy certain requirements designed to protect the benefit security of plan participants. Under one of these requirements, the accrued retirement benefits of participants under the pension plan (including participants who separated from service during the 1-year period ending on the date of the transfer) must be nonforfeitable as if the plan terminated immediately before the transfer. In addition, only excess pension assets may be transferred. Excess pension assets are defined to be the excess of the value of plan assets over the greater of (1) the plan's full funding limit, or (2) 125 percent of current liability. As described above, the first part of this standard is the same as the maximum limit for making contributions to the plan for deduction purposes. As under that limit, the interest rate used in calculating current liability for the 125 percent asset cushion must be between 90 and 110 percent of the four-year weighted average 30-year Treasury rate. The second part only applies if current liability is greater than the full funding limit. Thus, a transfer can only be made from a plan that is at the full funding limit and to which deductible employer contributions can no longer be made.

If any amount transferred is not used to pay retiree health expenses, such amount (and income thereon) must be transferred back to the pension plan. Such amounts transferred back are not includible in the employer's income, but are subject to the 20-percent excise tax on reversions.

An employer is required to notify plan participants 60 days before a transfer occurs.

The provision permitting certain transfers of excess pension assets was originally adopted for a 5-year period, through 1995. The excess pension assets transfer provision was extended through the year 2000 by the Retirement Protcction Act of 1994, which was enacted as part of the Uruguay Round Agreements Act (commonly referred to as the implementing legislation for the General Agreement on Tariffs and Trade ("GATT")). The GATT legislation did not change the way in which excess pension assets are calculated.

Reasons for Change

The Committee believes that the defined benefit pension plan system is a critical part of the retirement security of many Americans. Fundamental to the maintenance of that system is ensuring that defined benefit pension plans are adequately funded. Since the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"), and as recently as in GATT, the minimum funding rules have been improved to strengthen the funding of underfunded plans. In addition, the security of defined benefit pension plans depends on the willingness of the employer to make contributions in excess of those required by law. If employers are denied reasonable access to excess pension assets, they will be cautious in making contributions. It is that very cautious funding that creates a potential risk to plan participants and the Pension Benefit Guaranty Corporation ("PBGC").

In testimony before the Subcommittee on Private Retirement Plans of the Senate Committee on Finance on the Status of the PBGC in 1987, the then-Executive Director of the PBGC stated: "...the long-term health of the PBGC depends upon the continued health of the great majority of plans, those that are now fully funded or better. It is particularly important to allow employers reasonable access to truly surplus plan assets after full provision has been made for benefits promised to participants. Measures that would forbid pension asset reversions or drastically limit the amount that employers could recover upon plan termination would make companies very cautious about their contributions. Thus, paradoxical as it may sound, allowing employers access to pension surpluses protects plan participants because it helps produce better funding."

The Committee believes that the present-law asset transfer provision as included in the GATT legislation negotiated between the Congress and President Clinton embodies the policy that, while it is necessary to increase minimum funding contributions to help reduce underfunding, sponsors of overfunded plans should not be penalized for doing more than the law requires, provided benefit security is not threatened. The present-law transfer provision has been designed to provide employers access to excess plan assets and safeguard pension plan benefits. However, by restricting the use of excess assets, present law unfairly discriminates against employers that do not have substantial retiree health liabilities. The Committee believes it appropriate to provide more employers access to excess pension plan assets by permitting the employer to make transfers of excess assets for other types of employee benefits that are provided under plans which cover a broad group of employees, and are subject to regulation under the Internal Revenue Code and ERISA. In order to make such a transfer, the Committee believes that the present-law participant protections should be satisfied. In addition, the Committee believes it appropriate to include an additional safeguard to limit the amount that can be transferred to excess assets on January 1, 1995, or immediately preceding the transfer. Thus, the amount of excess assets that can be transferred could not increase, and the plan will be protected against decreases in excess assets.

The Committee believes that, by not imposing an excise tax on transfers from an ongoing plan, employers will have an incentive to continue to maintain, rather than terminate such plans.

Present law includes a variety of provisions that operate to protect plan participants and the PBGC from the risks posed by underfunded plans, including the minimum funding rules, additional funding requirements for underfunded plans, an additional PBGC premium for underfunded plans, and full liability for employers (up to 100 percent of net worth) for unfunded benefits on plan termination. Modifying the transfer provision extended in GATT will provide a financial incentive for more employers to make more than the minimum required contributions to their plans and thereby will help provide greater benefit security.

Explanation of Provision

The bill modifies the circumstances under which employers may transfer excess assets from a defined benefit pension plan. The bill permits a qualified transfer of excess assets from a defined benefit pension plan (other than a multiemployer plan) to the employer, provided such assets are used to pay for qualified employee benefits provided by the employer. Qualified employee benefits are defined as qualified retirement plan benefits, accident and health benefits, disability benefits, educational assistance, and dependent care assistance. For example, under the provision, excess pension assets can be transferred from an overfunded pension plan maintained by an employer to an underfunded pension plan maintained by the same employer.

The total amount of excess pension assets which can be transferred in qualified transfers during any year cannot exceed the amount the employer pays during the year of transfer for qualified employee benefits. In addition, in order for the transfer to be qualified, the accrued retirement benefits of participants (including participants who separated from service during the 1-year period ending on the date of the transfer) under the pension plan must be nonforfeitable as if the plan terminated immediately before the transfer.

Except as described below with respect to amounts required to be returned to the pension plan, amounts transferred are includible in the gross income of the employer, but are not subject to the excise tax on reversions. There is no limit on the number of qualified transfers that can be made during any taxable year. As under present law, a qualified transfer under the bill does not affect the plan's qualified status and is not a prohibited transaction. The present-law notice requirement applies to transfers under the provision.

Excess pension assets are defined as under present law, and are determined as of whichever of the following dates excess pension assets are lower: (1) January 1, 1995 (or, if January 1, 1995, is not a plan valuation date, as of the last plan valuation date preceding January 1, 1995), or (2) the most recent plan valuation date preceding the transfer. The amount of excess assets available for transfer is reduced by any previous transfers after the applicable valuation date (under either the present-law provision or the bill).

Transferred amounts (and income thereon) that are not used to pay for qualified employee benefits for the year of transfer must be returned to the pension plan. Income on returned amounts is calculated using the short-term applicable Federal rate. Amounts returned are not includible in the gross income of the employer, but are subject to the 20-percent excise tax on reversions. No deduction is allowed with respect to returned amounts (and income thereon).

By adopting this expansion of section 420, the Committee does not intend to affect the ability of employers to transfer assets within a defined benefit pension plan to separate account under present-law section 414(k).

The provision does not apply to transfers in taxable years beginning after December 31, 2001.

Effective Date

The provision is effective with respect to transfers on or after the date of enactment.

8. Repeal 50-percent interest income exclusion for financial institution loans to ESOPs (sec. 12808 of the bill and sec. 133 of the Code)

Present Law

An employee stock ownership plan ("ESOP") is a qualified pension plan that meets certain requirements and under which employer securities are held for the benefit of employees. Present law generally prohibits loans between a qualified plan and a disqualified person. An exception to this rule is provided in the case of an ESOP.

If employer securities are acquired by an ESOP with loan proceeds, the ESOP is referred to as a leveraged ESOP. The ESOP may borrow directly from a financial institution (typically with a guarantee from the employer), or the employer may borrow from a financial institution and in turn lend the funds to the ESOP which then uses them to acquire employer securities. Such loans are referred to as securities acquisition loans. The employer securities are typically pledged as security for the loan. The employer makes contributions to the ESOP which are then used to repay the securities acquisition loan. Shares that are purchased with a securities acquisition loan are allocated to the accounts of ESOP participants as the loan is repaid.

A bank, insurance company, regulated investment company, or a corporation actively engaged in the business of lending money may generally exclude from gross income 50 percent of interest received on an ESOP loan. The partial exclusion applies if the loan is made directly to the ESOP or if the loan is made to the employer who in turn lends the proceeds to the ESOP and certain requirements are satisfied. Generally effective for ESOP loans made after June 10, 1989, the 50-percent interest exclusion only applies if: (1) immediately after the acquisition of securities with the loan proceeds, the ESOP owns more 50 percent of the outstanding stock or more than 50 percent of the total value of all outstanding stock of the corporation; (2) the ESOP loan term will not exceed 15 years; and (3) the ESOP provides for full pass-through voting to participants on all allocated shares.

Reasons for Change

The Committee believes that the 50-percent exclusion for interest with respect to ESOP loans provides an unnecessary tax benefit to financial institutions for loans they would make without regard to the interest exclusion. The Committee finds no evidence that employers that maintain ESOPs have less access to borrowing than other borrowers or that there is a need to provide an incentive to lenders to make money available to ESOPs.

Explanation of Provision

The bill repeals the 50-percent interest exclusion with respect to ESOP loans.

Effective Date

The provision generally is effective with respect to loans made after October 13, 1995. The repeal of the 50-percent interest exclusion does not apply to the refinancing of an ESOP loan originally made on or before October 13, 1995, provided (1) such refinancing loan otherwise meets the requirements of section 133 in effect on or before October 13, 1995; (2) the outstanding principal amount of the loan is not increased; and (3) the term of the refinancing loan does not extend beyond the term of the original ESOP loan.

9. Modify exclusion of damages received on account of personal injury or sickness (sec. 12811 of the bill and sec. 104(a)(2) of the Code)

Present Law

Under present law, gross income does not include any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injury or sickness (sec. 104(a)(2)).

The exclusion from gross income of damages received on account of personal injury or sickness specifically does not apply to punitive damages received in connection with a case not involving physical injury or sickness. Courts presently differ as to whether the exclusion applies to punitive damages received in connection with a case involving a physical injury or physical sickness.

Courts have interpreted the exclusion from gross income of damages received on account of personal injury or sickness broadly in some cases to cover awards for personal injury that do not relate to a physical injury or sickness. For example, some courts have held that the exclusion applies to damages in cases involving certain forms of employment discrimination and injury to reputation where there is no physical injury or sickness. The damages received in these cases generally consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits. The Supreme Court recently held that damages received based on a claim under the Age Discrimination in Employment Act could not be excluded from income.[79] In light of the Supreme Court decision, the Internal Revenue Service has suspended existing guidance on the tax treatment of damages received on account of other forms of employment discrimination.

Reasons for Change

Punitive damages are intended to punish the wrongdoer and do not compensate the claimant for lost wages or pain and suffering. Thus, they are a windfall to the taxpayer and appropriately should be included in taxable income. Further, including all punitive damages in taxable income provides a bright-line standard which

[79] *Schleier v. Commissioner*, 115 S. Ct. 2159 (1995).

avoids prospective litigation on the tax treatment of punitive damages received in connection with a case involving a physical injury or physical sickness.

Damages received on a claim not involving a physical injury or physical sickness are generally to compensate the claimant for lost profits or lost wages that would otherwise be included in taxable income. The confusion as to the tax treatment of damages received in cases not involving physical injury or physical sickness has led to substantial litigation, including two Supreme Court cases within the last four years. The taxation of damages received in cases not involving a physical injury or physical sickness should not depend on the type of claim made.

Explanation of Provisions

Include in income all punitive damages

The bill provides that the exclusion from gross income does not apply to any punitive damages received on account of personal injury or sickness whether or not related to a physical injury or physical sickness. The Committee intends no inference as to the application of the exclusion to punitive damages received prior to the effective date of the bill in connection with a case involving a physical injury or physical sickness.

Include in income damage recoveries for nonphysical injuries

The bill provides that the exclusion from gross income only applies to damages received on account of a personal physical injury or physical sickness. If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party. For example, damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of such individual's spouse are excludable from gross income. In addition, damages (other than punitive damages) received on account of a claim of wrongful death continue to be excludable from taxable income as under present law.

The bill also specifically provides that emotional distress is not considered a physical injury or physical sickness. Thus, the exclusion from gross income does not apply to any damages received (other than for medical expenses as discussed below) based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. Because all damages received on account of physical injury or physical sickness are excludable from gross income, the exclusion from gross income does apply to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness. In addition, the exclusion from gross income specifically does apply to the amount of damages received that is not in excess of the amount paid for medical care attributable to emotional distress.

Effective Date

The provisions generally are effective with respect to amounts received after December 31, 1995. The provisions do not apply to amounts received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

10. Reporting of certain payments made to attorneys (sec. 12812 of the bill and sec. 6045 of the Code)

Present Law

Information reporting is required by persons engaged in a trade or business and making payments in the course of that trade or business of "rent, salaries, wages, ... or other fixed or determinable gains, profits, and income" (Code sec. 6041(a)). Treas. Reg. sec. 1.6041-1(d)(2) provides that attorney's fees are required to be reported if they are paid by a person in a trade or business in the course of a trade or business. Reporting is required to be done on Form 1099—Misc. If, on the other hand, the payment is a gross amount and it is not known what portion is the attorney's fee, no reporting is required on any portion of the payment.

Reasons for Change

There have been recent reports of attorneys who have either failed to file income tax returns or failed to report all their income. The Committee believes that it is important to require additional information reporting with respect to payments to attorneys to increase compliance by attorneys with the tax laws.

Explanation of Provision

The bill requires gross proceeds reporting on all payments to attorneys made by a trade or business in the course of that trade or business. It is anticipated that gross proceeds reporting would be required on Form 1099-B (currently used by brokers to report gross proceeds). The only exception to this new reporting requirement is for any payments reported on either Form 1099—Misc under section 6041 (reports of payment of income) or on Form W-2 under section 6051 (payments of wages).

In addition, the present exception in the regulations exempting from reporting any payments made to corporations will not apply to payments made to attorneys. Treas. Reg. sec. 1.6041-3(c) exempts payments to corporations generally (although payments to most corporations providing medical services must be reported). Reporting is required under both Code sections 6041 and 6045 (as proposed) for payments to corporations that provide legal services. The exception of Treas. Reg. sec. 1.6041-3(g) exempting from reporting payments of salaries or profits paid or distributed by a partnership to the individual partners will continue to apply to both sections (since these amounts are required to reported on Form K-1).

Effective Date

The provision is effective for payments made after December 31, 1995. Consequently, the first information reports will be filed with the IRS (and copies will be provided to recipients of the payments) in 1997, with respect to payments made in 1996.

11. Disallow rollover under section 1034 to extent of previously claimed depreciation for home office or other depreciable use of residence (sec. 12821 of the bill and sec. 1034 of the Code

Present Law

Rollover

Generally, no gain is recognized on the sale or exchange of a principal residence to the extent that the amount of the sales price of the old residence is reinvested in a new residence within a specified period. The specified period generally is a period beginning two years before the sale of the old residence and ending two years after the sale of the old residence.

One-time exclusion

In general, a taxpayer may exclude from gross income up to $125,000 of gain from the sale or exchange of a principal residence if the taxpayer (1) has attained age 55 before the sale, and (2) has used the residence as a principal residence for three or more years of the five years preceding the sale. This election is allowed only once in a lifetime unless all previous elections are revoked. For these purposes, sales on or before July 26, 1978, are not counted against the once-in-a-lifetime limit.

In the case of a mixed use of a residence, the exclusion is limited only to that portion of the residence that is owned and used by the individual as his principal residence for at least three of the previous five years before the date of sale. Gain on the portion not qualifying as a principal residence is not eligible for this exclusion.

Reasons for Change

The rollover and one-time exclusion provisions provide special treatment for the principal residence of a taxpayer. The Committee believes that, to the extent a structure is treated as a business asset (as evidenced by depreciation deductions allowable) and not as a principal residence, the special rules applicable to principal residences are not appropriate.

Explanation of Provision

Rollover

The bill provides that gain is recognized on the sale of a principal residence to the extent of any depreciation allowable with respect to such principal residence for periods after December 31, 1995.

One-time exclusion

The bill imposes an additional restriction on the availability of the one-time exclusion. Specifically, the bill provides that the amount of the otherwise allowable one-time exclusion is reduced to the extent of depreciation allowable with respect to such principal residence for periods after December 31, 1995. To illustrate the bill, assume the following facts: a 60-year old never-married taxpayer purchased a building on January 1, 1995, for $100,000 which will be used as the taxpayer's principal residence until its sale on January 1, 2002. Further, assume that the taxpayer will use one-tenth of the building as a qualified home office for three years between January 1, 1996, and December 31, 1998, with allowable annual depreciation of $256. Finally, assume that the taxpayer sells the building for $150,000 on January 1, 2002 and does not acquire a replacement residence. The taxpayer's realized gain is $50,768 ($150,000–($100,000–$768)). Under the bill $50,(0 ($50,768–$768) is eligible for the one-time exclusion. The taxpayer is subject to tax on $768.

Effective Date

The provision is effective for taxable years ending after December 31, 1995.

12. Provide that rollover of gain on sale of a principal residence cannot be elected by a resident alien unless the replacement property purchased is located within the United States (sec. 12822 of the bill and sec. 1034 of the Code)

Present Law

Generally, no gain is recognized on the sale or exchange of a principal residence to the extent that the amount of the sales price of the old residence is reinvested in a new residence within a specified period. The specified period generally is a period beginning two years before the sale of the old residence and ending two years after the sale of the old residence. There is no requirement that either the old residence or new residence be located within the United States or its possessions.

Reasons for Change

The Committee is concerned that resident aliens can improperly avoid taxation of gains from the sale of their principal residences in the United States. Specifically, a resident alien can avoid taxation by deferring gain under Code section 1034 and then ending residence status within two years of the sale of the old residence. The Committee believes that this provision is necessary to ensure such individuals remain subject to U.S. tax law on gain from the sale of their principal residence located in the United States.

Explanation of Provision

Generally, the bill requires recognition of gain on the sale or exchange of a principal residence by a resident alien unless the resident alien (1) retains resident alien status for at least two years after the date of sale, (2) becomes a U.S. citizen within two years of the date of sale, or (3) acquires a replacement residence located in the U.S. or its possessions within the specified time period.

The bill does not apply where (1) the old residence is held jointly by the resident alien and the resident alien's spouse, (2) they file a joint tax return, and (3) the spouse is a U.S. citizen on the date of sale of the old residence.

Effective Date

The provision applies to the sale of old residences after December 31, 1995, unless a replacement residence was purchased before September 13, 1995, or purchased on or after such date pursuant to a binding contract in effect on such date (and at all times thereafter before such purchase).

13. Repeal advance refunds of diesel fuel tax for diesel automobiles, vans, and light trucks (sec. 12831 of the bill and sec. 6427(g) of the Code)

Present Law

Excise taxes are imposed on gasoline (11.5 cents per gallon) and diesel fuel (17.5 cents per gallon) to fund the Federal Highway Trust Fund. Before 1985, the gasoline and diesel fuel tax rates were the same. The predominate highway use of diesel fuel is by trucks. In 1984, the diesel excise tax rate was increased above the gasoline tax as the revenue offset for a reduction in the annual heavy truck use tax. Because automobiles, vans, and light trucks, did not benefit from the use tax reductions, a provision was enacted allowing first purchasers of model year 1979 and later diesel-powered automobiles, vans, and light trucks a tax credit to offset this increased diesel fuel tax. The credit is $102 for automobiles, and $198 for vans and light trucks.

Reasons for Change

Changed driving patterns, and vehicles currently being marketed, have resulted in fewer diesel-powered automobiles, vans, and light trucks today than was the case when this advance refund was enacted. Additionally, the highway cost allocation study on which the refund was based is now outdated. The Committee believes, therefore, that this present-law credit is obsolete and should be repealed.

Explanation of Provision

The tax credit for purchasers of diesel-powered automobiles and light trucks is repealed.

Effective Date

The provision is effective for vehicles purchased after December 31, 1995.

14. Repeal the wine and flavors tax credit (sec. 12832 of the bill and sec. 5010 of the Code)

Present Law

Distilled spirits are subject to excise tax at $13.50 per proof gallon. (A proof gallon is a liquid gallon containing 50 percent alcohol, i.e., 100 proof.) Wine is subject to a graduated excise tax based on alcohol content. All wine tax rates (other than on champagne) are lower on an alcohol content basis than the distilled spirits tax rate.

Present law allows an excise tax credit equal to the difference between the distilled spirits tax rate and the applicable wine tax rate when wine alcohol is blended into distilled spirits. Wine is defined as any alcohol derived from fruit. Wine alcohol is not required to be alcohol that could be marketed to the public for consumption as "wine".

Present law also allows an excise tax credit equal to $13.50 per proof gallon (less an administrative processing fee) for each gallon of flavors contained in distilled spirits. Examples of "flavors" for which the credit is allowed are vanilla extract and mint. This credit is limited to tax on alcohol not exceeding 2.5 percent of the alcohol content of the finished product.

Reasons for Change

Before 1980, all ingredients in distilled spirits products—wine, flavors, and distilled spirits—were taxed individually before being combined into a final product. These ingredients were (and are) taxed at substantially different rates. To ensure that no tax advantage was gained by using lower taxed wine alcohol and flavors in distilled spirits products, a rectification tax was imposed. The rectification tax resulted in the tax rate on all components of a distilled spirits product substantially the same.

The Distilled Spirits Tax Revision Act of 1979 changed the taxes so as to levy them on final products. In 1980, Congress enacted the wine and flavors content credit, which has the effect of taxing alcohol in a distilled spirits product differently depending on its source. However, a new rectification tax was not reimposed. As a result, distilled spirits containing either wine alcohol or flavors are taxed substantially lower than those same products would have been taxed before 1980.

The current tax credit for wine and flavors content permits many distilled spirits products to bear a tax substantially below the $13.50-per-proof-gallon statutory tax rate for these beverages—as low as $9.14 per proof gallon—solely because a portion of their alcohol content is derived from fruit and therefore is characterized as wine or is associated with a flavoring such as vanilla or mint.

The ability to reduce excise taxes, and thereby product costs, has led to dramatic increases in the use of wine alcohol and flavors since 1979. In fact, according to the Bureau of Alcohol, Tobacco, and Firearms ("BATF"), wine alcohol and flavors are used in many products even though these additives increase the cost of the product because the tax credit more than offsets this increased cost. For example, gin may be flavored naturally through the fermentation process as the spirit is created, or artificially through the addition of juniper berry flavor to a neutral distilled spirit. The BATF reports that the natural method is cheaper absent the tax credit, but that many distillers are using the latter method because the tax credit lowers total cost when the flavor is artificially added.

The Committee believes that all alcohol in distilled spirits products should be taxed equally—regardless of its source. Repealing the wine and flavors content tax credit will curb purely tax-motivated business practices such as those described above by ensuring that the statutory tax rate applies equally to all distilled spirits products.

Explanation of Provision

The excise tax credit for wine alcohol and flavors content is repealed.

Effective Date

The provision is effective for distilled spirits removed from bonded premises after December 31, 1995.

15. Modifications to the excise tax on ozone-depleting chemicals (sec. 12883 of the bill and sec. 4682 of the Code)

Present Law

An excise tax is imposed on the sale or use by the manufacturer or importer of certain ozone-depleting chemicals (Code sec. 4681). The amount of tax generally is determined by multiplying the base tax amount applicable for the calendar year by an ozone-depleting factor assigned to each taxable chemical. The base tax amount is $5.35 per pound in 1995 and will increase by 45 cents per pound per year thereafter. The ozone-depleting factors for taxable halons are 3 for halon-1211, 10 for halon-1301, and 6 for halon-2402.

Taxable chemicals that are recovered and recycled within the United States are exempt from tax.

Reasons for Change

The Committee recognizes that, under the Clean Air Act as amended and under the terms of the Montreal Protocol, domestic production of halons generally ceased after 1993. However, these chemicals are valuable as fire suppressants, particularly in those environments where human life may be endangered. The international restriction on production of halons has caused some individuals who had used halons in certain fire suppression systems to withdraw the halons from those systems and make them available for more highly valued uses. The Committee believes that the substantial tax on imported halons impedes the flow of these recovered and recycled halons to their most highly valued uses. The Committee further observes that, because production of new halons is banned domestically, permitting imported recycled halons to enter the domestic market with a rate of tax less than that of new production does not place at a disadvantage domestic producers or dealers in halons. Therefore, the Committee believes it is appro-

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priate to provide comparable tax treatment to imported recycled halons to that accorded domestic recycled halons.

Explanation of Provision

The bill extends the exemption from tax for domestically recovered and recycled ozone-depleting chemicals to imported recycled halons. The exemption for imported recycled halons applies only to such chemicals imported from countries that are signatories to the Montreal Protocol on Substances that Deplete the Ozone Layer.

The Committee recognizes that it is generally impossible to distinguish recycled halons from newly manufactured halons. The Committee intends that the Secretary of the Treasury, after consultation with the Administrator of the Environmental Protection Agency, establish a certification procedure drawing upon the international regulatory framework for trade in such chemicals provided under the Montreal Protocol and its subsequent amendments, as ratified by the United States Senate.

Effective Date

The provision is effective on the date of enactment.

16. Allow certain utilities to elect not to be eligible for future tax-exempt bond financing (sec. 12834 of the bill and secs. 142 and 150 of the Code)

Present Law

Interest on State and local government bonds generally is excluded from income except where the bonds are issued to provide financing for private parties. Present law includes several exceptions, however, that allow tax-exempt bonds to be used to provide financing for certain specifically identified private parties. One such exception allows tax-exempt bonds to be issued for the benefit of electric and gas utilities whose service area does not exceed (1) two contiguous counties or (2) a city and a contiguous county (i.e., "local furnishers").

Most private activity tax-exempt bonds are subject to the general State private activity bond volume limits of $50 per resident of the State ($150 million, if greater) per year. Tax-exempt bonds for local furnishers of electricity or gas are subject to this limit. Like most other private beneficiaries of tax-exempt bonds, these local furnishers are denied interest deductions on debt underlying the bonds if they cease to qualify as a local furnisher. Additionally, as with all tax-exempt bonds, if the use of the proceeds (or the beneficiary of the bonds) changes its character to a use not qualified for tax-exempt financing after the debt is incurred, interest on the bonds becomes taxable unless certain safe harbor standards are satisfied.

Reasons for Change

Tax-exempt financing is a Federal tax subsidy which should be subject to careful scrutiny in the present budgetary environment. The Committee is aware that past use of this subsidy during periods when this scrutiny was less pronounced now may preclude prudent business expansion in certain cases, particularly for local furnishers of electricity or gas. The Committee determined that a narrow provision allowing for acceleration of the removal of this subsidy is appropriate in view of the current deregulation in these industries provided that the subsidy provided by those bonds does not accrue to new, unqualified activities of the utility.

Explanation of Provision

The bill allows utilities that currently qualify as local furnishers of electricity or gas to elect to terminate that status and to expand their service areas without incurring the present-law loss of interest deductions and loss of tax-exemption penalties if—

(1) no additional bonds are issued for the benefit of the electing utility after the date of the provision's enactment;

(2) the expansion of the utility's service area is not financed with any tax-exempt bond proceeds; and

(3) all outstanding tax-exempt bonds of the utility are redeemed no later than 6 months after the earliest date on which redemption is not prohibited under the terms of the bonds, as issued, (or 6 months after the election, if earlier).

The bill further limits the exception allowing tax-exempt bonds to be issued for local furnishers of electricity or gas to utilities that are qualified as such on the date of its enactment.

Effective Date

The provision is effective on the date of enactment.

17. Tax-exempt bonds for the sale of Alaska Power Administration facility (sec. 12835 of the bill)

Present Law

Interest on State and local government bonds generally is excluded from income unless the bonds are issued to provide financing for private parties. Present law includes several exceptions, however, that allow tax-exempt bonds to be used to provide financing for certain specifically identified private parties ("private activity bonds"). State and local government bonds issued to acquire existing output property (other than water facilities) are treated as private activity bonds even if a State or local government owns or operates the property. Similarly, bonds issued to acquire existing property, the output from which will be sold to a private party under a take or pay contract are private activity bonds.

Most private activity bonds are subject to annual State volume limits of the greater of $50 per resident of the State or $150 million. Additionally, persons acquiring property financed with most private activity bonds must satisfy a rehabilitation requirement as a condition of the financing.

Reasons for Change

Limited tax-exempt financing is an integral component of proposed legislation for the sale of certain facilities by the Alaska Power Administration. That sale legislation is a budget measure currently pending before Congress. The Committee determined that a limited exception to the tax-exempt bond rules is appropriate to facilitate this unique transaction.

Explanation of Provision

The bill provides an exception from the general rehabilitation requirement for private activity bonds used to acquire existing property for certain bonds to finance the acquisition of the Snettisham hydroelectric project from the Alaska Power Administration. Bonds for this acquisition will remain subject to the State of Alaska's private activity bond volume limit.

Effective Date

The provision is effective for bonds issued after the date of enactment.

18. Modify treatment of foreign trusts (secs. 12841–12846 of the bill and secs. 643, 665, 668(a), 672, 679, 1491, 1494, 6038, 6039G, 6677, 7701(a) and 7872(f) of the Code)

Present Law

Income taxation of trusts and their beneficiaries

Taxation of trusts

A trust is treated as a separate taxable entity, except in cases where the grantor (or a person with a power to revoke the trust) has certain powers with respect to the trust (discussed below). A trust generally is taxed like an individual with certain modifications. These modifications include: (1) a separate tax rate schedule applicable to estates and trusts; (2) an unlimited charitable deduction for amounts paid to charity; (3) a personal exemption of $300 for a trust that is required to distribute all of its income currently, or $100 for any other trust; (4) no standard deduction for trusts; and (5) a deduction for distributions to beneficiaries. A trust is required to use the calendar year as its taxable year. Trusts generally are required to pay estimated income tax.

Taxation of distributions to beneficiaries

Distributions from a trust to a beneficiary generally are includible in the beneficiary's gross income to the extent of the distributable net income ("DNI") of the trust for the taxable year ending with, or within, the taxable year of the beneficiary. DNI is taxable income (1) increased by any tax-exempt income (net of disallowed deductions attributable to such income), and (2) computed without regard to personal exemptions, the distribution deduction, capital gains that are allocated to corpus and are neither distributed to any beneficiary during the taxable year nor set aside for charitable purposes, capital losses other than capital losses taken into account in determining the amount of capital gains which are paid to beneficiaries, and (with respect to simple trusts) extraordinary dividends which are not distributed to beneficiaries (sec. 643). The exclusion for small business capital gains under section 1202 is not taken into account in determining DNI.

Distributions to trust beneficiaries out of previously accumulated income are taxed to the beneficiaries under a throwback rule (sec. 667). The effect of the throwback rule is to impose an additional tax on the distribution of previously accumulated income in the year of distribution at the beneficiary's average marginal rate for the 5 years prior to the distribution. The amount of the distribution is grossed-up by the amount of the taxes paid by the trust on the accumulated income and a nonrefundable credit is allowed to the beneficiary for such taxes. In order to prevent trusts from accumulating income for a year, the fiduciary of a trust may elect to treat distributions within the first 65 days after the close of its taxable year as having occurred at the end of the preceding taxable year.

If a trust makes a loan to one of its beneficiaries, the principal of such a loan is generally not taxable as income to the beneficiary.

Grantor trust rules

Under the grantor trust rules (secs. 671–679), the grantor of a trust will continue to be taxed as the owner of the trust (or a portion thereof) if it retains certain rights or powers. A grantor of a trust generally is treated as the owner of any portion of a trust when the following circumstances exist:

(1) The grantor has a reversionary interest that has more than a 5-percent probability of returning to the grantor.

(2) The grantor has power to control beneficial enjoyment of the income or corpus. Certain powers are disregarded for this purpose—(a) a power to apply income to support a dependent; (b) a power affecting beneficial enjoyment that can be exercised only after an event that has a 5 percent or less probability of occurring; (c) a power exercisable only by will; (d) a power to allocate among charities; (e) a power to distribute corpus under an ascertainable standard or as an advancement; (f) a power to withhold income temporarily; (g) a power to withhold income during disability; (h) a power to allocate between corpus and income; (i) a power to distribute, apportion, or accumulate income or corpus among a class of beneficiaries that is held by an independent trustee or trustees; and, (j) a power to distribute, apportion, or accumulate income among beneficiaries that is limited by an ascertainable standard.

(3) The grantor retains any of the following administrative powers—(a) a power to deal at non-arms' length; (b) a power to borrow trust funds without adequate interest or security; (c) a borrowing that extends over one taxable year; (d) a power to vote stock of a controlled corporation held in the trust; (e) a power to control investment of trust funds in a controlled corporation; and (f) a power to reacquire trust corpus by substituting property with equivalent value.

(4) The grantor has a power to revoke, unless such power may not be exercised any time before an event that has a 5-percent or less probability of occurring.

(5) The income is or may be distributed to, held for the future benefit of, or used to pay for life insurance on the lives of, the grantor or the grantor's spouse, unless such power may not be exercised any time before an event that has a 5-percent or less probability of occurring. (An exception is provided for income that may

be used to discharge an obligation of support, unless the income is so used.)

If the grantor is not treated as the owner of any portion of a trust, another person generally will be treated as the owner of that portion of the trust if he or she has the power to revoke that portion of the trust or gave up a power to revoke and retained any of the powers set forth above, unless the retained power is disclaimed within a reasonable time.

Under the grantor trust rules, a U.S. person who transfers property to a foreign trust generally is treated as the owner of the portion of the trust comprising that property for any taxable year in which there is a U.S. beneficiary of any portion of the trust. This treatment generally does not apply, however, to transfers by reason of death, to sales or exchanges of property at fair market value where gain is recognized to the transferor, or to transfers made before the transferor became a U.S. person (sec. 679).

Payments from foreign trusts through nominees

Under a special rule, intermediaries or nominees interposed between certain foreign trusts and their beneficiaries are disregarded. This special rule treats any amount paid from a foreign person to a U.S. person, where the amount was derived (directly or indirectly) from a foreign trust that was created by a U.S. person, as if paid to the recipient directly by the foreign trust (sec. 665(c)).

Grantor trusts established by non-U.S. persons

Under the grantor trust rules, a grantor generally is treated as the owner of the trust's assets without regard to whether the grantor is a domestic or foreign person. Under these rules, U.S. trust beneficiaries can avoid U.S. tax on distributions from a trust where a foreign grantor is treated as owner of the trust, even though no tax may be imposed on the trust income by any jurisdiction.[80]

A special rule applies in the case of a grantor trust with a U.S. beneficiary, where the grantor trust rules otherwise would treat a foreign person as the owner of a portion of the trust, and the U.S. beneficiary had made gifts at any time, directly or indirectly, to the foreign person. In such a case, the U.S. beneficiary generally is treated as the grantor and owner of that portion to the extent of the gifts to the foreign person (sec. 672(f)).

Foreign nongrantor trusts rules

In cases where the grantor trust rules do not apply to a foreign trust, its U.S. beneficiaries generally are taxable on their respective shares of the income of the trust that is required to be distributed, as well as any other income of the trust that is paid, credited, or distributed to them (secs. 652, 662). Distributions from a trust in excess of the trust's distributable net income[81] for the taxable year generally are treated as accumulation distributions (sec. 665(b)), subject to the throwback rules. Under these rules, a dis-

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[80] See Rev. Rul. 69–70, 1969–1 C.B. 182.

[81] In the case of a foreign trust, DNI also includes foreign-source income net of related deductions, income that is exempt under treaties, and capital gains reduced (but not below zero) by capital losses.

tribution by a foreign trust of previously accumulated income generally is taxed at the beneficiary's average marginal rate for the prior 5 years, plus interest (secs. 666, 667). Interest is computed at a fixed annual rate of 6 percent, with no compounding (sec. 668).

If adequate records of the trust are not available to determine the proper application of the rules relating to accumulation distributions to any distribution from a trust, the distribution is treated as an accumulation distribution out of income earned during the first year of the trust (sec. 666(d)).

Residence of trusts and estates

An estate or trust is treated as foreign if it is not subject to U.S. income taxation on its income that is neither derived from U.S. sources nor effectively connected with the conduct of a trade or business within the United States (sec. 7701(a)(31)). Thus, if a trust is taxed in a manner similar to a nonresident alien individual, it is considered to be a foreign trust. Any other estate or trust is treated as domestic (sec. 7701(a)(30)).

The Code does not specify what characteristics must exist before a trust is treated as being comparable to a nonresident alien individual. Internal Revenue Service ("IRS") rulings and court cases, however, indicate that this status depends on various factors, such as the residence of the trustee, the location of the trust assets, the country under whose laws the trust is created, the nationality of the grantor, and the nationality of the beneficiaries.[82] If an examination of these factors indicates that a trust has sufficient foreign contacts, it is deemed comparable to a nonresident alien individual and, thus, is a foreign trust.

Section 1491 generally imposes a 35-percent excise tax on a U.S. person that transfers appreciated property to certain foreign entities, including a foreign trust.[83] In the case of a domestic trust that changes its situs and becomes a foreign trust, it is unclear whether property has been transferred from a U.S. person to a foreign entity, and, thus, whether the transfer is subject to section 1491.

Information reporting requirements and associated penalties

Any U.S. person who creates a foreign trust or transfers money or property to a foreign trust is required to report that event to the IRS without regard to whether the trust is a grantor or a nongrantor trust (sec. 6048(a)). Current regulations require reporting of, inter alia, the name, address and identification number (if any) of the transferor, the trust, the fiduciary and trust beneficiaries; the interest of each beneficiary; the location of the trust records; and the value of each item transferred (Treas. Reg. sec. 16.3–1(c)). Similarly, any U.S. person who transfers property to a foreign trust that has one or more U.S. beneficiaries is required to report annually to the IRS (sec. 6048(c)). In addition, if the transfer of any appreciated property by a U.S. person is subject to section

[82] For example, see Rev. Rul. 87–61, 1987–2 C.B. 219, Rev. Rul. 81–112, 1981–1 C.B. 598, Rev. Rul. 60–181, 1960–1 C.B. 257, and *B.W. Jones Trust v. Commissioner*, 46 B.T.A. 531 (1942), *aff'd*, 132 F.2d 914 (4th Cir. 1943).

[83] In Rev. Rul. 87–61 the IRS held that a U.S. citizen who transferred appreciated property to a foreign grantor trust is not subject to the section 1491 excise tax because the grantor continues to own the property for income tax purposes.

1491, the transferor is required to report the transfer to the IRS (Treas. Reg. sec. 1.1494–1(a)).

Any person who fails to file a required report with respect to the creation of, or a transfer to, a foreign trust may be subjected to a penalty of 5 percent of the amount transferred to the foreign trust (sec. 6677). Similarly, any person who fails to file a required annual report with respect to a foreign trust with U.S. beneficiaries may be subjected to a penalty of 5 percent of the value of the corpus of the trust at the close of the taxable year. The maximum amount of the penalty imposed under either case may not exceed $1,000. A reasonable cause exception is available. These civil penalties are determined separately from any applicable criminal penalties.

Reasons for Change

Grantor trust rules

Inbound grantor trusts

The Committee has been informed that the U.S. grantor trust provisions are being used as a vehicle to avoid U.S. tax. If a trust is treated as a grantor trust, only the owner of the trust is taxable on the trust's income and not the trust's beneficiaries. Thus, if a foreign person creates a trust with U.S. beneficiaries that is treated as a grantor trust for U.S. tax purposes and if the foreign person's home country does not tax the income, the income of the trust would not be subject to tax by either the United States or the foreign country. The Committee believes that the income derived through these types of arrangements should be subject to tax by at least one jurisdiction.

Outbound grantor trusts

The Committee understands that taxpayers have avoided the application of the outbound grantor trust rules of section 679. An example of such avoidance is to structure transfers of property to a foreign trust as sales in exchange for notes issued by the trust or a person related to the trust where the notes are not repaid. The Committee is concerned about this and similar transactions. Therefore, the Committee believes that it is appropriate to disregard such notes in determining whether the transferor received fair market value for the property transferred.

Foreign nongrantor trust rules

The 6 percent simple interest charge applicable to accumulation distributions has not been updated since 1976. In essence, income earned through a foreign nongrantor trust may be deferred from U.S. taxation, then subjected to a below-market interest rate when distributed to a U.S. beneficiary. The Committee believes that it is appropriate to charge the rate of interest on accumulation distributions applicable to general underpayments of income tax.

Under current law, a U.S. beneficiary of a foreign trust may avoid U.S. tax on the income accumulated through the trust by obtaining a loan of cash or marketable securities from the trust in lieu of an actual distribution. The Committee believes that it is appropriate to treat such a loan as a distribution to the borrower.

Residence of trusts and estates

Because the U.S. tax treatment of a trust (and the beneficiaries of a trust) or an estate depends on its residence, the Committee believes that it is appropriate to provide objective criteria for determining the residence of trusts and estates.

Information reporting requirements and associated penalties

The Committee has been informed that certain U.S. settlors have established foreign trusts, including grantor trusts, in tax haven jurisdictions. Income from such foreign grantor trusts is taxable currently to the U.S. grantor, but the Committee understands that the level of compliance in this regard is lacking. The Committee is concerned that the present-law civil penalties on failure to comply with reporting requirements applicable to activities of foreign trusts established by U.S. persons has proven to be ineffective. In order to deter noncompliance, the Committee believes that it is appropriate to expand the reporting requirements relating to activities of foreign trusts with U.S. grantors or U.S. beneficiaries and to increase the civil penalties applicable to a failure to comply with such reporting requirements.

The Committee has been informed that some of the jurisdictions in which U.S. settlors have established foreign trusts have strict secrecy laws. The Committee is concerned that the secrecy laws may effectively preclude the IRS from obtaining information necessary to determine the tax liabilities of the U.S. grantors or U.S. beneficiaries with respect to items related to such foreign trusts. The Committee believes that to remove obstacles to the administration of the tax law applicable to taxation of income derived from foreign trusts, it is useful, in the case of a foreign trust with a U.S. grantor, to provide an incentive for the trust to have a limited U.S. agent to accept service of process.

Explanation of Provisions

a. *Inbound foreign grantor trust rules*

Foreign grantors not treated as owners

Under the bill, the grantor trust rules generally apply only to the extent that they result, directly or indirectly, in amounts being currently taken into account in computing the income of a U.S. citizen or resident or a domestic corporation. For this purpose, a controlled foreign corporation is treated as a domestic corporation. Thus, the grantor trust rules generally do not apply to any portion of a trust where their effect is to treat a foreign person as owner of that portion.

The bill provides certain exceptions to the rule described above. Under one exception, the provision generally does not apply to a trust if the power to revest absolutely the title to the trust property is exercisable solely by the grantor, either without approval of another person or with the consent of a related or subordinate party who is subservient to the grantor (as defined in sec. 672(c)). Under another exception, the provision does not apply to a trust if the only amounts distributable from the trust during the lifetime of the grantor are to the grantor or the grantor's spouse. These two exceptions do not apply to the extent of gifts made by a U.S. beneficiary of the trust to the foreign grantor. The provision also does not apply to trusts established to pay compensation, and certain trusts in existence as of September 19, 1995 provided such trust is treated as owned by the grantor or another person under section 676 or 677 (other than sec. 677(a)(3)).[84]

In a case where the foreign grantor, who is treated as the owner of the trust but for the above rule, actually pays tax on the income of the trust to a foreign country, the Committee anticipates that Treasury regulations will provide that U.S. beneficiaries who are subject to U.S. income tax on that income will be treated for foreign tax credit purposes as having paid the foreign taxes that are paid by the foreign grantor. Any resulting foreign tax credits are subject to applicable foreign tax credit limitations.

The bill provides a transition rule for any domestic trust that has a foreign grantor who is treated as the owner of the trust under present law. If such a trust becomes a foreign trust before January 1, 1997, or if the assets of such a trust are transferred to a foreign trust before that date, such trust is be exempt from the excise tax on transfers to a foreign trust otherwise imposed by section 1491. However, the bill's new reporting requirements and penalties are applicable to such transfers.

The bill provides a special rule that allows the Secretary of the Treasury to recharacterize a transfer, directly or indirectly, from a partnership or foreign corporation which the transferee treats as a gift or bequest, to prevent the avoidance of the purpose of this provision.[85]

Distributions by foreign trusts through nominees

The bill treats any amount paid to a U.S. person, where the amount was derived (directly or indirectly) from a foreign trust of which the payor is not the grantor, as if paid by the foreign trust directly to the U.S. person. This rule disregards the role of an intermediary or nominee that may be interposed between a foreign trust and a U.S. beneficiary. Unlike present law, however, the rule applies regardless of whether the trust was created by a U.S. person. The rule does not apply to a withdrawal from a foreign trust by its grantor, with a subsequent gift or other payment to a U.S. person.

Effective date

The provisions discussed in this part are effective on the date of enactment.

b. *Foreign nongrantor trust rules*

Interest charge on accumulation distributions

The bill changes the interest rate applicable to accumulation distributions from foreign trusts from simple interest at a fixed rate of 6 percent to compound interest determined in the manner of the interest imposed on underpayments of tax under section 6621(a)(2).

[84] The exception does not apply to the portion of any such trust attributable to any transfers made after September 19, 1995.

[85] See discussion below for reporting requirements under the bill with respect to certain foreign gifts and bequests received by a U.S. person.

Simple interest continues to accrue at the rate of 6 percent through 1995. Beginning on January 1, 1996, however, compound interest based on the underpayment rate is imposed not only on tax amounts determined under the accumulation distribution rules but also on the total simple interest for pre-1996 periods, if any. For purposes of computing the interest charge, the accumulation distribution is allocated proportionately to prior trust years in which the trust has undistributed net income (and the beneficiary receiving the distribution was a U.S. citizen or resident), rather than to the earliest of such years. An accumulation distribution is treated as reducing proportionately the undistributed net income for such years.

The bill includes a formula to determine the period for which interest is charged using the underpayment rates under section 6621(a)(2). Under the formula, for example, if a foreign nongrantor trust has $100 of undistributed net income each year in years 1 through 3 and the trust distributes $100 of accumulated income to its U.S. beneficiary in year 4, the taxpayer has to pay interest using the section 6621(a)(2) interest rates as if the income accrued for 2 years.[86] In addition, the $100 accumulation distribution reduces the trust's undistributed net income by $33 each year for years 1 through 3.[87]

The bill includes an anti-abuse rule which authorizes the Secretary of the Treasury to issue regulations, on or after the date of enactment, that may be necessary or appropriate to carry out the purposes of the rules applicable to accumulation distributions, including regulations to prevent the avoidance of those purposes.

Loans to grantors or beneficiaries

In the case of a loan of cash or marketable securities by the foreign trust to a U.S. grantor or a U.S. beneficiary (or a U.S. person related to such a grantor or beneficiary[88]), the bill treats the full amount of the loan as distributed to the grantor or beneficiary, even if the loan bears interest at an adequate rate and is subsequently repaid. In addition, any subsequent transaction between the trust and the original borrower regarding the principal of the loan (e.g., repayment) is disregarded for all purposes of the Code. This provision does not apply to loans made to organizations that are exempt from U.S. income tax.

Effective date

The provision to modify the interest charge on accumulation distributions applies to distributions after the date of enactment. The provision with respect to loans to U.S. grantors, U.S. beneficiaries

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[86] The number of years is determined as a weighted average as follows:

$$\frac{(\$100 \times 3 \text{ years})+(\$100 \times 2 \text{ years})+(\$100 \times 1 \text{ year})}{\$300} = 2$$

[87] That is, one-third of the $100 of distribution may reduce the $100 of undistributed net income for each of years 1, 2 and 3.

[88] For this purpose, a person is treated as related to the grantor or beneficiary if the relationship between such person and the grantor or beneficiary would result in a disallowance of losses under section 267 or 707(b), except that in applying section 267(c)(4) an individual's family includes the spouses of the members of the family.

or a U.S. person related to such a grantor or beneficiary applies to loans made after September 19, 1995.

c. ***Outbound foreign grantor trust rules***

The bill makes several modifications to the general rule of section 679(a)(1) under which a U.S. person who transfers property to a foreign trust generally is treated as the owner of the portion of the trust comprising that property for any taxable year in which there is a U.S. beneficiary of the trust. The bill also contains an amendment to conform the definition of certain foreign corporations the income of which is deemed to be accumulated for the benefit of a U.S. beneficiary to the definition of controlled foreign corporations (as defined in sec. 957(a)).

Sale or exchange at market value

Present law contains several exceptions to grantor trust treatment under section 679(a)(1) described above. Under one of the exceptions, grantor trust treatment does not result from a transfer of property by a U.S. person to a foreign trust in the form of a sale or exchange at fair market value where gain is recognized to the transferor. In determining whether the trust paid fair market value to the transferor, the bill provides that obligations issued (or, to the extent provided by regulations, guaranteed) by the trust, by any grantor or beneficiary of the trust, or by any person related to any grantor or beneficiary[89] (referred to as "trust obligations") generally are not taken into account except as provided in regulations. However, in determining whether the trust paid fair market value to the transferor, principal payments by the trust on any such trust obligations are taken into account on and after the payment date.

Other transfers

The bill adds a new exception to the general rule of section 679(a)(1) described above. Under the bill, a transfer of property to certain charitable trusts is exempt from the application of the rules treating foreign trusts with U.S. grantors and U.S. beneficiaries as grantor trusts.

Transferors or beneficiaries who become U.S. persons

The bill applies the rule of section 679(a)(1) to certain foreign persons who transfer property to a foreign trust and subsequently become U.S. persons. A nonresident alien individual who transfers property, directly or indirectly, to a foreign trust and then becomes a resident of the United States within 5 years after the transfer generally is treated as making a transfer to the foreign trust on the individual's U.S. residency starting date (as defined in sec. 7701(b)(2)(A)). The amount of the deemed transfer is the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally is treated under section 679(a)(1) as the owner of that portion of the trust in any taxable year in which the trust has U.S.

[89] For this purpose, a person is treated as related to the grantor or beneficiary if the relationship between such person and the grantor or beneficiary would result in a disallowance of losses under section 267 or 707(b), except that in applying section 267(c)(4) an individual's family includes the spouses of the members of the family.

beneficiaries. The bill's reporting requirements and penalties (discussed below) also are applicable.

Under the bill, a beneficiary is not treated as a U.S. person for purposes of determining whether the transferor of property to a foreign trust is taxed as a grantor with respect to any portion of a foreign trust if such beneficiary first became a U.S. person more than 5 years after the transfer. The Secretary of the Treasury may prescribe regulations to treat any person as a U.S. person for this purpose if that person was a U.S. person at any time during the existence of the trust.

Outbound trust migrations

The bill applies the rules of section 679(a) to a U.S. person that transferred property to a domestic trust if the trust subsequently becomes a foreign trust while the transferor is still alive. Such a person is treated as making a transfer to the foreign trust on the date of the migration. The amount of the deemed transfer is the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally is treated under section 679(a)(1) as the owner of that portion of the trust in any taxable year in which the trust has U.S. beneficiaries. The bill's reporting requirements and penalties (discussed below) also are applicable.

Effective date

The provisions to amend section 679 apply to transfers of property after February 6, 1995.

d. *Residence of estates and trusts*

Treatment as U.S. person

The bill establishes a two-part objective test for determining for tax purposes whether a trust is foreign or domestic. If both parts of the test are satisfied, the trust is treated as domestic. Only the first part of the test applies to estates.

Under the first part of the test, in order for an estate or trust to be treated as domestic, a U.S. court (i.e., Federal, State, or local) must be able to exercise primary supervision over the administration of the estate or trust. The Committee expects that this test is satisfied by any trust instrument that specifies that it is to be governed by the laws of any State. In addition, an estate or trust may be able to subject itself voluntarily to the jurisdiction of a U.S. court through registration of the estate or trust under a State law similar to Article VII of the American Law Institute's Uniform Probate Code.

Under the second part of the test, in order for a trust to be treated as domestic, one or more U.S. fiduciaries must have the authority to control all substantial decisions of the trust. The Committee expects that this test is satisfied in any case where fiduciaries who are U.S. persons hold a majority of the fiduciary power (whether by vote or otherwise), and where no foreign fiduciary, such as a "trust protector" or other trust advisor, has the power to veto important decisions of the U.S. fiduciaries. The Committee further expects that, in applying this test, a reasonable period of time is allowed for a trust to replace a U.S. fiduciary who resigns or dies before the trust is treated as foreign.

Under the bill, a foreign estate is defined as an estate other than an estate that is determined to be domestic under the court-supervision test. A foreign trust is defined as a trust other than a trust that is determined to be domestic under both the court-supervision test and the U.S. fiduciary test.

Outbound migration of domestic trusts

Under the bill, if a domestic trust changes its situs and becomes a foreign trust, the trust is treated as having made a transfer of its assets to the foreign trust and is subject to the 35-percent excise tax imposed by present-law section 1491 unless one of the exceptions to this excise tax is applicable. In addition, the U.S. grantor is required to report the transfer under the reporting requirements described below. Failure to report such a transfer would result in penalties (discussed below).

Effective date

The provision to modify the treatment of a trust or estate as a U.S. person applies to taxable years beginning after December 31, 1996. In addition, if the trustee of a trust so elects, the provision would apply to taxable years ending after the date of enactment. The amendment to section 1491 is effective on the date of enactment.

e. ***Information reporting requirements and associated penalties***

The bill expands the reporting requirements with respect to foreign trusts if there is a U.S. grantor of the foreign trust or a distribution from the foreign trust to a U.S. person. The bill requires the responsible parties to file the designated information reports with the IRS upon the occurrence of certain events. A failure to comply with the reporting requirements, without reasonable cause, will result in increased monetary penalties under the bill.

Information reporting requirements

First, the bill requires the grantor, transferor or executor (i.e., the "responsible party") to notify the IRS upon the occurrence of certain reportable events. The term "reportable events" means the creation of any foreign trust by a U.S. person, the direct and indirect transfer of any money or property to a foreign trust, including a transfer by reason of death, and the death of a U.S. citizen or resident if any portion of a foreign trust was included in the gross estate of the decedent. A reportable event does not include any transfer of property to a foreign trust in exchange for consideration of at least the fair market value of the property.[90] Also excluded are transfers to certain pension and charitable trusts. The required notice provides information regarding the amount of money or other property transferred to the trust, the identities of the trustee and beneficiaries of the foreign trust, and other items as prescribed by the Secretary of the Treasury.

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[90] For this purpose, consideration other than cash is taken into account at its fair market value and the rules of section 679(a)(3), as modified by the bill, apply (see earlier discussion).

Second, a U.S. person that is treated as the owner of any portion of a foreign trust is required to ensure that the trust files an annual report to provide full accounting of all the trust activities for the taxable year, the name of the U.S. agent for the trust, and other information as prescribed by the Secretary of the Treasury.[91] In addition, unless a U.S. person is authorized to accept service of process as the trust's limited agent with respect to with any request by the IRS to examine records or to take testimony and any summons for such records or testimony in connection with the tax treatment of any items related to the trust, the IRS is entitled to determine, in its sole discretion, the amount to be taken into account by a U.S. person under the grantor trust rules (secs. 671 through 679). This limited agency relationship does not constitute an agency relationship for any other purpose under Federal or State law. For this purpose, rules similar to rules of sections 6038A(e)(2) and (4) with respect to enforcement of requests for certain records apply.

Third, any U.S. person who receives (directly or indirectly) any distribution from a foreign trust is required to file a notice to report the name of the trust, the aggregate amount of the distributions received during the taxable year, and other information that the Secretary of the Treasury may prescribe. If adequate records are not provided to the Secretary to determine the proper treatment of any distributions from a foreign trust, the distribution includible in the gross income of the distributee will be treated as an accumulation distribution subject to the throw back rules applicable to U.S. beneficiaries of foreign trusts, unless the foreign trust elects to have a U.S. agent for the limited purpose of accepting service of process (as described above).

Monetary penalties for failure to report

Under the bill, a person who fails to provide the required notice in cases involving the transfer of property to a new or existing foreign trust, or a distribution by a foreign trust to a U.S. person, is subject to an initial penalty equal to 35 percent of the gross reportable amount. A failure to provide an annual reporting of trust activities will result in an initial penalty equal to 5 percent of the gross reportable amount.

In cases involving a transfer of property to a foreign trust, the gross reportable amount is the gross value of the property transferred. In cases involving the death of a U.S. citizen or resident whose estate included any portion of a foreign trust, the gross amount is the value of the property includible in the gross estate of the decedent. In cases where annual reporting of trust activities is required, the gross reportable amount is the gross value of the portion of the foreign trust's assets treated as owned by the U.S. grantor at the close of the year. In cases involving a distribution to a U.S. beneficiary of a foreign trust, the gross reportable amount is the amount of the distribution to the beneficiary. An additional $10,000 penalty is imposed for continued failure for each 30-day period (or fraction thereof) beginning 90 days after the IRS notifies

[91] It is intended that the regulations would require the trust to furnish information to U.S. grantors and beneficiaries concerning income reportable by such persons that is generally similar to the items on schedule K–1 of Form 1041.

the responsible party of such failure. Such penalties are subject to a reasonable cause exception. The Committee intends that the reasonable cause standard is satisfied upon the showing of reasonable efforts to comply with the reporting requirements. In no event will the total amount of penalties exceed the gross reportable amount.

Effective date

The reporting requirements and applicable penalties generally apply to reportable events occurring or distributions received after the date of enactment. The annual reporting requirement and penalties applicable to U.S. grantors apply to taxable years of such persons beginning after the date of enactment.

f. Reporting of certain foreign gifts

The bill requires any U.S. person (other than certain tax-exempt organizations) that receives purported gifts or bequests from foreign sources totaling more than $10,000 during the taxable year to report them to the IRS. The definition of a gift to a U.S. person for this purpose excludes qualified tuition or medical payments made on behalf of the U.S. person, as defined for gift tax purposes (sec. 2503(e)(2)). If the U.S. person fails, without reasonable cause, to report foreign gifts as required, the IRS is authorized to determine, in its sole discretion, the tax treatment of the unreported gifts, based on information in its possession or as it may obtain. In addition, the U.S. person is subject to a penalty equal to 5 percent of the amount of the gift for each month that the failure continues, with the total penalty not to exceed 25 percent of such amount.

Effective date

The provision applies to amounts received after the date of enactment.

19. Treatment of financial asset securitization investment trusts ("FASITs") (sec. 12851 of the bill and new Code secs. 860H–M)

Present Law

Overview of securitization

An individual can own income-producing assets directly, or indirectly through an entity (i.e., corporation, partnership, or trust). Where an individual owns assets through an entity (e.g., a corporation), the nature of the interest in the entity (e.g., stock of a corporation) is different than the nature of the assets held by the entity (e.g., assets of the corporation).

In general, securitization is the process of converting one type of asset into another and generally involves use of an entity separate from the underlying assets. In the case of securitization of debt instruments, the instruments created in the securitization typically have different maturities and characteristics than the debt obligations that are securitized.

Entities used in securitization

In general.—Entities used in securitization include entities that are subject to tax (e.g., a corporation), conduit entities that generally are not subject to income tax (e.g., a partnership, grantor trust, or real estate mortgage investment conduit ("REMIC")), or partial-conduit entities that generally are subject to tax only to the extent income is not distributed to owners (e.g., a trust, real estate investment trust ("REIT"), or regulated investment company ("RIC")). The benefits from securitization can be enhanced if the interests in entities used in the securitization process are not subject to Federal corporate income tax and the interests in the securitized assets are not treated as assets and liabilities of the person sponsoring the securitization process. The Internal Revenue Code ("Code") establishes a number of vehicles that are treated as conduits or partial conduits through which individuals can own income-producing assets indirectly. These vehicles include S corporations, REITs, RICs, and REMICs. Most of these statutory vehicles, other than REMICs, generally are not used for debt securitizations because they were enacted for other purposes and, consequently, are not amenable for securitizations of other types of assets (e.g., S corporations are limited to 35 individual shareholders and may issue only one class of stock; RICs are limited to holding securities; REITs are limited holding share-type interests in real estate and real estate mortgages[92]).

Classification rules.—Treasury regulations provide that whether a particular entity is classified as an association taxable as a corporation or as a partnership, trust, or some other entity not taxable as a corporation is determined by taking into account the presence or absence of certain characteristics associated with corporations. These characteristics are (1) the presence of associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralization of management, (5) liability for entity debts limited to entity property, and (6) free transferability of interests in the entity.

Corporations and partnerships share the first two characteristics described above, and so the classification of an unincorporated entity as an association taxable as a corporation rather than a partnership depends on whether the entity has at least three of the remaining four characteristics. Nonetheless, certain entities that otherwise satisfy the test for partnership classification, but whose interests are traded on an established securities market or are readily tradable on a secondary market (or the substantial equivalent thereof), are treated as corporations for Federal income tax purposes (sec. 7704).

Corporations and trusts share the last four characteristics described above. Accordingly, the Treasury regulations provide that whether a particular unincorporated entity is treated as a trust or as an association taxable as a corporation depends on whether the entity has associates and an objective to carry on business and divide the gains therefrom. Generally, if the purpose of an arrange-

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[92] REITs are subject to additional tax at the highest rate paid by corporations on net income from foreclosure property. Net income from foreclosure property is the excess of the sum of gains from foreclosure property that is held to customers in the ordinary course of a trade or business and gross income from foreclosure property (other than certain passive rental income) over all deductions directly connected with the production of such income. Foreclosure property is any real property or personal property incident to such real property that is acquired by a REIT as a result of default or imminent default on a lease of such property or indebtedness secured by such property. Limitations are imposed on the period of time that property may be considered foreclosure property (not more than 6 years) and the ability of REIT to operate foreclosure property other than through an independent contractor.

ment is to grant to trustees exclusive responsibility for the protection and conservation of trust property, and the persons with the beneficial interest in the property cannot share in the discharge of that responsibility, there are no associates or objective to carry on business. Such an arrangement generally is treated as a trust. A trust that holds income-producing assets (such as a fixed investment trust) may be treated as a trust if there is no power under the trust agreement to vary the investment.

Under Treasury regulations, an arrangement having more than one class of ownership interests generally is not treated as a trust, but is treated as a corporation for Federal income tax purposes. Under these regulations, a trust is treated as having one class of ownership if all of the beneficiaries of the trust have undivided interests in all of the trust property. Thus, under the regulations, if a trust held a portfolio of debt obligations, and interests in the trust assets were divided so that one class of beneficiaries was to receive all principal collected by the trust and a specified rate of interest thereon, until the trust had collected a specified amount of principal on the debt obligations, and another class of beneficiaries was to receive all remaining amounts collected by the trust, such trust would be treated as an association taxable as a corporation.

Corporations.—A corporation generally is a taxable entity, separate from its stockholders. Thus, income earned by a corporation is taxed to the corporation. In addition, when the after-tax earnings of a corporation are distributed to the corporation's stockholders as dividends, generally such earnings also are taxed to the stockholders. As a result of the additional tax on corporate income, ownership interests in corporations generally are not a preferred method for securitization. Nonetheless, since interest on corporate indebtedness is deductible in determining a corporation's income, the taxation of a highly-leveraged corporation more resembles a partial-conduit entity. Highly-leveraged corporations often are used for securitization; their major disadvantages typically are the inclusion of their assets and indebtedness in the sponsor's financial statements and problems in insuring that interests issued in the form of debt will be not treated as equity for Federal income tax purposes.[93]

Partnerships.—A partnership generally is a complete conduit for Federal income tax purposes—each partner takes into account his "distributive share" of the partnership's income, loss, deduction, and credit separately. Partnership form is not used frequently for securitization because partnership interests are cumbersome when there are multiple owners. Nonetheless, partnerships that issue indebtedness are sometimes used in securitization since a partnership with multiple creditors generally raise many fewer problems

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[93] The determination of whether an instrument issued by a corporation is debt or equity is based on all the facts and circumstances. Factors that may be taken into account to determine whether an interest in a corporation is debt include (1) whether a written unconditional promise exists to pay on demand or on a specified date a sum certain in money and to pay a fixed rate of interest, (2) whether a preference exists over any other indebtedness of the corporation, (3) the ratio of debt to equity of the corporation, (4) whether the interest is convertible into the stock of the corporation, and (5) whether there is a relationship between stock holdings and debt ownership. The Secretary of the Treasury is authorized to prescribe regulations to determine whether an interest in a corporation is stock or debt for Federal tax purposes (sec. 385(a)). Treasury regulations were issued under this authorization, but were subsequently withdrawn.

than multiple partners; highly-leveraged partnerships have the same disadvantages as highly-leveraged corporations.

Trusts.—A non-grantor trust generally is treated as a partial conduit for Federal income tax purposes since the trust, although in form a separate taxable entity, is allowed a deduction for amounts distributed to its beneficiaries, which amounts generally are includible in the beneficiaries' income. Non-grantor trusts generally are not used for securitization because of the rule that a trust which engages in a trade or business is taxed as a corporation.

Real estate mortgage investment conduits ("REMICs").—REMICs were specifically created for the securitization of real estate mortgages. In general, a REMIC is an entity that owns a fixed pool of mortgages and that issues multiple classes of interests in that pool. If specified requirements are met, the REMIC generally is not subject to Federal income tax.

The income of the REMIC is allocated to, and taken into account by, the holders of the interests therein. Holders of "regular interests" issued by a REMIC generally take into income the portion of the REMIC's income that would be recognized by an accrual method holder of a debt instrument having the same terms as the particular regular interest; holders of "residual interests" take into account all of the taxable income of the REMIC not taken into account by the holders of the regular interests or the net loss of the REMIC.

A portion of the income a residual holder derives from a REMIC is treated as unrelated business taxable income for tax-exempt entities and is subject to withholding at the statutory rate when paid to foreign persons, and generally may not be offset by net operating losses.

A REMIC's ability to engage in an active business is limited by a 100-percent tax on its net income from certain prohibited transactions, including certain dispositions of the assets a REMIC is entitled to hold, the receipt of income from assets other than assets a REMIC is entitled to hold, and the receipt of any compensation for services.

REMICs are the exclusive means of issuing multiple class real estate mortgage-backed securities without the imposition of two levels of Federal income tax. Any arrangement that qualifies as a "taxable mortgage pool" ("TMP") is treated as a taxable corporation that is not an includible corporation for purposes of filing consolidated returns. Any entity other than a REMIC is a TMP if (1) substantially all of the entity's assets consist of debt obligations (or interests in debt obligations) and a majority of the assets consists of real estate mortgages, (2) the entity issues debt obligations with two or more maturities, and (3) payments on such debt obligations are to bear a relationship to payments on the debt obligations (or interests therein) held by the entity.

Treatment of debt obligations

Original issue discount.—If a borrower receives less in a lending transaction than the amount to be repaid at the loan's maturity, the difference represents "discount." Discount performs the same function as stated interest, i.e., compensation of the lender for the use of the lender's money. Code sections 1272–1275 and section 163(e) (the "OID rules") generally require the holder of a debt instrument issued at a discount (provided that such discount is not less than a certain *de minimis* amount) to include annually in income a portion of the original issue discount ("OID") on the instrument, and allow the issuer of such an instrument to deduct a corresponding amount, irrespective of the methods of accounting that the holder and the issuer otherwise use.

Special rules for calculating the accrual of OID apply to regular interests in REMICs, qualified mortgages held by REMICs, and any debt instruments that have maturities that are initially fixed, but that may be accelerated based on prepayments of other debt obligations securing the debt instruments (or, to the extent provided in Treasury regulations, by reason of other events) (sec. 1272(a)(6)). These rules require OID for an accrual period to be calculated taking into account expected and actual rates of prepayments of the principal of the REMIC regular interests, the REMIC qualified mortgages, or the debt instruments.

Market discount.—Similarly, where a debt obligation is acquired subsequent to its original issuance at a price less than the amount receivable at the obligation's maturity, there is market discount. Market discount is defined as the excess of the stated redemption price of an obligation over the acquirer's basis immediately after acquisition (provided that such excess is not less than a certain *de minimis* amount). In the case of a obligation that has original issue discount, for purposes of the market discount rules, its stated redemption price generally is treated as the sum of its issue price and the amount of original issue discount that would have been includible in the income of an original holder.

Unlike in the case of OID, a holder of a debt obligation generally is not required to include accrued market discount in income currently. In general, however, gain on the disposition of a debt obligation generally is treated as ordinary income to the extent of any accrued market discount. In addition, if indebtedness is incurred to purchase or carry a debt obligation that has market discount, interest on such indebtedness in excess of the amount of interest includible in income with respect to such obligation is deductible only to the extent that such interest exceeds the accrued market discount allocable to the taxable year.

Coupon stripping rules.—Where there is a separation of ownership of the right to receive any payment of principal or interest on a debt obligation, other than a pro rata share of all payments, the holder who disposes of the right to receive certain payments on the debt obligation must allocate his basis in the obligation between the portion of the debt obligation that is disposed of and the portion retained for purposes of recognizing gain or loss (sec. 1286). This allocation is made based on the two positions' relative fair market values. The OID rules then govern the amount that the respective holders of the "stripped" debt obligation and the "stripped" coupons must include in income annually.

Special rules applicable to high yield discount obligations.—A certain portion of the yield on an applicable high yield discount obligation is treated as a dividend and is not deductible by the obligor and another portion is not deductible until paid. An applicable high yield discount obligation is one that: (1) has a maturity date more than 5 years from the date of issue; (2) has a yield to maturity at least equal to the applicable Federal rate plus 5 percentage points; and (3) has significant OID. An instrument has significant OID if, for any accrual period ending after the date 5 years after the date of issue, the aggregate amount of interest taken into account as income under the instrument exceeds the sum of the aggregate amount of interest paid plus the product of the issue price of the instrument and its yield to maturity.

Reasons for Change

The Committee believes that there are substantial benefits to the economy from increased securitization of debt since securitization of debt will spread the risk of credit. The Committee believes that the spreading of credit risk will lessen the concentration of such risk in banks and other financial intermediaries which, in turn, will lessen the pressure on Federal deposit insurance. Further, the Committee believes that the spreading of credit risk through securitization will result in lower interest rates for consumers.

The Committee understands that it is difficult to securitize revolving debt (such as credit card receivables) under present law without the imposition of a corporate tax if the sponsor of the securitization does not want to report the securitized assets and the interests therein on his financial reports. Accordingly, the Committee bill would create a new type of entity, known as a "financial asset securitization investment trust" or "FASIT," through which securitizations of all types of debt, including revolving credit debt, can be accomplished without the imposition of a corporate tax even though the securitized debt and the interests in the securitized debt are not reported on the financial statements of the securitization's sponsor.

Basically, the Committee bill achieves its purpose by allowing the FASIT to issue instruments, called "regular interests," which will be treated as debt (and, therefore, the return on such interests would be deductible as interest) even though such instruments would not otherwise be treated as debt for Federal income tax purposes. Nonetheless, in order that there be a corporate tax on returns that approach returns on equity, the Committee bill requires that instruments whose yield is more than 5 percentage points higher than the yield on U.S. Treasury obligations (called "high-yield interests") be held by domestic, non-exempt corporations and such yield cannot be offset by any net operating loss of its owner.

In addition, in order to insure that FASITs are not used for purposes other than securitization, the Committee bill imposes a 100-percent excise tax on any income not related to securitizations (called "prohibited income"). Where a FASIT acquires nondebt assets as a result of foreclosure (or threat of foreclosure), the committee would impose a corporate tax on any net income from such foreclosure property, similar to the present-law rules for foreclosure property of a real estate investment trust.

Explanation of Provision

In general

The bill creates a new type of statutory entity called a "financial asset securitization investment trust" ("FASIT") that facilitates the securitization of debt obligations such as credit card receivables, home equity loans, and auto loans. A FASIT generally will not be taxable; the FASIT's taxable income or net loss will flow through to the owner of the FASIT.

The ownership interest of a FASIT generally will be required to be entirely held by a single domestic C corporation. In addition, a FASIT generally may hold only qualified debt obligations, and certain other specified assets, and will be subject to certain restrictions on its activities. An entity that qualifies as a FASIT can issue instruments that meet certain specified requirements and treat those instruments as debt for Federal income tax purposes. Instruments bearing yields to maturity over 5 percentage points above the yield to maturity on specified United States government obligations (i.e., "high-yield interests") may be held only by domestic C corporations that are not exempt from income tax..

Qualification as a FASIT

To qualify as a FASIT an entity must: (1) make an election to be treated as a FASIT for the year of the election and all subsequent years; (2) have assets substantially all of which are specified types called "permitted assets"; (3) have non-ownership interests of certain types of debt instruments called "regular interests"; (4) have a single ownership interest which is held by an "eligible holder"; (5) have a taxable year that is the same as its owner; and (6) not qualify as a RIC. In addition, an entity cannot be a FASIT if any person other than the FASIT's owner owns the right to receive excess servicing fees with respect to permitted debt instruments.

Election to be a FASIT

The election to be a FASIT must be made on its return for its first year. Once made, the election applies for that year and all subsequent years until the entity ceases functioning as a FASIT. Once an entity ceases to be a FASIT, it is not a FASIT for that year or any subsequent year. Nonetheless, an entity can continue to be a FASIT where the Treasury Department determines that an entity inadvertently ceases to function as a FASIT, steps are taken reasonably soon after it is discovered that the entity ceased to function as a FASIT so that it again functions as a FASIT, and the FASIT and its owner take those steps that the Treasury Department thinks necessary.

Permitted assets

In general.—For an entity or arrangement to qualify as a FASIT, substantially all of its assets must consist of the following "permitted assets": (1) certain permitted debt instruments; (2) investments of amounts received from permitted debt obligations for a temporary period before distributions to regular and ownership interests in the FASIT ; (3) certain foreclosure property; (4) certain instruments or contracts that represent a hedge or guarantee of debt held or issued by the FASIT; (5) certain partnership interests, and (6) contract rights to acquire permitted debt instruments or hedges. A FASIT must meet the asset test at the 90th day after its formation and at all times thereafter. Permitted assets may be acquired at any time by a FASIT, including any time after its formation.

Permitted debt instruments.—For this purpose, a debt instrument will be a permitted asset only if the instrument is indebtedness for Federal income tax purposes and it bears (1) fixed interest, (2) variable interest of a type that relates to qualified variable rate debt (as defined in Treasury regulations prescribed under sec. 860G(a)(1)), or (3) other variable interest to the extent provided by Treasury regulations. Permitted debt obligations cannot be obligations issued, directly or indirectly, by the owner of the FASIT or a related person.

Foreclosure property.—Permitted assets include property acquired on default (or imminent default) of debt instruments held by the FASIT that would be foreclosure property to a REIT (under sec. 856(e)) or would be foreclosure property to a REIT but for certain leases entered into, or construction performed, (as described in sec. 856(e)(4)) while held by the FASIT .

Hedges.—Permitted assets include interest rate or foreign currency notional principal contracts, letters of credit, insurance, guarantees against payment defaults, or other similar instruments as permitted under Treasury regulations, which are reasonably required to guarantee or hedge against the FASIT's risks associated with being the obligor of regular interests.

Partnership interests.—A partnership interest is a permitted asset if all of the assets of the partnership are permitted debt instruments and the partnership interest provides the partner with an undivided interest in those permitted debt instruments.

"Regular interests" of a FASIT

Under the bill, "regular interests," including "high-yield interests," of a FASIT are treated as debt for Federal income tax purposes regardless of whether instruments with similar terms issued by non-FASITs might be recharacterized as equity under general tax principles. To be treated as a "regular interest," an instrument must have fixed terms and must (1) unconditionally entitle the holder to receive a specified principal amount, (2) pay interest that is based on one or more rates that are fixed or (to the extent permitted by Treasury regulations) variable if the FASIT would otherwise qualify as a REMIC and noncontingent payments in the case of any other FASIT, (3) have a term to maturity of no more than 30 years, except as permitted by Treasury regulations, (4) be issued to the public with a premium of not more than 25 percent of its stated principal amount, and (5) have a yield to maturity at issue of no more than 5 percentage points above the yield to maturity on outstanding marketable obligations of the United States Government having a comparable maturity.

A FASIT also may issue high-yield debt instruments, which includes any debt instrument issued by a FASIT that meets the second and third conditions described above, so long as such interests are not held by a disqualified holder. A disqualified holder generally is any holder other than (1) a domestic C corporation that does not qualify as a RIC or REIT or (2) a dealer who acquires FASIT debt for resale to customers in the ordinary course of business or whose interest represents loans made to finance customers' acquisition of goods and services from the dealer. A tax is imposed at the highest corporate rate on a dealer if there is a change in dealer status or if the holding of the instrument is for investment purposes. A 31-day grace period would be granted before ownership of an interest held by a dealer could be treated as held for investment purposes.

Permitted ownership holder

A permitted holder of the ownership interest in a FASIT generally is a non-exempt domestic C corporation, other than a corporation that qualifies as a RIC or REIT.

Transfers to non-permitted holders of high-yield and ownership interests

A transfer of an ownership interest or a high-yield interest to a disqualified holder, or a transfer of less than 100 percent of the ownership interest to a transferee, is to be ignored for Federal income tax purposes. Thus, such a transferor will continue to be liable for any taxes due with respect to the transferred interest.

Taxation of a FASIT

In general.

A FASIT generally is not subject to tax. Instead, all of the FASIT's income or loss is taxable directly to its owner. The taxable income of a FASIT generally is calculated as if it were a partnership using an accrual method of accounting. The constant yield method and principles that apply for purposes of determining OID accrual on debt obligations whose principal is subject to acceleration apply to all debt obligations held by a FASIT to calculate the FASIT's interest and discount income and premium deductions or adjustments. For this purpose, a FASIT's income does not include any income subject to the 100-percent tax on nonpermitted income and a deduction is allowed for the corporate tax paid on income from foreclosure property.

Income from foreclosure property

A FASIT is subject to tax at the highest corporate rate on net income from any foreclosure property that was acquired in connection with the default or imminent default of a permitted debt obligation. For this purpose, property is foreclosure property if it would be foreclosure property to a REIT, determined without the special rules for leased property or property under construction (sec. 856(e)(4)). Foreclosure property does not include property acquired pursuant to a security interest that was created for the principal purpose of having the FASIT acquire such property.

Income from prohibited transactions

In addition to any tax on foreclosure property, a FASIT is required to pay a tax equal to 100 percent of net income derived from

(1) an asset that is not a permitted asset, (2) any disposition of an asset other than a permitted disposition, (3) any trade or business other than the acquisition, holding, or processing of existing debt obligations or processing payments received on permitted instruments and making distributions to holders of interests in the FASIT, (4) compensation for services, and (5) foreclosure property if the debt obligation in connection with which the property was obtained was acquired for the purpose of obtaining the property. A permitted disposition is a qualified liquidation or any disposition incident to the foreclosure, default, or imminent default of the asset, incident to the bankruptcy or insolvency of the FASIT, or necessary to avoid a default on any indebtedness of the FASIT attributable to a default (or imminent default) on an asset of the FASIT, or to facilitate a clean-up call.

Taxation of interests in the FASIT

Taxation of holders of regular interests

In general.—A holder of a regular interest, including a high-yield interest, is taxed in the same manner as a holder of any other debt instrument, except that the regular interest holder is required to account for income relating to the interest on an accrual method of accounting, regardless of the method of accounting otherwise used by the holder.

High-yield interests.—Holders of high-yield interests are not allowed to use net operating losses to offset any income derived from the high-yield debt. Any net operating loss carryover shall be computed by disregarding any income arising by reason of the disallowed loss.

In addition, a transfer of a high-yield interest to a disqualified holder is not recognized for Federal income tax purposes such that the transferor will continue to be taxed on the income from the high-yield interest unless the transferee provides the transferor with an affidavit that the transferee is not a disqualified person or the Treasury Secretary determines that the high-yield interest is no longer held by a disqualified person and a corporate tax has been paid on the income from the high-yield interest while it was held by a disqualified person. High-yield interests may be held by certain persons without a corporate tax being imposed on the income from the high-yield interest where the interest is held (1) by a dealer in goods and services and the permitted debt instruments in the FASIT exclusively were loans made by a dealer in the ordinary course of his business to finance the dealers goods or services or (2) by a dealer in securities who acquired such high-yield interest for sale in the ordinary course of his business as a securities dealer. In the later case, a corporate tax is imposed on such a dealer if his reason for holding the high-yield interest changes to investment. There is a presumption that the dealer has not changed his intent for holding high-yield instruments to investment for the first 31 days he holds such interests unless such holding is part of a plan to avoid the restriction on holding of high-yield interests by disqualified persons.

Taxation of holder of ownership interest

The holder of a FASIT ownership interest takes into account the FASIT's taxable income or net loss for the taxable year. The FASIT is required to have the same taxable year as the owner of the ownership interest. The character, source, and other attributes of the income to the holder of an ownership interest is determined as if the income had been earned by a partnership, except tax-exempt interest is taken into income of the holder as ordinary income.

A portion of any net loss of a FASIT may be taken into account by the holder of the ownership interests to the extent of its adjusted basis in the interest. Disallowed losses may be carried forward by the holder. A special rule provides that the holder of a FASIT ownership interest cannot offset income from the FASIT ownership interest with any other losses. Any net operating loss carryover shall be computed by disregarding any income arising by reason of disallowed loss.

For purposes of the alternative minimum tax, the owner's taxable income is determined without regard to the minimum FASIT income. The alternative minimum taxable income of the FASIT owner cannot be less than the FASIT income for that year, and the alternative minimum tax net operating loss deduction is computed without regard to the minimum FASIT income..

Transfers to and distributions from FASITs

Gain or loss generally is recognized immediately by the owner of the FASIT upon the transfer of assets to a FASIT. However, to the extent provided by Treasury regulations, gain recognition on the contributed assets may be deferred until such assets support regular interests issued by the FASIT or any indebtedness of the owner. In addition, any assets of the FASIT owner or a related person that are used to support FASIT regular interests also are treated as sold at the earliest date that such assets support of the FASIT's regular interests. For these purposes, the value of contributed assets generally is the present value of the reasonably expected cash flows from such assets discounted over the weighted average life of such assets. The discount rate is 130 percent of the applicable Federal rate. For purposes of determining the value of a pool of revolving loan accounts having substantially the same terms, each extension of credit is treated as a separate debt instrument and the maturity of the instruments is determined using the reasonably anticipated periodic payment rate at which principal payments will be made as a proportion of their aggregate outstanding principal balances.

A distribution of assets by a FASIT with respect to a regular or ownership interest generally is treated as a sale of the assets and distribution of the sale proceeds. In addition, a distribution by a FASIT with respect to an ownership interest generally is not included in gross income by the holder to the extent that the distribution does not exceed the adjusted basis of the holder's interest, and is treated as gain from the sale or exchange of the interest to the extent it exceeds the adjusted basis of the interest.

The basis of any holder's ownership interest in a FASIT is increased by any money (and the value of any property) contributed by the holder and the amount of the taxable income taken into account by the holder from the FASIT with respect to the interest. The basis is decreased by the amount of any distributions to the holder, the amount of any deductions taken into account by the holder, and the amount of any losses taken into account by the holder with respect to the interest.

Related person

For purposes of the FASIT rules, a person is related to another person if that person bears a relationship to the other person specified in sections 267(b) or 707(b)(1), using a 20 percent ownership test instead of 50 percent test or such persons are engaged in trades or businesses under common control as determined under sections 52(a) or (b),

Effective Date

The provisions take effect on the date of their enactment.

20. Treatment of contributions in aid of construction for water utilities (sec. 12861(a) of the bill and sec. 118 of the Code)

Present and Prior Law

The gross income of a corporation does not include contributions to its capital. A contribution to the capital of a corporation does not include any contribution in aid of construction or any other contribution as a customer or potential customer.

Prior to the enactment of the Tax Reform Act of 1986 ("1986 Act"), 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 a tax-free contribution to its capital 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 basis of any property acquired with a contribution in aid of construction was zero.

If the contribution was in property other than electric energy, gas, steam, water, or sewerage disposal facilities, such contribution was not includible in the utility's gross income so long as: (1) an amount at least equal to the amount of the contribution was expended for the acquisition or construction of tangible property that 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 these contributions.

These rules were repealed by the 1986 Act. Thus, after the 1986 Act, the receipt by a utility of a contribution in aid of construction is includible in the gross income of the utility, and the basis of property received or constructed pursuant to the contribution is not reduced.

Reasons for Change

The Committee believes that the changes made by the 1986 Act with respect to the treatment of contributions in the aid of construction to water utilities may inhibit the development of certain communities and the modernization of water and sewerage facilities.

Explanation of Provision

The bill restores the contributions in aid of construction provisions that were repealed by the 1986 Act for regulated public utilities that provide water or sewerage disposal services.

Effective Date

The provision is effective for amounts received after the date of enactment.

21. Require water utility property to be depreciated over 25 years (sec. 12861(b) of the bill and sec. 168 of the Code)

Present Law

Property used by a water utility in the gathering, treatment, and commercial distribution of water and municipal sewers are depreciated over a 20-year period for regular tax purposes. The depreciation method generally applicable to property with a recovery period of 20 years is the 150-percent declining balance method (switching to the straight-line method in the year that maximizes the depreciation deduction). The straight-line method applies to property with a recovery period over 20 years.

Reasons for Change

The Committee believes that it is appropriate to extend the depreciable life of water utility property given the exception provided under the bill for contributions in aid of construction of water utility companies and the long useful lives generally exhibited by such property.

Explanation of Provision

The bill provides that water utility property will be depreciated using a 25-year recovery period and the straight-line method for regular tax purposes. For this purpose, "water utility property" means (1) property that is an integral part of the gathering, treatment, or commercial distribution of water, and that, without regard to the proposal, would have had a recovery period of 20 years and (2) any municipal sewer. Such property generally is described in Asset Classes 49.3 and 51 of Revenue Procedure 87–56, 1987–2 C.B. 674. The bill does not change the class lives of water utility property for purposes of the alternative depreciation system of section 168(g).

Effective Date

The provision is effective for property placed in service after the date of enactment, other than property placed in service pursuant to a binding contract in effect on such date and at all times thereafter before the property is placed in service.

22. Allow amortization for intrastate operating rights of motor carriers (sec. 12862 of the bill)

Present Law and Background

A taxpayer is allowed to write-off and deduct the adjusted basis of property used in trade or business when such property becomes worthless (sec. 165). A deduction is not allowed if the property merely loses value but does not become worthless. For example, in *CRST, Inc.*, 909 F2d. 1146 (8th Cir. 1990), a motor carrier was denied a worthlessness deduction for the basis of operating authorities that had become less valuable, but not worthless, due to deregulation.

Effective January 1, 1995, section 601 of the Federal Aviation Administration Authorization Act of 1994 preempts and prohibits State regulation of the price, route, or service of intrastate operations of motor carriers. In 1980, Congress similarly deregulated the operation of interstate motor carriers. Pursuant to section 266 of the Economic Recovery Tax Act of 1981, Congress allowed taxpayers who held operating authorities as of the effective date of such deregulation to amortize the adjusted basis of the authorities over a 60-month period.

Reasons for Change

The Committee believes that as a result of the Federal Aviation Administration Authorization Act of 1994, certain intrastate motor operating authorities may have lost significant value. Under present law, a taxpayer holding such authority as of the date of deregulation may or may not be able to claim a tax deduction to reflect this loss of value. In order to avoid disputes between taxpayers and the IRS as to whether or not these authorities have become completely worthless and thus subject to a current deduction, the Committee provides amortization deductions similar to those provided when interstate trucking was deregulated.

Explanation of Provision

The bill allows a taxpayer who held, on January 1, 1995, one or more operating authorities that were preempted by section 601 of the Federal Aviation Administration Authorization Act of 1994, to amortize the aggregate adjusted bases of such authorities ratably (i.e., on straight-line basis) over the 36-month period beginning January 1, 1995. The amortization deductions provided under the bill are treated as depreciation deductions for purposes of the Internal Revenue Code (e.g., for purposes of the carryover of attributes rules of sec. 381, the basis adjustment rules of sec. 1016, and the recapture rules of sec. 1245).

It is anticipated that no other deduction (e.g., an abandonment deduction under sec. 165) would be allowed with respect to such property to the extent the taxpayer remains in a trade or business involving trucking.[94]

Effective Date

The provision is effective for taxable years ending on or after January 1, 1995.

23. Establish 15-year recovery period for retail motor fuel outlet stores (sec. 12863 of the bill and sec. 168 of the Code)

Present Law

Under present law, property used in the retail gasoline trade is depreciated under section 168 using a 15-year recovery period and the 150-percent declining balance method. Nonresidential real property (such as a convenience store) is depreciated using a 39-year recovery period and the straight-line method. It is understood that taxpayers generally have taken the position that convenience stores and other structures installed at motor fuel retail outlets have a 15-year recovery period.[95] The IRS, in a position described in a recent Coordinated Issues Paper, generally limits the application of the 15-year recovery period to instances where the structure (1) is 1,400 square feet or less or (2) meets a 50-percent test. The 50-percent test is met if : (1) 50 percent or more of the gross revenues that are generated from the building are derived from petroleum sales and (2) 50 percent or more of the floor space in the building is devoted to petroleum marketing sales.

Reasons for Changes

The Committee believes that the position taken by the IRS with respect to certain structures installed at motor fuel retail outlets is contrary to the historical treatment of such property. The Committee bill seeks to clarify (and restore) the treatment of such property.

Explanation of Provision

The bill provides that 15-year property includes any section 1250 property (generally, depreciable real property) that is a retail motor fuel outlet (whether or not food or other convenience items are sold at the outlet). A retail motor fuel outlet does not include any facility related to petroleum or natural gas trunk pipelines or to any section 1250 property used only to an insubstantial extent in the retail marketing of petroleum or petroleum products. For example, it is intended that a convenience store may not qualify as 15-year property merely by installing a few gasoline pumps at the location.

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[94] See, for example, private letter ruling 8240017, June 30, 1982, which disallowed a loss deduction for abandonment of interstate operating authorities of a taxpayer that remained in the interstate trucking business. Amortization deductions had been allowed for such authorities pursuant to section 266 of the Economic Recovery Tax Act of 1981.

[95] This position apparently is based on Rev. Proc. 87-56, 1987-2 C.B. 674, which provides that 15-year property includes property described in Asset Class 57.1, which "(i)includes section 1250 assets, including service station buildings and depreciable land improvements, whether section 1245 property or section 1250 property, used in the marketing of petroleum and petroleum products, but not including any of these facilities related to petroleum or natural gas trunk pipelines."

Effective Date

The provision is effective for property placed in service before, on, or after the date of enactment and to which the amendments made by section 201 of the Tax Reform Act of 1986 apply (i.e., property subject to the modified Accelerated Cost Recovery System of sec. 168). The taxpayer may elect to forego the application of the provision for any property placed in service prior to the date of enactment.

24. Application of failure-to-pay penalty to substitute returns (sec. 12871 of the bill and sec. 6651 of the Code)

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.

Reasons for Change

Under the current penalty system, there is an inequity between voluntarily filed delinquent returns and substitute returns. Taxpayers who file delinquent returns must pay a failure to file penalty from the due date of the return, whereas the taxpayer who forces the IRS to utilize a substitute return is not assessed the penalty until billed by the IRS.

Explanation of Provision

The 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.

25. Repeal exemption for withholding on gambling winnings from bingo and keno where proceeds exceed $5,000 (sec. 12872 of the bill and sec. 3402(q) of the Code)

Present Law

In general, proceeds from a wagering transaction are subject to withholding at a rate of 28 percent if the proceeds exceed $5,000 and are at least 300 times as large as the amount wagered. The proceeds from a wagering transaction are determined by subtracting the amount wagered from the amount received. Any non-monetary proceeds that are received are taken into account at fair market value.

In the case of sweepstakes, wagering pools, or lotteries, proceeds from a wager are subject to withholding at a rate of 28 percent if the proceeds exceed $5,000, regardless of the odds of the wager.

No withholding tax is imposed on winnings from bingo or keno.

Reasons for Change

The Committee believes that imposing withholding on winnings from bingo and keno will improve tax compliance.

Explanation of Provision

The bill imposes withholding on proceeds from bingo or keno wagering transactions at a rate of 28 percent if such proceeds exceed $5,000, regardless of the odds of the wager.

Effective Date

The provision is effective on January 1, 1996.

26. Treatment of certain gains and losses of life insurance companies under section 818(b) (sec. 12873 of the bill and sec. 818(b) of the Code)

Present Law

In the case of a taxpayer that is a corporation, losses from the sale or exchange of a capital asset generally are allowed only to the extent of gains from such sales or exchanges (sec. 1211(a)). A loss on the sale or exchange of property used in the trade or business of the taxpayer, however, is treated as an ordinary loss, rather than as a loss from the sale or exchange of a capital asset (secs. 1221(2)). In addition, if losses from property used in the trade or business equal or exceed a taxpayer's gains from such property, then the gains and losses are treated as ordinary (sec. 1231).

A special limitation on ordinary loss treatment applies in the case of a life insurance company, under section 818(b). Section 818(b) provides that property used in the trade or business includes only property used in carrying on an insurance business. Thus, for example, a loss on the sale or exchange of real estate that is held by a life insurance company and that is not used in the insurance business is treated as a capital loss, and is allowed only to the extent of the taxpayer's capital gain.

Reasons for Change

The Committee believes that treating life insurance companies differently than other companies with respect to losses from property used in the trade or business is no longer justified. While the present-law rule was appropriate in the context of the three-phase system of taxation of life insurance companies prior to 1984, the limitation is no longer appropriate because investment income of life insurance companies is no longer subject to that unique regime. Further, the Committee has been made aware that life insurance companies may have an unusually large amount of unrealized losses from foreclosed real estate acquired as a result of downturns in real estate values. Nevertheless, the Committee is concerned that complete repeal of capital loss treatment for trade or business not used in the insurance business may provide excessive benefits to one sector of the economy. In addition, the Committee understands that life insurance companies are able to selectively realize capital gains from sales of assets such as bonds to offset losses treated as capital under present law. As a result, the Committee bill provides for a partial repeal of the rule with respect only to foreclosed real estate, and requires the ordinary loss to be spread over a period of years following the year of the disposition.

Explanation of Provision

Under the bill, capital loss treatment under present-law section 818(b) does not apply to 85 percent of a life insurance company's losses from the sale or exchange of foreclosed real estate. Losses from such property are treated as ordinary losses allowable in equal amounts over each of the first 10 taxable years following the year of disposition. Present-law capital loss treatment under section 818(b) is retained for the remaining 15 percent of such losses. Foreclosure property means real property used in the trade or business that is acquired by a life insurance company as the result of (1) such company having bid on such property at foreclosure, or (2) such company having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default (or default was imminent) on indebtedness which such property secured.

Effective Date

The provision is effective for taxable years beginning after December 31, 1994.

27. Coal industry retiree health equity (sec. 12874 of the bill and sec. 9704 of the Code)

Present Law

The financing of retiree health benefits previously provided by the United Mine Workers of America ("UMWA") 1950 and 1974 Benefit Funds was substantially revised by the Energy Policy Act of 1992 (H.R. 776, P.L. 102-486), enacted October 24, 1992. The relevant provisions, contained in the Coal Industry Retiree Health Benefit Act of 1992 (the "Coal Act"), created two new UMWA retiree health benefit funds and completely changed the financing mechanism. The two funds, known as the UMWA Combined Benefit Fund and the UMWA 1992 Benefit Plan, service beneficiaries who retired on or before September 30, 1994. No provision was made for employees who retired or will retire after September 30, 1994. Future retirees will remain dependent on the provisions of future collective bargaining agreements.

Under the Coal Act, which supersedes the retiree health benefits financing provisions of the 1988 National Bituminous Coal Wage Agreement ("NBCWA"), a company is charged an insurance premium based on the number of beneficiaries assigned to the company in its role as the retiree's "last signatory employer." Under what are referred to as the "reachback" provisions of the Coal Act, companies responsible for paying premiums include any company that had signed any NBCWA since 1946 or any related company as defined under the Act. To cover the costs associated with beneficiaries who cannot be assigned, up to $70 million per year is transferred into the Combined Fund. The first three transfers came from the surplus in the UMWA 1950 Pension Plan. Subsequent transfers will be made from the interest earnings of the Federal Abandoned Mine Reclamation Fund. If costs for unassigned beneficiaries exceed the annual transfer, they can be allocated to the signatory and reachback companies in proportion to their share of assigned beneficiaries.

The per beneficiary insurance premium is calculated each year by the Commissioner of the Social Security Administration. The dollar amount is based on the actual per capita net expenses of the 1950 and 1974 Benefit Funds in fiscal year 1992, indexed by the net increase in the medical component of the consumer price index. The insurance premium can be increased to offset any cuts in Medicare benefits.

Reasons for Change

Absent the provisions of the Coal Act, the 1988 signatory companies would be paying 100 percent of the expenses of the UMWA retiree health benefit funds. Because of the Coal Act, the 1988 signatories will contribute approximately 38 percent of the income of the Combined Fund for the fund year ending September 30, 1995. (Premiums paid by the reachback companies will account for approximately 24 percent, the transfer from the UMWA Pension Fund 32 percent, and the investment income of the accumulated assets of the Fund 6 percent.)

Many of the companies left the bituminous coal business and the bargaining agreement under the accepted terms of the agreement, at a time when the health benefit funds were not in financial difficulty. Now, decades later, they are held responsible for contributing.

The Committee believes it is appropriate to provide limited relief to companies that were not signatories to the 1988 Agreement to the extent of any surplus in the Combined Fund for the period beginning October 1, 1995, through September 30, 1997.

Explanation of Provision

The bill provides relief to reachback companies by reducing their insurance premiums required to be paid to the Combined Fund for the period beginning October 1, 1995, through September 30, 1997, to the extent of any surplus in the Combined Fund. Under the bill, the determination of whether the Combined Fund has any surplus is made by the trustees at the end of each fund year on a cash basis. The amount of any surplus is reduced by an amount equal to 10 percent of the benefits and administrative costs paid by the Combined Fund for the plan year and is determined without regard to amounts transferred to the Combined Fund from the UMWA 1950 Pension Fund and Federal Abandoned Mine Reclamation Fund. Any remaining surplus will be used to provide insurance premium relief to the reachback companies.

The bill also fixes the actual per capita net expenses of the 1950 and 1974 Benefit Funds in fiscal year 1992 at $2,116.67 per beneficiary.

Effective Date

The provision applies to Combined Fund years beginning after September 30, 1995.

28. Clarify treatment of newspaper distributors and carriers as direct sellers (sec. 12875 of the bill and sec. 3508)

Present Law

For Federal tax purposes, there are two classifications of workers: a worker is either an employee of the service recipient or an independent contractor. Significant tax consequences result from the classification of a worker as an employee or independent contractor. These differences relate to withholding and employment tax requirements, as well as the ability to exclude certain types of compensation from income or take tax deductions for certain expenses. Some of these consequences favor employee status, while others favor independent contractor status. For example, an employee may exclude from gross income employer-provided benefits such as pension, health, and group-term life insurance benefits. On the other hand, an independent contractor can establish his or her own pension plan and deduct contributions to the plan. An independent contractor also has greater ability to deduct work-related expenses.

Under present law, the determination of whether a worker is an employee or an independent contractor is generally made under a 20-factor common-law facts and circumstances test that seeks to determine whether the service provider is subject to the control of the service recipient, not only as to the nature of the work performed, but the circumstances under which it is performed. Under a special safe harbor rule (sec. 530 of the Revenue Act of 1978), a service recipient may treat a worker as an independent contractor for employment tax purposes even though the worker is an employee under the common-law test if the service recipient has a reasonable basis for treating the worker as an independent contractor and certain other requirements are met.

In addition to the 20-factor common-law test, there are also some persons who are treated by statute as either employees or independent contractors. For example, "direct sellers" are deemed to be independent contractors. A direct seller is a person engaged in the trade or business of selling consumer products in the home or otherwise than in a permanent retail establishment, if substantially all the remuneration for the performance of the services is directly related to sales or other output rather than to the number of hours worked, and the services performed by the person are performed pursuant to a written contract between such person and the service recipient and such contract provides that the person will not be treated as an employee for Federal tax purposes.

The newspaper industry has generally taken the position that newspaper distributors and carriers should be treated as direct sellers for income and employment tax purposes. The Internal Revenue Service has generally taken the position that the direct seller rules do not apply to newspaper distributors and carriers operating under an agency distribution system (i.e., where the publisher retains title to the newspapers).

Reasons for Change

The Committee recognizes that there are presently numerous disputes between newspaper distributors and carriers and the Internal Revenue Service regarding the treatment of newspaper distributors and carriers as direct sellers. The Committee believes that in the vast majority of these cases the newspaper distributors and carriers should properly be treated as direct sellers. Consequently, in order to avoid further disputes, the Committee wishes to clarify on a prospective basis the treatment of qualifying newspaper distributors and carriers as direct sellers.

Description of Proposal

The bill clarifies the treatment of qualifying newspaper distributors and carriers as direct sellers. Under the bill, a person engaged in the trade or business of the delivery or distribution of newspapers or shopping news (including any services that are directly related to such trade or business such as solicitation of customers or collection of receipts) qualifies as a direct seller, provided substantially all the remuneration for the performance of the services is directly related to sales or other output rather than to the number of hours worked, and the services performed by the person are performed pursuant to a written contract between such person and the service recipient and such contract provides that the person will not be treated as an employee for Federal tax purposes. The provision is intended to apply to newspaper distributors and carriers whether or not they hire others to assist in the delivery of newspapers. The provision also applies to newspaper distributors and carriers operating under either a buy-sell distribution system (i.e., where the newspaper distributors or carriers purchase the newspapers from the publisher) or an agency distribution system. For example, newspaper distributors and carriers operating under an agency distribution system who are paid based on the number of papers delivered and have an appropriate written agreement qualify as direct sellers. The status of newspaper distributors and carriers who do not qualify as direct sellers under the proposal continue to be determined under present-law rules. The Committee intends no inference with respect to the employment status of newspaper distributors and carriers prior to the effective date of the provision.

Effective Date

The provision is effective with respect to services performed after December 31, 1995.

29. Allow bank common trust funds to transfer assets to regulated investment companies without taxation (sec. 12876 of the bill and sec. 584 of the Code)

Present Law

Common trust funds

A common trust fund is a fund maintained by a bank exclusively for the collective investment and reinvestment of monies 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 an interest. Withdrawals from the fund generally are treated as the sale of an interest by the participant (sec. 584(e)).

Regulated investment companies (RICs)

A RIC also is treated as a conduit for Federal income tax purposes. Conduit treatment is accorded by allowing the RIC a deduction for dividend distributions to its shareholders. Present law is unclear as to the tax consequences when a common trust fund transfers its assets to one or more RICs.

Reasons for Change

The Committee understands that administrative costs of managing pools of assets can be reduced for many banks if the bank utilizes the expertise of professional investment managers employed at mutual funds rather than attempting to duplicate the same investment management services within the bank. The Committee further recognizes that generally both common trust funds and mutual funds seek broad diversification of the assets contributed by the investors in the common trust fund or the mutual fund. Because both the common trust fund and the mutual fund are conduit entities for Federal income tax purposes, the Committee believes that it would be inappropriate to impose a tax when the common trust fund transfers substantially all of its assets to one or more RICs, because only the form of the investment pool has been changed.

Explanation of Provision

In general, the bill permits a common trust fund to transfer substantially all of its assets to one or more RICs without gain or loss being recognized by the fund or its participants. The fund must transfer its assets to the RICs solely in exchange for shares of the RICs, 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 a RIC will be the basis of the asset in the hands of the fund prior to transfer (increased by the amount of gain recognized by reason of the rule regarding the assumption of liabilities). In addition, the basis of any RIC shares ("converted shares") that are received by a fund participant will be an allocable portion of the participant's basis in the interests exchanged. If stock in more than one RIC is received in a conversion, the basis of each RIC shall be determined by allocating the basis of common fund interests used in the exchange among each RIC received in the conversion on the basis of the respective fair market values of the RICs. For example, assume a common trust fund with basis of $100 and market value of $1,000 transfers its assets to two RICs, receiving $600 worth of shares in the first RIC and $400 worth of shares in the second RIC. The basis of first RIC shares will be $600 multiplied by $100 divided by $1,000, or $60.

The tax-free transfer is not available to a common trust fund with assets that are not diversified under the requirements of section 368(a)(2)(F)(ii), except that the diversification test is modified so that Government securities are not to be included as securities of an issuer and are to be included in determining total assets for purposes of the 25- and 50-percent tests.

No inference is intended as to the tax consequences under present law when a common trust fund transfers its assets to one or more RICs.

Effective Date

The provision is effective for transfers after December 31, 1995.

30. Treatment of certain insurance contracts on retired lives (sec. 12877 of the bill and sec. 817(d) of the Code)

Present Law

Life insurance companies are allowed a deduction for any net increase in reserves and are required to include in income any net decrease in reserves. The reserve of a life insurance company for any contract is the greater of the net surrender value of the contract or the reserve determined under Federally prescribed rules. In no event, however, may the amount of the reserve for tax purposes for any contract at any time exceed the amount of the reserve for annual statement purposes.

Special rules are provided in the case of a variable contract. Under these rules, the reserve for a variable contract is adjusted by (1) subtracting any amount that has been added to the reserve by reason of appreciation in the value of assets underlying such contract, and (2) adding any amount that has been subtracted from the reserve by reason of depreciation in the value of assets underlying such contract. In addition, the basis of each asset underlying a variable contract is adjusted for appreciation or depreciation to the extent the reserve is adjusted.

A variable contract generally is defined as any annuity or life insurance contract (1) that provides for the allocation of all or part of the amounts received under the contract to an account that is segregated from the general asset accounts of the company, and (2) under which, in the case of an annuity contract, the amounts paid in, or the amounts paid out, reflect the investment return and the market value of the segregated asset account, or, in the case of a life insurance contract, the amount of the death benefit (or the period of coverage) is adjusted on the basis of the investment return and the market value of the segregated asset account. A pension plan contract that is not a life, accident, or health, property, casualty, or liability insurance contract is treated as an annuity contract for purposes of this definition.

Reasons for Change

The Committee believes that certain contracts which provide insurance on retired lives should be treated as variable contracts in order to simplify the treatment of such contracts and to provide a more accurate measure of the income of life insurance companies with respect to such contracts.

Explanation of Provision

The bill provides that a variable contract is to include a contract that provides for the funding of group term life or group accident and health insurance on retired lives if: (1) the contract provides for the allocation of all or part of the amounts received under the contract to an account that is segregated from the general asset account of the company; and (2) the amounts paid in, or the amounts paid out, under the contract reflect the investment return and the market value of the segregated asset account underlying the contract.

Thus, the reserve for such a contract is to be adjusted by (1) subtracting any amount that has been added to the reserve by reason of appreciation in the value of assets underlying such contract, and (2) adding any amount that has been subtracted from the reserve by reason of depreciation in the value of assets underlying such contract. In addition, the basis of each asset underlying the contract is to be adjusted for appreciation or depreciation to the extent that the reserve is adjusted.

Effective Date

The provision applies to taxable years beginning after December 31, 1995.

31. Treatment of modified guaranteed contracts (sec. 12878 of the bill and new sec. 817A of the Code)

Present Law

Life insurance companies are allowed a deduction for any net increase in reserves and are required to include in income any net decrease in reserves. The reserve of a life insurance company for any contract is the greater of the net surrender value of the contract or the reserve determined under Federally prescribed rules.

The net surrender value of a contract is the cash surrender value reduced by any surrender penalty, except that any market value adjustment required on surrender is not taken into account. In no event, however, may the amount of the reserve for tax purposes for any contract at any time exceed the amount of the reserve for annual statement purposes.

In general, assets held for investment are treated as capital assets. Any gain or loss from the sale or exchange of a capital asset is treated as a capital gain or loss and is taken into account for the taxable year in which the asset is sold or exchanged.

Reasons for Change

Life insurance companies have recently begun issuing annuity contracts, life insurance contracts, and pension plan contracts that provide for a guaranteed interest rate for a specified period of time and a market value adjustment in the event that the owner of the contract surrenders the contract for cash prior to the end of the guaranteed interest period. These contracts are commonly referred to as modified guaranteed contracts.

If the premium or other consideration received under a modified guaranteed contract is allocated to an account that is segregated from the general asset accounts of the life insurance company, then the reserve for the contract and the assets in the segregated account generally are required to be taken into account at market value for annual statement purposes. For Federal income tax purposes, the reserve for a modified guaranteed contract may reflect the market value adjustment, while the market fluctuations in the assets underlying the contract are not taken into account unless the assets are disposed of.

The Committee considers it appropriate to conform the Federal income tax treatment of modified guaranteed contracts with the annual statement treatment of such contacts in order to simplify the accounting for such contracts and to provide a more accurate measure of the income of life insurance companies with respect to such contracts.

Explanation of Provision

The bill generally applies a mark-to-market regime to assets held as part of a segregated account under a modified guaranteed contract issued by a life insurance company. Gain or loss with respect to such assets held as of the close of any taxable year are taken into account for that year (even though the assets have not been sold or exchanged),[96] and are treated as ordinary. If gain or loss is taken into account by reason of the mark-to-market requirement, then the amount of gain or loss subsequently realized as a result of sale, exchange, or other disposition of the asset, or as a result of the application of the mark-to-market requirement is appropriately adjusted to reflect such gain or loss. In addition, the reserve for a modified guaranteed contract is determined by taking

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[96] The wash sale rules of section 1091 of the Code are not to apply to any loss that is required to be taken into account solely by reason of the mark-to-market requirement.

into account the market value adjustment required on surrender of the contract.

A modified guaranteed contract is defined as any life insurance contract, annuity contract or pension plan contract[97] that is not a variable contract (within the meaning of Code section 817), and that satisfies the following requirements. All or a part of the amounts received under the contract must be allocated to an account which, pursuant to State law or regulation, is segregated from the general asset accounts of the company and is valued from time to time by reference to market values.

The reserves for the contract must be valued at market for annual statement purposes and the Federally prescribed reserve for the contract under section 807(d)(2) must be valued at market. For this purpose, reserves are valued at market if they are calculated using a current market rate of interest, as of the reserve valuation date, that is appropriate for the obligations under the contract to which the reserve relates.

Further, a modified guaranteed contract includes only a contract that provides either for a net surrender value or for a policyholder's fund (within the meaning of section 807(e)(1)). It is intended that a policyholder's fund be more than de minimis. For example, Treasury regulations could provide that a policyholder's fund that represents 15 percent or less of the insurer's reserve for the contract under section 807, and that is attributable to employee contributions, would be considered de minimis.

If only a portion of the contract is not described in section 817, that portion is treated as a separate contract for purposes of the provision.

The Treasury Department is authorized to issue regulations that provide for the application of the mark-to-market requirement at times other than the close of a taxable year or the last business day of a taxable year. The Treasury Department is also authorized to issue such regulations as may be necessary or appropriate to carry out the purposes of the provision and to provide for the treatment of modified guaranteed contracts under sections 72, 7702, and 7702A. In addition, the Treasury Department is authorized to determine the interest rates applicable under sections 807(c)(3), 807(d)(2)(B) and 812 with respect to modified guaranteed contracts annually, calculating such rates as appropriate for modified guaranteed contracts. For example, it may be appropriate to take into account the yield on the assets underlying the contract in determining such rates. The Treasury Department may exercise this authority by issuing a periodic announcement of the appropriate market interest rates. The Treasury Department is also authorized, to the extent appropriate for such a contract, to modify or waive section 811(d).

The Treasury Department is also authorized to provide rules limiting the ordinary treatment provided under the provision to gain or loss on those assets properly taken into account in calculating the reserve for Federal tax purposes (and necessary to support such reserves) for modified guaranteed contracts, and to provide rules

[97] The provision applies only to a pension plan contract that is not a life, accident or health, property, casualty, or liability contract.

for limiting such treatment with respect to other assets (such as assets representing surplus of the company). Particular concern has been expressed about characterization of gain or loss as ordinary under the provision in transactions that would otherwise either (1) have to meet the requirements of the hedging exception to the straddle rules to receive this treatment, or (2) be treated as capital transactions under present law. It is intended that the mark-to-market treatment apply to all assets held as part of a segregated account established under the provision, even though ordinary treatment may not apply (pursuant to Treasury regulatory authority) to assets held as part of the segregated account that are not necessary to support the reserve for modified guaranteed contracts.

The bill authorizes the Treasury Department to prescribe regulations that provide for the treatment of assets transferred to or from a segregated account. This regulatory authority is provided because of concern that taxpayers may exercise selective ordinary loss (or income or gain) recognition by virtue of the ordinary treatment under the provision. One example of selective ordinary loss recognition could arise if assets are always marked to market when transferred out of the segregated account. For example, if at the beginning of the taxable year an asset in the segregated account is worth $1,000, but declines to $900 in July, the taxpayer might choose to recognize $100 of ordinary loss while continuing to own the asset, simply by transferring it out of the segregated account in July and replacing $1,000 of cash (for example) in the segregated account.

It is intended that the regulations relating to asset transfers will forestall opportunities for selective recognition of ordinary items. Prior to the issuance of these regulations, the following rules shall apply.

If an asset is transferred to a segregated account, gain or loss attributable to the period during which the asset was not in the segregated account is taken into account when the asset is actually sold, and retains the character (as ordinary or capital) properly attributable to that period. Appropriate adjustments are made to the basis of the asset to reflect gain or loss attributable to that period.

If an asset is transferred out of a segregated account, the transfer is deemed to occur on the last business day of the taxable year and gain or loss with respect to the transferred asset is taken into account as of that day. Loss with respect to such transferred asset is treated as ordinary to the extent of the lesser of (1) the loss (if any) that would have been recognized if the asset had been sold for its fair market value on the last business day of the taxable year (or the date the asset was actually sold by the taxpayer, if earlier) or (2) the loss (if any) that would have been recognized if the asset had been sold for its fair market value on the date of the transfer. A similar rule applies for gains. Proper adjustment is made in the amount of any gain or loss subsequently realized to reflect gain or loss under the provision.

For example, assume that a capital asset in the segregated account that is worth $1,000 at the beginning of the year is transferred out of the segregated account in July at a value of $900, is retained by the company and is worth $950 on the last business day of the taxable year. A $50 ordinary loss is taken into account with respect to the asset for the taxable year (the difference between $1,000 and $950). The asset is not marked to market in any subsequent year under the provision, provided that it is not transferred back to the segregated account.

As an additional example, assume that a capital asset in the segregated account that is worth $1,000 at the beginning of the year is transferred out of the segregated accounted in July at a value of $900, is retained by the company and continues to decline in value to $850 on the last business day of the taxable year. A $100 ordinary loss ($1,000 less $900) and a $50 capital loss ($900 less $850) is taken into account with respect to the asset for the taxable year.

Effective Date

The provision applies to taxable years beginning after December 31, 1995. A taxpayer that is required to (1) change its calculation of reserves to take into account market value adjustments and (2) mark to market its segregated assets in order to comply with the requirements of the provision is treated as having initiated changes in method of accounting and as having received the consent of the Treasury Department to make such changes.

The section 481(a) adjustments required by reason of the changes in method of accounting are to be combined and taken into account as a single net adjustment for the taxpayer's first taxable year beginning after December 31, 1995.

Subtitle J. Pension Simplification

A. Simplification of Nondiscrimination Provisions

1. Definition of highly compensated employees (sec. 12901 of the bill and secs. 401(a)(17), 404(l), and 414(q) of the Code)

Present Law

For purposes of the rules applying to qualified retirement plans under the Code, an employee, including a self-employed individual, generally 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 $100,000 (for 1995) in annual compensation from the employer; (3) received more than $66,000 (for 1995) 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 $60,000 (for 1995). If, for any year, no officer has compensation in excess of $60,000 (for 1995), then the highest paid officer of the employer for such year is treated as a highly compensated employee. 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)).

Reasons for Change

Under present law, the administrative burden on plan sponsors to determine which employees are highly compensated can be significant. The various categories of highly compensated employees require employers to perform a number of calculations that for many employers have largely duplicative results.

Explanation of Provision

The bill 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 the preceding year, or (2) had compensation for the preceding year in excess of $80,000, or (3) was the most highly compensated officer of the employer for the preceding year. The $80,000 threshold is adjusted for cost-of-living increases in the same manner and at the same time as the limitations on contributions and benefits (sec. 415(d)) (using a base period ending September 30, 1996). The rule providing that the most highly compensated officer is a highly compensated employee does not apply to plans maintained by tax-exempt or State and local governmental organizations for purposes of applying the nondiscrimination tests applicable to 401(k) plans, employer matching contributions, and employee after-tax contributions.

Effective Date

The provision is effective for years beginning after December 31, 1996, except that in determining whether an employee is highly compensated for years beginning in 1997, the provision will be treated as in effect for years beginning in 1996.

2. Repeal of family aggregation rules (sec. 12901 of the bill and secs. 401(a)(17) of the Code)

Present Law

Treatment of family members

A special rule applies with respect to the treatment of family members of certain highly compensated employees for purposes of the nondiscrimination rules applicable to qualified plans. 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 $150,000 (for 1995) 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.

Reasons for Change

The family aggregation rules impose undue restrictions on the ability of a family-owned small business to provide adequate retirement benefits for all members of the family working for the business. In addition, the complexity of the calculations required under the family aggregation rules appears to be unnecessary in light of the numerous other provisions that ensure that qualified pension plans do not disproportionately favor highly compensated employees.

Explanation of Provision

The bill repeals the family aggregation rules.

Effective Date

The provision is effective for years beginning after December 31, 1995.

3. Definition of compensation for purposes of the limits on contributions and benefits (sec. 12902 of the bill and sec. 415 of the Code)

Present Law

Present law imposes limits on contributions and benefits under qualified plans based on the type of plan. In the case of a defined contribution plan, the annual additions to the plan with respect to each plan participants are limits to the lesser of (1) 25 percent of compensation, or (2) $30,000 (for 1995). The limit on the annual benefits payable by a defined benefit pension plan is generally the lesser of (1) 100 percent of average compensation for the three years in which it was highest, or (2) $120,000 (for 1995).

For purposes of these limits, present law provides that compensation generally does not include elective employee contributions to certain employee benefit plans.

Reasons for Change

The Committee believes that not treating employee elective contributions as compensation for purposes of the limits on benefits and contributions under qualified plans unduly restricts the amount that employees, particularly employees who are not highly compensated, can earn under qualified plans.

Explanation of Provision

Under the bill, elective deferrals to 401(k) plans and similar arrangements, elective contributions to nonqualified deferred compensation plans of tax-exempt employers and State and local governments (sec. 457 plans), and salary reduction contributions to a cafeteria plan would be considered compensation for purposes of the limits on contributions and benefits.

Effective Date

The provision is effective for years beginning after December 31, 1997.

4. Modification of additional participation requirements (sec. 12903 of the bill and section 401(a)(26) of the Code)

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.

Reasons for Change

The minimum participation rule was adopted in the Tax Reform Act of 1986 because the Congress believed that it was inappropriate to permit an employer to maintain multiple plans, each of which covered a very small number of employees. Although plans that are aggregated for nondiscrimination purposes are required to satisfy comparability requirements with respect to the amount of contributions or benefits, such an arrangement may still discriminate in favor of highly compensated employees.

However, it is appropriate to better target the minimum participation rule by limiting the scope of the rule to defined benefit pension plans and increasing the minimum number of employees required to be covered under very small plans.

Also, the arbitrary requirement that a line of business must have at least 50 employees requires application of the minimum participation rule on an employer-wide basis in some cases in which the employer truly has separate lines of business.

Explanation of Provision

The bill provides that the minimum participation rule applies only to defined benefit pension plans. In addition, the bill provides that a defined benefit pension plan does not satisfy the rule unless it benefits no fewer than the lesser of (1) 50 employees or (2) the greater of (a) 40 percent of all employees of the employer or (b) 2 employees (1 employee if there is only 1 employee).

The bill provides that the requirement that a line of business has at least 50 employees does not apply in determining whether a plan satisfies the minimum participation rule on a separate line of business basis.

Effective Date

The provision is effective for years beginning after December 31, 1995.

5. Nondiscrimination rules for qualified cash or deferred arrangements and matching contributions (sec. 12904 of the bill and secs. 401(k) and (m) of the Code)

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 $9,240 for 1995. This dollar limit is indexed 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 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.

Reasons for Change

The sources of complexity generally associated with the nondiscrimination requirements for qualified cash or deferred arrangements and matching contributions are the recordkeeping necessary to monitor employee elections, the calculations involved in applying the tests, and the correction mechanism, i.e., what to do if the plan fails the tests.

The Committee believes that the complexity of nondiscrimination requirements, particularly after the Tax Reform Act of 1986 changes that imposed a dollar cap on elective deferrals ($9,240 in 1995), is not justified by the marginal additional participation of rank-and-file employees that might be achieved by the operation of these requirements. The result that the nondiscrimination rules are intended to produce can also be achieved by creating an incentive for employers to provide certain matching contributions or nonelective contributions on behalf of rank-and-file employees. Such contributions should create a sufficient inducement to rank-and-file employee participation. Thus, the Committee believes it is appropriate to provide a design-based safe harbor for qualified cash or deferred arrangements. Plans that satisfy the safe harbors would not have to satisfy the nondiscrimination tests for cash or deferred arrangements.

In addition, the significant simplification that a design-based safe harbor test achieves may reduce the complexity of the qualified cash or deferred arrangement requirements enough to encourage additional employers to establish such plans, thereby expanding employee access to voluntary retirement savings arrangements. The adoption of a nondiscrimination safe harbor that eliminates the testing of actual plan contributions removes a significant administrative burden that may act as a deterrent to employers who would not otherwise set up such a plan. Thus, the adoption of a simpler nondiscrimination test may encourage more employers, particularly small employers, who do not now provide any tax-favored retirement plan for their employees, to set up such plans.

A design-based nondiscrimination test provides certainty to an employer and plan participants that does not exist under present law. Under such a test, an employer will know at the beginning of each plan year whether the plan satisfies the nondiscrimination requirements for the year.

Simplifying the nondiscrimination tests will also reduce administrative burdens for those plans that do not utilize the safe harbor.

Explanation of Provision

In general

The bill modifies the present-law nondiscrimination test applicable to elective deferrals and employer matching and after-tax employee contributions to provide that the maximum permitted actual deferral percentage for highly compensated employees for the year is determined by reference to the actual deferral percentage for nonhighly compensated employees for the preceding, rather than the current, year. In the case of the first plan year of a qualified cash or deferred arrangement, the actual deferral percentage of nonhighly compensated employees for the previous year is deemed to be 3 percent or, at the election of the employer, the actual deferral percentage for such first plan year. An employer can elect to use current year actual deferral percentages. An election to use current year data can be revoked only as provided by the Secretary.

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

A plan satisfies the contribution requirements under the safe harbor rule for qualified cash or deferred arrangements if the plan either (1) 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 equal to (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 would be 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 and the aggregate amount of matching contributions is at least equal to the matching contributions required under the general safe harbor rule.

Employer matching and nonelective contributions used to satisfy the contribution requirements of the safe harbor rules are required to be 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 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.

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. After-tax employee contributions are tested separately under the ACP test.

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.

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 provision is effective for plan years beginning after December 31, 1998.

B. Simplified Distribution Rules (secs. 12911–12914 of the bill and secs. 72(d), 101(b), 401(a)(9), and 402(d) of the Code)

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"), and employer-provided death benefits.

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(d)). In general, a lump-sum distribution is a distribution within one taxable year of the balance to the credit of an employee that 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. Lump-sum treatment is not available for distributions from a tax-sheltered annuity.

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. In general, this election allows the taxpayer to pay a separate tax on the lump-sum distribution that approximates the tax that would be due if the lump-sum distribution were received in 5 equal installments. If the election is made, the taxpayer is entitled to deduct the amount of the lump-sum distribution from gross income. 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 income 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).

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(a)). 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(b)). 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.

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 both the pro-rata and simplified alternative methods, in no event can the total amount excluded from income as nontaxable return of basis be greater than the recipient's total investment in the contract.

Required distributions

Present law provides uniform minimum distribution rules generally applicable to all types of tax-favored retirement vehicles, including qualified plans and annuities, IRAs, and tax-sheltered annuities.

Under present law, a qualified plan is required to provide that the entire interest of each participant will be distributed beginning no later than the participant's required beginning date (sec. 401(a)(9)). The required beginning date is generally April 1 of the calendar year following the calendar year in which the plan participant or IRA owner attains age 70½. In the case of a governmental plan or a church plan, the required beginning date is the later of (1) such April 1, or (2) the April 1 of the year following the year in which the participant retires.

Reasons for Change

In almost all cases, the responsibility for determining the tax liability associated with a distribution from a qualified plan, tax-sheltered annuity, or IRA rests with the individual receiving the distribution. Under present law, this task can be burdensome. Among other things, the taxpayer must consider (1) whether special tax rules apply that reduce the tax that otherwise would be paid, (2) the amount of the taxpayer's basis in the plan, annuity, or IRA and the rate at which such basis is to be recovered, and (3) whether or not a portion of the distribution is excludable from income as a death benefit.

The number of special rules for taxing pension distributions makes it difficult for taxpayers to determine which method is best for them and also increases the likelihood of error. In addition, the specifics of each of the rules create complexity. For example, the present-law rules for determining the rate at which a participant's basis in a qualified plan is recovered often entail calculations that the average participant has difficulty performing. These rules require a fairly precise estimate of the period over which benefits are expected to be paid. The IRS publication on taxation of pension distributions (Publication 939) contains over 60 pages of actuarial tables used to determine total expected payments.

The original intent of the income averaging rules for pension distributions was to prevent a bunching of taxable income because a taxpayer received all of the benefits in a qualified plan in a single taxable year. Liberalization of the rollover rules in the Unemployment Compensation Amendments of 1992 increased taxpayers' ability to determine the time of the income inclusion of pension distributions, and eliminates the need for special rules such as 5-year forward income averaging to prevent bunching of income.

It is inappropriate to require all participants to commence distributions by age 70½ without regard to whether the participant is still employed by the employer. However, the accrued benefit of employees who retire after age 70½ generally should be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits.

Explanation of Provisions

In general

The bill repeals 5-year averaging for lump-sum distributions from qualified plans, repeals the $5,000 death benefit exclusion, and simplifies the basis recovery rules applicable to distributions from qualified plans. In addition, the bill modifies the rule that generally requires all participants to commence distributions by age 70½.

Special rules for lump-sum distributions

The bill repeals the special 5-year forward income averaging rule. Thus, the bill repeals the separate tax paid on a lump-sum distribution and also repeals the deduction from gross income for taxpayers who elect to pay the separate tax on a lump-sum distribution. The bill preserves the transition rules adopted in the Tax Reform Act of 1986.

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 IRS. 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 in accordance with the table below. 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 used instead of the number of anticipated payments listed in the table.

If the age of the primary annuitant on the annuity starting date is:	*The number of anticipated payments is:*
Not more than 55	360
More than 55 but not more than 60	310
More than 60 but not more than 65	260
More than 65 but not more than 70	210
More than 70	160

The simplified method is not available 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 is the total amount excluded from income as nontaxable return of basis greater than the recipient's total investment in the contract.

Required distributions

The bill modifies the rule that requires all participants in qualified plans to commence distributions by age 70½ without regard to whether the participant is still employed by the employer and generally replaces it with the rule in effect prior to the Tax Reform Act of 1986. Under the bill, distributions generally are required to begin by April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, in the case of a 5-percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the 5-percent owner attains age 70½.

In addition, in the case of an employee (other than a 5-percent owner) who retires in a calendar year after attaining age 70½, the bill generally requires the employee's accrued benefit to be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan. Thus, under the bill, the employee's accrued benefit is required to reflect the value of benefits that the employee would have received if the employee had retired at age 70½ and had begun receiving benefits at that time.

The actuarial adjustment rule and the rule requiring 5-percent owners to begin distributions after attainment of age 70½ do not apply, under the bill, in the case of a governmental plan or church plan.

The bill provides that the plan amendments required to be made by this provision, or any other, do not have to be made before the first plan year beginning on or after January 1, 1997, if (1) the plan is operated in accordance with the applicable provision, (2) the plan is amended to comply with the required changes no later than the first day of the first plan year beginning after December 31, 1996, and (3) the amendment is retroactive to the effective date of the applicable provision. In the case of a governmental plan, plan amendments are not required before January 1, 1999, provided the requirements for the delay in plan amendments are otherwise satisfied.

Effective Date

The simplified distribution rules generally apply to years beginning after December 31, 1995. The modifications to the basis recovery rules apply with respect to annuity starting dates after December 31, 1995. The repeal of 5-year forward averaging is effective with respect to taxable years beginning after December 31, 1998.

C. Targeted Access to Pension Plans for Small Employers

1. Credit for pension plan start-up costs of small employers (sec. 12916 of the bill and new sec. 45C of the Code)

Present Law

Under present law, an employer is generally entitled to deduct ordinary and necessary business expenses, including expenses associated with establishing pension plans.

Reasons for Change

Retirement plan coverage is lower with respect to employees of small firms than it is with respect to employees of middle-sized and large firms. The Committee believes that one of the reasons for the lower coverage is the costs associated with establishing a tax-qualified retirement plan. The Committee believe that small employers who do not currently maintain retirement plans should have incentives to establish retirement plans.

Explanation of Provision

Under the bill, small employers would be entitled to a credit with respect to the expenses of establishing a SIMPLE retirement plan. The credit would be equal to 50 percent of the start-up costs of establishing the plan, up to a maximum credit of $500. Start-up costs that are taken into account for purposes of the credit are the ordinary and necessary expenses of the employer which are paid or incurred in connection with the establishment of a SIMPLE plan and are of a nonrecurring nature.

In general, the credit would be available with respect to any employer that establishes a SIMPLE plan (including a SIMPLE plan that is part of a 401(k) plan). However, the credit is not available to an employer that made contributions to a tax-qualified pension plan (or a SIMPLE plan) during the 2 years preceding the year in question. In addition, the credit is not available to employers substantially all of the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing acts, or consulting.

No deduction would be allowed with respect to start-up costs for which a credit is allowed.

Effective Date

The provision would be effective with respect to costs incurred after the date of enactment in taxable years ending after such date.

2. Tax-exempt organizations eligible under section 401(k) (sec. 12917 of the bill and sec. 401(k) of the Code)

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 and State and local governmental organizations are generally prohibited from establishing qualified cash or deferred arrangements.

Reasons for Change

Nongovernmental tax-exempt entities should be permitted to maintain qualified cash or deferred arrangements for their employees on the same basis as other employers.

Explanation of Provision

The bill allows organizations exempt from tax under section 501(c)(3) to maintain cash or deferred arrangements.

Effective Date

The provision is effective with respect to years beginning after December 31, 1997.

D. Paperwork Reduction

1. Repeal of combined plan limit (sec. 415(e)) (sec. 12921 of the bill and sec. 415(e) of the Code)

Present Law

In general

Present law provides limits on contributions and benefits under qualified plans based on the type of plan, i.e., based on whether the plan is a defined contribution plan or a defined benefit pension plan (sec. 415). An overall limit applies if an individual is a participant in both a defined benefit pension plan and a defined contribution plan.

Defined contribution plan limit

Under a defined contribution plan, annual additions to the plan with respect to each participant for a limitation year cannot exceed the lesser of (1) 25 percent of compensation or (2) $30,000 (for 1995). Annual additions generally are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. The $30,000 limit is indexed for inflation in $5,000 increments.

Defined benefit plan limit

The limit on the annual benefit payable to (or with respect to) a participant by all defined benefit pension plans of the same employer is generally the lesser of (1) 100 percent of average compensation for the three years in which it was the highest, or (2) $120,000 (for 1995). The $120,000 limit is indexed for inflation in $5,000 increments. If a benefit is payable under the plan in a form other than a straight life annuity, then the benefit must be actuarially adjusted to an equivalent annual straight life annuity before applying the limit on benefits. In addition, if a benefit is payable beginning at an age other than the participant's social security retirement age, the $120,000 dollar limitation is actuarially adjusted so that it equals an annual benefit that is equivalent to the dollar limitation at the participant's social security retirement age. The limit is reduced if benefits begin before social security retirement age, and increased if benefits begin after social security retirement age.

Combined plan limit

An additional limit applies if an employee participates in both a defined benefit pension plan and a defined contribution plan maintained by the same employer (sec. 415(e)). The combined plan limitation is designed to prevent avoidance of the separate plan limits through the creation of different types of plans.

The combined limit is satisfied if the sum of the "defined benefit plan fraction" and the "defined contribution plan fraction" is not greater than 1.0. Although the sum of these fractions may not exceed 1.0, the plan fractions effectively provide an aggregate limit of the lesser of 1.25 (as applied with respect to the dollar limits) or 1.4 (as applied with respect to the percentage limits).

The defined benefit plan fraction is designed to measure the portion of the maximum permitted defined benefit plan limit that the employee actually uses. The numerator is the participant's projected normal retirement benefit determined at the close of the year. The denominator is generally the lesser of 125 percent of the dollar limitation for the year, or 140 percent of the employee's average compensation for the three years of employment in which the employee's average compensation was highest.

The defined contribution plan fraction measures the portion that the employee actually uses of the maximum permitted contributions to a defined contribution plan for the employee's total years of service with the employer. The numerator is generally the total of the contributions and forfeitures allocated to the employee's account for each of the employee's years of service with the employer through the close of the year for which the fraction is being determined. The denominator is the sum of the lesser of the following amounts, computed separately for such year and each prior year of service with the employer: (1) 125 percent of the dollar amount in effect for such year, or (2) 140 percent of the 25 percent of compensation limit for the participant.

Excise tax on excess accumulations

Present law imposes a 15-percent excise tax on excess distributions from qualified retirement plans, tax-sheltered annuities, and individual retirement arrangements. Excess distributions are generally the aggregate amount of retirement distributions from such plans made with respect to an individual during any calendar year which exceed $150,00. In the case of certain lump-sum distributions, the dollar limit is $750,000. Present law also imposes a 15-percent additional estate tax on an individual's excess retirement accumulation.

The excise tax on excess distributions was enacted as part of the Tax Reform Act of 1986. That Act contained grandfather rules under which certain distributions are not subject to the excess distribution tax.

Reasons for Change

One of the most significant sources of complexity relating to qualified pension plans is the calculation of the combined plan limit under section 415(e). Many new employers do not establish defined benefit pension plans, which provide employees with the greatest retirement income security. One of the reasons that defined benefit pension plans are not being established is because of the complex rules governing these plan and the significant administrative costs entailed in maintaining them. Section 415(e) is just one of the deterrents to the establishment and maintenance of qualified defined benefit pension plans. Thus, the Committee does not believe that the administrative costs associated with section 415(e) and the complexity of the calculations required are justified. Further, the Committee believes that section 415(e) may have the effect of discouraging employers from providing adequate retirement benefits to their employees.

The excise tax on excess distributions has a similar purpose to the combined plan limit, although it applies to all an individual's retirement distributions, not just from a single employer. The Committee believes that both the combined plan limit and the excise tax on excess distributions should not apply at the same time.

Explanation of Provision

The bill repeals the combined limit for participants in both a defined contribution plan and a defined benefit pension plan maintained by the same employer. The repeal of the combined plan limit does not apply with respect to plans maintained by professional service employers. A professional service employer is an employer substantially all of the activities of which are in the fields of architecture, science, health, law, performing arts, financial services, actuarial services, engineering, accounting, and consulting.

In addition, until the repeal of the combined plan limit is effective, the excise tax on excess distributions does not apply. Distributions made during this period are treated as made first from nongrandfathered amounts. The additional estate on excess accumulations continues to apply.

Effective Date

The repeal of the combined plan limit applies to limitation years beginning after December 31, 1998. The waiver of the excess distribution tax applies to distribution in 1996, 1997, and 1998.

E. Miscellaneous Pension Simplification

1. Treatment of leased employees (sec. 12931 of the bill and sec. 414(n) of the Code)

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 if the services are performed pursuant to an agreement between the recipient and any other 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 is 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. Each leased employee is to be treated as an employee of the recipient, regardless of the existence of a safe-harbor plan, if more than 20 percent of an employer's nonhighly compensated workforce are leased.

Reasons for Change

The leased employee rules are complex and have unexpected and sometimes indefensible results, especially as interpreted under regulations proposed by the Secretary. For example, under the "historically performed" standard, the employees and partners of a law firm may be the leased employees of a client of the firm if they work a sufficient number of hours for the client and if it is not unusual for employers in that business field to have in-house counsel. While arguably meeting the present-law leased employee definition, it is believed that situations such as this are outside the intended scope of the rules.

Explanation of Provision

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 individual's services are performed under the primary direction or control of 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 could 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 primary 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.

Effective Date

The provision is effective for years beginning after December 31, 1995, 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, the Secretary is directed to use a reasonable interpretation of the statute to apply the leasing rules to prevent abuse.

2. Plans covering self-employed individuals (sec. 12932 of the bill and sec. 401(d) of the Code)

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 of unincorporated businesses that do not apply to other qualified plans (sec. 401(d)(1) and (2)).

Reasons for Change

The remaining special aggregation rules for plans maintained by unincorporated employers are unnecessary and should be eliminated. Applying the same set of rules to all types of plans would make the qualification standards easier to apply and administer.

Explanation of Provision

The 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, 1995.

3. Elimination of special vesting rule for multiemployer plans (sec. 12933 of the bill and sec. 411(a) of the Code)

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 a 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.

Reasons for Change

The present-law vesting rules for multiemployer plans add to complexity because there are different vesting schedules for different types of plans, and different vesting schedules for persons within the same multiemployer plan. In addition, the present-law rule prevents some workers from earning a pension under a multiemployer plan. Conforming the multiemployer plan rules to the rules for other plans would mean that workers could earn additional benefits.

Explanation of Provision

The 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, 1996, or the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates, or (2) January 1, 1998, with respect to participants with an hour of service after the effective date.

4. Full-funding limitation of multiemployer plans (sec. 12934 of the bill and sec. 412(c)(7) of the Code)

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 current liability, over (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.

Reasons for Change

It is not necessary to apply the 150-percent of current liability full funding limit to multiemployer plans. The full funding limit is intended to limit employer deductions for liabilities that have not yet accrued. Employers who participate in multiemployer plans do not have the same incentive to make excessive contributions to the plan as is the case with single-employer plans.

Explanation of Provision

The bill provides that the 150 percent of current liability limitation does not apply to multiemployer plans. In addition, the bill repeals the 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, 1997.

5. Treatment of governmental plans under section 415 (sec. 12935 of the bill and secs. 415 and 457 of the Code)

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 (for 1995). The limit on the annual benefits payable by a defined benefit pension plan is generally the lesser of (1) 100 percent of average compensation for the three years in which it was highest, or (2) $120,000 (for 1995). The dollar limit are increased 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. The $120,000 limit is phased in with respect to participants with less than 10 years of participation.

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.

Reasons for Change

The limits on contributions and benefits create unique problems for plans maintained by public employers and multiemployer plans.

Explanation of Provision

The bill makes the following modifications to the limits on contributions and benefits as applied to governmental plans: (1) the 100 percent of compensation limitation does not apply; and (2) the early retirement reduction and the 10-year phase in of the defined benefit plan dollar limit does not apply to certain disability and survivor benefits. The bill 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). The waiver of the 100 percent of compensation limitation does not apply to State legislators (as defined in sec. 162(h)).

Under the bill, the 100 percent of compensation limitation also does not apply to multiemployer plans. In addition, the rule described above with respect to disability and survivor benefits does not apply to multiemployer plan.

Effective Date

The provision is effective for years beginning on or after January 1, 1995. With respect to governmental plans, no inference is intended with respect to prior years.

6. Treatment of deferred compensation plans of State and local governments and tax-exempt organizations (sec. 12936 of the bill and sec. 457(e) of the Code)

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.

Reasons for Change

It is appropriate to index the dollar limits on deferrals under section 457 plans to maintain the value of the deferral and to provide two additional exceptions to the principle of constructive receipt with respect to distributions from such plans.

Explanation of Provision

The bill makes three changes to the rules governing unfunded deferred compensation 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 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 the 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.

Third, the bill provides for indexing of the dollar limit on deferrals.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

7. Contributions on behalf of disabled employees (sec. 12937 of the bill and sec. 415(c)(3) of the Code)

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.

Reasons for Change

It is appropriate to facilitate the provision of benefits for disabled employees, if it is done on a nondiscriminatory basis.

Explanation of Provision

The bill 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, 1995.

8. Distributions under rural cooperative plans (sec. 12938 of the bill and sec. 401(k)(7) of the Code)

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, 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.

Reasons for Change

It is appropriate to permit qualified cash or deferred arrangements of rural cooperatives to permit distributions to plan participants under the same circumstances as other qualified cash or deferred arrangements.

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Explanation of Provision

The 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 December 31, 1995.

9. Tenured faculty (sec. 19239 of the bill and sec. 457 of the Code)

Present Law

Under an unfunded deferred compensation plan of a tax-exempt organization or State or local government (a "sec. 457 plan"), an employee who elects to defer the receipt of current compensation is 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) 33½ percent of compensation (net of the deferral).

Reasons for Change

The limit on annual deferrals under a section 457 plan prevent educational institutions from providing early retirement incentives to tenured faculty.

Explanation of Provision

The limits of section 457 do not apply to eligible faculty voluntary retirement incentive pay. In order to qualify for the exception, the payments must be made to employees who elect, during a specified period of time of limited duration (as established by the employer) to retire early; the total amount of the payments cannot exceed twice the individual's annual compensation; and (3) all such payments to the employee must be completed within 5 years after the employee's termination of employment. Such payments are includible in gross income in the year received.

Effective Date

The provision is effective with respect to years beginning after December 31, 1995.

10. Uniform retirement age (sec. 12940 of the bill and sec. 401(a)(5) of the Code)

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.

Reasons for Change

Many plans base benefits on social security retirement age so that the benefits under the plan complement social security. Under present law, plans that do so may fail applicable nondiscrimination tests. It is believed that the social security retirement age is an appropriate age for use under plans maintained by private employers.

Explanation of Provision

The bill 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 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 (as defined in sec. 415).

Effective Date

The provision is effective for years beginning after December 31, 1995.

11. Multiple salary reduction agreements permitted under section 403(b) (sec. 12941 of the bill and sec. 403(b) of the Code)

Present Law

Under Treasury regulations, a participant in a tax-sheltered annuity plan (sec. 403(b)) is not permitted to enter into more than one salary reduction agreement in any taxable year. These regulations further provide that a salary reduction agreement is effective only with respect to amounts "earned" after the agreement becomes effective, and that a salary reduction agreement must be irrevocable with respect to amounts earned while the agreement is in effect.

These restrictions do not apply to other elective deferral arrangements such as a qualified cash or deferred arrangement (sec. 401(k)). Under Treasury regulations, participants in a qualified cash or deferred arrangement may enter into more than one salary reduction agreement in a taxable year, such an agreement is effective with respect to compensation currently available to the participant after the agreement becomes effective even though previously "earned," and the agreement may be revoked by the participant.

Reasons for Change

It is appropriate to conform the treatment of salary reduction agreements under section 403(b) to the treatment of qualified cash or deferred arrangements.

Explanation of Provision

The bill provides that for participants in a tax-sheltered annuity plan, the frequency that a salary reduction agreement may be entered into, the compensation to which such agreement applies, and the ability to revoke such agreement shall be determined under the rules applicable to qualified cash or deferred arrangements.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

12. Application of elective deferral limit to section 403(b) plans (sec. 12941 of the bill and sec. 403(b) of the Code)

Present Law

Elective deferrals made by an employee under a tax-sheltered annuity plan (sec. 403(b)) are subject to a $9,500 (for 1995) annual limit (sec. 402(g)). Elective deferrals in excess of this limit are includible in the employee's taxable income. In addition, a tax-sheltered annuity plan must provide that elective deferrals made under plan may not exceed this annual limit. Plans that do not comply with this requirement may lose their tax-favored status.

Reasons for Change

The Committee does not believe that employees participating in a tax-sheltered annuity plan should be negatively affected if other employees violate the annual limit on elective deferrals with respect to their individual tax-sheltered annuity contracts (or custodial accounts).

Explanation of Provision

The bill eliminates the requirement that a tax-sheltered annuity plan must provide that elective deferrals under the plan may not exceed the annual limit on elective deferrals. Consequently, neither the plan nor employees participating in the plan will be negatively affected if one or more other employees make elective deferral in excess of the annual limit. As under present law, employees who make elective deferrals in excess of the annual limit will have to include such amounts in their taxable income.

Effective Date

The provision is effective with respect to plan years beginning after December 31, 1995.

13. Treatment of Indian tribal governments under section 403(b) (sec. 12941 of the bill)

Present Law

Under present law, organizations that are tax exempt under section 501(c)(3) of the Code and certain State and local government educational organizations are permitted to maintain tax-sheltered annuity plans (sec. 403(b)). Indian tribal governments are treated as States for this purpose, so certain educational organizations associated with a tribal government are eligible to maintain tax-sheltered annuity plans. However, while tax exempt, Indian tribes themselves are not the type of tax-exempt organization permitted to maintain tax-sheltered annuity plans.

Reasons for Change

The Committee believes that there is some uncertainty under present law about the ability of Indian tribal governments to establish 403(b) plans for all tribal government employees. Following enactment of the Indian Tribal Government Tax Status Act of 1982, several insurance companies and financial advisors marketed 403(b) plans to tribes representing that the plans could be adopted on a tribal-wide basis to cover all employees. As a result, many tribes adopted 403(b) plans for their employees that are not in compliance with the law. Given this uncertainty, the Committee believes it is appropriate to requalify such plans.

Explanation of Provision

The bill provides that any 403(b) annuity contract purchased in a plan year beginning before January 1, 1995, by an Indian tribal government on behalf of its employees is not disqualified merely because the contract was purchased on behalf of tribal employees who are not employees of tribal educational organizations.

Effective Date

The provision is effective on the date of enactment.

14. Tax on prohibited transactions (sec. 12942 of the bill and sec. 4975 of the Code)

Present Law

Present law prohibits certain transactions between a qualified pension plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan participants and beneficiaries (sec. 4975). A disqualified person includes any fiduciary, a person providing services to the plan, an employer any of whose employees are covered by the plan, an employee organization any of whose members are covered by the plan, and certain persons related to such disqualified persons.

Transactions prohibited include (1) the sale or exchange, or leasing of property between the plan and a disqualified person, (2) the lending of money or other extension of credit between the plan and a disqualified person, (3) the furnishing of goods, services, or facilities between the plan and a disqualified person, or (4) the transfer to, or use by or for the benefit of, a disqualified person, of any assets of the plan.

Present law imposes a two-tier excise tax on prohibited transactions. The initial level tax is equal to 5 percent of the amount involved with respect to the transaction. In any case in which the initial tax is imposed and the prohibited transaction is not corrected within a certain period, a tax equal to 100 percent of the amount involved may be imposed. Each disqualified person engaging in the prohibited transaction is jointly and severally liable for the excise taxes. The Secretary of the Treasury has the authority to waive the second-level tax.

Reasons for Change

The Committee believes it is appropriate to increase the initial level prohibited transaction tax to discourage disqualified persons from engaging in such transactions.

Explanation of Provision

The bill increases the initial-level prohibited transaction tax from 5 percent to 10 percent.

Effective Date

The provision is effective for transactions occurring after December 31, 1995.

15. Extension of Internal Revenue Service user fees (sec. 12943 of the bill)

Present Law

The Internal Revenue Service ("IRS") provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS responds to these inquiries through the issuance of letter rulings, determination letters, and opinion letters. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. The Uruguay Round Agreements Act (commonly referred to as the implementing legislation for the General Agreement on Tariffs and Trade "GATT") extended the IRS user fee program for five years (until October 1, 2000).

Explanation of Provision

The IRS user fees are extended for 2 additional years (through October 1, 2002).

Effective Date

The provision is effective on the date of enactment.

F. Special Rules for Church Pension Plans (secs. 12951–12968 of the bill and new secs. 401A and 414(u) and (v) and secs. 72(f), 105(h), 401(a)(9) and (h), 402(g), 403(b)(9), 404(a), 413(c), 457(e), 1402(a), and 7701(a)(20) of the Code)

Present Law

In general, a church plan is a plan established and maintained for employees (or their beneficiaries) by a church or a church convention or association of churches that is exempt from tax (sec. 414(e)). Church plans include plans maintained by an organization, whether a corporation or otherwise, that has as its principal purpose or function the administration or funding of a plan or program for providing retirement or welfare benefits for the employees of the church or convention or association of churches. Employees of a church include any minister, regardless of the source of his or her compensation, and an employee of an organization which is exempt from tax and which is controlled by or associated with a church or a convention or association of churches.[98]

Plans maintained by churches and certain church-controlled organizations are exempt from certain of the requirements applicable to pension plans under the Code pursuant to the Employee Retirement Income Security Act of 1974 (as amended) ("ERISA"). For example, such plans are not subject to ERISA's vesting, coverage, and funding requirements. In some cases, such plans are subject to provisions in effect before the enactment of ERISA. Church plans may elect to waive the exemption from the qualification rules (sec. 410(d)). Electing plans become subject to all the tax Code (sec. 401(a)) qualification requirements, Title I of ERISA, the excise tax on prohibited transactions, and participation in the pension plan termination insurance program administered by the Pension Benefit Guaranty Corporation.

Certain eligible employers may maintain tax-sheltered annuity plans (sec. 403(b)). These plans provide tax-deferred retirement savings for employees of public education institutions and employees of certain tax-exempt organizations (including churches and certain organizations associated with churches). In addition to tax-sheltered annuities, alternative funding mechanisms that provide similar tax benefits include church-maintained retirement income accounts (sec. 403(b)(9)).

Reasons for Change

The Committee believes that the unique characteristics of churches compared to other employers, including tax-exempt employers, create particular problems in complying with the many requirements that apply to qualified pension plans. Thus, the Committee finds it appropriate to create special rules that apply to church pension plans. These rules are designed to provide certain safeguards to employees of churches, while recognizing the unique relationship that ministers have with their churches.

Explanation of Provisions

In general, the bill revises the rules relating to church-maintained qualified retirement plans. In addition, the bill modifies the rules relating to employee annuity contracts and retirement income accounts maintained for the benefit of church employees.

a. Consolidation and modification of rules relating to church-maintained qualified retirement plans

In general

The bill adds a new section 401A to the Code that defines a qualified church plan. If the requirements of the new section are

[98] With respect to certain provisions (e.g., the exemption for church plans from nondiscrimination requirements applicable to tax-sheltered annuities), the more limited definition of church under the employment tax rules applies (secs. 3121(w)(3)(A) and (B)).

met, then the qualified church plan is treated as satisfying the general qualification requirements of section 401(a). None of the general qualification requirements applies to church plans except as specifically provided in the new Code section 401A.

Definition of qualified church plan

In general

In order to be a qualified church plan, the plan must be a church plan as under present law (sec. 414(e)). In addition, the church that maintains the plan may not have elected (pursuant to section 410(d)) to waive the exemption from certain qualification requirements available to church plans (e.g., participation, vesting and funding rules).

Employee contributions and vesting

In order for a church plan to be qualified, an employee's rights in his or her accrued benefit derived from his or her own contributions must be nonforfeitable. In addition, accrued benefits derived from employer contributions must vest at least as rapidly as under a 10-year cliff vesting schedule or a 5- to 15-year vesting schedule. A plan satisfies the 10-year cliff vesting schedule if an employee who has at least 10 years of service has a nonforfeitable right to 100 percent of his or her accrued benefit derived from employer contributions. A plan meets the 5- to 15-year vesting schedule if benefits vest at least as rapidly as under the following schedule:

Years of service:	*Nonforfeitable percentage:*
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100

As under present law, a qualified church plan must meet the funding requirements of section 401(a)(7) as that section was in effect on September 1, 1974 (before the enactment of ERISA).

Additional requirements

A qualified church plan must meet the requirements of sections 401(a)(1) (contributions are to be made to a trust for the purpose of distributing the trust income and principal to plan participants), 401(a)(2) (a plan must be maintained for the exclusive benefit of participants and plan assets cannot be diverted for any other purpose), 401(a)(8) (forfeitures under a defined benefit plan cannot be used to increase benefits), 401(a)(9) (benefits under a church plan must begin no later than the later of age 70½ or retirement), 401(a)(16) (benefits under the plan must not exceed certain limits provided in sec. 415), 401(a)(17) (the amount of compensation taken into account under a qualified plan cannot exceed $150,000 (indexed)), 401(a)(25) (defined benefit pension plans must specify actuarial assumptions used to determine benefits), 401(a)(27) (plans intended to be profit-sharing or money purchase plans must be designated as such), and 401(a)(30) (employee elective deferrals cannot exceed a certain dollar amount).

In addition, the requirements of sections 401(b) (relating to retroactive changes in the plan), 401(c) (special rules for owner-employees and self-employed individuals), and 401(h) (separate accounts in defined benefit plans used to pay retiree health benefits) applies to such plans.

If the plan includes employees of an organization that is not a church, then the plan must meet the requirements (minimum coverage rules) of sections 401(a)(3) and 401(a)(6) as in effect on September 1, 1974, as well as sections 401(a)(4) (general nondiscrimination rule), 401(a)(5) (special rules relating to nondiscrimination)[99] and 401(m) (special nondiscrimination test for employer matching and employee after-tax contributions). The plan administrator can elect to treat the portion of a plan covering employees that are not church employees as a separate plan.

Definitions and special rules

Definition of church.—A church is defined as a church or a convention or association of churches, including organizations (controlled by or associated with a church) whose principal function is to fund or maintain a plan for churches. The definition of church also includes tax-exempt church controlled organizations other than (1) schools above the secondary level (other than those for religious training) or (2) health care organizations (including hospitals) that provide community service for inpatient care if not more than 50 percent of total patient days are customarily assignable to certain categories of medical treatment.

Satisfaction of trust requirements.—A church plan does not fail to be a qualified plan merely because such plan is funded through a church, convention or association of churches, or an organization controlled by or associated with a church the principal function of which is to provide benefits to church employees, rather than through a trust if: (1) such organization is subject to fiduciary requirements under applicable State law, (2) such organization is separately incorporated from the church which controls it, (3) the assets which equitably belong to the plan are separately accounted for, and (4) under the plan, prior to satisfaction of all liabilities with respect to plan participants and beneficiaries, plan assets cannot be used for or diverted to purposes other than for the exclusive benefit of participants and their beneficiaries.

Failure of one organization to qualify.—If one or more organizations maintaining a church plan fails to satisfy the qualification requirements applicable to church plans, the plan is not disqualified with respect to the other organizations maintaining the plan that meet such requirements.

Special rules relating to highly compensated and excludable employees.—For purposes of the nondiscrimination requirements ap-

[99] Sec. 401(a)(5) provides generally that a plan is not considered discriminatory merely because it is limited to salaried or clerical employees or because benefits bear a uniform relationship to compensation. Sec. 401(a)(5) also provides that benefits may favor highly compensated employees by a permitted disparity (sec. 401(l)).

plicable to church plans, a person generally is considered highly compensated if the person is an officer or person whose principal duties consist of supervising the work of other employees. Under the bill, no employee is considered to be highly compensated under this definition if such employee during the year or the preceding year received compensation of less than $50,000 (indexed). In addition, certain employees covered by collective bargaining agreements (as described in sec. 410(b)(3)(A)) is not taken into account in applying the church plan qualification rules.

No regulation or ruling under the general qualification standards (sec. 401(a)) issued after December 31, 1994, applies to a qualified church plan (as defined in the bill) unless such regulation or ruling is specifically made applicable to such plans.

b. Retirement income accounts of churches

Under present law, retirement income accounts (described in sec. 403(b)(9)) maintained by certain churches are treated as tax-sheltered annuities. The bill modifies certain rules relating to such accounts. First, the bill allows tax-exempt church-controlled organizations to maintain such accounts. Second, the bill provides that ministers (including self-employed ministers) are treated as employees for purposes of the rules relating to retirement income accounts.

c. Tax-sheltered annuity contracts purchased by churches

The bill modifies several rules relating to tax-sheltered annuity contracts purchased by churches. The first modification relates to the nondiscrimination rules. Under the bill, if a contract is purchased under a church plan by (1) schools above the secondary level (other than those for religious training) or (2) health care organizations (including hospitals and medical research organizations) which provide community service for inpatient care if not more than 50 percent of total patient days are customarily assignable to certain categories of medical treatment, the plan must meet the requirements of sections 401(a)(3) and (a)(6) as in effect on September 1, 1974 (minimum coverage rules), 401(a)(4) (general nondiscrimination rule), 401(a)(5) (special rules relating to nondiscrimination), 401(a) (17)(limit on includible compensation) and 401(m) (nondiscrimination rules for employer matching and employee after-tax contributions).

The bill defines a contract purchased by a church to include an annuity (sec. 403(b)(1)), a custodial account (sec. 403(b)(7)), and a retirement income account (sec. 403(b)(9) as amended by the bill). A church is defined as a church or a convention or association of churches, including tax-exempt church controlled organizations.

The vesting requirements that apply for purposes of the new church plan qualification requirements applies to contracts purchased by a church. The present-law vesting rules relating to tax-sheltered annuities do not apply (secs. 403(b)(1)(C) and 403(b)(6)). In addition, salary reduction amounts must be nonforfeitable. The rules relating to the failure of one organization to meet the requirements of section 403(b) and the rules relating to highly compensated and excludable employees are similar to the rules applicable to qualified church plans.

The bill treats as an employee for section 403(b) purposes certain self-employed ministers and any other duly ordained, commissioned or licensed minister that is employed by an organization other than an organization described in section 501(c)(3). Thus, these individuals may participate in tax-sheltered annuity programs.

No regulation or ruling under section 401(a) or 403(b) issued after December 31, 1994, applies to a contract purchased by a church unless such regulation or ruling is specifically made applicable to such contracts.

d. Modification of distribution requirements

Under present law, a tax-sheltered annuity contract must provide that distributions cannot begin before age 59½, separation from service, death, disability (as defined in sec. 72(m)(7)) or (with respect to principal under the contract) in the case of hardship. The bill modifies the definition of disability for purposes of retirement income accounts to conform to the definition used for purposes of the rules relating to cash or deferred arrangements (sec. 401(k)(2)).

e. Modification of required beginning date for distributions

Under present law, distributions under qualified pension plans are required to begin no later than April 1 of the year following the year in which a participant attains 70½ (sec. 401(a)(9)). With respect to church plans, the required beginning date is the later of the date described in the preceding sentence and April 1 of the year after the year in which the employee retires. Under the bill, the special rule for church plans applies to all church plans described in section 414(e) instead of the present law rule that applies the special rule only to those churches treated as such for employment tax purposes (secs. 3121(w)(3)(A) and (B)).

f. Exclusion of ministers from nondiscrimination requirements

The bill provides that ministers are excluded in applying the nondiscrimination requirements applicable to pensions and certain other employee benefits. In particular, the bill excludes ministers from being considered when an employer applies the following sections: 401(a)(3), (4) and (5) as those sections were in effect on September 1, 1974, as well as sections 401(a)(4) and 401(a)(5) under present law, 401(a)(26) (minimum participation rule), 401(k)(3) (special nondiscrimination rules for qualified cash or deferred arrangements), 401(m) (special nondiscrimination rules for employer matching and after-tax employee contributions), 403(b)(1)(D) (nondiscrimination requirements for tax-sheltered annuities), 410 (minimum coverage rules), 79(d) (nondiscrimination rules for employer-provided group-term life insurance), 105(h) (nondiscrimination requirements for self-insured medical reimbursement plans), 125(b) (nondiscrimination rules for cafeteria plans), and 129(d)(2), (3) and (8) (nondiscrimination rules for dependent care assistance plans).

The church plan in which a minister participates is treated as a plan or contract meeting the requirements of section 401(a), 401A (the new requirements for qualified church plans), or 403(b) with respect to such minister's participation.

g. Aggregation rules not to apply to churches

The bill exempts churches from certain aggregation rules (secs. 414(b), (c), (m), (o) and (t)) that must be applied in order to determine who is the employer for certain nondiscrimination rules and for certain other purposes (secs. 401(a)(3), (4), and (5) as those sections were in effect on September 1, 1974, 401(a)(4), (a)(5), (a)(17), (a)(26), 401(h), 401(m), 410(b), 411(d)(1) and 416).

The exemption is available to church-related organizations except in the case of such organizations that are not exempt from tax under section 501(a) and which have a common, immediate parent.

A church-related organization may make an election to use this provision for itself and other related organizations on or before the last day of the plan year beginning on or after January 1, 1998.

h. Self-employed ministers treated as employees for purposes of certain welfare benefit plans

Under the bill, self-employed ministers are treated as employees for purposes of certain welfare benefit and qualified plan rules. In particular, self-employed ministers are treated as employees for purposes of the exclusions for employer-provided group-term life insurance, employer-provided accident or health insurance, and employee death benefits. In addition, self-employed ministers are treated as employees for purposes of the rules relating to cafeteria plans (sec. 125) and pension plans.

i. Deductions for contributions by certain ministers to retirement income accounts

Under the bill, if a minister makes a contribution to a retirement income account, such contribution is treated as though it were made to a tax-exempt pension trust and is deductible to the extent it does not exceed the exclusion allowance applicable to tax-sheltered annuities (sec. 403(b)(2)).

j. Modification of rules for plans maintained by more than one employer

Under the bill, a church plan is not treated as a single plan merely because employers commingle assets solely for purposes of investment and pooling of mortality experience.

k. Section 457 not to apply to deferred compensation of church employees

Present law imposes dollar limits and certain other requirements on deferred compensation of employees of tax exempt and State and local government employers (sec. 457). Under present law, these rules do not apply to churches (as defined in sec. 3121(w)(3)(A)) and certain church-controlled organizations (as defined in sec. 3121(w)(3)(B)). The bill expands the definition of churches under this rule to include all churches as defined under the qualification requirements applicable to church plans (new sec. 401A).

l. Modification to health benefits accounts in church plans

Under present law, a pension or annuity plan may provide for the payment of retiree medical expenses through a segregated account (sec. 401(h)). In the case of a key employee, a separate account must be maintained and any additions to the account with respect to such employee are treated as annual additions for purposes of the rules relating to limitations on contributions and benefits (sec. 415). Under the bill, with respect to a church plan maintained by more than one employer, a separate account is not required for an employee who is a key employee solely by reason of being an officer with annual compensation greater than $45,000. The bill modifies the amount of the annual addition under section 415 with respect to participants of church plans.

m. Modification of rule relating to investment in contract

The bill grants foreign missionaries the exception to the special rules for computing employees' contributions (sec. 72(f)) currently available only with respect to certain contributions relating to credits for service performed prior to January 1, 1963.

n. Modification of rule relating to elective deferral catch-up limitation for retirement income accounts

The bill modifies the elective catch-up provisions relating to retirement income accounts by repealing one of the limitations on the amount of such catch-up contribution (sec. 402(g)(8)(A)(iii)).

o. Church plans may annuitize benefits

Under the bill, a retirement income account, a church plan, or an account comprised of qualified voluntary employee contributions (permitted under prior law) does not fail to meet the qualification requirements merely because it pays benefits to participants and their beneficiaries from a pool of assets administered or funded through an organization whose principal purpose is to provide such benefits (described in sec. 414(e)(3)(A)), rather than through the purchase of annuities from an insurance company.

p. Church plans may increase benefits

Under the bill, a retirement income account, a church plan, or an account comprised of qualified voluntary employee contributions (permitted under prior law) does not fail to meet applicable qualification requirements merely because it provides benefit payments that (1) take into account the investment performance of the underlying assets or favorable interest or mortality experience, or (2) that increase in an amount not in excess of 5 percent per year.

q. Exemption for church plans from nondiscrimination rules applicable to self-insured medical accounts

The bill exempts plans maintained by churches from the nondiscrimination rules relating to self-insured medical plans (sec. 105(h)).

r. Retirement benefits of ministers not subject to tax on net earnings from self-employment

The bill provides that retirement benefits of ministers are not subject to self-employment taxes.

Effective Dates

The provisions are effective for years beginning after December 31, 1994.

ESTIMATED BUDGET EFFECTS OF REVENUE RECONCILIATION PROVISIONS
AS APPROVED BY THE SENATE FINANCE COMMITTEE ON OCTOBER 19, 1995

Fiscal Years 1996 - 2005

[Millions of Dollars]

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
I. Family Tax Relief											
A. $500 Tax Credit for Children Under Age 18	tyba 1/1/96	-4,449	-22,290	-22,515	-22,731	-22,942	-23,140	-23,340	-94,927	-141,407	-212,846
B. Credit for Adoption Expenses; Exclusion for Adoption Expenses	tyba 1/1/96	-27	-283	-303	-325	-346	-347	-348	-1,284	-1,978	-3,026
C. Marriage Penalty Relief: Increase standard deduction for joint returns to 200% of single by 2005	tyba 1/1/96	-137	-612	-1,079	-1,787	-2,196	-2,746	-3,720	-5,811	-12,277	-28,987
D. Student Loan Interest Credit ($500 per person not to exceed $1,000 per return)	1/1/96	-51	-146	-151	-157	-162	-168	-174	-667	-1,009	-1,868
Total for Family Tax Relief		-4,664	-23,331	-24,048	-25,000	-25,646	-26,401	-27,582	-102,689	-156,671	-246,727
II. Increase Savings and Investment											
A. Individual Retirement Arrangements (increase deductible IRA income limits; adopt back-end IRAs; and increase spousal IRAs)	tyba 1/1/96	-262	-636	-337	-1,190	-1,922	-3,446	-4,931	-4,349	-12,726	-38,963
B. Adopt SIMPLE pension plan	yba 12/31/95	-46	-71	-73	-75	-78	-80	-84	-343	-507	-775
C. Capital Gains Reforms: (a) 50% deduction for individuals; (b) maximum rate of 28% for corporations; (c) collectibles - 28% maximum rate; (d) one-half of deduction in minimum tax; and (e) 75% deduction for individuals, maximum 21% rate for corporations, for venture capital investments:											
1. Corporate	sa 10/13/95	-1,008	-893	-912	-946	-971	-1,024	-1,129	-4,730	-6,883	-10,824
2. Individual	sa 10/13/95	3,950	-2,296	-5,674	-6,882	-7,296	-7,455	-7,836	-18,187	-33,477	-88,496

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
D. Alternative Minimum Tax (AMT) Reform: Conform AMT depreciation methods to regular tax recovery methods (effective ppisa 12/31/95); allow taxpayers to take certain minimum tax credits against minimum tax (effective tyba 12/31/95)	—	-856	-1,875	-2,017	-1,748	-1,125	-821	-794	-7,621	-9,236	-11,241
E. Modify Depreciation for Small Motor Fuel/Convenience Store Outlets	ppisoa/a DOE	-1	-4	-23	-26	-29	-16	-19	-83	-118	-191
F. Allow for Tax-Free Conversion of Common Trust Funds to Mutual Funds	1/1/96	-4	-9	-8	-8	-8	-8	-8	-37	-53	-78
Total for Increase Savings and Investment		1,772	-5,775	-9,044	-10,574	-11,429	-12,840	-14,899	-35,350	-62,988	-116,378
III. Health Care-Related Provisions											
A. Treatment of Long-Term Care Insurance	1/1/96	-886	-980	-1,209	-1,396	-1,575	-1,798	-2,040	-6,047	-9,885	-17,582
B. Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts	1/1/96	-5	-50	-82	-128	-166	-207	-240	-431	-867	-1,971
C. Permit Medical Savings Accounts	1/1/96	-88	-122	-166	-194	-236	-259	-283	-786	-1,308	-2,305
D. Increase Tax-free Death Benefit Limit on Burial Insurance Policies	1/1/96	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
E. Treat Certain Health Insurers Similar to Blue Cross/Blue Shield Organizations	tyea 10/13/95	-1	-1	-1	-1	-1	-1	-1	-5	-8	-12
Total for Health Care Related Provisions		-989	-1,163	-1,448	-1,709	-1,978	-2,286	-2,573	-7,240	-12,098	-21,841
IV. Estate Tax Reform											
A. Reduction in Estate Taxes for Qualified Businesses After Unified Credit Increase	dda 12/31/95	—	-889	-898	-821	-985	-1,132	-1,313	-3,073	-6,517	-11,165
B. Phaseup Unified Credit to $750,000 by 2001	dda/gma 12/31/95	—	-333	-663	-1,020	-1,401	-1,805	-2,144	-3,417	-7,366	-14,799
C. Provide a 50% Exclusion From Estate Taxes for Property Donated Subject to a Conservation Easement	dda 12/31/95	—	-46	-60	-65	-64	-71	-79	-214	-364	-663
D. Technical Modification to the Generation Skipping Transfer Tax	gsta 12/31/94	-3	-4	-4	-4	-4	-4	-4	-19	-27	-41
E. Clarify Cash Leases Under Section 2032A	dla 12/31/95	—	-2	-2	-2	-2	-2	-2	-8	-12	-18
Total for Estate Tax Reform		-3	-973	-1,417	-1,982	-2,436	-3,014	-3,542	-6,731	-13,286	-28,897
TOTAL FOR SECTIONS I, II, III, AND IV		-3,846	-31,242	-35,957	-39,486	-41,469	-44,529	-48,487	-152,929	-245,943	-419,834

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Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-06
V. Expiring Tax Provisions											
A. Provisions Extended Through 2/28/97:											
1. Work opportunity tax credit [2]	1/1/96	-67	-122	-86	-36	-15	-4	—	-327	-332	-332
2. Employer-provided educational assistance	1/1/95	-731	-404	-65	—	—	—	—	-1,201	-1,201	-1,201
3. R&E credit, with modifications	7/1/95	-1,149	-842	-449	-286	-177	-60	-7	-2,902	-2,969	-2,969
4. Reinstate tax-free treatment of employer-provided group legal services	1/1/96	-73	-45	—	—	—	—	—	-118	-118	-118
5. Orphan drug tax credit	1/1/95	-37	-12	-4	-2	-1	[1]	[1]	-56	-57	-57
6. Contributions of appreciated stock to private foundations	1/1/95	-47	-76	-14	-5	—	—	—	-142	-142	-142
7. Commercial Aviation Fuel: extend 4.3 cents/gallon exemption	10/1/95	-417	-187	—	—	—	—	—	-604	-604	-604
8. Suspend tax on diesel fuel for recreational boats	1/1/96	-24	-16	-4	-3	-1	—	—	-48	-48	-48
B. Extend Excise Tax Refund Authority for Alcohol Fuels Blenders Through 9/30/99	10/1/95	Negligible Revenue Effect									
C. Diesel Dyeing Exemption for Alaska During Period of Clean Air Act Exemption	[3]	-1	[1]	—	—	—	—	—	-1	-1	-1
D. Extend Section 29 Binding Contract Date to 12/31/96 and Placed-In-Service Date to 12/31/97 for Biomass and Coal	DOE	—	-17	-94	-137	-135	-139	-146	-383	-668	-1,192
E. Superfund and Oil Spill Liability Taxes:											
1. Extend Superfund excise taxes through 9/30/02	DOE	198	641	661	663	676	691	683	2,839	4,204	4,236
2. Extend Superfund AMT (through 12/31/97) [4]	DOE	300	503	202	—	—	—	—	1,005	1,005	1,005
3. Extend oil spill tax through 9/30/02 (leave billion dollar cap)	1/1/96	—	—	—	—	—	60	60	—	120	120
F. Expatriation Tax Provisions	2/6/95	21	37	63	97	139	161	216	357	734	1,574
Total for Expiring Tax Provisions		-2,027	-640	289	290	486	729	886	-1,580	-67	391
VI. TAXPAYER BILL OF RIGHTS 2											
1. Expand IRS authority to abate interest	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
2. Tax Court review of IRS failure to abate interest	ras DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
3. Substitute joint returns for separate returns without full payment of separate return tax liability	tyba DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
4. Increase in amount of property exempt from levy	lla 12/31/96	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
5. Modify offers-in-compromise rule	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
6. Allow litigation cost recoveries in declaratory judgment proceedings	pca DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
7. Enrolled agents included as third-party recordkeepers for purposes of receiving designated summonses	sia DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
8. New safeguards relating to designated summonses	sia DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[7]
9. Annual reminders to taxpayers with delinquent accounts	1/1/96	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
10. Expand court discretion to reduce award for litigation costs for failure to exhaust administrative remedies	pca DOE	-1	-1	-1	-1	-1	-1	-1	-5	-7	-10
Total for Taxpayer Bill of Rights 2		-3	-3	-3	-3	-3	-3	-3	-16	-26	-31
VII. CASUALTY AND INVOLUNTARY CONVERSION PROVISIONS											
1. Modify basis adjustment rules under section 1033	ica 9/13/95	2	4	6	9	14	20	29	35	84	225
2. Modify the exception to the related-party rule of section 1033 for individuals to only provide an exception for de minimis amounts ($100,000)	ica 9/13/95	1	2	4	6	8	11	13	21	46	96
3. Provide that a taxpayer may elect to include in income crop insurance proceeds and disaster payments in the year of the disaster or in the following year	pra 12/31/92	2	-1	-1	-1	-1	-1	-1	-2	-4	-6
4. Change involuntary conversion rules for Presidentially declared disaster areas	DDA 12/31/94	-6	-14	-10	-10	-10	-10	-10	-50	-70	-100
Total for Casualty and Involuntary Conversion Provisions		-1	-9	-1	4	11	20	31	4	56	215
VIII. TAX EXEMPT AND CHARITABLE REFORMS											
1. Provide tax-exempt status to common investment funds	tyea 12/31/95	-4	-6	-6	-7	-7	-7	-8	-30	-45	-70
2. Change charitable corporate sponsorship rules	1/1/96	Negligible Revenue Effect									
3. Treatment of dues paid to agricultural or horticultural organizations	tyba 12/31/94	Negligible Revenue Effect									

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Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
4. Repeal tax credit for contributions to special Community Development Corporations	DOE	1	1	2	2	2	2	2	8	12	18
5. Notice to charitable beneficiaries for certain gifts	tca 12/31/95	Negligible Revenue Effect									
6. Football coaches' pension plan clarification	[10]	Negligible Revenue Effect									
7. Grandfather section 403(b) pension plans which have been established by certain Indian Tribal governments	tdacppt 1/1/95	Negligible Revenue Effect									
Total for Tax Exempt and Charitable Reforms		-3	-5	-4	-5	-5	-5	-6	-21	-33	-52
IX. CORPORATE, OTHER REFORMS AND MISCELLANEOUS PROVISIONS											
1. Reform the tax treatment of certain corporate stock redemptions	da 5/3/95	-83	-100	-17	84	209	343	437	93	873	2,444
2. Require corporate tax shelter reporting	atsotpps DOE	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[12]	[12]	[13]
3. Disallow interest deduction for corporate-owned life insurance policy loans; modification of treatment of deferred acquisition costs for surrendered policies	Ipoaa 10/13/95	134	372	594	802	966	1,830	2,006	2,868	6,412	12,314
4. Phaseout preferential tax deferral for certain large farm corporations required to use accrual accounting	[14]	26	37	38	39	40	41	42	179	261	382
5. Section 936: (a) Phaseout income-based credit from 1996 through 2001; (b) eliminate economic activity credit in 2002; (c) eliminate credit for new QPSII, permit credit for maximum of five years on old QPSII; (d) no credit method change after 1997; and (e) elimination of credit for certain U.S. possessions in 2005	[15]	208	257	343	461	563	636	2,109	1,832	4,579	14,851
6. Corporate accounting -- reform of income forecast method	pplsa 9/13/95	32	69	29	13	14	16	19	157	192	273
7. Provide 3-year amortization of intrastate operating rights of truckers	tyea/a 1/1/95	-11	-14	-8	-4	---	---	---	-37	-37	-37

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Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
8. Permit corporate pension transfers to fund employee benefits (generally includes ERISA covered benefits).....	DOE	1,591	1,499	916	471	295	136	46	4,772	4,953	4,946
9. Modify exclusion of damages received on account of personal injury or sickness:											
a. Treat all punitive damages as taxable..............................	ama 12/31/95	3	4	6	7	7	7	8	27	42	66
b. Include in income damage recoveries for non-physical injuries..............................	ama 12/31/95	31	47	49	52	54	57	60	233	350	546
10. Require tax reporting for payments to attorneys..............................	pma 12/31/95	[9]	[9]	[9]	[9]	[9]	[9]	[9]	[12]	[12]	[13]
11. Disallow rollover under section 1034 to extent of previously claimed depreciation for home office or other depreciable use of residence..............	tyea 12/31/95	1	3	4	5	6	8	9	19	36	69
12. Provide that rollover of gain on sale of a principal residence cannot be elected unless the replacement property purchased is located within the United States (limited to non-citizens who terminate residence within 2 years)..............................	sea 12/31/95	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]
13. Repeal exemption for withholding on gambling winnings from bingo and keno, where proceeds exceed $5,000..............................	1/1/96	20	6	6	6	6	7	7	46	60	80
14. Repeal advance refunds of diesel fuel tax for diesel cars and light trucks..............................	12/31/95	8	19	19	19	19	19	19	84	122	179
15. Apply failure to pay penalty to substitute returns..............................	DOE	1	3	29	30	32	33	35	95	163	276
16. Modify treatment of foreign trusts......	[16]	93	162	171	180	188	197	206	794	1,197	1,879
17. Repeal 50% interest income exclusion for financial institution loans to ESOPs..............................	lma 10/13/95	27	69	109	149	187	224	261	541	1,026	2,019
18. Repeal the wine and flavors excise tax credit..............................	1/1/96	58	87	92	97	102	107	113	436	656	1,034
19. Provide for flow through treatment for Financial Asset Securitization Investment Trusts (FASITs)..............	DOE	34	18	10	5	2	---	-2	69	67	49
20. Tax-free treatment of contributions in aid of construction for water utilities; change depreciation for water utilities..............................	[17]	-16	-28	-12	4	19	32	43	-32	43	225

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Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
21. Modify the ozone depleting chemicals tax for imported recycled halons	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[7]	[7]	[18]
22. Modify two county tax-exempt bond rule for local furnishers of electricity or gas	DOE	[11]	1	2	3	4	5	6	11	22	48
23. Provide tax-exempt bonds status for Alaska Power Administration sale	bia DOE	[1]	-1	-1	-1	-1	-1	-1	-6	-8	-12
24. Require that life insurance companies treat 80% of their capital losses from foreclosed real estate as ordinary losses spread over 10 years	tyba 12/31/94	6	[11]	-1	-2	-2	[11]	1	1	2	-7
25. Modify treatment of reachback companies under coal industry retiree tax [19]	10/1/95	-43	-8	27	32	[20]	[20]	[20]	8	8	8
26. Clarify that newspaper carriers and other workers are independent contractors	spe 12/31/95					Negligible Revenue Effect					
Total for Corporate, Other Reforms and Miscellaneous Provisions		2,120	2,510	2,411	2,460	2,716	3,413	5,429	12,217	21,064	41,282
X. PENSION SIMPLIFICATION PROVISIONS											
A. Simplification of Nondiscrimination Provisions:											
1. Definition of highly compensated employees (effective 1/1/97); repeal of family aggregation (effective 1/1/96)	—					Considered in Other Provisions					
2. Definition of compensation for section 415 purposes	1/1/98	—	—	-1	-1	-2	-2	-2	-4	-8	-17
3. Modification of additional participation requirements	1/1/96					Negligible Revenue Effect					
4. Nondiscrimination rules for qualified cash or deferred arrangements and matching contributions [21]	1/1/99	—	—	—	-42	-162	-167	-171	-204	-541	-1,086
B. Simplified Distributions Rules:											
1. Repeal of 5-year income averaging for lump-sum distributions	1/1/96	24	74	63	94	65	41	16	319	376	429
2. Repeal of $5,000 exclusion of employees' death benefits	tyba 12/31/95	16	46	49	52	54	55	56	218	328	498
3. Simplified method for taxing annuity distributions under certain employer plans	asda 1/1/96	10	28	28	28	29	29	29	123	182	273
4. Required distributions	1/1/96	25	7	7	6	6	5	4	51	60	70

Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
C. Targeted Access to Pension Plans for Small Employers:											
1. Credit for pension plan start-up costs of small employers [21]	DOE	-6	-11	-10	-10	-9	-9	-8	-46	-64	-87
2. Tax-exempt organizations eligible under section 401(k)	1/1/98	—	—	-5	-16	-23	-24	-25	-43	-93	-173
D Paperwork Reduction:											
1. Repeal of combined section 415 limit	1/1/99	—	—	—	-40	-100	-103	-106	-140	-349	-687
2. 3-year waiver of excess distribution tax	1/1/96	38	40	43	3	—	—	—	124	124	124
E. Miscellaneous Simplification:											
1. Treatment of leased employees	yba 12/31/96	Negligible Revenue Effect									
2. Plans covering self-employed individuals	yba 12/31/96	Negligible Revenue Effect									
3. Elimination of special vesting rule for multiemployer plans	pybo/a 1/1/96	[1]	-1	-1	-1	-1	-1	-1	-4	-6	-9
4. Full-funding limitation of multiemployer plans	1/1/96	—	—	-3	-16	-15	-14	-14	-33	-61	-100
5. Treatment of governmental plans under section 415	tybo/a DOE	Negligible Revenue Effect									
6. Treatment of deferred compensation plans of State and local governments and tax-exempt organizations	tyba 12/31/96	[1]	-1	-1	-1	-1	-2	-2	-4	-8	-14
7. Contributions on behalf of disabled employees	1/1/96	Negligible Revenue Effect									
8. Distributions under rural cooperative plans	DOE	Negligible Revenue Effect									
9. Tenured faculty	tyba 12/31/96	-7	-6	-4	-2	[1]	[1]	[1]	-18	-18	-18
10. Uniform retirement age	1/1/96	Considered In Other Provisions									
11. Increase section 4975 excise tax on prohibited transactions from 5% to 10%	ptoo/a 1/1/96	1	4	4	4	4	4	4	17	24	38
12. Simplified contribution and benefit limits for multi-employer plans	1/1/96	-2	-3	-3	-4	-4	-4	-5	-16	-26	-41
13. Extend IRS user fees through 9/30/02 [22]	10/1/00	—	—	—	—	36	36	36	36	106	106
14. Treatment of certain insurance contract on retired lives	tyba 12/31/96	6	-4	5	4	4	12	-7	16	21	19
15. Treatment of modified guaranteed contracts	tyba 12/31/96	-1	2	4	1	2	1	-1	8	8	7

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Item	Effective	1996	1997	1998	1999	2000	2001	2002	1996-00	1996-02	1996-05
16. The "Church Retirement Benefits Simplification Act of 1995"	various	---	Negligible Revenue Effect								
Total for Pension Simplification Provisions		104	176	175	60	-118	-144	-189	389	54	-579
NET TOTALS		-3,640	-29,113	-33,179	-36,681	-38,402	-40,519	-42,438	-141,029	-223,989	-388,589

Joint Committee on Taxation

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

Legend for "Effective" column:

ppisa = property placed in service after
sea = sales and exchanges after
sa = sales after
DOE = date of enactment
tyba = taxable years beginning after
tyea = taxable years ending after
ama = awards made after
ipoaa = interest paid or accrued after
ica = involuntary conversion after
tybo/a = taxable years beginning on or after
yba = years beginning after
gsta = generation skipping transfers after
raa = requests for abatement after
cla = cash leases after
tyeo/a = taxable years ending on or after
asda = annuity starting date after
ria DOE = regulations issued after date of enactment
ppiso/a/b DOE = property placed in service on, after, or before date of enactment
atsotppa DOE = any tax shelter offered to potential participants after date of enactment
lma = loans made after
dda = decedents dying after
dda/gma = decedents dying after and gifts made after
pra = payments received after
bia DOE = bonds issued after date of enactment
pca DOE = proceeding commenced after date of enactment
pra = payments received after
DDA = disasters declared after
da = distributions after
lia = levies issued after
sia = summonses issued after
tca = trusts created after
spa = services performed after
pma = payments made after
tdacppt = tax deferred annuity contracts purchased prior to
pybo/a = plan years beginning on or after
ptoo/a = prohibited transactions occurring on or after

[Footnotes appear on the following page]

Footnotes:

[1] Loss of less than $500,000.
[2] Credit rate at 35% on first $6,000 of income; eligible workers expanded to include welfare cash recipients and veteran foodstamp recipients; 400 hour work requirement.
[3] Effective as if included in the Omnibus Budget Reconciliation Act of 1993.
[4] Estimates presented after interaction with Alternative Minimum Tax provisions and are shown net of offset with the corporate income tax.
[5] Loss of less than $1 million.
[6] Loss of less than $2 million.
[7] Loss of less than $5 million.
[8] Gain of less than $1 million.
[9] Gain of less than $5 million.
[10] Generally effective as if included in Public Law 100-202 (i.e., years beginning after 12/22/87). Excise tax is payable in the first year beginning after the date of enactment.
[11] Gain of less than $500,000.
[12] Gain of less than $25 million.
[13] Gain of less than $30 million.
[14] No new suspense accounts could be established in taxable years ending after 9/13/95. The income in existing suspense accounts would be recognized in equal installments over a 20-year period beginning with the first taxable year beginning after 9/13/95.
[15] QPSII investments after 10/13/95 and date of enactment for other provisions generally.
[16] Various effective dates depending on provisions.
[17] Effective for amounts received after date of enactment and property placed in service after date of enactment.
[18] Loss of less than $10 million.
[19] Estimate provided by the Congressional Budget Office. Includes indirect tax effects estimated by the Joint Committee on Taxation.
[20] Negligible revenue effect.
[21] This provision considers interaction effects of SIMPLE retirement plan provisions.
[22] Estimate provided by the Congressional Budget Office.

Statutory Language of Provisions Approved by the Committee on October 19, 1995

TITLE XII—COMMITTEE ON FINANCE—REVENUE PROVISIONS

SEC. 12000. SHORT TITLE; REFERENCES; TABLE OF CONTENTS.

(a) SHORT TITLE.—This title may be cited as the "Revenue Reconciliation Act of 1995".

(b) AMENDMENTS TO INTERNAL REVENUE CODE OF 1986.—Except as otherwise specifically provided, wherever in this title an amendment 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 that section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents of this title is as follows:

CHAPTER 3—EXTENSIONS RELATING TO FUEL TAXES

CHAPTER 4—DIESEL DYEING PROVISIONS

CHAPTER 5—TREATMENT OF INDIVIDUALS WHO EXPATRIATE

Subtitle F—Taxpayer Bill of Rights 2 Provisions

Subtitle G—Casualty And Involuntary Conversion Provisions

Subtitle H—Exempt Organizations and Charitable Reforms

Subtitle I—Tax Reform and Other Provisions

CHAPTER 1—PROVISIONS RELATING TO BUSINESSES

CHAPTER 2—LEGAL REFORMS

CHAPTER 3—REFORMS RELATING TO NONRECOGNITION PROVISIONS

CHAPTER 4—EXCISE TAX AND TAX-EXEMPT BOND PROVISIONS

CHAPTER 5—FOREIGN TRUST TAX COMPLIANCE

CHAPTER 6—FINANCIAL ASSET SECURITIZATION INVESTMENTS

CHAPTER 7—DEPRECIATION PROVISIONS

CHAPTER 8—OTHER PROVISIONS

Subtitle J—Pension Simplification

CHAPTER 1—GENERAL PROVISIONS

SUBCHAPTER A—SIMPLIFICATION OF NONDISCRIMINATION PROVISIONS

SUBCHAPTER B—SIMPLIFIED DISTRIBUTION RULES

Subtitle A—Family Tax Relief

SEC. 12001. CHILD TAX CREDIT.

(a) IN GENERAL.—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. CHILD TAX CREDIT.

"(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to $500 multiplied by the number of qualifying children of the taxpayer.

"(b) LIMITATION.—

"(1) IN GENERAL.—The amount of the credit which would (but for this subsection) be allowed by subsection (a) shall be reduced (but not below zero) by $25 for each $1,000 (or fraction thereof) by which the taxpayer's adjusted gross income exceeds the threshold amount.

"(2) THRESHOLD AMOUNT.—For purposes of paragraph (1), the term 'threshold amount' means—

"(A) $110,000 in the case of a joint return,

"(B) $75,000 in the case of an individual who is not married, and

"(C) $55,000 in the case of a married individual filing a separate return.

For purposes of this paragraph, marital status shall be determined under section 7703.

"(c) QUALIFYING CHILD.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualifying child' means any individual if—

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

"(B) such individual has not attained the age of 18 as of the close of the calendar year in which the taxable year of the taxpayer begins, and

"(C) such individual bears a relationship to the taxpayer described in section 32(c)(3)(B) (determined without regard to clause (ii) thereof).

"(2) EXCEPTION FOR CERTAIN NONCITIZENS.—The term 'qualifying child' shall not include any individual who would not be a dependent if the first sentence of section 152(b)(3) were applied without regard to all that follows 'resident of the United States'.

"(d) CERTAIN OTHER RULES APPLY.—Rules similar to the rules of subsections (d) and (e) of section 32 shall apply for purposes of this section."

(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. Child tax credit."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12002. REDUCTION IN MARRIAGE PENALTY.

(a) INCREASE IN BASIC STANDARD DEDUCTION FOR MARRIED INDIVIDUALS.—Section 63(c) (relating to standard deduction) is amended—

(1) by striking "$5,000" in paragraph (2)(A) and inserting "the applicable dollar amount",

(2) by striking "$2,500" in paragraph (2)(D) and inserting "½ of the applicable dollar amount", and

(3) by inserting after paragraph (6) the following new paragraph:

"(7) APPLICABLE DOLLAR AMOUNT.—For purposes of paragraph (2), the applicable dollar amount shall be determined under the following table:

"For taxable years beginning in calendar year—	The applicable dollar amount is—
1996	$6,800
1997	7,150
1998	7,500
1999	7,950
2000	8,200
2001	8,600
2002	9,100
2003	9,500
2004	9,950
2005 and thereafter	10,800."

(b) COST-OF-LIVING ADJUSTMENTS.—Section 63(c)(4) (relating to adjustments for inflation) is amended by adding at the end the following new flush sentence:

"This paragraph shall also apply to the $10,800 amount in paragraph (7) for taxable years beginning after 2005, except that subparagraph (B) shall be applied by substituting '2004' for '1987'."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12003. CREDIT FOR ADOPTION EXPENSES.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to nonrefundable personal credits), as amended by section 12001, is amended by inserting after section 23 the following new section:

"SEC. 24. ADOPTION EXPENSES.

"(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this subtitle for the taxable year the amount of the qualified adoption expenses paid or incurred by the taxpayer during such taxable year.

"(b) LIMITATIONS.—

"(1) DOLLAR LIMITATION.—The aggregate amount of qualified adoption expenses which may be taken into account under subsection (a) with respect to the adoption of a child shall not exceed $5,000.

"(2) INCOME LIMITATION.—The amount allowable as a credit under subsection (a) for any taxable year shall be reduced (but not below zero) by an amount which bears the same ratio to the amount so allowable (determined without regard to this paragraph but with regard to paragraph (1)) as—

"(A) the amount (if any) by which the taxpayer's taxable income exceeds $60,000, bears to

"(B) $40,000.

"(3) DENIAL OF DOUBLE BENEFIT.—

"(A) IN GENERAL.—No credit shall be allowed under subsection (a) for any expense for which a deduction or credit is allowable under any other provision of this chapter.

"(B) GRANTS.—No credit shall be allowed under subsection (a) for any expense to the extent that funds for such expense are received under any Federal, State, or local program.

"(C) REIMBURSEMENT.—No credit shall be allowed under subsection (a) for any expense to the extent that such expense is reimbursed and the reimbursement is excluded from gross income under section 137.

"(c) CARRYFORWARDS OF UNUSED CREDIT.—If the credit allowable under subsection (a) for any taxable year exceeds the limitation imposed by section 26(a) for such taxable year reduced by the sum of the credits allowable under this subpart (other than this section), such excess shall be carried to the succeeding taxable year and added to the credit allowable under subsection (a) for such taxable year. No credit may be carried forward under this subsection to any taxable year following the fifth taxable year after the taxable year in which the credit arose.

"(d) QUALIFIED ADOPTION EXPENSES.—

"(1) IN GENERAL.—The term 'qualified adoption expenses' means reasonable and necessary adoption fees, court costs, attorney fees, and other expenses—

"(A) which are directly related to, and the principal purpose of which is for, the legal and final adoption of an eligible child by the taxpayer, and

"(B) which are not incurred in violation of State or Federal law or in carrying out any surrogate parenting arrangement.

"(2) EXPENSES FOR ADOPTION OF SPOUSE'S CHILD NOT ELIGIBLE.—The term 'qualified adoption expenses' shall not include any expenses in connection with the adoption by an individual of a child who is the child of such individual's spouse.

"(3) ELIGIBLE CHILD.—The term 'eligible child' means any individual—

"(A) who has not attained age 18 as of the time of the adoption, or

"(B) who is physically or mentally incapable of caring for himself.

"(e) MARRIED COUPLES MUST FILE JOINT RETURNS.—Rules similar to the rules of paragraphs (2), (3), and (4) of section 21(e) shall apply for purposes of this section."

(b) EXCLUSION OF AMOUNTS RECEIVED UNDER EMPLOYER'S ADOPTION ASSISTANCE PROGRAMS.—Part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income) is amended by redesignating section 137 as section 138 and by inserting after section 136 the following new section:

"SEC. 137. ADOPTION ASSISTANCE PROGRAMS.

"(a) IN GENERAL.—Gross income of an employee does not include amounts paid or expenses incurred by the employer for qualified adoption expenses in connection with the adoption of a child by an employee if such amounts are furnished pursuant to an adoption assistance program.

"(b) LIMITATIONS.—

"(1) DOLLAR LIMITATION.—The aggregate amount excludable from gross income under subsection (a) for all taxable years with respect to the adoption of any single child by the taxpayer shall not exceed $5,000.

"(2) INCOME LIMITATION.—The amount excludable from gross income under subsection (a) for any taxable year shall be reduced (but not below zero) by an amount which bears the same ratio to the amount so excludable (determined without regard to this paragraph but with regard to paragraph (1)) as—

"(A) the amount (if any) by which the taxpayer's taxable income (determined without regard to this section) exceeds $60,000, bears to

"(B) $40,000.

"(c) ADOPTION ASSISTANCE PROGRAM.—For purposes of this section, an adoption assistance program is a plan of an employer—

"(1) under which the employer provides employees with adoption assistance, and

"(2) which meets requirements similar to the requirements of paragraphs (2), (3), and (5) of section 127(b).

An adoption reimbursement program operated under section 1052 of title 10, United States Code (relating to armed forces) or section 514 of title 14, United States Code (relating to members of the Coast Guard) shall be treated as an adoption assistance program for purposes of this section.

"(d) QUALIFIED ADOPTION EXPENSES.—For purposes of this section, the term 'qualified adoption expenses' has the meaning given such term by section 24(d)."

(c) CONFORMING AMENDMENTS.—

(1) The table of sections for subpart A of part IV of subchapter A of chapter 1, as amended by section 12001, is amended by inserting after the item relating to section 23 the following new item:

"Sec. 24. Adoption expenses."

(2) The table of sections for part III of subchapter B of chapter 1 is amended by striking the item relating to section 137 and inserting the following:

"Sec. 137. Adoption assistance programs.
"Sec. 138. Cross reference to other Acts."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12004. 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 sections 12001 and 12003, is amended by inserting after section 24 the following new section:

"SEC. 24A. 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 20 percent of the interest paid by the taxpayer during the taxable year on any qualified education loan.

"(b) MAXIMUM CREDIT.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the credit allowed by subsection (a) for the taxable year shall not exceed $500 ($1,000 if the taxpayer has 1 or more qualified education loans covering the qualified higher education expenses of more than 1 individual).

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

"(A) IN GENERAL.—If the modified adjusted gross income of the taxpayer for the taxable year exceeds $40,000 ($60,000 in the case of a joint return), the amount which would (but for this paragraph) be allowable as a credit under this section shall be reduced (but not below zero) by the amount which bears the same ratio to the amount which would be so allowable as such excess bears to $15,000.

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

"(i) without regard to sections 135, 911, 931, and 933, and

"(ii) after application of sections 86, 219, and 469.

"(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 1996, the $40,000 and $60,000 amounts referred to in subparagraph (A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section (1)(f)(3) for the calendar year in which the taxable year begins, by substituting '1995' for '1992'.

"(D) ROUNDING.—If any amount as adjusted under subparagraph (C) is not a multiple of $50, such amount shall be rounded to the nearest multiple of $50.

"(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) IN GENERAL.—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 during the first 60 months (whether or not consecutive) in which interest payments are required. 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 qualified higher 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 incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer,

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

"(C) 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.—The term 'qualified higher education expenses' means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087*ll*, as in effect on the day before the date of the enactment of this Act) of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at an eligible educational institution, reduced by the sum of—

"(A) the amount excluded from gross income under section 135 by reason of such expenses, and

"(B) the amount of the reduction described in section 135(d)(1).

For purposes of the preceding sentence, the term 'eligible educational institution' has the same meaning given such term by section 135(c)(3), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

"(3) 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.

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

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

(b) REPORTING REQUIREMENT.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by inserting after section 6050P the following new section:

"SEC. 6050Q. RETURNS RELATING TO EDUCATION LOAN INTEREST RECEIVED IN TRADE OR BUSINESS FROM INDIVIDUALS.

"(a) EDUCATION LOAN INTEREST OF $600 OR MORE.—Any person—

"(1) who is engaged in a trade or business, and

"(2) who, in the course of such trade or business, receives from any individual interest aggregating $600 or more for any calendar year on 1 or more qualified education loans,

shall make the return described in subsection (b) with respect to each individual from whom such interest was received at such time as the Secretary may by regulations prescribe.

"(b) FORM AND MANNER OF RETURNS.—A return is described in this subsection if such return—

"(1) is in such form as the Secretary may prescribe,

"(2) contains—

"(A) the name, address, and TIN of the individual from whom the interest described in subsection (a)(2) was received,

"(B) the amount of such interest received for the calendar year, and

"(C) such other information as the Secretary may prescribe.

"(c) APPLICATION TO GOVERNMENTAL UNITS.—For purposes of subsection (a)—

"(1) TREATED AS PERSONS.—The term 'person' includes any governmental unit (and any agency or instrumentality thereof).

"(2) SPECIAL RULES.—In the case of a governmental unit or any agency or instrumentality thereof—

"(A) subsection (a) shall be applied without regard to the trade or business requirement contained therein, and

"(B) any return required under subsection (a) shall be made by the officer or employee appropriately designated for the purpose of making such return.

"(d) STATEMENTS TO BE FURNISHED TO INDIVIDUALS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each individual whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the aggregate amount of interest described in subsection (a)(2) received by the person required to make such return from the individual to whom the statement is required to be furnished.

The written statement required under the preceding sentence shall be furnished on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made.

"(e) QUALIFIED EDUCATION LOAN DEFINED.—For purposes of this section, except as provided in regulations prescribed by the Secretary, the term 'qualified education loan' has the meaning given such term by section 24A(e)(1).

"(f) RETURNS WHICH WOULD BE REQUIRED TO BE MADE BY 2 OR MORE PERSONS.—Except to the extent provided in regulations prescribed by the Secretary, in the case of interest received by any person on behalf of another person, only the person first receiving such interest shall be required to make the return under subsection (a)."

(2) ASSESSABLE PENALTIES.—Section 6724(d) (relating to definitions) is amended—

(A) by redesignating clauses (ix) through (xiv) as clauses (x) through (xv), respectively, in paragraph (1)(B) and by inserting after clause (viii) of such paragraph the following new clause:

"(ix) section 6050Q (relating to returns relating to education loan interest received in trade or business from individuals),", and

(B) by redesignating subparagraphs (Q) through (T) as subparagraphs (R) through (U), respectively, in paragraph (2) and by inserting after subparagraph (P) of such paragraph the following new subparagraph:

"(Q) section 6050Q (relating to returns relating to education loan interest received in trade or business from individuals),".

(c) CLERICAL AMENDMENTS.—

(1) The table of sections for subpart A of part IV of subchapter A of chapter 1, as amended by sections 12001 and 12003, is amended by inserting after the item relating to section 24 the following new item:

"Sec. 24A. Interest on education loans."

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6050P the following new item:

"Sec. 6050Q. Returns relating to education loan interest received in trade or business from individuals."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to any qualified education loan (as defined in section 24A(e)(1) of the Internal Revenue Code of 1986, as added by this section) incurred on, before, or after the date of the enactment of this Act, but only with respect to any loan interest payment due after December 31, 1995.

Subtitle B—Savings and Investment Incentives

CHAPTER 1—RETIREMENT SAVINGS INCENTIVES

Subchapter A—Individual Retirement Plans

PART I—RESTORATION OF IRA DEDUCTION

SEC. 12101. RESTORATION OF IRA DEDUCTION.

(a) INCREASE IN INCOME LIMITS FOR ACTIVE PARTICIPANTS.—

(1) IN GENERAL.—Subparagraph (B) of section 219(g)(3) (relating to applicable dollar amount) is amended to read as follows:

"(B) APPLICABLE DOLLAR AMOUNT.—The term 'applicable dollar amount' means the following:

"(i) In the case of a taxpayer filing a joint return:

"For taxable years beginning in:	The applicable dollar amount is:
1996	$45,000
1997	$50,000
1998	$55,000
1999	$60,000
2000	$65,000
2001	$70,000
2002	$75,000
2003	$80,000
2004	$85,000
2005	$90,000
2006	$95,000
2007 and thereafter	$100,000.

"(ii) In the case of any other taxpayer (other than a married individual filing a separate return):

"For taxable years beginning in:	The applicable dollar amount is:
1996	$30,000
1997	$35,000
1998	$40,000
1999	$45,000
2000	$50,000
2001	$55,000
2002	$60,000
2003	$65,000
2004	$70,000
2005	$75,000
2006	$80,000
2007 and thereafter	$85,000.

"(iii) In the case of a married individual filing a separate return, zero."

(2) INCREASE IN PHASE-OUT RANGE FOR JOINT RETURNS.—Clause (ii) of section 219(g)(2)(A) is amended by inserting "($20,000 in the case of a joint return)" after "$10,000".

(3) COST-OF-LIVING ADJUSTMENTS.—Section 219(g)(3) is amended by adding at the end the following new subparagraph:

"(C) COST-OF-LIVING ADJUSTMENTS.—In the case of any taxable year beginning in a calendar year after 2007, the

$100,000 and $85,000 amounts in clauses (i) and (ii) of subparagraph (B) shall each be increased by an amount equal to the product of such dollar amount and the cost-of-living adjustment for the calendar year determined under subsection (h)(3), except that subsection (h)(3)(A)(ii) shall be applied by substituting '2006' for '1994'. If any amount to which either such amount is increased is not a multiple of $5,000, such amount shall be rounded to the next lower multiple of $5,000."

(b) INDIVIDUAL NOT DISQUALIFIED BY SPOUSE'S PARTICIPATION.—Paragraph (1) of section 219(g) (relating to limitation on deduction for active participants in certain pension plans) is amended by striking "or the individual's spouse".

(c) REPEAL OF NONDEDUCTIBLE CONTRIBUTIONS.—

(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 the following new paragraph.

"(5) TERMINATION.—This subsection shall not apply to any designated nondeductible contribution for any taxable year beginning after December 31, 1995."

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

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12102. INFLATION ADJUSTMENT FOR DEDUCTIBLE AMOUNT.

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

"(h) COST-OF-LIVING ADJUSTMENTS.—

"(1) DEDUCTION AMOUNT.—

"(A) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 1996, the $2,000 amount under subsection (b)(1)(A) shall be increased by an amount equal to the product of $2,000 and the cost-of-living adjustment for the calendar year.

"(B) ROUNDING TO NEXT LOWER $500.—If the amount to which $2,000 would be increased under subparagraph (A) is not a multiple of $500, such amount shall be rounded to the next lower multiple of $500.

"(2) 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 1995.

"(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)."

(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".

SEC. 12103. HOMEMAKERS ELIGIBLE FOR FULL IRA DEDUCTION.

(a) SPOUSAL IRA COMPUTED ON BASIS OF COMPENSATION OF BOTH SPOUSES.—Subsection (c) of section 219 (relating to special rules for certain married individuals) is amended to read as follows:

"(c) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS.—

"(1) IN GENERAL.—In the case of an individual to whom this paragraph applies for the taxable year, the limitation of paragraph (1) of subsection (b) shall be equal to the lesser of—

"(A) the dollar amount in effect under subsection (b)(1)(A) for the taxable year, or

"(B) the sum of—

"(i) the compensation includible in such individual's gross income for the taxable year, plus

"(ii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by—

"(I) the amount allowable as a deduction under subsection (a) to such spouse for such taxable year, and

"(II) the amount of any contribution on behalf of such spouse to an IRA Plus account under section 408A for such taxable year.

"(2) INDIVIDUALS TO WHOM PARAGRAPH (1) APPLIES.—Paragraph (1) shall apply to any individual if—

"(A) such individual files a joint return for the taxable year, and

"(B) the amount of compensation (if any) includible in such individual's gross income for the taxable year is less than the compensation includible in the gross income of such individual's spouse for the taxable year."

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 219(f) (relating to other definitions and special rules) is amended by striking "subsections (b) and (c)" and inserting "subsection (b)".

(2) Section 408(d)(5) is amended by striking "$2,250" and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(3) Section 219(g)(1) is amended by striking "(c)(2)" and inserting "(c)(1)(A)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12104. CERTAIN COINS AND BULLION NOT TREATED AS COLLECTIBLES.

(a) IN GENERAL.—Paragraph (3) of section 408(m) (relating to exception for certain coin) is amended to read as follows:

"(3) EXCEPTION FOR CERTAIN COINS AND BULLION.—For purposes of this subsection, the term 'collectible' shall not include—

"(A) any coin certified by a recognized grading service and traded on a nationally recognized electronic network, or listed by a recognized wholesale reporting service, and—

"(i) which is or was at any time legal tender in the country of issuance, or

"(ii) issued under the laws of any State, and

"(B) any gold, silver, platinum, or palladium bullion (whether fabricated in the form of a coin or otherwise) of a fineness equal to or exceeding the minimum fineness required for metals which may be delivered in satisfaction of a regulated futures contract subject to regulation by the Commodity Futures Trading Commission under the Commodity Exchange Act,

if such coin or bullion is in the physical possession of a trustee described under subsection (a) of this section."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1995.

PART II—NONDEDUCTIBLE TAX-FREE IRAS

SEC. 12111. 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. IRA PLUS ACCOUNTS.

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

"(b) IRA PLUS ACCOUNT.—For purposes of this title, the term 'IRA Plus account' means an individual retirement plan which is designated at the time of establishment of the plan as an IRA Plus account.

"(c) TREATMENT OF CONTRIBUTIONS.—

"(1) NO DEDUCTION ALLOWED.—No deduction shall be allowed under section 219 for a contribution to an IRA Plus account.

"(2) CONTRIBUTION LIMIT.—The aggregate amount of contributions for any taxable year to all IRA Plus 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 (computed without regard to subsection (g) of such section), over

"(B) the amount so allowed.

"(3) ROLLOVER CONTRIBUTIONS.—

"(A) IN GENERAL.—No rollover contribution may be made to an IRA Plus account unless it is a qualified rollover contribution.

"(B) COORDINATION WITH LIMIT.—A qualified rollover contribution shall not be taken into account for purposes of paragraph (2).

"(d) TAX TREATMENT OF DISTRIBUTIONS.—

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

"(2) EXCEPTION FOR EARNINGS ON CONTRIBUTIONS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), any amount distributed out of an IRA Plus account which consists of earnings shall be included in the gross income of the distributee for the taxable year in which the distribution occurs.

"(B) EXCEPTIONS FOR EARNINGS ON CONTRIBUTIONS HELD AT LEAST 5 YEARS.—Subparagraph (A) shall not apply to earnings allocable to contributions held in an IRA Plus account for at least 5 years as of the date of the distribution but only if—

"(i) such distribution occurs on or after the date on which the individual for whom the account was established attains age 59½, or

"(ii) in any case where such distribution occurs before such date, the distribution is described in any subparagraph of section 72(t)(2) (other than subparagraph (A)(i) thereof).

"(C) ORDERING RULE.—

"(i) FIRST-IN, FIRST-OUT RULE.—Distributions from an IRA Plus 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.—For purposes of this subparagraph and section 72(t)(8), all contributions made for the same taxable year shall be treated as 1 contribution made on the first day of the taxable year.

"(D) CROSS REFERENCE.—

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

"(3) ROLLOVERS.—

"(A) IN GENERAL.—Paragraph (2) shall not apply to any distribution which is transferred in a qualified rollover contribution to another IRA Plus account.

"(B) CONTRIBUTION PERIOD.—For purposes of paragraph (2), the IRA Plus account to which any contributions are transferred from another IRA Plus account 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 account from which transferred.

"(4) SPECIAL RULES RELATING TO QUALIFIED ROLLOVERS.—

"(A) IN GENERAL.—Notwithstanding any other provision of law, in the case of a qualified rollover contribution to an IRA Plus account from an individual retirement plan which is not an IRS Plus account—

"(i) there shall be included in gross income any amount which, but for the qualified rollover contribution, 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 rollover contribution which occurs before January 1, 1998, 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 ROLLOVER CONTRIBUTION.—For purposes of this section, the term 'qualified rollover contribution' means a rollover contribution to an IRA Plus account from another such account, or from an individual retirement plan but only if such rollover contribution meets the requirements of section 408(d)(3). For purposes of section 408(d)(3)(B), there shall be disregarded any qualified rollover contribution from an individual retirement plan to an IRA plus account."

(b) EARLY WITHDRAWAL PENALTY.—Section 72(t), as amended by section 12121(c), is amended by adding at the end the following new paragraph:

"(8) SPECIAL RULES FOR DISTRIBUTIONS FROM IRA PLUS ACCOUNTS.—Notwithstanding any other provision of this subsection, paragraph (1) shall apply to any amount received from an IRA Plus account to the extent such amount is required to be included in gross income under section 408A(d)(2) unless such amount is part of a distribution required under section 401(a)(9)."

(c) EXCESS CONTRIBUTIONS.—Section 4973(b) is amended by adding at the end 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. IRA Plus accounts."

(e) EFFECTIVE DATES.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

Subchapter B—Penalty-Free Distributions

SEC. 12121. DISTRIBUTIONS FROM CERTAIN PLANS MAY BE USED WITHOUT PENALTY TO PURCHASE FIRST HOMES OR TO PAY HIGHER EDUCATION OR FINANCIALLY DEVASTATING MEDICAL EXPENSES.

(a) 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 at the end the following new subparagraph:

"(D) DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR FIRST HOME PURCHASES OR EDUCATIONAL EXPENSES.—Distributions to an individual from an individual retirement plan—

"(i) which are qualified first-time homebuyer distributions (as defined in paragraph (6)), or

"(ii) to the extent such distributions do not exceed the qualified higher education expenses (as defined in paragraph (7)) of the taxpayer for the taxable year."

(b) FINANCIALLY DEVASTATING MEDICAL EXPENSES.—

(1) IN GENERAL.—Section 72(t)(3)(A) 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) in the case of an individual retirement plan, 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)".

(c) DEFINITIONS.—Section 72(t) is amended by adding at the end the following new paragraphs:

"(6) QUALIFIED FIRST-TIME HOMEBUYER DISTRIBUTIONS.—For purposes of paragraph (2)(D)(i)—

"(A) IN GENERAL.—The term 'qualified first-time homebuyer distribution' means any payment or distribution received by an individual to the extent such payment or distribution is used by the individual before the close of the 60th day after the day on which such payment or distribution is received to pay qualified acquisition costs with respect to a principal residence of a first-time homebuyer who is such individual, the spouse of such individual, or any child, grandchild, or ancestor of such individual or the individual's spouse.

"(B) LIFETIME DOLLAR LIMITATION.—The aggregate amount of payments or distributions received by an individual which may be treated as qualified first-time homebuyer distributions for any taxable year shall not exceed the excess (if any) of—

"(i) $10,000, over

"(ii) the aggregate amounts treated as qualified first-time homebuyer distributions with respect to such individual for all prior taxable years.

"(C) QUALIFIED ACQUISITION COSTS.—For purposes of this paragraph, the term 'qualified acquisition costs' means the costs of acquiring, constructing, or reconstructing a residence. Such term includes any usual or reasonable settlement, financing, or other closing costs.

"(D) FIRST-TIME HOMEBUYER; OTHER DEFINITIONS.—For purposes of this paragraph—

"(i) FIRST-TIME HOMEBUYER.—The term 'first-time homebuyer' means any individual if—

"(I) such individual (and if married, such individual's spouse) had no present ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which this paragraph applies, 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).

"(ii) PRINCIPAL RESIDENCE.—The term 'principal residence' has the same meaning as when used in section 1034.

"(iii) DATE OF ACQUISITION.—The term 'date of acquisition' means the date—

"(I) on which a binding contract to acquire the principal residence to which subparagraph (A) applies is entered into, or

"(II) on which construction or reconstruction of such a principal residence is commenced.

"(E) SPECIAL RULE WHERE DELAY IN ACQUISITION.—If any distribution from any 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 in determining whether section 408(d)(3)(A)(i) applies to any other amount.

"(7) QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of paragraph (2)(D)(ii)—

"(A) IN GENERAL.—The term 'qualified higher education expenses' means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of—

"(i) the taxpayer,

"(ii) the taxpayer's spouse, or

"(iii) any child (as defined in section 151(c)(3)), grandchild, or ancestor of the taxpayer or the taxpayer's spouse,

at an eligible educational institution (as defined in section 135(c)(3)).

"(B) COORDINATION WITH SAVINGS BOND PROVISIONS.—The amount of qualified higher education expenses for any taxable year shall be reduced by any amount excludable from gross income under section 135."

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

"(E) DISTRIBUTIONS TO UNEMPLOYED INDIVIDUALS.—A distribution from an individual retirement plan 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.

To the extent provided in regulations, a self-employed individual shall be treated as meeting the requirements of clause (i) if, under Federal or State law, the individual would have received unemployment compensation but for the fact the individual was self-employed."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

Subchapter C—Simple Savings Plans

SEC. 12131. ESTABLISHMENT OF SAVINGS INCENTIVE MATCH PLANS FOR EMPLOYEES OF SMALL EMPLOYERS.

(a) IN GENERAL.—Section 408 (relating to individual retirement accounts) is amended by redesignating subsection (p) as subsection (q) and by inserting after subsection (o) the following new subsection:

"(p) SIMPLE RETIREMENT ACCOUNTS.—

"(1) IN GENERAL.—For purposes of this title, the term 'simple retirement account' means an individual retirement plan—

"(A) with respect to which the requirements of paragraphs (3), (4), and (5) are met; and

"(B) with respect to which the only contributions allowed are contributions under a qualified salary reduction arrangement.

"(2) QUALIFIED SALARY REDUCTION ARRANGEMENT.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'qualified salary reduction arrangement' means a written arrangement of an eligible employer under which—

"(i) an employee eligible to participate in the arrangement may elect to have the employer make payments—

"(I) as elective employer contributions to a simple retirement account on behalf of the employee, or

"(II) to the employee directly in cash,

"(ii) the amount which an employee may elect under clause (i) for any year is required to be expressed as a percentage of compensation and may not exceed a total of $6,000 for any year,

"(iii) the employer is required to make a matching contribution to the simple retirement account for any year in an amount equal to so much of the amount the employee elects under clause (i)(I) as does not exceed the applicable percentage of compensation for the year, and

"(iv) no contributions may be made other than contributions described in clause (i) or (iii).

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

"(i) ELIGIBLE EMPLOYER.—The term 'eligible employer' means an employer who normally employs 100 or fewer employees on any day during the year.

"(ii) APPLICABLE PERCENTAGE.—

"(I) IN GENERAL.—The term 'applicable percentage' means 3 percent.

"(II) ELECTION OF LOWER PERCENTAGE.—An employer may elect to apply a lower percentage (not less than 1 percent) for any year for all employees eligible to participate in the plan for such year if the employer notifies the employees of such lower percentage within a reasonable period of time before the 60-day election period for such year under paragraph (5)(C). An employer may not elect a lower percentage under this subclause for any year if that election would result in the applicable percentage being lower than 3 percent in more than 2 of the years in the 5-year period ending with such year.

"(III) SPECIAL RULE FOR YEARS ARRANGEMENT NOT IN EFFECT.—If any year in the 5-year period described in subclause (II) is a year prior to the first year for which any qualified salary reduction arrangement is in effect with respect to the employer (or any predecessor), the employer shall be treated as if the level of the employer matching contribution was at 3 percent of compensation for such year.

"(C) ARRANGEMENT MAY BE ONLY PLAN OF EMPLOYER.—

"(i) IN GENERAL.—An arrangement shall not be treated as a qualified salary reduction arrangement for any year if the employer (or any predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, for service in any year in the period beginning with the year such arrangement became effective and ending with the year for which the determination is being made.

"(ii) QUALIFIED PLAN.—For purposes of this subparagraph, the term 'qualified plan' means a plan, contract, pension, or trust described in subparagraph (A) or (B) of section 219(g)(5).

"(D) NO FEE OR PENALTY ON EMPLOYEE'S INITIAL INVESTMENT DETERMINATION.—An arrangement shall not be treated as a qualified salary reduction arrangement unless it provides that no fee or penalty will be imposed on an employee's initial determination with respect to the investment of any contribution.

"(E) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust the $6,000 amount under subparagraph (A)(ii) at the same time and in the same manner as under section 415(d), except that the base period taken into account shall be the calendar quarter ending September 30, 1995, and any increase under this subparagraph which is not a multiple of $500 shall be rounded to the next lower multiple of $500.

"(3) VESTING REQUIREMENTS.—The requirements of this paragraph are met with respect to a simple retirement account if the employee's rights to any contribution to the simple retirement account are nonforfeitable. For purposes of this paragraph, the rules similar to the rules of subsection (k)(4) shall apply.

"(4) PARTICIPATION REQUIREMENTS.—

"(A) IN GENERAL.—The requirements of this paragraph are met with respect to any simple retirement account for a year only if, under the qualified salary reduction arrangement, all employees of the employer who—

"(i) received at least $5,000 in compensation from the employer during each of the 2 preceding years, and

"(ii) who are reasonably expected to receive at least $5,000 in compensation during the year,

are eligible to make the election under paragraph (2)(A)(i).

"(B) EXCLUDABLE EMPLOYEES.—An employer may elect to exclude from the requirement under subparagraph (A) employees described in section 410(b)(3).

"(5) ADMINISTRATIVE REQUIREMENTS.—The requirements of this paragraph are met with respect to any simplified retirement account if, under the qualified salary reduction arrangement—

"(A) an employer must—

"(i) make the elective employer contributions under paragraph (2)(A)(i) not later than the close of the 30-day period following the last day of the month with respect to which the contributions are to be made, and "(ii) make the matching contributions under paragraph (2)(A)(iii) not later than the date described in section 404(m)(2)(B),

"(B) an employee may elect to terminate participation in such arrangement at any time during the year, except that if an employee so terminates, the arrangement may provide that the employee may not elect to resume participation until the beginning of the next year, and

"(C) each employee eligible to participate may elect, during the 60-day period before the beginning of any year, to participate in the arrangement, or to modify the amounts subject to such arrangement, for such year.

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

"(A) COMPENSATION.—

"(i) IN GENERAL.—The term 'compensation' means amounts described in paragraphs (3) and (8) of section 6051(a).

"(ii) SELF-EMPLOYED.—In the case of an employee described in subparagraph (B), compensation means net earnings from self-employment determined under section 1402(a) without regard to any contribution under this subsection.

"(B) EMPLOYEE.—The term 'employee' includes an employee as defined in section 401(c)(1).

"(C) YEAR.—The term 'year' means the calendar year."

(b) SIMPLE RETIREMENT ACCOUNTS NOT TREATED AS PENSION PLANS.—Notwithstanding any other provision of law, a simplified retirement account or qualified salary reduction arrangement under section 408(p) of the Internal Revenue Code of 1986 shall not be treated as an employee benefit plan or pension plan for purposes of the Employee Retirement Income Security Act of 1974.

(c) TAX TREATMENT OF SIMPLE RETIREMENT ACCOUNTS.—

(1) DEDUCTIBILITY OF CONTRIBUTIONS BY EMPLOYEES.—

(A) Section 219(b) (relating to maximum amount of deduction) is amended by adding at the end the following new paragraph:

"(4) SPECIAL RULE FOR SIMPLE RETIREMENT ACCOUNTS.—This section shall not apply with respect to any amount contributed to a simple retirement account established under section 408(p)."

(B) Section 219(g)(5)(A) (defining active participant) is amended by striking "or" at the end of clause (iv) and by adding at the end the following new clause:

"(vi) any simple retirement account (within the meaning of section 408(p)), or".

(2) DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS.—Section 404 (relating to deductions for contributions of an employer to pension, etc. plans) is amended by adding at the end the following new subsection:

"(m) SPECIAL RULES FOR SIMPLE RETIREMENT ACCOUNTS.—

"(1) IN GENERAL.—Employer contributions to a simple retirement account shall be treated as if they are made to a plan subject to the requirements of this section.

"(2) TIMING.—

"(A) DEDUCTION.—Contributions described in paragraph (1) shall be deductible in the taxable year of the employer with or within which the calendar year for which the contributions were made ends.

"(B) CONTRIBUTIONS AFTER END OF YEAR.—For purposes of this subsection, contributions shall be treated as made for a taxable year if they are made on account of the taxable year and are made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof)."

(3) CONTRIBUTIONS AND DISTRIBUTIONS.—

(A) Section 402 (relating to taxability of beneficiary of employees' trust) is amended by adding at the end the following new subsection:

"(k) TREATMENT OF SIMPLE RETIREMENT ACCOUNTS.—Rules similar to the rules of paragraphs (1) and (3) of subsection (h) shall apply to contributions and distributions with respect to a simple retirement account under section 408(p)."

(B) Section 408(d)(3) is amended by adding at the end the following new subparagraph:

"(G) SIMPLE RETIREMENT ACCOUNTS.—This paragraph shall not apply to any amount paid or distributed out of a simple retirement account (as defined in section 408(p)) unless it is paid into another simple retirement account."

(C) Clause (i) of section 457(c)(2)(B) is amended by striking "section 402(h)(1)(B)" and inserting "section 402(h)(1)(B) or (k)".

(4) PENALTIES.—

(A) EARLY WITHDRAWALS.—Section 72(t) (relating to additional tax in early distributions), as amended by sections 12111(b) and 12121(c), is amended by adding at the end the following new paragraph:

"(9) SPECIAL RULES FOR SIMPLE RETIREMENT ACCOUNTS.—In the case of any amount received from a simple retirement account (within the meaning of section 408(p)) during the 2-year period beginning on the date such individual first participated in any qualified salary reduction arrangement maintained by the individual's employer under section 408(p)(2), paragraph (1) shall be applied by substituting '25 percent' for '10 percent'."

(B) FAILURE TO REPORT.—Section 6693 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) PENALTIES RELATING TO SIMPLE RETIREMENT ACCOUNTS.—

"(1) EMPLOYER PENALTIES.—An employer who fails to provide 1 or more notices required by section 408(l)(2)(C) shall pay a penalty of $50 for each day on which such failures continue.

"(2) TRUSTEE PENALTIES.—A trustee who fails—

"(A) to provide 1 or more statements required by the last sentence of section 408(i) shall pay a penalty of $50 for each day on which such failures continue, or

"(B) to provide 1 or more summary descriptions required by section 408(l)(2)(B) shall pay a penalty of $50 for each day on which such failures continue.

"(3) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under this subsection with respect to any failure which the taxpayer shows was due to reasonable cause."

(5) REPORTING REQUIREMENTS.—

(A)(i) Section 408(l) is amended by adding at the end the following new paragraph:

"(2) SIMPLE RETIREMENT ACCOUNTS.—

"(A) NO EMPLOYER REPORTS.—Except as provided in this paragraph, no report shall be required under this section by an employer maintaining a qualified salary reduction arrangement under subsection (p).

"(B) SUMMARY DESCRIPTION.—The trustee of any simple retirement account established pursuant to a qualified salary reduction arrangement under subsection (p) shall provide to the employer maintaining the arrangement, each year a description containing the following information:

"(i) The name and address of the employer and the trustee.

"(ii) The requirements for eligibility for participation.

"(iii) The benefits provided with respect to the arrangement.

"(iv) The time and method of making elections with respect to the arrangement.

"(v) The procedures for, and effects of, withdrawals from the arrangement.

"(C) EMPLOYEE NOTIFICATION.—The employer shall notify each employee immediately before the period for which an election described in subsection (p)(5)(C) may be made of the employee's opportunity to make such election. Such notice shall include a copy of the description described in subparagraph (B)."

(ii) Section 408(l) is amended by striking "An employer" and inserting—

"(1) IN GENERAL.—An employer".

(B) Section 408(i) is amended by adding at the end the following new flush sentence:

"In the case of a simple retirement account under subsection (p), only one report under this subsection shall be required to be submitted each calendar year to the Secretary (at the time provided under paragraph (2)) but, in addition to the report under this subsection, there shall be furnished, within 30 days after each calendar year, to the individual on whose behalf the account is maintained a statement with respect to the account balance as of the close of, and the account activity during, such calendar year."

(6) EXEMPTION FROM TOP-HEAVY PLAN RULES.—Section 416(g)(4) (relating to special rules for top-heavy plans) is amended by adding at the end the following new subparagraph:

"(G) SIMPLE RETIREMENT ACCOUNTS.—The term 'top-heavy plan' shall not include a simple retirement account under section 408(p)."

(7) CONFORMING AMENDMENTS.—

(A) Section 280G(b)(6) is amended by striking "or" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", or" and by adding after subparagraph (C) the following new subparagraph:

"(D) a simple retirement account described in section 408(p)."

(B) Section 402(g)(3) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by adding after subparagraph (C) the following new subparagraph:

"(D) any elective employer contribution under section 408(p)(2)(A)(i)."

(C) Subsections (b), (c), (m)(4)(B), and (n)(3)(B) of section 414 are each amended by inserting "408(p)," after "408(k),".

(D) Section 4972(d)(1)(A) is amended by striking "and" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", and", and by adding after clause (iii) the following new clause:

"(iv) any simple retirement account (within the meaning of section 408(p))."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12132. EXTENSION OF SIMPLE PLAN TO 401(k) ARRANGEMENTS.

(a) ALTERNATIVE METHOD OF SATISFYING SECTION 401(k) NONDISCRIMINATION TESTS.—Section 401(k) (relating to cash or deferred arrangements) is amended by adding at the end the following new paragraph:

"(11) ADOPTION OF SIMPLE PLAN TO MEET NONDISCRIMINATION TESTS.—

"(A) IN GENERAL.—A cash or deferred arrangement maintained by an eligible employer shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement meets—

"(i) the contribution requirements of subparagraph (B),

"(ii) the exclusive benefit requirements of subparagraph (C), and

"(iii) the vesting requirements of section 408(p)(3).

"(B) CONTRIBUTION REQUIREMENTS.—The requirements of this subparagraph are met if, under the arrangement—

"(i) an employee may elect to have the employer make elective contributions for the year on behalf of the employee to a trust under the plan in an amount which is expressed as a percentage of compensation of the employee but which in no event exceeds $6,000,

"(ii) the employer is required to make a matching contribution to the trust for the year in an amount equal to so much of the amount the employee elects under clause (i) as does not exceed 3 percent of compensation for the year, and

"(iii) no other contributions may be made other than contributions described in clause (i) or (ii).

"(C) EXCLUSIVE BENEFIT.—The requirements of this subparagraph are met for any year to which this paragraph applies if no contributions were made, or benefits were accrued, for services during such year under any qualified plan of the employer on behalf of any employee eligible to participate in the cash or deferred arrangement, other than contributions described in subparagraph (B).

"(D) DEFINITIONS AND SPECIAL RULE.—

"(i) DEFINITIONS.—For purposes of this paragraph, any term used in this paragraph which is also used in section 408(p) shall have the meaning given such term by such section.

"(ii) COORDINATION WITH TOP-HEAVY RULES.—A plan meeting the requirements of this paragraph for any year shall not be treated as a top-heavy plan under section 416 for such year."

(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 defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

"(A) meets the contribution requirements of subparagraph (B) of subsection (k)(11),

"(B) meets the exclusive benefit requirements of subsection (k)(11)(C), and

"(C) meets the vesting requirements of section 408(p)(3)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 1995.

CHAPTER 2—CAPITAL GAINS REFORM

Subchapter A—Taxpayers Other Than Corporations

SEC. 12141. CAPITAL GAINS DEDUCTION.

(a) IN GENERAL.—Part I of subchapter P of chapter 1 (relating to treatment of capital gains) is amended by redesignating section 1202 as section 1203 and by inserting after section 1201 the following new section:

"SEC. 1202. CAPITAL GAINS DEDUCTION.

"(a) GENERAL RULE.—If for any taxable year a taxpayer other than a corporation has a net capital gain, 50 percent of such gain shall be a deduction from gross income.

"(b) ESTATES AND TRUSTS.—In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any) of the gains for the taxable year from sales or exchanges of capital assets which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

"(c) COORDINATION WITH TREATMENT OF CAPITAL GAIN UNDER LIMITATION ON INVESTMENT INTEREST.—For purposes of this section, the net capital gain for any taxable year shall be reduced (but not below zero) by the amount which the taxpayer takes into account as investment income under section 163(d)(4)(B)(iii).

"(d) SPECIAL RULE FOR COLLECTIBLES.—The rate of tax imposed by section 1 on the excess of—

"(1) the net capital gain for the taxable year determined as if section 1222(12) had not applied to any collectible sold or exchanged during the taxable year, over

"(2) the net capital gain for the taxable year,

shall not exceed 28 percent.

"(e) TRANSITIONAL RULE.—

"(1) IN GENERAL.—In the case of a taxable year which includes October 14, 1995—

"(A) the amount taken into account as the net capital gain under subsection (a) shall not exceed the net capital gain determined by only taking into account gains and losses properly taken into account for the portion of the taxable year on or after October 14, 1995, and

"(B) the amount of the net capital gain taken into account in applying section 1(h) for such year shall be reduced by the amount taken into account under subsection (a) for such year.

"(2) SPECIAL RULES FOR PASS-THRU ENTITIES.—

"(A) IN GENERAL.—In applying paragraph (1) with respect to any pass-thru entity, the determination of when gains and losses are properly taken into account shall be made at the entity level.

"(B) PASS-THRU ENTITY DEFINED.—For purposes of subparagraph (A), 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) DEDUCTION ALLOWABLE IN COMPUTING ADJUSTED GROSS INCOME.—Subsection (a) of section 62 is amended by inserting after paragraph (15) the following new paragraph:

"(16) LONG-TERM CAPITAL GAINS.—The deduction allowed by section 1202."

(c) ALTERNATIVE MINIMUM TAX.—

(1) HALF OF DEDUCTION DISALLOWED.—Section 56(b)(1) (relating to limitations on deductions of individuals) is amended by adding at the end the following new subparagraph:

"(G) CAPITAL GAINS DEDUCTION REDUCED.—In determining the deduction allowable under section 1202, section 1202(a) shall be applied by substituting '25 percent' for '50 percent'".

(2) CONFORMING AMENDMENT.—Section 57(a)(7) is amended by striking "1202" and inserting "1203".

(d) 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 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 the following: "and section 1222 shall be applied without regard to paragraph (12) thereof (relating to special rule for collectibles)".

(e) TECHNICAL AND CONFORMING CHANGES.—

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

(2) Paragraph (1) of section 170(e) is amended by striking "the amount of gain" in the material following subparagraph (B)(ii) and inserting "50 percent ($^{28}/_{35}$ in the case of a corporation) of the amount of gain".

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

"(B) the deduction under section 1202 and the exclusion under section 1203 shall not be allowed."

(4) The last sentence of section 453A(c)(3) is amended by striking all that follows "long-term capital gain," and inserting "the maximum rate on net capital gain under section 1201 or the deduction under section 1202 and the exclusion under section 1203 (whichever is appropriate) shall be taken into account."

(5) 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 from the sale or exchange of capital assets held for more than 1 year or gain described in section 1203(a), proper adjustment shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses) or for the exclusion allowable to the estate or trust under section 1203 (relating to exclusion for gain from certain small business stock). In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income)."

(6) The last sentence of section 643(a)(3) is amended to read as follows: "The deduction under section 1202 (relating to deduction of excess of capital gains over capital losses) and the exclusion under section 1203 (relating to exclusion for gain from certain small business stock) shall not be taken into account."

(7) Subparagraph (C) of section 643(a)(6) is amended by inserting "(i)" before "there shall" and by inserting before the period ", and (ii) the deduction under section 1202 (relating to capital gains deduction) and the exclusion under section 1203 (relating to exclusion for gain from certain small business stock) shall not be taken into account".

(8) Paragraph (4) of section 691(c) is amended by striking "sections 1(h), 1201, 1202, and 1211" and inserting "sections 1201, 1202, 1203, and 1211".

(9) The second sentence of section 871(a)(2) is amended by inserting "or 1203" after "section 1202".

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

"(B) OTHER TAXPAYERS.—In the case of a taxpayer other than a corporation, taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only to the extent of foreign source capital gain net income."

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

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

"(A) CORPORATIONS.—In the case of a corporation—", and

(ii) by striking in clause (i) "in lieu of applying subparagraph (A),".

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

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

(D) Clause (v) of section 593(b)(2)(D) is amended—

(i) by striking "if there is a capital gain rate differential (as defined in section 904(b)(3)(D)) for the taxable year,", and

(ii) by striking "section 904(b)(3)(E)" and inserting "section 904(b)(3)(D)".

(11) The last sentence of section 1044(d) is amended by striking "1202" and inserting "1203".

(12)(A) Paragraph (2) of section 1211(b) is amended to read as follows:

"(2) the sum of—

"(A) the excess of the net short-term capital loss over the net long-term capital gain, and

"(B) one-half of the excess of the net long-term capital loss over the net short-term capital gain."

(B) So much of paragraph (2) of section 1212(b) as precedes subparagraph (B) thereof is amended to read as follows:

"(2) SPECIAL RULES.—

"(A) ADJUSTMENTS.—

"(i) For purposes of determining the excess referred to in paragraph (1)(A), there shall be treated as short-term capital gain in the taxable year an amount equal to the lesser of—

"(I) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b), or

"(II) the adjusted taxable income for such taxable year.

"(ii) For purposes of determining the excess referred to in paragraph (1)(B), there shall be treated as short-term capital gain in the taxable year an amount equal to the sum of—

"(I) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b) or the adjusted taxable income for such taxable year, whichever is the least, plus

"(II) the excess of the amount described in subclause (I) over the net short-term capital loss (determined without regard to this subsection) for such year."

(C) Subsection (b) of section 1212 is amended by adding at the end the following new paragraph:

"(3) TRANSITIONAL RULE.—In the case of any amount which, under this subsection and section 1211(b) (as in effect for taxable years beginning before January 1, 1996), is treated as a capital loss in the first taxable year beginning after December 31, 1995, paragraph (2) and section 1211(b) (as so in effect) shall apply (and paragraph (2) and section 1211(b) as in effect for taxable years beginning after December 31, 1995, shall not apply) to the extent such amount exceeds the total of any capital gain net income (determined without regard to this subsection) for taxable years beginning after December 31, 1995."

(13) Paragraph (1) of section 1402(i) is amended by inserting ", and the deduction provided by section 1202 and the ex-

clusion provided by section 1203 shall not apply" before the period at the end thereof.

(14) Subsection (e) of section 1445 is amended—

(A) in paragraph (1) by striking "35 percent (or, to the extent provided in regulations, 28 percent)" and inserting "28 percent (or, to the extent provided in regulations, 19.8 percent)", and

(B) in paragraph (2) by striking "35 percent" and inserting "28 percent".

(15)(A) The second sentence of section 7518(g)(6)(A) is amended—

(i) by striking "during a taxable year to which section 1(h) or 1201(a) applies", and

(ii) by striking "28 percent (34 percent" and inserting "19.8 percent (28 percent".

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

(i) by striking "during a taxable year to which section 1(h) or 1201(a) of such Code applies", and

(ii) by striking "28 percent (34 percent" and inserting "19.8 percent (28 percent".

(16) Section 1203, as redesignated by subsection (a), is amended by adding at the end the following new subsection:

"(l) CROSS REFERENCE.—

"For treatment of eligible gain not excluded under subsection (a), see section 1202."

(f) CLERICAL AMENDMENT.—The table of sections for part I of subchapter P of chapter 1 is amended by striking the item relating to section 1202 and by inserting after the item relating to section 1201 the following new items:

"Sec. 1202. Capital gains deduction.
"Sec. 1203. 50-percent exclusion for gain from certain small business stock."

(g) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years ending after October 13, 1995.

(2) COLLECTIBLES.—The amendments made by subsection (d) shall apply to sales and exchanges after October 13, 1995.

(3) REPEAL OF SECTION 1(h).—The amendment made by subsection (e)(1) shall apply to taxable years beginning after October 13, 1995.

(4) CONTRIBUTIONS.—The amendment made by subsection (e)(2) shall apply to contributions after October 13, 1995.

(5) USE OF LONG-TERM LOSSES.—The amendments made by subsection (e)(12) shall apply to taxable years beginning after December 31, 1995.

(6) WITHHOLDING.—The amendment made by subsection (e)(14) shall apply only to amounts paid after the date of the enactment of this Act.

SEC. 12142. MODIFICATIONS TO EXCLUSION OF GAIN ON CERTAIN SMALL BUSINESS STOCK.

(a) STOCK OF LARGER BUSINESSES ELIGIBLE FOR EXCLUSION.—Paragraph (1) of section 1203(d), as redesignated by section 12141, is amended by striking "$50,000,000" each place it appears and inserting "$100,000,000".

(b) REPEAL OF PER-ISSUER LIMITATION.—Section 1203, as so redesignated, is amended by striking subsection (b).

(c) OTHER MODIFICATIONS.—

(1) REPEAL OF WORKING CAPITAL LIMITATION.—Paragraph (6) of section 1203(e), as so redesignated, is amended—

(A) by striking "2 years" in subparagraph (B) and inserting "5 years", and

(B) by striking the last sentence.

(2) EXCEPTION FROM REDEMPTION RULES WHERE BUSINESS PURPOSE.—Paragraph (3) of section 1203(c), as so redesignated, is amended by adding at the end the following new subparagraph:

"(D) WAIVER WHERE BUSINESS PURPOSE.—A purchase of stock by the issuing corporation shall be disregarded for purposes of subparagraph (B) if the issuing corporation establishes that there was a business purpose for such purchase and one of the principal purposes of the purchase was not to avoid the limitations of this section."

(d) EFFECTIVE DATES.—

(1) INCREASE IN SIZE.—The amendment made by subsection (a) shall apply to stock issued after the date of the enactment of this Act.

(2) OTHER RULES.—The amendments made by subsections (b) and (c) shall apply to stock issued after August 10, 1993.

SEC. 12143. ROLLOVER OF GAIN FROM SALE OF QUALIFIED STOCK.

(a) IN GENERAL.—Part III of subchapter O of chapter 1 is amended by adding at the end the following new section:

"SEC. 1045. ROLLOVER OF GAIN FROM QUALIFIED SMALL BUSINESS STOCK TO ANOTHER QUALIFIED SMALL BUSINESS STOCK.

"(a) NONRECOGNITION OF GAIN.—If a taxpayer other than a corporation elects the application of this section to any sale of qualified small business stock, eligible gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds—

"(1) the cost of any qualified small business stock purchased by the taxpayer during the 60-day period beginning on the date of such sale, reduced by

"(2) any portion of such cost previously taken into account under this section.

This section shall not apply to any gain which is treated as ordinary income for purposes of this title.

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

"(1) QUALIFIED SMALL BUSINESS STOCK.—The term 'qualified small business stock' has the meaning given such term by section 1203(c).

"(2) ELIGIBLE GAIN.—The term 'eligible gain' means any gain from the sale or exchange of qualified small business stock held for more than 5 years.

"(3) PURCHASE.—A taxpayer shall be treated as having purchased any property if, but for paragraph (4), the unadjusted basis of such property in the hands of the taxpayer would be its cost (within the meaning of section 1012).

"(4) BASIS ADJUSTMENTS.—If gain from any sale is not recognized by reason of subsection (a), such gain shall be applied to reduce (in the order acquired) the basis for determining gain or loss of any qualified small business stock which is purchased by the taxpayer during the 60-day period described in subsection (a).

"(c) SPECIAL RULES FOR TREATMENT OF REPLACEMENT STOCK.—

"(1) HOLDING PERIOD FOR ACCRUED GAIN.—For purposes of this chapter, gain from the disposition of any replacement qualified small business stock shall be treated as eligible gain to the extent that the amount of such gain does not exceed the amount of the reduction in the basis of such stock by reason of subsection (b)(4).

"(2) TACKING OF HOLDING PERIOD FOR PURPOSES OF DEFERRAL.—Solely for purposes of applying this section, if any replacement qualified small business stock is disposed of before the taxpayer has held such stock for more than 5 years, gain from such stock shall be treated eligible gain for purposes of subsection (a).

"(3) REPLACEMENT QUALIFIED SMALL BUSINESS STOCK.—For purposes of this subsection, the term 'replacement qualified small business stock' means any qualified small business stock the basis of which was reduced under subsection (b)(4)."

(b) CONFORMING AMENDMENTS.—

(1) Section 1016(a)(23) is amended—

(A) by striking "or 1044" and inserting ", 1044, or 1045", and

(B) by striking "or 1044(d)" and inserting ", 1044(d), or 1045(b)(4)".

(2) The table of sections for part III of subchapter O of chapter 1 is amended by adding at the end the following new item:

"Sec. 1045. Rollover of gain from qualified small business stock to another qualified small business stock."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to stock sold or exchanged after the date of the enactment of this Act.

Subchapter B—Corporate Capital Gains

SEC. 12151. REDUCTION OF ALTERNATIVE CAPITAL GAIN TAX FOR CORPORATIONS.

(a) IN GENERAL.—Section 1201 is amended to read as follows:

"SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.

"(a) GENERAL RULE.—If for any taxable year a corporation has a net capital gain, then, in lieu of the tax imposed by sections 11, 511, and 831 (a) and (b) (whichever is applicable), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

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

"(2) a tax of 28 percent of the net capital gain.

"(b) SPECIAL RULES FOR QUALIFIED SMALL BUSINESS GAIN.—

"(1) IN GENERAL.—If for any taxable year a corporation has gain from the sale or exchange of any qualified small business stock held for more than 5 years, the amount determined under subsection (a)(2) for such taxable year shall be equal to the sum of—

"(A) 21 percent of the lesser of such gain or the corporation's net capital gain, plus

"(B) 28 percent of the net capital gain reduced by the gain taken into account under subparagraph (A).

"(2) QUALIFIED SMALL BUSINESS STOCK.—For purposes of paragraph (1), the term 'qualified small business stock' has the meaning given such term by section 1203(c), except that stock shall not be treated as qualified small business stock if such stock was at any time held by a member of a parent-subsidiary controlled group (as defined in section 1203(d)(3)).

"(c) TRANSITIONAL RULE.—

"(1) IN GENERAL.—In applying this section, net capital gain for any taxable year shall not exceed such net capital gain determined by taking into account only gain or loss properly taken into account for the portion of the taxable year after October 13, 1995.

"(2) SPECIAL RULE FOR PASS-THRU ENTITIES.—Section 1202(e)(2) shall apply for purposes of paragraph (1).

"(d) CROSS REFERENCES.—

"For computation of the alternative tax—

"(1) in the case of life insurance companies, see section 801(a)(2),

"(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3)(A) and (D), and

"(3) in the case of real estate investment trusts, see section 857(b)(3)(A)."

(b) TECHNICAL AMENDMENT.—Clause (iii) of section 852(b)(3)(D) is amended by striking "65 percent" and inserting "72 percent".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years ending after October 13, 1995.

(2) QUALIFIED SMALL BUSINESS STOCK.—Section 1201(b) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to gain from qualified small business stock acquired on or after the date of the enactment of this Act.

CHAPTER 3—CORPORATE ALTERNATIVE MINIMUM TAX REFORM

SEC. 12161. MODIFICATION OF DEPRECIATION RULES UNDER MINIMUM TAX.

(a) IN GENERAL.—Clause (i) of section 56(a)(1)(A) is amended by striking "under the alternative system of section 168(g)" and inserting "under section 168 except that the recovery period used shall be the period determined under section 168(g)".

(b) CONFORMING AMENDMENT.—Clause (ii) of section 56(a)(1)(A) is amended by striking "The method" and inserting "In the case of property placed in service before January 1, 1996, the method".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after December 31, 1995.

SEC. 12162. LONG-TERM UNUSED CREDITS ALLOWED AGAINST MINIMUM TAX.

(a) IN GENERAL.—Section 53(c) (relating to limitation) is amended by adding at the end the following new paragraph:

"(2) SPECIAL RULE FOR TAXPAYERS WITH LONG-TERM UNUSED CREDITS.—

"(A) IN GENERAL.—If—

"(i) a corporation to which section 56(g) applies has a long-term unused minimum tax credit for a taxable year, and

"(ii) no credit would be allowable under this section for the taxable year by reason of paragraph (1),

then there shall be allowed a credit under subsection (a) for the taxable year in the amount determined under subparagraph (B).

"(B) AMOUNT OF CREDIT.—For purposes of subparagraph (A), the amount of the credit shall be equal to the least of the following for the taxable year:

"(i) The long-term unused minimum tax credit.

"(ii) 50 percent of the taxpayer's tentative minimum tax.

"(iii) The excess (if any) of the amount under paragraph (1)(B) over the amount under paragraph (1)(A).

"(C) LONG-TERM UNUSED MINIMUM TAX CREDIT.—For purposes of this paragraph—

"(i) IN GENERAL.—The long-term unused minimum tax credit for any taxable year is the portion of the minimum tax credit determined under subsection (b) attributable to the adjusted net minimum tax for taxable years beginning after 1986 and ending before the 5th taxable year immediately preceding the taxable year for which the determination is being made.

"(ii) FIRST-IN, FIRST-OUT ORDERING RULE.—For purposes of clause (i), credits shall be treated as allowed under subsection (a) on a first-in, first-out basis."

(b) CONFORMING AMENDMENTS.—(1) Section 53(c) (as in effect before the amendment made by subsection (a)) is amended—

(A) by striking "The" and inserting:

"(1) IN GENERAL.—The", and

(B) by redesignating paragraphs (1) and (2) as subparagraphs (A) and (B), respectively.

(2) Subparagraph (C) of section 108(b)(4) is amended by striking "and (G)" in the text and heading thereof and inserting ", (C), and (G)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

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Subtitle C—Health Related Provisions

CHAPTER 1—LONG-TERM CARE PROVISIONS

Subchapter A—Long-Term Care Services and Contracts

PART I—GENERAL PROVISIONS

SEC. 12201. QUALIFIED LONG-TERM CARE SERVICES TREATED AS MEDICAL CARE.

(a) GENERAL RULE.—Paragraph (1) of section 213(d) (defining medical care) is amended by striking "or" at the end of subparagraph (B), by redesignating subparagraph (C) as subparagraph (D), and by inserting after subparagraph (B) the following new subparagraph:

"(C) for qualified long-term care services (as defined in section 7702B(e)), or".

(b) TECHNICAL AMENDMENTS.—

(1) Subparagraph (D) of section 213(d)(1) (as redesignated by subsection (a)) is amended to read as follows:

"(D) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged)—

"(i) covering medical care referred to in subparagraphs (A) and (B), or

"(ii) covering medical care referred to in subparagraph (C), but only if such coverage is provided under a qualified long-term care insurance contract (as defined in section 7702B(b))."

(2) Paragraph (6) of section 213(d) is amended—

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

(B) by striking "paragraph (1)(C)" in subparagraph (A) and inserting "paragraph (1)(D)".

(3) Paragraph (7) of section 213(d) is amended by striking "subparagraphs (A) and (B)" and inserting "subparagraphs (A), (B), and (C)".

SEC. 12202. TREATMENT OF LONG-TERM CARE INSURANCE OR PLANS.

(a) GENERAL RULE.—Chapter 79 (relating to definitions) is amended by inserting after section 7702A the following new section:

"SEC. 7702B. TREATMENT OF LONG-TERM CARE INSURANCE OR PLANS.

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

"(1) a qualified long-term care insurance contract shall be treated as an accident or health insurance contract,

"(2) any plan of an employer providing coverage of qualified long-term care services shall be treated as an accident or health plan with respect to such services,

"(3) amounts (other than policyholder dividends, as defined in section 808, or premium refunds) received under such a contract or plan shall be treated as amounts received for personal injuries or sickness and shall be treated as reimbursement for expenses actually incurred for medical care (as defined in section 213(d)),

"(4) payments described in subsection (b)(5) shall be treated as payments made with respect to qualified long-term care services, and

"(5) a qualified long-term care insurance contract shall be treated as a guaranteed renewable contract subject to the rules of section 816(e).

"(b) QUALIFIED LONG-TERM CARE INSURANCE CONTRACT.—

"(1) IN GENERAL.—For purposes of this title, the term 'qualified long-term care insurance contract' means any insurance contract if—

"(A) the only insurance protection provided under such contract is coverage of qualified long-term care services, and

"(B) such contract meets the requirements of paragraphs (2), (3), and (4).

"(2) PREMIUM REQUIREMENTS.—

"(A) IN GENERAL.—The requirements of this paragraph are met with respect to a contract if such contract provides that—

"(i) premium payments may not be made earlier than the date such payments would have been made if the contract provided for level annual payments over the life of the contract (or, if shorter, 20 years), and

"(ii) all refunds of premiums, and all policyholder dividends or similar amounts, under such contract are to be applied as a reduction in future premiums or to increase future benefits.

A contract shall not be treated as failing to meet the requirements of clause (i) solely by reason of a provision providing for a waiver of premiums if the insured becomes a functionally impaired individual.

"(B) REFUNDS UPON DEATH OR COMPLETE SURRENDER OR CANCELLATION.—Subparagraph (A)(ii) shall not apply to any refund on the death of the insured, or on any complete surrender or cancellation of the contract, if, under the contract, the amount refunded may not exceed the amount of the premiums paid under the contract. For purposes of this title, any refund described in the preceding sentence shall be includible in gross income to the extent that any deduction or exclusion was allowed with respect to the refund.

"(3) BORROWING, PLEDGING, OR ASSIGNING PROHIBITED.—The requirements of this paragraph are met with respect to a contract if such contract provides that no money may be borrowed under such contract and that such contract (or any portion thereof) may not be assigned or pledged as collateral for a loan.

"(4) PROHIBITION OF DUPLICATE PAYMENT.—

"(A) IN GENERAL.—The requirements of this paragraph are met with respect to a contract if such contract does not pay or reimburse expenses incurred to the extent that such expenses are reimbursable under title XVIII of the Social Security Act, or would be so reimbursable but for the application of a deductible or coinsurance amount.

"(B) EXCEPTION.—Subparagraph (A) shall not apply to expenses which are reimbursable under title XVIII of the Social Security Act only as a secondary payor.

"(C) COORDINATION WITH OTHER LAWS.—No provision of law shall be construed or applied so as to prohibit the offering of a qualified long-term care insurance contract on the basis that it coordinates its benefits with those provided under title XVIII of the Social Security Act.

"(5) PER DIEM AND OTHER PERIODIC PAYMENTS PERMITTED.—For purposes of subsection (a)(4), payments are described in this paragraph for any calendar year if, under the contract, such payments are made to (or on behalf of) a functionally impaired individual on a per diem or other periodic basis without regard to the expenses incurred or services rendered during the period to which the payments relate.

"(c) SPECIAL RULES FOR TREATMENT OF INSUREDS.—For purposes of this title, solely with respect to the insured under any qualified long-term care insurance contract—

"(1) AGGREGATE PAYMENTS IN EXCESS OF LIMITS.—

"(A) IN GENERAL.—If the aggregate payments under all qualified long-term care insurance contracts with respect to an insured for any period (whether on a periodic basis or otherwise) exceed the dollar amount in effect for such period under subparagraph (B), such excess payments shall be treated as made for qualified long-term care services only if made with respect to such services provided during such period.

"(B) DOLLAR AMOUNT.—The dollar amount in effect under this paragraph shall be $150 per day (or the equivalent amount in the case of payments on another periodic basis).

"(C) ADJUSTMENTS FOR INCREASED COSTS.—

"(i) IN GENERAL.—In the case of any calendar year after 1997, the dollar amount in effect under subparagraph (B) for any period occurring during such calendar year shall be equal to the sum of—

"(I) the amount in effect under subparagraph (B) for the preceding calendar year (after application of this subparagraph), plus

"(II) the applicable percentage of the amount under subclause (I).

"(ii) APPLICABLE PERCENTAGE.—For purposes of clause (i), the term 'applicable percentage' means, with respect to any calendar year, the lesser of—

"(I) 5 percent, or

"(II) the cost-of-living adjustment for such calendar year.

"(iii) COST-OF-LIVING ADJUSTMENT.—For purposes of clause (ii), the cost-of-living adjustment for any calendar year is the percentage (if any) by which the cost index under clause (iv) for the preceding calendar year exceeds such index for the second preceding calendar year. In the case of any calendar year beginning before 1999, this clause shall be applied by substituting the Consumer Price Index (as defined in section 1(f)(5)) for the cost index under clause (iv).

"(iv) COST INDEX.—The Secretary, in consultation with the Secretary of Health and Human Services, shall before January 1, 1999, establish a cost index to measure increases in costs of nursing home and similar facilities. The Secretary may from time to time revise such index to the extent necessary to accurately measure increases or decreases in such costs.

"(2) ASSIGNMENT OR PLEDGE.—Such contract shall not be treated as a qualified long-term care insurance contract during any period on or after the date on which the contract (or any portion thereof) is assigned or pledged as collateral for a loan.

"(d) TREATMENT OF COVERAGE PROVIDED AS PART OF A LIFE INSURANCE CONTRACT.—Except as otherwise provided in regulations prescribed by the Secretary, in the case of any long-term care insurance coverage provided under a life insurance contract—

"(1) IN GENERAL.—This section shall apply as if the portion of the contract providing such coverage is a separate contract.

"(2) APPLICATION OF SECTION 7702.—Section 7702(c)(2) (relating to the guideline premium limitation) shall be applied by increasing the guideline premium limitation with respect to a life insurance contract, as of any date—

"(A) by the sum of the charges against the contract's cash surrender value (within the meaning of section 7702(f)(2)(A)) for such coverage made to that date under the contract, less

"(B) any such charges the imposition of which reduces the premiums paid for the contract (within the meaning of section 7702(f)(1)).

"(3) APPLICATION OF SECTION 213.—No deduction shall be allowed under section 213(a) for charges against the life insurance contract's cash surrender value described in paragraph (2), unless such charges are includible in income as a result of the application of section 72(e)(10) and the rider is a qualified long-term care insurance contract under subsection (b).

"(4) PORTION.—For purposes of this subsection, the term 'portion' means only the terms and benefits under a life insurance contract that are in addition to the terms and benefits under the contract without regard to the coverage of qualified long-term care services, except that the payment of benefits shall not result in the benefits failing to be treated as long-term care insurance by reason of a reduction in the contract's death benefit or cash surrender value resulting from any such payment.

"(e) QUALIFIED LONG-TERM CARE SERVICES.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified long-term care services' means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, or rehabilitative services, and maintenance or personal care services, which—

"(A) are required by an individual during any period during which such individual is a functionally impaired individual,

"(B) have as their primary purpose the provision of—

"(i) needed assistance with 1 or more activities of daily living which a functionally impaired individual is certified as being unable to perform under paragraph (2), or

"(ii) substantial supervision which the individual is certified under paragraph (2) as needing to protect the individual from threats to health and safety due to substantial cognitive impairment, and

"(C) are provided pursuant to a continuing plan of care prescribed by a licensed health care practitioner.

"(2) FUNCTIONALLY IMPAIRED INDIVIDUAL.—The term 'functionally impaired individual' means any individual who is certified by a licensed health care practitioner as—

"(A) being unable to perform, without substantial assistance from another individual (including assistance involving verbal reminding or physical cuing), at least 2 activities of daily living described in paragraph (3), or

"(B) requiring substantial supervision to protect such individual from threats to health and safety due to substantial cognitive impairment.

Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless, within the preceding 12-month period, a licensed health care practitioner has certified that such individual meets such requirements.

"(3) ACTIVITIES OF DAILY LIVING.—Each of the following is an activity of daily living:

"(A) Eating.

"(B) Transferring.

"(C) Toileting.

"(D) Dressing.

"(E) Bathing.

"(F) Continence.

"(4) LICENSED HEALTH CARE PRACTITIONER.—

"(A) IN GENERAL.—The term 'licensed health care practitioner' means any individual—

"(i) who is—

"(I) a physician (as defined in section 1861(r)(1) of the Social Security Act) or registered professional nurse,

"(II) a qualified community care case manager (as defined in subparagraph (B)), or

"(III) any other individual who meets such requirements as may be prescribed by the Secretary after consultation with the Secretary of Health and Human Services, and

"(ii) who is not a relative of the individual receiving care.

"(B) QUALIFIED COMMUNITY CARE CASE MANAGER.—The term 'qualified community care case manager' means an individual or entity which—

"(i) has experience or has been trained in providing case management services and in preparing individual care plans;

"(ii) has experience in assessing individuals to determine their functional and cognitive impairment; and

"(iii) meets such requirements as may be prescribed by the Secretary after consultation with the Secretary of Health and Human Services.

"(5) RELATIVE.—The term 'relative' means an individual bearing a relationship to another individual which is described in paragraphs (1) through (8) of section 152(a).

"(f) CONTINUATION COVERAGE TREATMENT NOT TO APPLY.—Section 4980B shall not apply to—

"(1) qualified long-term care insurance contracts, or

"(2) plans described in subsection (a)(2).

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the requirements of this section, including regulations to prevent the avoidance of this section by providing qualified long-term care services under a life insurance contract."

(b) LONG-TERM CARE INSURANCE NOT PERMITTED UNDER CAFETERIA PLANS OR FLEXIBLE SPENDING ARRANGEMENTS.—

(1) CAFETERIA PLANS.—Section 125(f) is amended by adding at the end the following new sentence: "Such term shall not include any qualified long-term care insurance contract (as defined in section 7702B(b))."

(2) FLEXIBLE SPENDING ARRANGEMENTS.—The text of section 106 (relating to contributions by employer to accident and health plans) is amended to read as follows:

"(a) GENERAL RULE.—Except as provided in subsection (b), gross income of an employee does not include employer-provided coverage under an accident or health plan.

"(b) INCLUSION OF LONG-TERM CARE BENEFITS PROVIDED THROUGH FLEXIBLE SPENDING ARRANGEMENTS.—

"(1) IN GENERAL.—Effective on and after January 1, 1996, gross income of an employee shall include employer-provided coverage for qualified long-term care services (as defined in section 7702B(e)) to the extent that such coverage is provided through a flexible spending or similar arrangement.

"(2) FLEXIBLE SPENDING ARRANGEMENT.—For purposes of this subsection, a flexible spending arrangement is a benefit program which provides employees with coverage under which—

"(A) specified incurred expenses may be reimbursed (subject to reimbursement maximums and other reasonable conditions), and

"(B) the maximum amount of reimbursement which is reasonably available to a participant for such coverage is less than 500 percent of the value of such coverage.

In the case of an insured plan, the maximum amount reasonably available shall be determined on the basis of the underlying coverage."

(c) RESERVES.—Clause (iii) of section 807(d)(3)(A) is amended by inserting "(other than a qualified long-term care insurance contract within the meaning of section 7702B)" after "contract".

(d) COORDINATION WITH INSURANCE DUPLICATION RULES UNDER MEDICARE.—

(1) IN GENERAL.—Section 1882(d)(3)(A) of the Social Security Act (42 U.S.C. 1395ss(d)(3)(A)) is amended to read as follows:

"(3)(A)(i) It is unlawful for a person to sell or issue a health insurance policy, other than a medicare supplemental policy, to an individual entitled to benefits under part A or enrolled under part B of this title with the knowledge that such policy duplicates health benefits to which the individual is otherwise entitled under this title or title XIX.

"(ii) Clause (i) shall not apply to—

"(I) a health insurance policy providing for benefits which are payable to or on behalf of an individual without regard to other health benefit coverage of such individual; or

"(II) a health insurance policy (or a rider to an insurance contract which is not a health insurance policy) providing benefits only for long-term care, nursing home care, home health care, or community-based care, or any combination thereof, that coordinates against or excludes items and services available or paid for under this title, and such coordination or exclusion is disclosed in the policy's outline of coverage.

For purposes of this subparagraph, a health insurance policy meeting the requirements of subclause (I) or (II) shall be deemed to be nonduplicative and a State may impose additional requirements with respect to duplication under clause (i) only for policies not meeting the requirements of such subclauses.

"(iii)(I) It is unlawful for a person to sell or issue a medicare supplemental policy to an individual entitled to benefits under part A or enrolled under part B of this title with the knowledge that such policy duplicates health benefits to which the individual is entitled under another medicare supplemental policy.

"(II) A seller (who is not the issuer) shall not be considered to have violated this subparagraph if the policy is sold in compliance with subparagraph (B) and the statement under subparagraph (B) indicates on its face that the sale of the policy will not duplicate health benefits to which the individual is otherwise entitled under another medicare supplemental policy.

"(iv) Whoever violates clause (i) or (iii) shall be fined under title 18, United States Code, or imprisoned not more than 5 years, or both, and, in addition to or in lieu of such a criminal penalty, is subject to a civil money penalty of not to exceed $25,000 (or $15,000 in the case of a person other than the issuer of the policy) for each such prohibited act. With respect to clause (iii), this clause shall not apply to a seller until such date as the Secretary publishes a list of the standardized benefit packages that may be offered consistent with subsection (p)."

(2) MODIFICATION OF CERTAIN DISCLOSURE REQUIREMENTS.—Section 1882(d)(3) of the Social Security Act (42 U.S.C. 1395ss(d)(3)) is amended—

(A) in subparagraph (C)—

(i) by striking clauses (ii) and (iii);

(ii) by striking "(i)"; and

(iii) by striking the comma at the end and inserting a period; and

(B) by striking subparagraph (D).

(3) EFFECTIVE DATE AND OTHER RULES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by this subsection shall take effect as if included in the enactment of section 4354 of the Omnibus Budget Reconciliation Act of 1990 (Public Law 101–508) (hereafter referred to as "OBRA–1990") on November 5, 1990.

(B) DISCLOSURE REQUIREMENTS.—Any amendment made by paragraph (1) relating to disclosure requirements for certain health insurance policies shall take effect on the date that is 90 days after the date of the enactment of this Act.

(C) NO PENALTIES.—No penalty shall be imposed under section 1882(d)(3)(A)(i) of the Social Security Act (42 U.S.C. 1395ss(d)(3)(A)(i)) for any act or omission occurring after the effective date of the amendments made by section 4354 of OBRA–90 and before the date of the enactment of this Act relating to any health insurance policy that—

(i) meets the requirements of section 1882(d)(3)(A)(ii) of the Social Security Act (42 U.S.C. 1395ss(d)(3)(A)(ii)) (as amended by this Act), except that the disclosure requirement in subclause (II) of such section shall not apply; or

(ii) was sold or issued before the effective date of the amendments made by section 4354 of OBRA–90.

(D) LIMITATION ON LEGAL ACTION.—No legal action shall be brought or continued in any Federal or State court if such legal action—

(i) includes any cause of action which arose, or any act or omission which occurred, prior to the date of the enactment of this Act;

(ii) relates to the application of clause (i) or (ii) of section 1882(d)(3)(A) of the Social Security Act (42 U.S.C. 1395ss(d)(3)(A)(i) or (ii)) to any act or omission with respect to the sale, issuance, or renewal of any health insurance policy;

(iii) was filed after the effective date of the amendments made by section 4354 of OBRA–1990; and

(iv) relates to any health insurance policy that—

(I) meets the requirements of section 1882(d)(3)(A)(ii) of the Social Security Act (42 U.S.C. 1395ss(d)(3)(A)(ii)) (as amended by this Act), except that the disclosure requirement in subclause (II) of such section shall not apply; or

(II) was sold or issued before the effective date of the amendments made by section 4354 of OBRA–90.

(E) EXCLUSIVE REMEDIES.—Notwithstanding any other provision of law, the remedies provided for in section 1882(d)(3) of the Social Security Act (42 U.S.C. 1395ss(d)(3)), as amended by this subsection, are the exclusive remedies available with respect to the nonduplication requirements described in such section.

(e) CLERICAL AMENDMENT.—The table of sections for chapter 79 is amended by inserting after the item relating to section 7702A the following new item:

"Sec. 7702B. Treatment of long-term care insurance or plans."

SEC. 12203. REPORTING REQUIREMENTS.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61, as amended by section 12004(b), is amended by adding at the end the following new section:

"SEC. 6050R. CERTAIN LONG-TERM CARE BENEFITS.

"(a) REQUIREMENT OF REPORTING.—Any person who pays long-term care benefits shall make a return, according to the forms or regulations prescribed by the Secretary, setting forth—

"(1) the aggregate amount of such benefits paid by such person to any individual during any calendar year, and

"(2) the name, address, and TIN of such individual.

"(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each individual whose name is required to be set forth in such return a written statement showing—

"(1) the name of the person making the payments, and

"(2) the aggregate amount of long-term care benefits paid to the individual which are required to be shown on such return.

The written statement required under the preceding sentence shall be furnished to the individual on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made.

"(c) LONG-TERM CARE BENEFITS.—For purposes of this section, the term 'long-term care benefit' means any amount paid under a long-term care insurance policy (within the meaning of section 4980C(e))."

(b) PENALTIES.—

(1) Subparagraph (B) of section 6724(d)(1), as amended by section 12004, is amended by redesignating clauses (x) through (xv) as clauses (xi) through (xvi), respectively, and by inserting after clause (ix) the following new clause:

"(x) section 6050R (relating to certain long-term care benefits),".

(2) Paragraph (2) of section 6724(d), as so amended, is amended by redesignating subparagraphs (R) through (U) as subparagraphs (S) through (V), respectively, and by inserting after subparagraph (Q) the following new subparagraph:

"(R) section 6050R(b) (relating to certain long-term care benefits),".

(c) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by adding at the end the following new item:

"Sec. 6050R. Certain long-term care benefits."

SEC. 12204. EFFECTIVE DATES.

(a) SECTION 12201.—The amendments made by section 12201 shall apply to taxable years beginning after December 31, 1995.

(b) SECTION 12202.—The amendments made by section 12202 shall apply to contracts issued after December 31, 1995.

(c) SECTION 12203.—The amendments made by section 12203 shall apply to benefits paid after December 31, 1995.

(d) TRANSITION RULE.—If, after the date of the enactment of this Act and before January 1, 1997, a contract providing coverage for services which are similar to qualified long-term care services (as defined in section 7702B(e) of the Internal Revenue Code of 1986) and issued on or before such date of enactment, is exchanged for a qualified long-term care insurance contract (as defined in section 7702B(b) of such Code), such exchange shall be treated as an exchange to which section 1035 of such Code applies.

(e) ISSUANCE OF CERTAIN RIDERS PERMITTED.—For purposes of section 101(f), 7702, or 7702A of the Internal Revenue Code of 1986, the issuance of a rider on a life insurance contract providing coverage of qualified long-term care services, or the conformance of such a rider to the requirements of this Act, shall not be treated as a modification or material change of such contract.

(f) NO INFERENCE.—No inference shall be drawn from the amendments made by this subpart as to how the Internal Revenue Code of 1986 is to be applied before the effective date of such amendments to qualified long-term care services or contracts.

PART II—CONSUMER PROTECTION PROVISIONS

SEC. 12211. POLICY REQUIREMENTS.

(a) IN GENERAL.—Section 7702B (as added by section 12202) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) CONSUMER PROTECTION PROVISIONS.—

"(1) IN GENERAL.—The requirements of this subsection are met with respect to any contract if any long-term care insurance policy issued under the contract meets—

"(A) the requirements of the model regulation and model Act described in paragraph (2),

"(B) the disclosure requirement of paragraph (3), and

"(C) the requirements relating to nonforfeitability under paragraph (4).

"(2) REQUIREMENTS OF MODEL REGULATION AND ACT.—

"(A) IN GENERAL.—The requirements of this paragraph are met with respect to any policy if such policy meets—

"(i) MODEL REGULATION.—The following requirements of the model regulation:

"(I) Section 7A (relating to guaranteed renewal or noncancellability), and the requirements of section 6B of the model Act relating to such section 7A.

"(II) Section 7B (relating to prohibitions on limitations and exclusions).

"(III) Section 7C (relating to extension of benefits).

"(IV) Section 7D (relating to continuation or conversion of coverage).

"(V) Section 7E (relating to discontinuance and replacement of policies).

"(VI) Section 8 (relating to unintentional lapse).

"(VII) Section 9 (relating to disclosure), other than section 9F thereof.

"(VIII) Section 10 (relating to prohibitions against post-claims underwriting).

"(IX) Section 11 (relating to minimum standards).

"(X) Section 12 (relating to requirement to offer inflation protection), except that any requirement for a signature on a rejection of inflation protection shall permit the signature to be on an application or on a separate form.

"(XI) Section 23 (relating to prohibition against preexisting conditions and probationary periods in replacement policies or certificates).

"(ii) MODEL ACT.—The following requirements of the model Act:

"(I) Section 6C (relating to preexisting conditions).

"(II) Section 6D (relating to prior hospitalization).

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

"(i) MODEL PROVISIONS.—The terms 'model regulation' and 'model Act' mean the long-term care insurance model regulation, and the long-term care insurance model Act, respectively, promulgated by the National Association of Insurance Commissioners (as adopted as of January 1993).

"(ii) COORDINATION.—Any provision of the model regulation or model Act listed under clause (i) or (ii) of subparagraph (A) shall be treated as including any other provision of such regulation or Act necessary to implement the provision.

"(3) DISCLOSURE REQUIREMENT.—The requirement of this paragraph is met with respect to any policy if such policy meets the requirements of section 4980C(d)(1).

"(4) NONFORFEITURE REQUIREMENTS.—

"(A) IN GENERAL.—The requirements of this paragraph are met with respect to any level premium long-term care insurance policy, if the issuer of such policy offers to the policyholder, including any group policyholder, a nonforfeiture provision meeting the requirements of subparagraph (B).

"(B) REQUIREMENTS OF PROVISION.—The nonforfeiture provision required under subparagraph (A) shall meet the following requirements:

"(i) The nonforfeiture provision shall be appropriately captioned.

"(ii) The nonforfeiture provision shall provide for a benefit available in the event of a default in the payment of any premiums and the amount of the benefit may be adjusted subsequent to being initially granted only as necessary to reflect changes in claims, persistency, and interest as reflected in changes in rates for premium paying policies approved by the Secretary for the same policy form.

"(iii) The nonforfeiture provision shall provide at least one of the following:

"(I) Reduced paid-up insurance.

"(II) Extended term insurance.

"(III) Shortened benefit period.

"(IV) Other similar offerings approved by the Secretary.

"(5) LONG-TERM CARE INSURANCE POLICY DEFINED.—For purposes of this subsection, the term 'long-term care insurance policy' has the meaning given such term by section 4980C(e)."

(b) CONFORMING AMENDMENT.—Section 7702B(b)(1)(B) (as added by section 12202) is amended by inserting "and of subsection (g)" after "and (4)".

SEC. 12212. REQUIREMENTS FOR ISSUERS OF LONG-TERM CARE INSURANCE POLICIES.

(a) IN GENERAL.—Chapter 43 is amended by adding at the end the following new section:

"SEC. 4980C. REQUIREMENTS FOR ISSUERS OF LONG-TERM CARE INSURANCE POLICIES.

"(a) GENERAL RULE.—There is hereby imposed on any person failing to meet the requirements of subsection (c) or (d) a tax in the amount determined under subsection (b).

"(b) AMOUNT.—

"(1) IN GENERAL.—The amount of the tax imposed by subsection (a) shall be $100 per policy for each day any requirements of subsection (c) or (d) are not met with respect to each long-term care insurance policy.

"(2) WAIVER.—In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed by subsection (a) to the extent that payment of the tax would be excessive relative to the failure involved.

"(c) RESPONSIBILITIES.—The requirements of this subsection are as follows:

"(1) REQUIREMENTS OF MODEL PROVISIONS.—

"(A) MODEL REGULATION.—The following requirements of the model regulation must be met:

"(i) Section 13 (relating to application forms and replacement coverage).

"(ii) Section 14 (relating to reporting requirements), except that the issuer shall also report at least annually the number of claims denied during the reporting period for each class of business (expressed as a percentage of claims denied), other than claims denied for failure to meet the waiting period or because of any applicable preexisting condition.

"(iii) Section 20 (relating to filing requirements for marketing).

"(iv) Section 21 (relating to standards for marketing), including inaccurate completion of medical histories, other than sections 21C(1) and 21C(6) thereof, except that—

"(I) in addition to such requirements, no person shall, in selling or offering to sell a long-term care insurance policy, misrepresent a material fact; and

"(II) no such requirements shall include a requirement to inquire or identify whether a prospective applicant or enrollee for long-term care insurance has accident and sickness insurance.

"(v) Section 22 (relating to appropriateness of recommended purchase).

"(vi) Section 24 (relating to standard format outline of coverage).

"(vii) Section 25 (relating to requirement to deliver shopper's guide).

"(B) MODEL ACT.—The following requirements of the model Act must be met:

"(i) Section 6F (relating to right to return), except that such section shall also apply to denials of applications and any refund shall be made within 30 days of the return or denial.

"(ii) Section 6G (relating to outline of coverage).

"(iii) Section 6H (relating to requirements for certificates under group plans).

"(iv) Section 6I (relating to policy summary).

"(v) Section 6J (relating to monthly reports on accelerated death benefits).

"(vi) Section 7 (relating to incontestability period).

"(C) DEFINITIONS.—For purposes of this paragraph, the terms 'model regulation' and 'model Act' have the meanings given such terms by section 7702B(g)(2)(B).

"(2) DELIVERY OF POLICY.—If an application for a long-term care insurance policy (or for a certificate under a group long-term care insurance policy) is approved, the issuer shall deliver to the applicant (or policyholder or certificateholder) the policy (or certificate) of insurance not later than 30 days after the date of the approval.

"(3) INFORMATION ON DENIALS OF CLAIMS.—If a claim under a long-term care insurance policy is denied, the issuer shall, within 60 days of the date of a written request by the policyholder or certificateholder (or representative)—

"(A) provide a written explanation of the reasons for the denial, and

"(B) make available all information directly relating to such denial.

"(d) DISCLOSURE.—The requirements of this subsection are met if the issuer of a long-term care insurance policy discloses in such policy and in the outline of coverage required under subsection (c)(1)(B)(ii) that the policy is intended to be a qualified long-term care insurance contract under section 7702B(b) of the Internal Revenue Code of 1986.

"(e) LONG-TERM CARE INSURANCE POLICY DEFINED.—For purposes of this section, the term 'long-term care insurance policy' means any product which is advertised, marketed, or offered as long-term care insurance."

(b) CONFORMING AMENDMENT.—The table of sections for chapter 43 is amended by adding at the end the following new item:

"Sec. 4980C. Requirements for issuers of long-term care insurance policies."

SEC. 12213. COORDINATION WITH STATE REQUIREMENTS.

Nothing in this part shall prevent a State from establishing, implementing, or continuing in effect standards related to the protection of policyholders of long-term care insurance policies (as defined in section 4980C(e) of the Internal Revenue Code of 1986), if such standards are not in conflict with or inconsistent with the standards established under such Code.

SEC. 12214. EFFECTIVE DATES.

(a) IN GENERAL.—The provisions of, and amendments made by, this part shall apply to contracts issued after December 31, 1995. The provisions of section 12204(d) of this Act (relating to transition rule) shall apply to such contracts.

(b) ISSUERS.—The amendments made by section 12212 shall apply to actions taken after December 31, 1995.

Subchapter B—Treatment of Accelerated Death Benefits

SEC. 12221. TREATMENT OF ACCELERATED DEATH BENEFITS UNDER LIFE INSURANCE CONTRACTS.

(a) GENERAL RULE.—Section 101 (relating to certain death benefits) is amended by adding at the end the following new subsection:

"(g) TREATMENT OF CERTAIN ACCELERATED DEATH BENEFITS.—

"(1) IN GENERAL.—For purposes of this section, any amount received under a life insurance contract on the life of an insured who is a terminally ill individual shall be treated as an amount paid by reason of the death of such insured.

"(2) NECESSARY CONDITIONS.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to any amount received unless—

"(i) the total amount received is not less than the present value (determined under subparagraph (B)) of the reduction in the death benefit otherwise payable in the event of the death of the insured, and

"(ii) the percentage reduction in the cash surrender value of the contract by reason of the distribution does not exceed the percentage reduction in the death benefit payable under the contract by reason of such distribution.

"(B) PRESENT VALUE.—The present value of the reduction in the death benefit shall be determined by—

"(i) using a discount rate which is based on an interest rate which does not exceed the highest interest rate set forth in subparagraph (C), and

"(ii) assuming that the death benefit (or the portion thereof) would have been paid on the date which is 12 months after the date of the certification referred to in paragraph (3).

"(C) RATES.—The interest rates set forth in this subparagraph are the following:

"(i) The 90-day Treasury bill yield.

"(ii) The rate described as Moody's Corporate Bond Yield Average-Monthly Average Corporates as published by Moody's Investors Service, Inc., or any successor thereto, for the calendar month ending 2 months before the date on which the rate is determined.

"(iii) The rate used to compute the cash surrender values under the contract during the applicable period plus 1 percent per annum.

"(D) SPECIAL RULES RELATING TO LIENS.—If a lien is imposed against a life insurance contract with respect to any amount referred to in paragraph (1)—

"(i) for purposes of subparagraph (A), the amount of such lien shall be treated as a reduction (at the time of receipt) in the death benefit or cash surrender value to the extent that such benefit or value, as the case may be, is (or may become) subject to the lien, and

"(ii) paragraph (1) shall not apply to the amount received unless any rate of interest with respect to any amount in connection with which such lien is imposed does not exceed the highest rate set forth in subparagraph (C).

"(3) TREATMENT OF VIATICAL SETTLEMENTS.—

"(A) IN GENERAL.—In the case of a life insurance contract on the life of an insured described in paragraph (1), if—

"(i) any portion of such contract is sold to any viatical settlement provider, or

"(ii) any portion of the death benefit is assigned to such a provider,

the amount paid for such sale or assignment shall be treated as an amount paid under the life insurance contract by reason of the death of such insured.

"(B) VIATICAL SETTLEMENT PROVIDER.—The term 'viatical settlement provider' means any person regularly engaged in the trade or business of purchasing, or taking assignments of, life insurance contracts on the lives of insureds described in paragraph (1) if—

"(i) such person is licensed for such purposes in the State in which the insured resides, or

"(ii) in the case of an insured who resides in a State not requiring the licensing of such persons for such purposes, such person—

"(I) meets the requirements of sections 8 and 9 of the Viatical Settlements Model Act of the National Association of Insurance Commissioners, and

"(II) meets the requirements of the Model Regulations of the National Association of Insurance Commissioners (relating to standards for evaluation of reasonable payments) in determining amounts paid by such person in connection with such purchases or assignments.

"(4) TERMINALLY ILL INDIVIDUAL.—For purposes of this subsection, the term 'terminally ill individual' means an individual who the insurer has determined, after receipt of an acceptable certification by a licensed physician (as defined in section 1861(r)(1) of the Social Security Act), has an illness or physical condition which is reasonably expected to result in death within 12 months after the date of certification.

"(5) EXCEPTION FOR BUSINESS-RELATED POLICIES.—This subsection shall not apply in the case of any amount paid to any taxpayer other than the insured if such taxpayer has an insurable interest with respect to the life of the insured by reason of the insured being a director, officer, or employee of the taxpayer or by reason of the insured having a financial interest in any trade or business carried on by the taxpayer."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by this section shall apply to amounts received after December 31, 1995.

(2) DELAY IN APPLICATION OF DISCOUNT RULES.—Clause (i) of section 101(g)(2)(A) of the Internal Revenue Code of 1986 shall not apply to any amount received before July 1, 1996.

(3) ISSUANCE OF RIDER NOT TREATED AS MATERIAL CHANGE.—For purposes of applying section 101(f), 7702, or 7702A of the Internal Revenue Code of 1986 to any contract, the issuance of a qualified accelerated death benefit rider (as defined in section 818(g) of such Code (as added by this Act)), or the conformance of such a rider to the requirements of such section, shall not be treated as a modification or material change of such contract.

SEC. 12222. TREATMENT OF COMPANIES ISSUING QUALIFIED ACCELERATED DEATH BENEFIT RIDERS.

(a) QUALIFIED ACCELERATED DEATH BENEFIT RIDERS TREATED AS LIFE INSURANCE.—Section 818 (relating to other definitions and special rules) is amended by adding at the end the following new subsection:

"(g) QUALIFIED ACCELERATED DEATH BENEFIT RIDERS TREATED AS LIFE INSURANCE.—For purposes of this part—

"(1) IN GENERAL.—Any reference to a life insurance contract shall be treated as including a reference to a qualified accelerated death benefit rider on such contract.

"(2) QUALIFIED ACCELERATED DEATH BENEFIT RIDERS.—For purposes of this subsection, the term 'qualified accelerated death benefit rider' means any rider on a life insurance contract which provides for a distribution to an individual upon the insured becoming a terminally ill individual (as defined in section 101(g)(3))."

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1996.

Subchapter C—Medical Savings Accounts

SEC. 12231. DEDUCTION FOR CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 220 as section 221 and by inserting after section 219 the following new section:

"SEC. 220. CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.

"(a) DEDUCTION ALLOWED.—In the case of an eligible individual, the amounts paid in cash during the taxable year by such individual to a medical savings account for the benefit of such individual or for the benefit of such individual and any spouse or dependent of such individual who is an eligible individual shall be treated for purposes of sections 162(l) and 213 as amounts paid for insurance which constitutes medical care.

"(b) LIMITATIONS.—

"(1) ONLY 1 ACCOUNT PER FAMILY.—Except as provided in regulations prescribed by the Secretary, no amount shall be treated as paid for insurance by reason of subsection (a) for amounts paid to any medical savings account if the account beneficiary, or such beneficiary's spouse or dependent, is a beneficiary of any other medical savings account.

"(2) DOLLAR LIMITATION.—

"(A) IN GENERAL.—Except as otherwise provided in this subsection, the aggregate amount which may be treated as paid for insurance under subsection (a) with respect to any account beneficiary shall not exceed the lesser of—

"(i) $2,000, or

"(ii) the deductible under the high deductible health plan covering such individual.

"(B) FAMILY ACCOUNT.—If the high deductible health plan covering an eligible individual provides coverage for any other eligible individual who is the spouse or any dependent (as defined in section 152) of the taxpayer, the limitation under subparagraph (A) shall be equal to the lesser of—

"(i) $4,000, or

"(ii) the annual limit under the high deductible health plan on the aggregate amount of deductibles required to be paid by all individuals.

"(3) PRORATION OF LIMITATION.—

"(A) IN GENERAL.—The limitation under paragraph (2) shall be the sum of the monthly limitations for months during the taxable year that the individual is an eligible individual if—

"(i) such individual is not an eligible individual for all months of the taxable year,

"(ii) the deductible under the high deductible health plan covering such individual is not the same throughout such taxable year, or

"(iii) such limitation is determined under paragraph (2)(B) for some but not all months during such taxable year.

"(B) MONTHLY LIMITATION.—The monthly limitation for any month shall be an amount equal to 1/12 of the limitation which would (but for this paragraph) be determined under paragraph (2) if the facts and circumstances as of the first day of such month that such individual is covered under a high deductible health plan were true for the entire taxable year.

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

"(1) ELIGIBLE INDIVIDUAL.—The term 'eligible individual' means, with respect to any month, any individual—

"(A) who is covered under a high deductible health plan during such month, and

"(B) who is not eligible during such month—

"(i) to participate in an employer-subsidized health plan maintained by an employer of the individual, the individual's spouse, or any dependent of either, or

"(ii) to receive any employer contribution to a medical savings account.

For purposes of subparagraph (B), a self-employed individual (within the meaning of section 401(c)) shall not be treated as his own employer.

"(2) HIGH DEDUCTIBLE HEALTH PLAN.—The term 'high deductible health plan' means a health plan which—

"(A) has an annual deductible limit for each individual covered by the plan which is not less than $1,500, and

"(B) has an annual limit on the aggregate amount of deductibles required to be paid with respect to all individuals covered by the plan which is not less than $3,000.

"(3) COST-OF-LIVING ADJUSTMENTS.—In the case of taxable years beginning after December 31, 1996, each dollar amount contained in paragraph (2) and subsection (b)(2) shall be increased by an amount equal to the product of—

"(A) such dollar amount, and

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, except that such section shall be applied by substituting 'the medical component of the CPI' for 'the CPI' each place it appears and by substituting '1995' for '1992' in subparagraph (B).

If any amount under this paragraph is not a multiple of $50, such amount shall be rounded to the next lower multiple of $50.

"(4) MEDICAL SAVINGS ACCOUNT.—The term 'medical savings account' has the meaning given such term by section 7705.

"(5) TIME WHEN CONTRIBUTIONS DEEMED MADE.—A contribution shall be deemed to be made on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof)."

(b) CLERICAL AMENDMENT.—The table of sections for part VII of subchapter B of chapter 1 is amended by striking the last item and inserting the following new item:

"Sec. 220. Contributions to medical savings accounts."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12232. EXCLUSION FROM INCOME OF EMPLOYER CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.

(a) IN GENERAL.—Section 106 (relating to contributions by employers to accident and health plans), as amended by section 12202(b), is amended by adding at the end the following new subsection:

"(c) CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.—

"(1) TREATMENT OF CONTRIBUTIONS.—

"(A) IN GENERAL.—Gross income of an employee who is covered by a high deductible health plan of an employer shall not include any employer contribution to a medical savings account on behalf of the employee or the employee's spouse or dependents.

"(B) NO CONSTRUCTIVE RECEIPT.—No amount shall be included in the gross income of any employee solely because the employee may choose between the contributions described in subparagraph (A) and employer contributions to a health plan of the employer.

"(2) LIMITATIONS.—

"(A) ONLY 1 ACCOUNT PER FAMILY.—Except as provided in regulations, no amount may be excluded under subsection (a) for contributions to a medical savings account if the employee, or such employee's spouse or dependent, is a beneficiary of any other medical savings account.

"(B) DOLLAR LIMITATION.—The amount which may be excluded under paragraph (1) for any taxable year shall not exceed the limitation under section 220(b)(2) (without regard to this subsection) which is applicable to such employee for such taxable year.

"(3) SPECIAL RULE FOR DEDUCTION OF EMPLOYER CONTRIBUTIONS.—Any employer contribution to a medical savings account, if otherwise allowable as a deduction under this chapter, shall be allowed only for the taxable year in which paid.

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

"(A) HIGH DEDUCTIBLE HEALTH PLAN.—The term 'high deductible health plan' has the meaning given such term by section 220(c)(2).

"(B) MEDICAL SAVINGS ACCOUNT.—The term 'medical savings account' has the meaning given such term by section 7705."

(b) EXCLUSION OF EMPLOYER PAYMENTS.—

(1) IN GENERAL.—Notwithstanding any other provision of law, any payment made to or for the benefit of an employee with respect to which, at the time of the payment, it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(c) shall be treated in the same manner as payments to or for the benefit of an employee on account of sickness or accident.

(2) RAILROAD RETIREMENT TAX.—Subsection (e) of section 3231 is amended by adding at the end the following new paragraph:

"(10) MEDICAL SAVINGS ACCOUNT CONTRIBUTIONS.—The term 'compensation' shall not include any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(c)."

(3) UNEMPLOYMENT TAX.—Subsection (b) of section 3306 is amended by striking "or" at the end of paragraph (15), by striking the period at the end of paragraph (16) and inserting "; or", and by inserting after paragraph (16) the following new paragraph:

"(17) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(c)."

(4) WITHHOLDING TAX.—Subsection (a) of section 3401 is amended by striking "or" at the end of paragraph (19), by striking the period at the end of paragraph (20) and inserting "; or", and by inserting after paragraph (20) the following new paragraph:

"(21) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(c)."

(c) MEDICAL SAVINGS ACCOUNTS NOT PERMITTED UNDER CAFETERIA PLANS.—Section 125(f) is amended by adding at the end the following new sentence: "Such term shall not include any contribution to a medical savings account under section 7705."

(d) CONFORMING AMENDMENT.—Section 106(a), as designated by section 12202(b), is amended by striking "subsection (b)" and inserting "subsection (b) or (c)".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12233. MEDICAL SAVINGS ACCOUNTS.

(a) IN GENERAL.—Chapter 79 is amended by adding at the end the following new section:

"SEC. 7705. MEDICAL SAVINGS ACCOUNTS.

"(a) GENERAL RULE.—The term 'medical savings account' means a trust created or organized in the United States for the exclusive benefit of the beneficiaries of the trust, but only if the written governing instrument creating the trust meets the following requirements:

"(1) Except in the case of a rollover contribution described in subsection (c)(5)—

"(A) no contribution will be accepted unless—

"(i) it is in cash, and

"(ii) it is made for a period during which the individual on whose behalf it is made is covered under a high deductible health plan, and

"(B) contributions will not be accepted for any taxable year in excess of the amount determined under section 220(b)(2) for such taxable year.

"(2) The trustee is a bank (as defined in section 408(n)), insurance company (as defined in section 816), or another person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with the requirements of this section.

"(3) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.

"(4) No part of the trust assets will be invested in life insurance contracts.

"(5) The interest of an individual in the balance in the individual's account is nonforfeitable.

"(b) TAX TREATMENT OF ACCOUNTS.—

"(1) IN GENERAL.—A medical savings account is exempt from taxation under this subtitle unless such account has ceased to be a medical savings account by reason of paragraph (2) or (3). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc. organizations).

"(2) ACCOUNT TERMINATIONS.—Rules similar to the rules of paragraphs (2) and (4) of section 408(e) shall apply to medical savings accounts, and any amount treated as distributed under such rules shall be treated as not used to pay qualified medical expenses.

"(3) FAILURE TO REMAIN IN HEALTH PLAN.—

"(A) IN GENERAL.—If, at any time during the 2-taxable year period beginning with the first taxable year in which an individual was an account beneficiary in a medical savings account, the account beneficiary becomes a participant in a health plan which has a lower individual (or aggregate) deductible limit than the lowest individual (or aggregate) limit permitted under a high deductible health plan, the account shall cease to be a medical savings account as of the first day of the taxable year in which the individual ceases to be so covered.

"(B) EXCEPTION.—This paragraph shall not apply to any account beneficiary who becomes a participant in a plan described in subparagraph (A) by reason of separation from employment.

"(C) ACCOUNT TREATED AS DISTRIBUTING ALL ITS ASSETS.—In any case in which any account ceases to be a medical savings account by reason of subparagraph (A) on the first day of any taxable year, subsection (c) shall be applied as if—

"(i) there were a distribution on such first day in an amount equal to the fair market value (on such first day) of all assets in the account (on such first day), and

"(ii) no portion of such distribution were used to pay qualified medical expenses.

"(c) TAX TREATMENT OF DISTRIBUTIONS.—

"(1) AMOUNTS USED FOR QUALIFIED MEDICAL EXPENSES.—

"(A) IN GENERAL.—Any amount paid or distributed out of a medical savings account which is used exclusively to pay qualified medical expenses of any account beneficiary (or any spouse or dependent of the beneficiary) shall not be includible in gross income.

"(B) TREATMENT AFTER DEATH OF ACCOUNT BENEFICIARY.—

"(i) TREATMENT IF BENEFICIARY IS SPOUSE.—If, after the death of the account beneficiary, the account beneficiary's interest is payable to (or for the benefit of) the beneficiary's spouse, the medical savings account shall be treated as if the spouse were the account beneficiary.

"(ii) TREATMENT IF DESIGNATED BENEFICIARY IS NOT SPOUSE.—In the case of an account beneficiary's interest in a medical savings account which is payable to (or for the benefit of) any person other than such beneficiary's spouse upon the death of such beneficiary—

"(I) such account shall cease to be a medical savings account as of the date of death, and

"(II) an amount equal to the fair market value of the assets in such account on such date shall be includible if such person is not the estate of such beneficiary, in such person's gross income for the taxable year which includes such date, or if such person is the estate of such beneficiary, in such beneficiary's gross income for last taxable year of such beneficiary.

"(2) INCLUSION OF AMOUNTS NOT USED FOR QUALIFIED MEDICAL EXPENSES.—

"(A) IN GENERAL.—Any amount paid or distributed out of a medical savings account which is not used exclusively to pay the qualified medical expenses of the account beneficiary or of the spouse or dependents of such beneficiary shall be included in the gross income of such beneficiary to the extent such amount does not exceed the excess of—

"(i) the aggregate contributions to such account which were allowed as a deduction under section

162(l) or 213 or which were excluded under section 106(c), over

"(ii) the aggregate prior payments or distributions from such account which were includible in gross income under this paragraph.

"(B) SPECIAL RULES.—For purposes of subparagraph (A)—

"(i) all medical savings accounts of the account beneficiary shall be treated as 1 account,

"(ii) all payments and distributions during any taxable year shall be treated as 1 distribution, and

"(iii) any distribution of property shall be taken into account at its fair market value on the date of the distribution.

"(3) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—Paragraph (2) shall not apply to the distribution of any contribution paid during a taxable year to a medical savings account to the extent that such contribution exceeds the amount under subsection (a)(1)(B) if—

"(A) such distribution is received by the individual on or before the last day prescribed by law (including extensions of time) for filing such individual's return for such taxable year, and

"(B) such distribution is accompanied by the amount of net income attributable to such excess contribution.

Any net income described in subparagraph (B) shall be included in the gross income of the individual for the taxable year in which it is received.

"(4) PENALTY FOR DISTRIBUTIONS NOT USED FOR QUALIFIED MEDICAL EXPENSES.—

"(A) IN GENERAL.—The tax imposed by chapter 1 on the account beneficiary for any taxable year in which there is a payment or distribution from a medical savings account of such beneficiary which is includible in gross income under paragraph (2) shall be increased by 10 percent of the amount which is so includible.

"(B) EXCEPTION FOR DISABILITY OR DEATH.—Subparagraph (A) shall not apply if the payment or distribution is made after the account beneficiary becomes disabled within the meaning of section 72(m)(7) or dies.

"(C) EXCEPTION FOR DISTRIBUTIONS AFTER AGE 59½.—Subparagraph (A) shall not apply to any payment or distribution after the date on which the account beneficiary attains age 59½.

"(5) ROLLOVER CONTRIBUTION.—An amount is described in this paragraph as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

"(A) IN GENERAL.—Paragraph (2) shall not apply to any amount paid or distributed from a medical savings account to the account beneficiary to the extent the amount received is paid into a medical savings account for the benefit of such beneficiary not later than the 60th day after the day on which the beneficiary receives the payment or distribution.

"(B) LIMITATION.—This paragraph shall not apply to any amount described in subparagraph (A) received by an individual from a medical savings account if, at any time during the 1-year period ending on the day of such receipt, such individual received any other amount described in subparagraph (A) from a medical savings account which was not includible in the individual's gross income because of the application of this paragraph.

"(6) COORDINATION WITH MEDICAL EXPENSE DEDUCTION.—For purposes of determining the amount of the deduction under section 213, any payment or distribution out of a medical savings account for qualified medical expenses shall not be treated as an expense paid for medical care.

"(7) TRANSFER OF ACCOUNT INCIDENT TO DIVORCE.—The transfer of an individual's interest in a medical savings account to an individual's spouse or former spouse under a divorce or separation instrument described in subparagraph (A) of section 71(b)(2) shall not be considered a taxable transfer made by such individual notwithstanding any other provision of this subtitle, and such interest shall, after such transfer, be treated as a medical savings account with respect to which the spouse is the account beneficiary.

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

"(1) QUALIFIED MEDICAL EXPENSES.—

"(A) IN GENERAL.—The term 'qualified medical expenses' means any expense for medical care (as defined in section 213(d)).

"(B) EXCEPTION FOR INSURANCE.—

"(i) IN GENERAL.—Such term shall not include any expense for insurance.

"(ii) EXCEPTIONS.—Clause (i) shall not apply to any expense for—

"(I) coverage under a health plan during a period of continuation coverage described in section 4980B(f)(2)(B),

"(II) coverage under a qualified long-term care contract (as defined in section 7702B(b)), or

"(III) coverage under a health plan during a period in which the individual is receiving unemployment compensation under any Federal or State law.

"(2) ACCOUNT BENEFICIARY.—The term 'account beneficiary' means the individual for whose benefit the medical savings account is maintained.

"(e) CUSTODIAL ACCOUNTS.—For purposes of this section, a custodial account shall be treated as a trust if—

"(1) the assets of such account are held by a bank (as defined in section 408(n)), insurance company (as defined in section 816), or another person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the account will be consistent with the requirements of this section, and

"(2) the custodial account would, except for the fact that it is not a trust, constitute a medical savings account described in subsection (a).

For purposes of this title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

"(f) REPORTS.—The trustee of a medical savings account shall make such reports regarding such account to the Secretary and to the individual for whose benefit the account is maintained with respect to contributions, distributions, and such other matters as the Secretary may require under regulations. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required by those regulations."

(b) EXCLUSION OF ACCOUNTS FROM ESTATE TAX.—

(1) IN GENERAL.—Section 2057, as added by section 7006, is amended—

(A) by inserting "or medical savings account (as defined in section 7705)" before "included", and

(B) by inserting "or medical savings" after "choice" in the heading.

(2) CONFORMING AMENDMENT.—The table of sections for part IV of subchapter A of chapter 11 is amended by inserting "or medical savings" after "choice".

(c) TAX ON EXCESS CONTRIBUTIONS.—Section 4973 (relating to tax on excess contributions to individual retirement accounts, certain section 403(b) contracts, and certain individual retirement annuities) is amended—

(1) by inserting "medical savings accounts," after "accounts," in the heading of such section,

(2) by striking "or" at the end of paragraph (1) of subsection (a),

(3) by redesignating paragraph (2) of subsection (a) as paragraph (3) and by inserting after paragraph (1) the following:

"(2) a medical savings account (within the meaning of section 7705(a)), or", and

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

"(d) EXCESS CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.—For purposes of this section, in the case of a medical savings account (within the meaning of section 7705(a)), the term 'excess contributions' means the amount by which the amount contributed for the taxable year to the account exceeds the amount which may be contributed to the account under section 7705(a)(1)(B) for such taxable year. For purposes of this subsection, any contribution which is distributed out of the medical savings account in a distribution to which section 7705(c)(3) applies shall be treated as an amount not contributed."

(d) TAX ON PROHIBITED TRANSACTIONS.—Section 4975 (relating to prohibited transactions), as amended by section 7006(c), is amended—

(1) by adding at the end of subsection (c) the following new paragraph:

"(5) SPECIAL RULE FOR MEDICAL SAVINGS ACCOUNTS.—An individual for whose benefit a medical savings account (within the meaning of section 7705(a)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a medical savings account by reason of the application of section 7705(b)(2)(A)(i) to such account.", and

(2) by striking "or" at the end of subparagraph (D), by redesignating subparagraph (E) as subparagraph (F), and by inserting after subparagraph (D) the following new subparagraph:

"(E) a medical savings account described in section 7705(a), or".

(e) FAILURE TO PROVIDE REPORTS ON MEDICAL SAVINGS ACCOUNTS.—Section 6693(a)(2) (relating to failure to provide reports on individual retirement accounts or annuities), as amended by section 7006, 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 adding at the end the following subparagraph:

"(C) section 7705(f) (relating to medical savings accounts)."

(f) EXCEPTION FROM CAPITALIZATION OF POLICY ACQUISITION EXPENSES.—Subparagraph (B) of section 848(e)(1) (defining specified insurance contract), as amended by 7006, is amended by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", and", and by adding at the end the following new clause:

"(v) any contract which is a medical savings account (as defined in section 7705)."

(g) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1996.

Subchapter D—Other Provisions

SEC. 12241. ADJUSTMENT OF DEATH BENEFIT LIMITS FOR CERTAIN POLICIES.

(a) IN GENERAL.—Subparagraph (C)(i) of section 7702(e)(2) (relating to limited increases in death benefit permitted) is amended by striking "$5,000" and inserting "$7,000" and by striking "$25,000" and inserting "$30,000".

(b) INFLATION ADJUSTMENTS.—Section 7702(e) (relating to computational rules) is amended by adding at the end the following new paragraph:

"(3) INFLATION ADJUSTMENT TO DEATH BENEFIT LIMITS FOR YEARS AFTER 1996.—In the case of any taxable year beginning in a calendar year after 1996, each dollar amount contained in paragraph (2)(C)(i) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3), for the calendar year in which the taxable year begins, by substituting 'calendar year 1995' for 'calendar year 1992' in subparagraph (B) thereof."

(c) CONFORMING AMENDMENT.—Section 72(e)(10)(B) is amended by striking "$25,000" and inserting "$30,000 (adjusted at the same time and in the same manner as under section 7702(e)(3))".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts entered into after December 31, 1995.

SEC. 12242. ORGANIZATIONS SUBJECT TO SECTION 833.

(a) IN GENERAL.—Section 833(c) (relating to organization to which section applies) is amended by adding at the end the following new paragraph:

"(4) TREATMENT AS EXISTING BLUE CROSS OR BLUE SHIELD ORGANIZATION.—

"(A) IN GENERAL.—Paragraph (2) shall be applied to an organization described in subparagraph (B) as if it were a Blue Cross or Blue Shield organization.

"(B) APPLICABLE ORGANIZATION.—An organization is described in this subparagraph if it—

"(i) is organized under, and governed by, State laws which are specifically and exclusively applicable to not-for-profit health insurance or health service type organizations, and

"(ii) is not a Blue Cross or Blue Shield organization or health maintenance organization."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years ending after October 13, 1995.

Subtitle D—Estate Tax Reform

SEC. 12301. FAMILY-OWNED BUSINESS EXCLUSION.

(a) IN GENERAL.—Part III of subchapter A of chapter 11 (relating to gross estate) is amended by inserting after section 2033 the following new section:

"SEC. 2033A. FAMILY-OWNED BUSINESS EXCLUSION.

"(a) IN GENERAL.—In the case of an estate of a decedent to which this section applies, the value of the gross estate shall not include the lesser of—

"(1) the adjusted value of the qualified family-owned business interests of the decedent otherwise includible in the estate, or

"(2) the sum of—

"(A) $1,500,000, plus

"(B) 50 percent of the excess (if any) of the adjusted value of such interests over $1,500,000, but not over $5,000,000.

"(b) ESTATES TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—This section shall apply to an estate if—

"(A) the decedent was (at the date of the decedent's death) a citizen or resident of the United States,

"(B) the sum of—

"(i) the adjusted value of the qualified family-owned business interests described in paragraph (2), plus

"(ii) the amount of the gifts of such interests determined under paragraph (3),

exceeds 50 percent of the adjusted gross estate, and

"(C) during the 8-year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which—

"(i) such interests were owned by the decedent or a member of the decedent's family, and

"(ii) there was material participation (within the meaning of section 2032A(e)(6)) by the decedent or a member of the decedent's family in the operation of the business to which such interests relate.

"(2) INCLUDIBLE QUALIFIED FAMILY-OWNED BUSINESS INTERESTS.—The qualified family-owned business interests described in this paragraph are the interests which—

"(A) are included in determining the value of the gross estate (without regard to this section), and

"(B) are acquired by any qualified heir from, or passed to any qualified heir from, the decedent (within the meaning of section 2032A(e)(9)).

"(3) INCLUDIBLE GIFTS OF INTERESTS.—The amount of the gifts of qualified family-owned business interests determined under this paragraph is the excess of—

"(A) the sum of—

"(i) the amount of such gifts from the decedent to members of the decedent's family taken into account under subsection 2001(b)(1)(B), plus "(ii) the amount of such gifts otherwise excluded under section 2503(b),

to the extent such interests are continuously held by members of such family (other than the decedent's spouse) between the date of the gift and the date of the decedent's death, over

"(B) the amount of gifts from the decedent to members of the decedent's family otherwise included in the gross estate.

"(c) ADJUSTED GROSS ESTATE.—For purposes of this section, the term 'adjusted gross estate' means the value of the gross estate (determined without regard to this section)—

"(1) reduced by any amount deductible under paragraph (3) or (4) of section 2053(a), and

"(2) increased by the excess of—

"(A) the sum of—

"(i) the amount of gifts determined under subsection (b)(3), plus

"(ii) the amount of other transfers from the decedent to the decedent's spouse (at the time of the transfer) within 10 years of the date of the decedent's death, plus

"(iii) the amount of other gifts (not included under clause (i) or (ii)) from the decedent within 3 years of such date, other than gifts to members of the decedent's family otherwise excluded under section 2503(b), over

"(B) the sum of the amounts described in clauses (i), (ii), and (iii) of subparagraph (A) which are otherwise includible in the gross estate.

For purposes of the preceding sentence, the Secretary may provide that de minimis gifts to persons other than members of the decedent's family shall not be taken into account.

"(d) ADJUSTED VALUE OF THE QUALIFIED FAMILY-OWNED BUSINESS INTERESTS.—For purposes of this section, the adjusted value of any qualified family-owned business interest is the value of such interest for purposes of this chapter (determined without regard to this section), reduced by the excess of—

"(1) any amount deductible under paragraph (3) or (4) of section 2053(a), over

"(2) the sum of—

"(A) any indebtedness on any qualified residence of the decedent the interest on which is deductible under section 163(h)(3), plus

"(B) any indebtedness to the extent the taxpayer establishes that the proceeds of such indebtedness were used for the payment of educational and medical expenses of the decedent, the decedent's spouse, or the decedent's dependents (within the meaning of section 152), plus

"(C) any indebtedness not described in clause (i) or (ii), to the extent such indebtedness does not exceed $10,000.

"(e) QUALIFIED FAMILY-OWNED BUSINESS INTEREST.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified family-owned business interest' means—

"(A) an interest as a proprietor in a trade or business carried on as a proprietorship, or

"(B) an interest in an entity carrying on a trade or business, if—

"(i) at least—

"(I) 50 percent of such entity is owned (directly or indirectly) by the decedent and members of the decedent's family,

"(II) 70 percent of such entity is so owned by members of 2 families, or

"(III) 90 percent of such entity is so owned by members of 3 families, and

"(ii) for purposes of subclause (II) or (III) of clause (i), at least 30 percent of such entity is so owned by the decedent and members of the decedent's family.

"(2) LIMITATION.—Such term shall not include—

"(A) any interest in a trade or business the principal place of business of which is not located in the United States,

"(B) any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was readily tradable on an established securities market or secondary market (as defined by the Secretary) at any time within 3 years of the date of the decedent's death,

"(C) any interest in a trade or business not described in section 542(c)(2), if more than 35 percent of the adjusted ordinary gross income of such trade or business for the taxable year which includes the date of the decedent's death would qualify as personal holding company income (as defined in section 543(a)),

"(D) that portion of an interest in a trade or business that is attributable to—

"(i) cash or marketable securities, or both, in excess of the reasonably expected day-to-day working capital needs of such trade or business, and

"(ii) any other assets of the trade or business (other than assets used in the active conduct of a trade or business described in section 542(c)(2)), the income of which is described in section 543(a) or in subparagraph (B), (C), (D), or (E) of section 954(c)(1) (determined by substituting 'trade or business' for 'controlled foreign corporation)'.

"(3) RULES REGARDING OWNERSHIP.—

"(A) OWNERSHIP OF ENTITIES.—For purposes of paragraph (1)(B)—

"(i) CORPORATIONS.—Ownership of a corporation shall be determined by the holding of stock possessing the appropriate percentage of the total combined voting power of all classes of stock entitled to vote and the appropriate percentage of the total value of shares of all classes of stock.

"(ii) PARTNERSHIPS.—Ownership of a partnership shall be determined by the owning of the appropriate percentage of the capital interest or the profits interest in such partnership.

"(B) OWNERSHIP OF TIERED ENTITIES.—For purposes of this section, if by reason of holding an interest in a trade or business, a decedent or any member of the decedent's family is treated as holding an interest in any other trade or business—

"(i) such ownership interest in the other trade or business shall be disregarded in determining if the ownership interest in the first trade or business is a qualified family-owned business interest, and

"(ii) this section shall be applied separately in determining if such interest in any other trade or business is a qualified family-owned business interest.

"(C) INDIVIDUAL OWNERSHIP RULES.—For purposes of this section, an interest owned, directly or indirectly, by or for an entity described in paragraph (1)(B) shall be considered as being owned proportionately by or for the entity's shareholders, partners, or beneficiaries. A person shall be treated as a beneficiary of any trust only if such person has a present interest in such trust.

"(f) TAX TREATMENT OF FAILURE TO MATERIALLY PARTICIPATE IN BUSINESS OR DISPOSITIONS OF INTERESTS.—

"(1) IN GENERAL.—There is imposed an additional estate tax if, within 10 years after the date of the decedent's death and before the date of the qualified heir's death—

"(A) the material participation requirements described in section 2032A(c)(6)(B) are not met with respect to the qualified family-owned business interest which was acquired (or passed) from the decedent,

"(B) the qualified heir disposes of any portion of a qualified family-owned business interest (other than by a disposition to a member of the qualified heir's family or through a qualified conservation contribution under section 170(h)),

"(C) the qualified heir loses United States citizenship (within the meaning of section 877A) or with respect to whom an event described in subparagraph (A) or (B) of section 877A(e)(1) occurs, and such heir does not comply with the requirements of subsection (g), or

"(D) the principal place of business of a trade or business of the qualified family-owned business interest ceases to be located in the United States.

"(2) ADDITIONAL ESTATE TAX.—

"(A) IN GENERAL.—The amount of the additional estate tax imposed by paragraph (1) shall be equal to—

"(i) the applicable percentage of the adjusted tax difference attributable to the qualified family-owned business interest (as determined under rules similar to the rules of section 2032A(c)(2)(B)), plus

"(ii) interest on the amount determined under clause (i) at the underpayment rate established under section 6621 for the period beginning on the date the estate tax liability was due under this chapter and ending on the date such additional estate tax is due.

"(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the applicable percentage shall be determined under the following table:

"If the event described in paragraph (1) occurs in the following year of material participation:	The applicable percentage is:
1 through 6	100
7	80
8	60
9	40
10	20.

"(g) SECURITY REQUIREMENTS FOR NONCITIZEN QUALIFIED HEIRS.—

"(1) IN GENERAL.—Except upon the application of subparagraph (F) or (M) of subsection (h)(3), if a qualified heir is not a citizen of the United States, any interest under this section passing to or acquired by such heir (including any interest held by such heir at a time described in subsection (f)(1)(C)) shall be treated as a qualified family-owned business interest only if the interest passes or is acquired (or is held) in a qualified trust.

"(2) QUALIFIED TRUST.—The term 'qualified trust' means a trust—

"(A) which is organized under, and governed by, the laws of the United States or a State, and

"(B) with respect to which the trust instrument requires that at least 1 trustee of the trust be an individual citizen of the United States or a domestic corporation.

"(h) OTHER DEFINITIONS AND APPLICABLE RULES.—For purposes of this section—

"(1) QUALIFIED HEIR.—The term 'qualified heir'—

"(A) has the meaning given to such term by section 2032A(e)(1), and

"(B) includes any active employee of the trade or business to which the qualified family-owned business interest relates if such employee has been employed by such trade or business for a period of at least 10 years before the date of the decedent's death.

"(2) MEMBER OF THE FAMILY.—The term 'member of the family' has the meaning given to such term by section 2032A(e)(2).

"(3) APPLICABLE RULES.—Rules similar to the following rules shall apply:

"(A) Section 2032A(b)(4) (relating to decedents who are retired or disabled).

"(B) Section 2032A(b)(5) (relating to special rules for surviving spouses).

"(C) Section 2032A(c)(2)(D) (relating to partial dispositions).

"(D) Section 2032A(c)(3) (relating to only 1 additional tax imposed with respect to any 1 portion).

"(E) Section 2032A(c)(4) (relating to due date).

"(F) Section 2032A(c)(5) (relating to liability for tax; furnishing of bond).

"(G) Section 2032A(c)(7) (relating to no tax if use begins within 2 years; active management by eligible qualified heir treated as material participation).

"(H) Section 2032A(e)(10) (relating to community property).

"(I) Section 2032A(e)(14) (relating to treatment of replacement property acquired in section 1031 or 1033 transactions).

"(J) Section 2032A(f) (relating to statute of limitations).

"(K) Section 6166(b)(3) (relating to farmhouses and certain other structures taken into account).

"(L) Subparagraphs (B), (C), and (D) of section 6166(g)(1) (relating to acceleration of payment).

"(M) Section 6324B (relating to special lien for additional estate tax)."

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter A of chapter 11 is amended by inserting after the item relating to section 2033 the following new item:

"Sec. 2033A. Family-owned business exclusion."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 1995.

SEC. 12302. INCREASE IN UNIFIED ESTATE AND GIFT TAX CREDIT.

(a) ESTATE TAX CREDIT.—

(1) IN GENERAL.—Section 2010 (relating to unified credit against estate tax) is amended—

(A) by striking "$192,800" in subsection (a) and inserting "$248,300", and

(B) by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) PHASE-IN OF CREDIT.—

"In the case of decedents dying in:	Subsection (a) shall be applied by substituting for '$248,300' the following amount:
1996	$202,050
1997	211,300
1998	220,550
1999	229,800
2000	239,050."

(2) CONFORMING AMENDMENTS.—

(A) Subsection (a) of section 6018 is amended—

(i) by striking "$600,000" in paragraph (1) and inserting "$750,000", and

(ii) by adding at the end the following new paragraph:

"(5) PHASE-IN OF FILING REQUIREMENT AMOUNT.—

"In the case of decedents dying in:	Paragraph (1) shall be applied by substituting for '$750,000' the following amount:
1996	$625,000
1997	650,000
1998	675,000

"In the case of decedents dying in:	Paragraph (1) shall be applied by substituting for '$750,000' the following amount:
1999	700,000
2000	725,000."

(B) Section 2001(c)(2) is amended to read as follows:

"(2) PHASEOUT OF GRADUATED RATES AND UNIFIED CREDIT.—

"(A) IN GENERAL.—The tentative tax determined under paragraph (1) shall be increased by an amount equal to 5 percent of so much of the amount (with respect to which the tentative is to be computed) as exceeds $10,000,000 but does not exceed $22,150,000.

"(B) PHASE-IN OF END POINT OF PHASEOUT RANGE.—

"In the case of decedents dying in:	Subparagraph (A) shall be applied by substituting for '$22,150,000' the following amount:
1996	$21,225,000
1997	21,410,000
1998	21,595,000
1999	21,780,000
2000	21,965,000."

(C) Paragraph (3) of section 2102(c) is amended—

(i) by striking "$192,800" in subparagraph (A) and inserting "$248,300", and

(ii) by adding at the end the following new subparagraph:

"(C) PHASE-IN OF CREDIT.—

"In the case of decedents dying in:	Subparagraph (A) shall be applied by substituting for '$248,300' the following amount:
1996	$202,050
1997	211,300
1998	220,550
1999	229,800
2000	239,050."

(b) UNIFIED GIFT TAX CREDIT.—Section 2505 (relating to unified credit against gift tax) is amended—

(1) by striking "$192,800" in subsection (a)(1) and inserting "$248,300", and

(2) by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) PHASE-IN OF CREDIT.—

"In the case of gifts made in:	Subsection (a)(1) shall be applied by substituting for '$248,300' the following amount:
1996	$202,050
1997	211,300
1998	220,550
1999	229,800
2000	239,050."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to the estates of decedents dying, and gifts made, after December 31, 1995.

SEC. 12303. TREATMENT OF LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.

(a) ESTATE TAX WITH RESPECT TO LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—Section 2031 (relating to the definition of gross estate) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) ESTATE TAX WITH RESPECT TO LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—

"(1) IN GENERAL.—If the executor makes the election described in paragraph (5), then, except as otherwise provided in this subsection, there shall be excluded from the gross estate the applicable percentage of the lesser of—

"(A) the value of land subject to a qualified conservation easement, reduced by the amount of any deduction under section 2055(f) with respect to such land, or

"(B) the excess (if any) of—

"(i) $5,000,000, over

"(ii) the adjusted value of the qualified family-owned business interests of the decedent determined under section 2033A.

"(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term 'applicable percentage' means 50 percent reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development right (as defined in paragraph (4)).

"(3) TREATMENT OF CERTAIN INDEBTEDNESS.—

"(A) IN GENERAL.—The exclusion provided in paragraph (1) shall not apply to the extent that the land is debt-financed property.

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

"(i) DEBT-FINANCED PROPERTY.—The term 'debt-financed property' means any property with respect to which there is an acquisition indebtedness (as defined in clause (ii)) on the date of the decedent's death.

"(ii) ACQUISITION INDEBTEDNESS.—The term 'acquisition indebtedness' means, with respect to debt-financed property, the unpaid amount of—

"(I) the indebtedness incurred by the donor in acquiring such property,

"(II) the indebtedness incurred before the acquisition of such property if such indebtedness would not have been incurred but for such acquisition,

"(III) the indebtedness incurred after the acquisition of such property if such indebtedness would not have been incurred but for such acquisition and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition, and

"(IV) the extension, renewal, or refinancing of an acquisition indebtedness.

"(4) TREATMENT OF RETAINED DEVELOPMENT RIGHT.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to the value of any development right retained by the donor in the conveyance of a qualified conservation easement.

"(B) TERMINATION OF RETAINED DEVELOPMENT RIGHT.—If every person in being who has an interest (whether or not in possession) in the land executes an agreement to extinguish permanently some or all of any development rights (as defined in subparagraph (D)) retained by the donor on or before the date for filing the return of the tax imposed by section 2001, then any tax imposed by section 2001 shall be reduced accordingly. Such agreement shall be filed with the return of the tax imposed by section 2001. The agreement shall be in such form as the Secretary shall prescribe.

"(C) ADDITIONAL TAX.—Any failure to implement the agreement described in subparagraph (B) not later than the earlier of—

"(i) the date which is 2 years after the date of the decedent's death, or

"(ii) the date of the sale of such land subject to the qualified conservation easement),

shall result in the imposition of an additional tax in the amount of the tax which would have been due on the retained development rights subject to such agreement. Such additional tax shall be due and payable on the last day of the 6th month following such date.

"(D) DEVELOPMENT RIGHT DEFINED.—For purposes of this paragraph, the term 'development right' means any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes (within the meaning of section 6420(c).

"(5) ELECTION.—The election under this subsection shall be made on the return of the tax imposed by section 2001. Such an election, once made, shall be irrevocable.

"(6) CALCULATION OF ESTATE TAX DUE.—An executor making the election described in paragraph (5) shall, for purposes of calculating the amount of tax imposed by section 2001, include the value of any development right (as defined in paragraph (4)) retained by the donor in the conveyance of such qualified conservation easement. The computation of tax on any retained development right prescribed in this paragraph shall be done in such manner and on such forms as the Secretary shall prescribe.

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

"(A) LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—The term 'land subject to a qualified conservation easement' means land—

"(i) which is located in or within 25 miles of an area which, on the date of the decedent's death, is—

"(I) a metropolitan area (as defined by the Office of Management and Budget), or

"(II) a national park or wilderness area designated as part of the National Wilderness Preservation System (unless it is determined by the Secretary that land in or within 25 miles of such a park or wilderness area is not under significant development pressure),

"(ii) which was owned by the decedent or a member of the decedent's family at all times during the 3-year period ending on the date of the decedent's death, and

"(iii) with respect to which a qualified conservation easement is or has been made by the decedent or a member of the decedent's family.

"(B) QUALIFIED CONSERVATION EASEMENT.—The term 'qualified conservation easement' means a qualified conservation contribution (as defined in section 170(h)(1)) of a qualified real property interest (as defined in section 170(h)(2)(C)), except that clause (iv) of section 170(h)(4)(A) shall not apply, and the restriction on the use of such interest described in section 170(h)(2)(C) shall include a prohibition on commercial recreational activity.

"(C) MEMBER OF FAMILY.—The term 'member of the decedent's family' means any member of the family (as defined in section 2032A(e)(2)) of the decedent.

"(8) APPLICATION OF THIS SECTION TO INTERESTS IN PARTNERSHIPS, CORPORATIONS, AND TRUSTS.—This section shall apply to an interest in a partnership, corporation, or trust if at least 30 percent of the entity is owned (directly or indirectly) by the decedent, as determined under the rules described in section 2033A(e)(3)."

(b) CARRYOVER BASIS.—Section 1014(a) (relating to basis of property acquired from a decedent) is amended by striking the period at the end of paragraph (3) and inserting ", or" and by adding after paragraph (3) the following new paragraph:

"(4) to the extent of the applicability of the exclusion described in section 2031(c), the basis in the hands of the decedent."

(c) QUALIFIED CONSERVATION CONTRIBUTION IS NOT A DISPOSITION.—Subsection (c) of section 2032A (relating to alternative valuation method) is amended by adding at the end the following new paragraph:

"(8) QUALIFIED CONSERVATION CONTRIBUTION IS NOT A DISPOSITION.—A qualified conservation contribution (as defined in section 170(h)) by gift or otherwise shall not be deemed a disposition under subsection (c)(1)(A)."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 1995.

SEC. 12304. EXPANSION OF EXCEPTION FROM GENERATION-SKIPPING TRANSFER TAX FOR TRANSFERS TO INDIVIDUALS WITH DECEASED PARENTS.

(a) IN GENERAL.—Section 2651 (relating to generation assignment) is amended by redesignating subsection (e) as subsection (f), and by inserting after subsection (d) the following new subsection:

"(e) SPECIAL RULE FOR PERSONS WITH A DECEASED PARENT.—

"(1) IN GENERAL.—For purposes of determining whether any transfer is a generation-skipping transfer, if—

"(A) an individual is a descendant of a parent of the transferor (or the transferor's spouse or former spouse), and

"(B) such individual's parent who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse) is dead at the time the transfer from which such interest is established or derived is subject to a tax imposed by chapter 11 or 12 upon the transferor (and if there shall be more than 1 such time, then at the earliest such time),

such individual shall be treated as if such individual were a member of the generation which is 1 generation below the lower of the transferor's generation or the generation assignment of the youngest living ancestor of such individual who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse), and the generation assignment of any descendant of such individual shall be adjusted accordingly.

"(2) LIMITED APPLICATION OF SUBSECTION TO COLLATERAL HEIRS.—This subsection shall not apply with respect to a transfer to any individual who is not a lineal descendant of the transferor (or the transferor's spouse or former spouse) if, at the time of the transfer, such transferor has any living lineal descendant."

(b) CONFORMING AMENDMENTS.—

(1) Section 2612(c) (defining direct skip) is amended by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(2) Section 2612(c)(2) (as so redesignated) is amended by striking "section 2651(e)(2)" and inserting "section 2651(f)(2)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to terminations, distributions, and transfers occurring after December 31, 1994.

SEC. 12305. EXTENSION OF TREATMENT OF CERTAIN RENTS UNDER SECTION 2032A TO LINEAL DESCENDANTS.

(a) GENERAL RULE.—Paragraph (7) of section 2032A(c) (relating to special rules for tax treatment of dispositions and failures to use for qualified use) is amended by adding at the end the following new subparagraph:

"(E) CERTAIN RENTS TREATED AS QUALIFIED USE.—For purposes of this subsection, a surviving spouse or lineal descendant of the decedent shall not be treated as failing to use qualified real property in a qualified use solely because such spouse or descendant rents such property to a member of the family of such spouse or descendant on a net cash basis. For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as the child of such individual by blood."

(b) CONFORMING AMENDMENT.—Section 2032A(b)(5)(A) is amended by striking out the last sentence.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to leases entered into after December 31, 1995.

Subtitle E—Extension of Expiring Provisions

CHAPTER 1—EXTENSIONS THROUGH FEBRUARY 28, 1997

SEC. 12401. WORK OPPORTUNITY TAX CREDIT.

(a) AMOUNT OF CREDIT.—Subsection (a) of section 51 (relating to amount of credit) is amended by striking "40 percent" and inserting "35 percent".

(b) MEMBERS OF TARGETED GROUPS.—Subsection (d) of section 51 is amended to read as follows:

"(d) MEMBERS OF TARGETED GROUPS.—For purposes of this subpart—

"(1) IN GENERAL.—An individual is a member of a targeted group if such individual is—

"(A) a qualified IV–A recipient,

"(B) a qualified veteran,

"(C) a qualified ex-felon,

"(D) a high-risk youth,

"(E) a vocational rehabilitation referral, or

"(F) a qualified summer youth employee.

"(2) QUALIFIED IV–A RECIPIENT.—

"(A) IN GENERAL.—The term 'qualified IV–A recipient' means any individual who is certified by the designated local agency as being a member of a family receiving assistance under a IV–A program for at least a 9-month period ending during the 9-month period ending on the hiring date.

"(B) IV–A PROGRAM.—For purposes of this paragraph, the term 'IV–A program' means any program providing assistance under a State plan approved under part A of title IV of the Social Security Act (relating to assistance for needy families with minor children) and any successor of such program.

"(3) QUALIFIED VETERAN.—

"(A) IN GENERAL.—The term 'qualified veteran' means any veteran who is certified by the designated local agency as being—

"(i) a member of a family receiving assistance under a IV–A program (as defined in paragraph (2)(B)) for at least a 9-month period ending during the 12-month period ending on the hiring date, or

"(ii) a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for at least a 3-month period ending during the 12-month period ending on the hiring date.

"(B) VETERAN.—For purposes of subparagraph (A), the term 'veteran' means any individual who is certified by the designated local agency as—

"(i)(I) having served on active duty (other than active duty for training) in the Armed Forces of the United States for a period of more than 180 days, or

"(II) having been discharged or released from active duty in the Armed Forces of the United States for a service-connected disability, and

"(ii) not having any day during the 60-day period ending on the hiring date which was a day of extended active duty in the Armed Forces of the United States.

For purposes of clause (ii), the term 'extended active duty' means a period of more than 90 days during which the individual was on active duty (other than active duty for training).

"(4) QUALIFIED EX-FELON.—The term 'qualified ex-felon' means any individual who is certified by the designated local agency—

"(A) as having been convicted of a felony under any statute of the United States or any State,

"(B) as having a hiring date which is not more than 1 year after the last date on which such individual was so convicted or was released from prison, and

"(C) as being a member of a family which had an income during the 6 months immediately preceding the earlier of the month in which such income determination occurs or the month in which the hiring date occurs, which, on an annual basis, would be 70 percent or less of the Bureau of Labor Statistics lower living standard.

Any determination under subparagraph (C) shall be valid for the 45-day period beginning on the date such determination is made.

"(5) HIGH-RISK YOUTH.—

"(A) IN GENERAL.—The term 'high-risk youth' means any individual who is certified by the designated local agency—

"(i) as having attained age 18 but not age 25 on the hiring date, and

"(ii) as having his principal place of abode within an empowerment zone or enterprise community.

"(B) YOUTH MUST CONTINUE TO RESIDE IN ZONE.—In the case of a high-risk youth, the term 'qualified wages' shall not include wages paid or incurred for services performed while such youth's principal place of abode is outside an empowerment zone or enterprise community.

"(6) VOCATIONAL REHABILITATION REFERRAL.—The term 'vocational rehabilitation referral' means any individual who is certified by the designated local agency as—

"(A) having a physical or mental disability which, for such individual, constitutes or results in a substantial handicap to employment, and

"(B) having been referred to the employer upon completion of (or while receiving) rehabilitative services pursuant to—

"(i) an individualized written rehabilitation plan under a State plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973, or

"(ii) a program of vocational rehabilitation carried out under chapter 31 of title 38, United States Code.

"(7) QUALIFIED SUMMER YOUTH EMPLOYEE.—

"(A) IN GENERAL.—The term 'qualified summer youth employee' means any individual—

"(i) who performs services for the employer between May 1 and September 15,

"(ii) who is certified by the designated local agency as having attained age 16 but not 18 on the hiring date (or if later, on May 1 of the calendar year involved),

"(iii) who has not been an employee of the employer during any period prior to the 90-day period described in subparagraph (B)(i), and

"(iv) who is certified by the designated local agency as having his principal place of abode within an empowerment zone or enterprise community.

"(B) SPECIAL RULES FOR DETERMINING AMOUNT OF CREDIT.—For purposes of applying this subpart to wages paid or incurred to any qualified summer youth employee—

"(i) subsection (b)(2) shall be applied by substituting 'any 90-day period between May 1 and September 15' for 'the 1-year period beginning with the day the individual begins work for the employer', and

"(ii) subsection (b)(3) shall be applied by substituting '$3,000' for '$6,000'.

The preceding sentence shall not apply to an individual who, with respect to the same employer, is certified as a member of another targeted group after such individual has been a qualified summer youth employee.

"(C) YOUTH MUST CONTINUE TO RESIDE IN ZONE.—Paragraph (4)(B) shall apply for purposes of this paragraph.

"(8) HIRING DATE.—The term 'hiring date' means the day the individual is hired by the employer.

"(9) DESIGNATED LOCAL AGENCY.—The term 'designated local agency' means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49-49n).

"(10) SPECIAL RULES FOR CERTIFICATIONS.—

"(A) IN GENERAL.—An individual shall not be treated as a member of a targeted group unless—

"(i) on or before the day on which such individual begins work for the employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group, or

"(ii)(I) on or before the day the individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and

"(II) not later than the 14th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for such a certification from such agency.

For purposes of this paragraph, the term 'pre-screening notice' means a document (in such form as the Secretary shall prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

"(B) INCORRECT CERTIFICATIONS.—If—

"(i) an individual has been certified by a designated local agency as a member of a targeted group, and

"(ii) such certification is incorrect because it was based on false information provided by such individual,

the certification shall be revoked and wages paid by the employer after the date on which notice of revocation is received by the employer shall not be treated as qualified wages.

"(C) EXPLANATION OF DENIAL OF REQUEST.—If a designated local agency denies a request for certification of membership in a targeted group, such agency shall provide to the person making such request a written explanation of the reasons for such denial."

(c) MINIMUM EMPLOYMENT PERIOD.—Paragraph (3) of section 51(i) (relating to certain individuals ineligible) is amended to read as follows:

"(3) INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIOD.—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual either—

"(A) is employed by the employer at least 180 days (20 days in the case of a qualified summer youth employee), or

"(B) has completed at least 400 hours (120 hours in the case of a qualified summer youth employee) of services performed for the employer."

(d) TERMINATION.—Paragraph (4) of section 51(c) (relating to wages defined) is amended to read as follows:

"(4) TERMINATION.—The term 'wages' shall not include any amount paid or incurred to an individual who begins work for the employer—

"(A) after December 31, 1994, and before January 1, 1996, or

"(B) after February 28, 1997."

(e) REDESIGNATION OF CREDIT.—

(1) Sections 38(b)(2) and 51(a) are each amended by striking "targeted jobs credit" and inserting "work opportunity credit".

(2) The subpart heading for subpart F of part IV of subchapter A of chapter 1 is amended by striking "**Targeted Jobs Credit**" and inserting "**Work Opportunity Credit**".

(3) The table of subparts for such part IV is amended by striking "targeted jobs credit" and inserting "work opportunity credit".

(f) BUSINESS AWARENESS PROGRAM.—The Secretary of Labor shall implement a program to encourage small businesses to use the services of local agencies to identify individuals who qualify to be certified as members of targeted groups (as defined in section 51 of the Internal Revenue Code of 1986, as amended by this section). Such Secretary, and the heads of other Federal agencies, shall make every effort to encourage small businesses to benefit from the credit allowable under such section by simplifying procedures to the extent possible.

(g) TECHNICAL AMENDMENTS.—

(1) Paragraph (1) of section 51(c) is amended by striking ", subsection (d)(8)(D),".

(2) Paragraph (3) of section 51(i) is amended by striking "(d)(12)" each place it appears and inserting "(d)(6)".

(h) EFFECTIVE DATE.—The amendments made by this section shall apply to individuals who begin work for the employer after December 31, 1995.

SEC. 12402. EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE PROGRAMS.

(a) EXTENSION.—Subsection (d) of section 127 (relating to educational assistance programs) is amended by striking "December 31, 1994" and inserting "February 28, 1997".

(b) CONFORMING AMENDMENTS.—Paragraph (2) of section 127(a) is amended—

(1) by inserting "($875 in calendar year 1997)" after "$5,250" the second and third place it appears, and

(2) by striking "$5,250" in the heading.

(c) SPECIAL RULE.—In the case of any taxable year beginning in 1997, only amounts paid before March 1, 1997, by the employer for educational assistance for the employee shall be taken into account in determining the amount excluded under section 127 of the Internal Revenue Code of 1986 with respect to such employee for such taxable year.

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after December 31, 1994.

SEC. 12403. RESEARCH CREDIT.

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

(1) by striking "June 30, 1995" each place it appears and inserting "February 28, 1997", and

(2) by striking "July 1, 1995" each place it appears and inserting "March 1, 1997".

(b) BASE AMOUNT FOR START-UP COMPANIES.—Clause (i) of section 41(c)(3)(B) (relating to start-up companies) is amended to read as follows:

"(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The fixed-base percentage shall be determined under this subparagraph if—

"(I) the first taxable year in which a taxpayer had both gross receipts and qualified research expenses begins after December 31, 1983, or

"(II) there are fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses."

(c) CONFORMING AMENDMENT.—Subparagraph (D) of section 28(b)(1) is amended by striking "June 30, 1995" and inserting "February 28, 1997".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after June 30, 1995.

SEC. 12404. EMPLOYER-PROVIDED GROUP LEGAL SERVICES.

(a) IN GENERAL.—Subsection (e) of section 120 (relating to amounts received under qualified group legal services plans) is amended to read as follows:

"(e) APPLICATION OF SECTIONS.—This section and section 501(c)(20) shall not apply to any taxable year beginning before January 1, 1996, or after February 28, 1997."

(b) CONFORMING AMENDMENTS.—Subsection (a) of section 120 is amended by inserting "($12 in taxable years beginning in 1997)" after "$70".

(c) SPECIAL RULE.—In the case of any taxable year beginning in 1997, only amounts paid before March 1, 1997, by the employer for coverage for the employee, the employee's spouse, or the employee's dependents, under a qualified group legal services plan for periods before March 1, 1997, shall be taken into account in determining the amount excluded under section 120 of the Internal Revenue Code of 1986 with respect to such employee for such taxable year.

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after December 31, 1995.

SEC. 12405. ORPHAN DRUG TAX CREDIT.

(a) RECATEGORIZED AS A BUSINESS CREDIT.—

(1) IN GENERAL.—Section 28 (relating to clinical testing expenses for certain drugs for rare diseases or conditions) is transferred to subpart D of part IV of subchapter A of chapter 1, inserted after section 45B, and redesignated as section 45C.

(2) CONFORMING AMENDMENT.—Subsection (b) of section 38 (relating to general business credit) is amended by striking "plus" at the end of paragraph (10), by striking the period at the end of paragraph (11) and inserting ", plus", and by adding at the end the following new paragraph:

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

(3) CLERICAL AMENDMENTS.—

(A) The table of sections for subpart B of such part IV is amended by striking the item relating to section 28.

(B) The table of sections for subpart D of such part IV is amended by adding at the end the following new item:

"Sec. 45C. Clinical testing expenses for certain drugs for rare diseases or conditions."

(b) CREDIT TERMINATION.—Subsection (e) of section 45C, as redesignated by subsection (a)(1), is amended by striking "December 31, 1994" and inserting "February 28, 1997".

(c) NO PRE-1995 CARRYBACKS.—Subsection (d) of section 39 (relating to carryback and carryforward of unused credits) is amended by adding at the end the following new paragraph:

"(7) NO CARRYBACK OF SECTION 45C CREDIT BEFORE 1995.—No portion of the unused business credit for any taxable year which is attributable to the orphan drug credit determined under section 45C may be carried back to a taxable year beginning before January 1, 1995."

(d) ADDITIONAL CONFORMING AMENDMENTS.—

(1) Section 45C(a), as redesignated by subsection (a)(1), is amended by striking "There shall be allowed as a credit against the tax imposed by this chapter for the taxable year" and inserting "For purposes of section 38, the credit determined under this section for the taxable year is".

(2) Section 45C(d), as so redesignated, is amended by striking paragraph (2) and by redesignating paragraphs (3), (4), and (5) as paragraphs (2), (3), and (4).

(3) Section 29(b)(6)(A) is amended by striking "sections 27 and 28" and inserting "section 27".

(4) Section 30(b)(3)(A) is amended by striking "sections 27, 28, and 29" and inserting "sections 27 and 29".

(5) Section 53(d)(1)(B) is amended—

(A) by striking "or not allowed under section 28 solely by reason of the application of section 28(d)(2)(B)," in clause (iii), and

(B) by striking "or not allowed under section 28 solely by reason of the application of section 28(d)(2)(B)" in clause (iv)(II).

(6) Section 55(c)(2) is amended by striking "28(d)(2),".

(7) Section 280C(b) is amended—

(A) by striking "section 28(b)" in paragraph (1) and inserting "section 45C(b)",

(B) by striking "section 28" in paragraphs (1) and (2)(A) and inserting "section 45C(b)", and

(C) by striking "subsection (d)(2) thereof" in paragraphs (1) and (2)(A) and inserting "section 38(c)".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after December 31, 1994.

SEC. 12406. CONTRIBUTIONS OF STOCK TO PRIVATE FOUNDATIONS.

(a) IN GENERAL.—Subparagraph (D) of section 170(e)(5) (relating to special rule for contributions of stock for which market quotations are readily available) is amended by striking "December 31, 1994" and inserting "February 28, 1997".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made after December 31, 1994.

SEC. 12407. DELAY OF SCHEDULED INCREASE IN TAX ON FUEL USED IN COMMERCIAL AVIATION.

(a) IN GENERAL.—Sections 4092(b)(2), 6421(f)(2)(B), and 6427(l)(4)(B) are each amended by striking "September 30, 1995" and inserting "February 28, 1997".

(b) CONFORMING AMENDMENT.—Section 13245 of the Omnibus Budget Reconciliation Act of 1993 is hereby repealed.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall take effect after September 30, 1995.

(2) CROSS REFERENCE.—

For refund of tax paid on commercial aviation fuel before the date of the enactment of this Act, see section 6427(l) of the Internal Revenue Code of 1986.

(d) FLOOR STOCKS TAX.—

(1) IMPOSITION OF TAX.—In the case of commercial aviation fuel which is held by any person on March 1, 1997, there is hereby imposed a floor stocks tax equal to 4.3 cents per gallon.

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

(A) LIABILITY FOR TAX.—A person holding aviation fuel on March 1, 1997, to which the tax imposed by paragraph (1) applies shall be liable for such tax.

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

(C) TIME FOR PAYMENT.—The tax imposed by paragraph (1) shall be paid on or before September 30, 1997.

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

(A) HELD BY A PERSON.—Aviation fuel shall be considered as "held by a person" if title thereto has passed to such person (whether or not delivery to the person has been made).

(B) COMMERCIAL AVIATION FUEL.—The term "commercial aviation fuel" means aviation fuel (as defined in section 4093 of such Code) which is held on March 1, 1997, for sale or use in commercial aviation (as defined in section 4092(b) of such Code).

(C) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or the Secretary's delegate.

(4) EXCEPTION FOR EXEMPT USES.—The tax imposed by paragraph (1) shall not apply to aviation fuel held by any person exclusively for any use for which a credit or refund of the entire tax imposed by section 4091 of such Code (other than the rate imposed by section 4091(b)(2) of such Code) is allowable for aviation fuel so used.

(5) EXCEPTION FOR CERTAIN AMOUNTS OF FUEL.—

(A) IN GENERAL.—No tax shall be imposed by paragraph (1) on aviation fuel held on March 1, 1997, by any person if the aggregate amount of commercial aviation fuel held by such person on such date does not exceed 2,000 gallons. The preceding sentence shall apply only if such person submits to the Secretary (at the time and in the manner required by the Secretary) such information as the Secretary shall require for purposes of this paragraph.

(B) EXEMPT FUEL.—For purposes of subparagraph (A), there shall not be taken into account fuel held by any person which is exempt from the tax imposed by paragraph (1) by reason of paragraph (4).

(C) CONTROLLED GROUPS.—For purposes of this paragraph—

(i) CORPORATIONS.—

(I) IN GENERAL.—All persons treated as a controlled group shall be treated as 1 person.

(II) CONTROLLED GROUP.—The term "controlled group" has the meaning given to such term by subsection (a) of section 1563 of such Code; except that for such purposes the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in such subsection.

(ii) NONINCORPORATED PERSONS UNDER COMMON CONTROL.—Under regulations prescribed by the Secretary, principles similar to the principles of clause (i) shall apply to a group of persons under common control where 1 or more of such persons is not a corporation.

(6) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 4091 of such Code shall, insofar as applicable and not inconsistent with the provisions of this subsection, apply with respect to the floor stock taxes imposed by paragraph (1) to the same extent as if such taxes were imposed by such section 4091.

CHAPTER 2—EXTENSIONS OF SUPERFUND AND OIL SPILL LIABILITY TAXES

SEC. 12411. EXTENSION OF HAZARDOUS SUBSTANCE SUPERFUND.

(a) EXTENSION OF TAXES.—

(1) ENVIRONMENTAL TAX.—Section 59A(e) is amended to read as follows:

"(e) APPLICATION OF TAX.—The tax imposed by this section shall apply to taxable years beginning after December 31, 1986, and before January 1, 1998."

(2) EXCISE TAXES.—Section 4611(e) is amended to read as follows:

"(e) APPLICATION OF HAZARDOUS SUBSTANCE SUPERFUND FINANCING RATE.—The Hazardous Substance Superfund financing rate under this section shall apply after December 31, 1986, and before October 1, 2002."

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 12412. EXTENSION OF OIL SPILL LIABILITY TAX.

(a) IN GENERAL.—Section 4611(f)(1) (relating to application of oil spill liability trust fund financing rate) is amended by striking "after December 31, 1989, and before January 1, 1995" and inserting "after December 31, 1995, and before October 1, 2002".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on January 1, 1996.

CHAPTER 3—EXTENSIONS RELATING TO FUEL TAXES

SEC. 12421. ETHANOL BLENDER REFUNDS.

(a) IN GENERAL.—Paragraph (4) of section 6427(f) (relating to gasoline, diesel fuel, and aviation fuel used to produce certain alcohol fuels) is amended by striking "1995" and inserting "1999".

(b) SPECIAL RULE.—With respect to refund claims which could have been filed under section 6427(f) of the Internal Revenue Code of 1986 during the period beginning on October 8, 1995, and ending on the date of the enactment of this Act, but for the expiration of such section after September 30, 1995, interest shall accrue on such claims from the date which is the later of—

(1) November 1, 1995, or

(2) 20 days after the claim could have been filed under such section as in effect on September 30, 1995.

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 12422. EXTENSION OF BINDING CONTRACT DATE FOR BIOMASS AND COAL FACILITIES.

(a) IN GENERAL.—Subparagraph (A) of section 29(g)(1) (relating to extension of certain facilities) is amended by striking "January 1, 1997" and inserting "January 1, 1998" and by striking "January 1, 1996" and inserting "January 1, 1997".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

CHAPTER 4—DIESEL DYEING PROVISIONS

SEC. 12431. EXEMPTION FROM DIESEL FUEL DYEING REQUIREMENTS WITH RESPECT TO CERTAIN STATES.

(a) IN GENERAL.—Section 4082 (relating to exemptions for diesel fuel) is amended by redesignating subsections (c) and (d) as subsections (d) and (e), respectively, and by inserting after subsection (b) the following new subsection:

"(c) EXCEPTION TO DYEING REQUIREMENTS.—Paragraph (2) of subsection (a) shall not apply with respect to any diesel fuel—

"(1) removed, entered, or sold before March 1, 1997, in a State for ultimate sale or use in an area of such State which is exempted from the fuel dyeing requirements under subsection (i) of section 211 of the Clean Air Act (as in effect on the date of the enactment of this subsection) by the Administrator of the Environmental Protection Agency under paragraph (4) of such subsection, and

"(2) the use of which is certified pursuant to regulations issued by the Secretary."

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendments made by section 13242(b) of the Omnibus Budget Reconciliation Act of 1993.

SEC. 12432. MORATORIUM FOR EXCISE TAX ON DIESEL FUEL SOLD FOR USE OR USED IN DIESEL-POWERED MOTORBOATS.

(a) IN GENERAL.—Subparagraph (D) of section 4041(a)(1) (relating to the imposition of tax on diesel fuel and special motor fuels) is amended to read as follows:

"(D) DIESEL FUEL USED IN MOTORBOATS.—

"(i) MORATORIUM.—No tax shall be imposed by subsection (a) or (d)(1) on diesel fuel sold for use or used in a diesel-powered motorboat during the period after December 31, 1995, and before March 1, 1997.

"(ii) SPECIAL TERMINATION DATE.—In the case of any sale for use, or use, of fuel in a diesel-powered motorboat—

"(I) effective during the period after September 30, 1999, and before January 1, 2000, the rate of tax imposed by this paragraph is 24.3 cents per gallon, and

"(II) the termination of the tax under subsection (d) shall not occur before January 1, 2000."

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect after December 31, 1995.

CHAPTER 5—Treatment of Individuals Who Expatriate

SEC. 12441. REVISION OF TAX RULES ON EXPATRIATION.

(a) IN GENERAL.—Subpart A of part II of subchapter N of chapter 1 is amended by inserting after section 877 the following new section:

"SEC. 877A. TAX RESPONSIBILITIES OF EXPATRIATION.

"(a) GENERAL RULES.—For purposes of this subtitle—

"(1) MARK TO MARKET.—Except as provided in subsection (f), all property of a covered expatriate to which this section applies shall be treated as sold on the expatriation date for its fair market value.

"(2) RECOGNITION OF GAIN OR LOSS.—In the case of any sale under paragraph (1)—

"(A) notwithstanding any other provision of this title, any gain arising from such sale shall be taken into account for the taxable year of the sale unless such gain is excluded from gross income under part III of subchapter B, and

"(B) any loss arising from such sale shall be taken into account for the taxable year of the sale to the extent otherwise provided by this title, except that section 1091 shall not apply (and section 1092 shall apply) to any such loss.

"(3) EXCLUSION FOR CERTAIN GAIN.—The amount which would (but for this paragraph) be includible in the gross income of any individual by reason of this section shall be reduced (but not below zero) by $600,000. For purposes of this paragraph, allocable expatriation gain taken into account under subsection (f)(2) shall be treated in the same manner as an amount required to be includible in gross income.

"(4) ELECTION TO CONTINUE TO BE TAXED AS UNITED STATES CITIZEN.—

"(A) IN GENERAL.—If an expatriate elects the application of this paragraph—

"(i) this section (other than this paragraph) shall not apply to the expatriate, but

"(ii) the expatriate shall be subject to tax under this title, with respect to property to which this section would apply but for such election, in the same manner as if the individual were a United States citizen.

"(B) LIMITATION ON AMOUNT OF ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES.—The aggregate amount of taxes imposed under subtitle B with respect to any transfer of property by reason of an election under subparagraph (A) shall not exceed the amount of income tax which would be due if the property were sold for its fair market value immediately before the time of the transfer or death (taking into account the rules of paragraph (2)).

"(C) REQUIREMENTS.—Subparagraph (A) shall not apply to an individual unless the individual—

"(i) provides security for payment of tax in such form and manner, and in such amount, as the Secretary may require,

"(ii) consents to the waiver of any right of the individual under any treaty of the United States which would preclude assessment or collection of any tax which may be imposed by reason of this paragraph, and

"(iii) complies with such other requirements as the Secretary may prescribe.

"(D) ELECTION.—An election under subparagraph (A) shall apply to all property to which this section would apply but for the election and, once made, shall be irrevocable. Such election shall also apply to property the basis of which is determined in whole or in part by reference to the property with respect to which the election was made.

"(b) ELECTION TO DEFER TAX.—

"(1) IN GENERAL.—If the taxpayer elects the application of this subsection with respect to any property—

"(A) no amount shall be required to be included in gross income under subsection (a)(1) with respect to the gain from such property for the taxable year of the sale, but

"(B) the taxpayer's tax for the taxable year in which such property is disposed of shall be increased by the deferred tax amount with respect to the property.

Except to the extent provided in regulations, subparagraph (B) shall apply to a disposition whether or not gain or loss is recognized in whole or in part on the disposition.

"(2) DEFERRED TAX AMOUNT.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'deferred tax amount' means, with respect to any property, an amount equal to the sum of—

"(i) the difference between the amount of tax paid for the taxable year described in paragraph (1)(A) and the amount which would have been paid for such taxable year if the election under paragraph (1) had not applied to such property, plus

"(ii) an amount of interest on the amount described in clause (i) determined for the period—

"(I) beginning on the 91st day after the expatriation date, and

"(II) ending on the due date for the taxable year described in paragraph (1)(B),

by using the rates and method applicable under section 6621 for underpayments of tax for such period.

For purposes of clause (ii), the due date is the date prescribed by law (determined without regard to extension) for filing the return of the tax imposed by this chapter for the taxable year.

"(B) ALLOCATION OF LOSSES.—For purposes of subparagraph (A), any losses described in subsection (a)(2)(B) shall be allocated ratably among the gains described in subsection (a)(2)(A).

"(3) SECURITY.—

"(A) IN GENERAL.—No election may be made under paragraph (1) with respect to any property unless adequate security is provided with respect to such property.

"(B) ADEQUATE SECURITY.—For purposes of subparagraph (A), security with respect to any property shall be treated as adequate security if—

"(i) it is a bond in an amount equal to the deferred tax amount under paragraph (2)(A) for the property, or

"(ii) the taxpayer otherwise establishes to the satisfaction of the Secretary that the security is adequate.

"(4) WAIVER OF CERTAIN RIGHTS.—No election may be made under paragraph (1) unless the taxpayer consents to the waiver of any right under any treaty of the United States which would preclude assessment or collection of any tax imposed by reason of this section.

"(5) DISPOSITIONS.—For purposes of this subsection, a taxpayer making an election under this subsection with respect to any property shall be treated as having disposed of such property—

"(A) immediately before death if such property is held at such time, and

"(B) at any time the security provided with respect to the property fails to meet the requirements of paragraph (3) and the taxpayer does not correct such failure within the time specified by the Secretary.

"(6) ELECTIONS.—An election under paragraph (1) shall only apply to property described in the election and, once made, is irrevocable. An election may be under paragraph (1) with respect to an interest in a trust with respect to which gain is required to be recognized under subsection (f)(1).

"(c) COVERED EXPATRIATE.—For purposes of this section—

"(1) IN GENERAL.—The term 'covered expatriate' means an expatriate—

"(A) whose average annual net income tax (as defined in section 38(c)(1)) for the period of 5 taxable years ending before the expatriation date is greater than $100,000, or

"(B) whose net worth as of such date is $500,000 or more.

If the expatriation date is after 1996, such $100,000 and $500,000 amounts 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 '1995' for '1992' in subparagraph (B) thereof. Any increase under the preceding sentence shall be rounded to the nearest multiple of $1,000.

"(2) EXCEPTIONS.—An individual shall not be treated as a covered expatriate if—

"(A) the individual—

"(i) became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and

"(ii) has been a resident of the United States (as defined in section 7701(b)(1)(A)(ii)) for not more than 8 taxable years during the 15-taxable year period ending with the taxable year during which the expatriation date occurs, or

"(B)(i) the individual's relinquishment of United States citizenship occurs before such individual attains age 18½, and

"(ii) the individual has been a resident of the United States (as so defined) for not more than 5 taxable years before the date of relinquishment.

"(d) PROPERTY TO WHICH SECTION APPLIES.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided by the Secretary, this section shall apply to—

"(A) any interest in property held by a covered expatriate on the expatriation date the gain from which would be includible in the gross income of the expatriate if such interest had been sold for its fair market value on such date in a transaction in which gain is recognized in whole or in part, and

"(B) any other interest in a trust to which subsection (f) applies.

"(2) EXCEPTIONS.—This section shall not apply to the following property:

"(A) UNITED STATES REAL PROPERTY INTERESTS.—Any United States real property interest (as defined in section 897(c)(1)), other than stock of a United States real property holding corporation which does not, on the expatriation date, meet the requirements of section 897(c)(2).

"(B) INTEREST IN CERTAIN RETIREMENT PLANS.—

"(i) IN GENERAL.—Any interest in a qualified retirement plan (as defined in section 4974(c)), other than any interest attributable to contributions which are in excess of any limitation or which violate any condition for tax- favored treatment.

"(ii) FOREIGN PENSION PLANS.—

"(I) IN GENERAL.—Under regulations prescribed by the Secretary, interests in foreign pension plans or similar retirement arrangements or programs.

"(II) LIMITATION.—The value of property which is treated as not sold by reason of this subparagraph shall not exceed $500,000.

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

"(1) EXPATRIATE.—The term 'expatriate' means—

"(A) any United States citizen who relinquishes his citizenship, or

"(B) any long-term resident of the United States who—

"(i) ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)), or

"(ii) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and who does not waive the benefits of such treaty applicable to residents of the foreign country.

"(2) EXPATRIATION DATE.—The term 'expatriation date' means—

"(A) the date an individual relinquishes United States citizenship, or

"(B) in the case of a long-term resident of the United States, the date of the event described in clause (i) or (ii) of paragraph (1)(B).

"(3) RELINQUISHMENT OF CITIZENSHIP.—A citizen shall be treated as relinquishing his United States citizenship on the earliest of—

"(A) the date the individual renounces his United States nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5)),

"(B) the date the individual furnishes to the United States Department of State a signed statement of voluntary relinquishment of United States nationality confirming the performance of an act of expatriation specified in paragraph (1), (2), (3), or (4) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(1)–(4)),

"(C) the date the United States Department of State issues to the individual a certificate of loss of nationality, or

"(D) the date a court of the United States cancels a naturalized citizen's certificate of naturalization.

Subparagraph (A) or (B) shall not apply to any individual unless the renunciation or voluntary relinquishment is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the United States Department of State.

"(4) LONG-TERM RESIDENT.—

"(A) IN GENERAL.—The term 'long-term resident' means any individual (other than a citizen of the United States) who is a lawful permanent resident of the United States in at least 8 taxable years during the period of 15 taxable years ending with the taxable year during which the expatriation date occurs. For purposes of the preceding sentence, an individual shall not be treated as a lawful permanent resident for any taxable year if such individual is treated as a resident of a foreign country for the taxable year under the provisions of a tax treaty between the United States and the foreign country and does not waive the benefits of such treaty applicable to residents of the foreign country.

"(B) SPECIAL RULE.—For purposes of subparagraph (A), there shall not be taken into account—

"(i) any taxable year during which any prior sale is treated under subsection (a)(1) as occurring, or

"(ii) any taxable year prior to the taxable year referred to in clause (i).

"(f) SPECIAL RULES APPLICABLE TO BENEFICIARIES' INTERESTS IN TRUST.—

"(1) IN GENERAL.—Except as provided in paragraph (2), if an individual is determined under paragraph (3) to hold an interest in a trust—

"(A) the individual shall not be treated as having sold such interest,

"(B) such interest shall be treated as a separate share in the trust, and

"(C)(i) such separate share shall be treated as a separate trust consisting of the assets allocable to such share,

"(ii) the separate trust shall be treated as having sold its assets immediately before the expatriation date for their fair market value and as having distributed all of its assets to the individual as of such time, and

"(iii) the individual shall be treated as having recontributed the assets to the separate trust.

Subsection (a)(2) shall apply to any income, gain, or loss of the individual arising from a distribution described in subparagraph (C)(ii).

"(2) SPECIAL RULES FOR INTERESTS IN QUALIFIED TRUSTS.—

"(A) IN GENERAL.—If the trust interest described in paragraph (1) is an interest in a qualified trust—

"(i) paragraph (1) and subsection (a) shall not apply, and

"(ii) in addition to any other tax imposed by this title, there is hereby imposed on each distribution with respect to such interest a tax in the amount determined under subparagraph (B).

"(B) AMOUNT OF TAX.—The amount of tax under subparagraph (A)(ii) shall be equal to the lesser of—

"(i) the highest rate of tax imposed by section 1(e) for the taxable year in which the expatriation date occurs, multiplied by the amount of the distribution, or

"(ii) the balance in the deferred tax account immediately before the distribution determined without regard to any increases under subparagraph (C)(ii) after the 30th day preceding the distribution.

"(C) DEFERRED TAX ACCOUNT.—For purposes of subparagraph (B)(ii)—

"(i) OPENING BALANCE.—The opening balance in a deferred tax account with respect to any trust interest is an amount equal to the tax which would have been imposed on the allocable expatriation gain with respect to the trust interest if such gain had been included in gross income under subsection (a).

"(ii) INCREASE FOR INTEREST.—The balance in the deferred tax account shall be increased by the amount of interest determined (on the balance in the account at the time the interest accrues), for periods after the 90th day after the expatriation date, by using the rates and method applicable under section 6621 for underpayments of tax for such periods.

"(iii) DECREASE FOR TAXES PREVIOUSLY PAID.—The balance in the tax deferred account shall be reduced—

"(I) by the amount of taxes imposed by subparagraph (A) on any distribution to the person holding the trust interest, and

"(II) in the case of a person holding a nonvested interest, to the extent provided in regulations, by the amount of taxes imposed by subparagraph (A) on distributions from the trust with respect to nonvested interests not held by such person.

"(D) ALLOCABLE EXPATRIATION GAIN.—For purposes of this paragraph, the allocable expatriation gain with respect to any beneficiary's interest in a trust is the amount of gain which would be allocable to such beneficiary's vested and nonvested interests in the trust if the beneficiary held directly all assets allocable to such interests.

"(E) TAX DEDUCTED AND WITHHELD.—

"(i) IN GENERAL.—The tax imposed by subparagraph (A)(ii) shall be deducted and withheld by the trustees from the distribution to which it relates.

"(ii) EXCEPTION WHERE FAILURE TO WAIVE TREATY RIGHTS.—If an amount may not be deducted and withheld under clause (i) by reason of the distributee failing to waive any treaty right with respect to such distribution—

"(I) the tax imposed by subparagraph (A)(ii) shall be imposed on the trust and each trustee shall be personally liable for the amount of such tax, and

"(II) any other beneficiary of the trust shall be entitled to recover from the distributee the amount of such tax imposed on the other beneficiary.

"(F) DISPOSITION.—If a trust ceases to be a qualified trust at any time, a covered expatriate disposes of an interest in a qualified trust, or a covered expatriate holding an interest in a qualified trust dies, then, in lieu of the tax imposed by subparagraph (A)(ii), there is hereby imposed a tax equal to the lesser of—

"(i) the tax determined under paragraph (1) as if the expatriation date were the date of such cessation, disposition, or death, whichever is applicable, or

"(ii) the balance in the tax deferred account immediately before such date.

Such tax shall be imposed on the trust and each trustee shall be personally liable for the amount of such tax and any other beneficiary of the trust shall be entitled to recover from the covered expatriate or the estate the amount of such tax imposed on the other beneficiary.

"(G) DEFINITIONS AND SPECIAL RULE.—For purposes of this paragraph—

"(i) QUALIFIED TRUST.—The term 'qualified trust' means a trust—

"(I) which is organized under, and governed by, the laws of the United States or a State, and

"(II) with respect to which the trust instrument requires that at least 1 trustee of the trust be an individual citizen of the United States or a domestic corporation.

"(ii) VESTED INTEREST.—The term 'vested interest' means any interest which, as of the expatriation date, is vested in the beneficiary.

"(iii) NONVESTED INTEREST.—The term 'nonvested interest' means, with respect to any beneficiary, any interest in a trust which is not a vested interest. Such interest shall be determined by assuming the maximum exercise of discretion in favor of the beneficiary and the occurrence of all contingencies in favor of the beneficiary.

"(iv) ADJUSTMENTS.—The Secretary may provide for such adjustments to the bases of assets in a trust or a deferred tax account, and the timing of such adjustments, in order to ensure that gain is taxed only once.

"(3) DETERMINATION OF BENEFICIARIES' INTEREST IN TRUST.—

"(A) DETERMINATIONS UNDER PARAGRAPH (1).—For purposes of paragraph (1), a beneficiary's interest in a trust shall be based upon all relevant facts and circumstances, including the terms of the trust instrument and any letter of wishes or similar document, historical patterns of trust distributions, and the existence of and functions performed by a trust protector or any similar advisor.

"(B) OTHER DETERMINATIONS.—For purposes of this section—

"(i) CONSTRUCTIVE OWNERSHIP.—If a beneficiary of a trust is a corporation, partnership, trust, or estate, the shareholders, partners, or beneficiaries shall be deemed to be the trust beneficiaries for purposes of this section.

"(ii) TAXPAYER RETURN POSITION.—A taxpayer shall clearly indicate on its income tax return—

"(I) the methodology used to determine that taxpayer's trust interest under this section, and

"(II) if the taxpayer knows (or has reason to know) that any other beneficiary of such trust is using a different methodology to determine such beneficiary's trust interest under this section.

"(g) TERMINATION OF DEFERRALS, ETC.—On the date any property held by an individual is treated as sold under subsection (a), notwithstanding any other provision of this title—

"(1) any period during which recognition of income or gain is deferred shall terminate, and

"(2) any extension of time for payment of tax shall cease to apply and the unpaid portion of such tax shall be due and payable at the time and in the manner prescribed by the Secretary.

"(h) IMPOSITION OF TENTATIVE TAX.—

"(1) IN GENERAL.—If an individual is required to include any amount in gross income under subsection (a) for any taxable year, there is hereby imposed, immediately before the expatriation date, a tax in an amount equal to the amount of tax which would be imposed if the taxable year were a short taxable year ending on the expatriation date.

"(2) DUE DATE.—The due date for any tax imposed by paragraph (1) shall be the 90th day after the expatriation date.

"(3) TREATMENT OF TAX.—Any tax paid under paragraph (1) shall be treated as a payment of the tax imposed by this chapter for the taxable year to which subsection (a) applies.

"(4) DEFERRAL OF TAX.—The provisions of subsection (b) shall apply to the tax imposed by this subsection to the extent attributable to gain includible in gross income by reason of this section.

"(i) COORDINATION WITH ESTATE AND GIFT TAXES.—If subsection (a) applies to property held by an individual for any taxable year and—

"(1) such property is includible in the gross estate of such individual solely by reason of section 2107, or

"(2) section 2501 applies to a transfer of such property by such individual solely by reason of section 2501(a)(3),

then there shall be allowed as a credit against the additional tax imposed by section 2101 or 2501, whichever is applicable, solely by reason of section 2107 or 2501(a)(3) an amount equal to the increase in the tax imposed by this chapter for such taxable year by reason of this section.

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

"(1) to prevent double taxation by ensuring that—

"(A) appropriate adjustments are made to basis to reflect gain recognized by reason of subsection (a) and the exclusion provided by subsection (a)(3), and

"(B) any gain by reason of a deemed sale under subsection (a) of an interest in a corporation, partnership, trust, or estate is reduced to reflect that portion of such gain which is attributable to an interest in a trust which a shareholder, partner, or beneficiary is treated as holding directly under subsection (f)(3)(B)(i), and

"(2) which provide for the proper allocation of the exclusion under subsection (a)(3) to property to which this section applies.

"(k) CROSS REFERENCE.—

"For income tax treatment of individuals who terminate United States citizenship, see section 7701(a)(47)."

(b) INCLUSION IN INCOME OF GIFTS AND INHERITANCES FROM COVERED EXPATRIATES.—Section 102 (relating to gifts, etc. not included in gross income) is amended by adding at the end the following new subsection:

"(d) GIFTS AND INHERITANCES FROM COVERED EXPATRIATES.—Subsection (a) shall not exclude from gross income the value of any property acquired by gift, bequest, devise, or inheritance from a covered expatriate after the expatriation date. For purposes of this subsection, any term used in this subsection which is also used in section 877A shall have the same meaning as when used in section 877A."

(c) DEFINITION OF TERMINATION OF UNITED STATES CITIZENSHIP.—Section 7701(a) is amended by adding at the end the following new paragraph:

"(47) TERMINATION OF UNITED STATES CITIZENSHIP.—An individual shall not cease to be treated as a United States citizen before the date on which the individual's citizenship is treated as relinquished under section 877A(e)(3)."

(d) CONFORMING AMENDMENTS.—

(1) Section 877 is amended by adding at the end the following new subsection:

"(f) APPLICATION.—This section shall not apply to any individual who relinquishes (within the meaning of section 877A(e)(3)) United States citizenship on or after February 6, 1995."

(2) Section 2107(c) is amended by adding at the end the following new paragraph:

"(3) CROSS REFERENCE.—For credit against the tax imposed by subsection (a) for expatriation tax, see section 877A(i)."

(3) Section 2501(a)(3) is amended by adding at the end the following new flush sentence:

"For credit against the tax imposed under this section by reason of this paragraph, see section 877A(i)."

(4) Paragraph (10) of section 7701(b) is amended by adding at the end the following new sentence: "This paragraph shall not apply to any long-term resident of the United States who is an expatriate (as defined in section 877A(e)(1))."

(e) CLERICAL AMENDMENT.—The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by inserting after the item relating to section 877 the following new item:

"Sec. 877A. Tax responsibilities of expatriation."

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to expatriates (within the meaning of section 877A(e) of the Internal

Revenue Code of 1986, as added by this section) whose expatriation date (as so defined) occurs on or after February 6, 1995.

(2) GIFTS AND BEQUESTS.—Section 102(d) of the Internal Revenue Code of 1986 (as added by subsection (b)) shall apply to amounts received from expatriates (as so defined) whose expatriation date (as so defined) occurs on and after February 6, 1995.

(3) SPECIAL RULES RELATING TO CERTAIN ACTS OCCURRING BEFORE FEBRUARY 6, 1995.—In the case of an individual who took an act of expatriation specified in paragraph (1), (2), (3), or (4) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a) (1)–(4)) before February 6, 1995, but whose expatriation date (as so defined) occurs after February 6, 1995—

(A) the amendment made by subsection (c) shall not apply,

(B) the amendment made by subsection (d)(1) shall not apply for any period prior to the expatriation date, and

(C) the other amendments made by this section shall apply as of the expatriation date.

(4) DUE DATE FOR TENTATIVE TAX.—The due date under section 877A(h)(2) of such Code shall in no event occur before the 90th day after the date of the enactment of this Act.

SEC. 12442. INFORMATION ON INDIVIDUALS EXPATRIATING.

(a) IN GENERAL.—Subpart A of part III of subchapter A of chapter 61 is amended by inserting after section 6039E the following new section:

"SEC. 6039F. INFORMATION ON INDIVIDUALS EXPATRIATING.

"(a) REQUIREMENT.—

"(1) IN GENERAL.—Notwithstanding any other provision of law, any expatriate (within the meaning of section 877A(e)(1)) shall provide a statement which includes the information described in subsection (b).

"(2) TIMING.—

"(A) CITIZENS.—In the case of an expatriate described in section 877(e)(1)(A), such statement shall be—

"(i) provided not later than the expatriation date (within the meaning of section 877A(e)(2)), and

"(ii) provided to the person or court referred to in section 877A(e)(3).

"(B) NONCITIZENS.—In the case of an expatriate described in section 877A(e)(1)(B), such statement shall be provided to the Secretary with the return of tax imposed by chapter 1 for the taxable year during which the event described in such section occurs.

"(b) INFORMATION TO BE PROVIDED.—Information required under subsection (a) shall include—

"(1) the taxpayer's TIN,

"(2) the mailing address of such individual's principal foreign residence,

"(3) the foreign country in which such individual is residing, "(4) the foreign country of which such individual is a citizen,

"(5) in the case of an individual having a net worth of at least the dollar amount applicable under section 877A(c)(1)(B), information detailing the assets and liabilities of such individual, and

"(6) such other information as the Secretary may prescribe.

"(c) PENALTY.—Any individual failing to provide a statement required under subsection (a) shall be subject to a penalty for each year during any portion of which such failure continues in an amount equal to the greater of—

"(1) 5 percent of the additional tax required to be paid under section 877A for such year, or

"(2) $1,000,

unless it is shown that such failure is due to reasonable cause and not to willful neglect.

"(d) INFORMATION TO BE PROVIDED TO SECRETARY.—Notwithstanding any other provision of law—

"(1) any Federal agency or court which collects (or is required to collect) the statement under subsection (a) shall provide to the Secretary—

"(A) a copy of any such statement, and

"(B) the name (and any other identifying information) of any individual refusing to comply with the provisions of subsection (a),

"(2) the Secretary of State shall provide to the Secretary a copy of each certificate as to the loss of American nationality under section 358 of the Immigration and Nationality Act which is approved by the Secretary of State, and

"(3) the Federal agency primarily responsible for administering the immigration laws shall provide to the Secretary the name of each lawful permanent resident of the United States (within the meaning of section 7701(b)(6)) whose status as such has been revoked or has been administratively or judicially determined to have been abandoned.

Notwithstanding any other provision of law, not later than 30 days after the close of each calendar quarter, the Secretary shall publish in the Federal Register the name of each individual relinquishing United States citizenship (within the meaning of section 877A(e)(3)) with respect to whom the Secretary receives information under the preceding sentence during such quarter.

"(e) EXEMPTION.—The Secretary may by regulations exempt any class of individuals from the requirements of this section if the Secretary determines that applying this section to such individuals is not necessary to carry out the purposes of this section."

(b) CLERICAL AMENDMENT.—The table of sections for such subpart A is amended by inserting after the item relating to section 6039E the following new item:

"Sec. 6039F. Information on individuals expatriating."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to individuals to whom section 877A of the Internal Revenue Code of 1986 applies and whose expatriation date (as defined in section 877A(e)(2)) occurs on or after February 6, 1995, except that no statement shall be required by such amendments before the 90th day after the date of the enactment of this Act.

Subtitle F—Taxpayer Bill of Rights 2 Provisions

SEC. 12501. 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—

(1) by inserting "unreasonable" before "error" each place it appears in subparagraphs (A) and (B), and

(2) by striking "in performing a ministerial act" each place it appears and inserting "in performing a ministerial or managerial act".

(b) CLERICAL AMENDMENT.—The subsection heading for subsection (e) of section 6404 is amended—

(1) by striking "ASSESSMENTS" and inserting "ABATEMENT", and

(2) by inserting "UNREASONABLE" before "ERRORS".

(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. 12502. REVIEW OF IRS FAILURE TO ABATE INTEREST.

(a) IN GENERAL.—Section 6404 is amended by adding at the end the following new subsection:

"(g) REVIEW OF DENIAL OF REQUEST FOR ABATEMENT OF INTEREST.—The Tax Court shall have jurisdiction over any action brought by a taxpayer who meets the requirements referred to in section 7430(c)(4)(A)(iii) to determine whether the Secretary's failure to abate interest under this section was an abuse of discretion if such action is brought within 6 months after the date of the Secretary's final determination not to abate such interest."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to requests for abatement after the date of the enactment of this Act.

SEC. 12503. 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 by redesignating subparagraphs (B) through (E) as subparagraphs (A) through (D), respectively.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 12504. MODIFICATIONS TO CERTAIN LEVY EXEMPTION AMOUNTS.

(a) FUEL, ETC.—Paragraph (2) of section 6334(a) (relating to fuel, provisions, furniture, and personal effects exempt from levy) is amended—

(1) by striking "If the taxpayer is the head of a family, so" and inserting "So",

(2) by striking "his household" and inserting "the taxpayer's household", and

(3) by striking "$1,650 ($1,550 in the case of levies issued during 1989)" and inserting "$2,500".

(b) BOOKS, ETC.—Paragraph (3) of section 6334(a) (relating to books and tools of a trade, business, or profession) is amended by striking "$1,100 ($1,050 in the case of levies issued during 1989)" and inserting "$1,250".

(c) INFLATION ADJUSTMENT.—Section 6334 (relating to property exempt from levy) is amended by adding at the end the following new subsection:

"(f) INFLATION ADJUSTMENT.—

"(1) IN GENERAL.—In the case of any calendar year beginning after 1996, 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 1995' for 'calendar year 1992' 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."

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect with respect to levies issued after December 31, 1995.

SEC. 12505. OFFERS-IN-COMPROMISE.

(a) 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."

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 12506. AWARD OF LITIGATION COSTS PERMITTED IN DECLARATORY JUDGMENT PROCEEDINGS.

(a) IN GENERAL.—Subsection (b) of section 7430 is amended by striking paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to proceedings commenced after the date of the enactment of this Act.

SEC. 12507. COURT DISCRETION TO REDUCE AWARD FOR LITIGATION COSTS FOR FAILURE TO EXHAUST ADMINISTRATIVE REMEDIES.

(a) GENERAL RULE.—Paragraph (1) of section 7433(d) (relating to civil damages for certain unauthorized collection actions) is amended to read as follows:

"(1) AWARD FOR DAMAGES MAY BE REDUCED IF ADMINISTRATIVE REMEDIES NOT EXHAUSTED.—The amount of damages awarded under subsection (b) may be reduced if the court determines that the plaintiff has not exhausted the administrative remedies available to such plaintiff within the Internal Revenue Service."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to proceedings commenced after the date of the enactment of this Act.

SEC. 12508. ENROLLED AGENTS INCLUDED AS THIRD-PARTY RECORDKEEPERS.

(a) IN GENERAL.—Paragraph (3) of section 7609(a) (relating to third-party recordkeeper defined) is amended by striking "and" at the end of subparagraph (G), by striking the period at the end of subparagraph (H) and inserting "; and", and by adding at the end the following new subparagraph:

"(I) any enrolled agent."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to summonses issued after the date of the enactment of this Act.

SEC. 12509. SAFEGUARDS RELATING TO DESIGNATED SUMMONSES.

(a) LIMITATION ON PERSONS TO WHOM DESIGNATED SUMMONS MAY BE ISSUED.—Paragraph (1) of section 6503(k), as added by section 11311(a) of the Omnibus Budget Reconciliation Act of 1990, is amended by striking "with respect to any return of tax by a corporation" and inserting "to a corporation (or to any other person to whom the corporation has transferred records) with respect to any return of tax by such corporation for a taxable year (or other period) for which such corporation is being examined under the coordinated examination program (or any successor program) of the Internal Revenue Service".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to summonses issued after the date of the enactment of this Act.

SEC. 12510. ANNUAL REMINDERS TO TAXPAYERS WITH OUTSTANDING DELINQUENT ACCOUNTS.

(a) IN GENERAL.—Chapter 77 (relating to miscellaneous provisions) is amended by adding at the end the following new section:

"SEC. 7524. ANNUAL NOTICE OF TAX DELINQUENCY.

"Not less often than annually, the Secretary shall send a written notice to each taxpayer who has a tax delinquent account of the amount of the tax delinquency as of the date of the notice."

(b) CLERICAL AMENDMENT.—The table of sections for chapter 77 is amended by adding at the end the following new item:

"Sec. 7524. Annual notice of tax delinquency."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years after 1995.

Subtitle G—Casualty and Involuntary Conversion Provisions

SEC. 12601. BASIS ADJUSTMENT TO PROPERTY HELD BY CORPORATION WHERE STOCK IN CORPORATION IS REPLACEMENT PROPERTY UNDER INVOLUNTARY CONVERSION RULES.

(a) IN GENERAL.—Subsection (b) of section 1033 is amended to read as follows:

"(b) BASIS OF PROPERTY ACQUIRED THROUGH INVOLUNTARY CONVERSION.—

"(1) CONVERSIONS DESCRIBED IN SUBSECTION (a)(1).—If the property was acquired as the result of a compulsory or involuntary conversion described in subsection (a)(1), the basis shall be the same as in the case of the property so converted—

"(A) decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and

"(B) increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

"(2) CONVERSIONS DESCRIBED IN SUBSECTION (a)(2).—In the case of property purchased by the taxpayer in a transaction described in subsection (a)(2) which resulted in the nonrecognition of any part of the gain realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of such property decreased in the amount of the gain not so recognized; and if the property purchased consists of more than 1 piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

"(3) PROPERTY HELD BY CORPORATION THE STOCK OF WHICH IS REPLACEMENT PROPERTY.—

"(A) IN GENERAL.—If the basis of stock in a corporation is decreased under paragraph (2), an amount equal to such decrease shall also be applied to reduce the basis of property held by the corporation at the time the taxpayer acquired control (as defined in subsection (a)(2)(E)) of such corporation.

"(B) LIMITATION.—Subparagraph (A) shall not apply to the extent that it would (but for this subparagraph) require a reduction in the aggregate adjusted bases of the property of the corporation below the taxpayer's adjusted basis of the stock in the corporation (determined immediately after such basis is decreased under paragraph (2)).

"(C) ALLOCATION OF BASIS REDUCTION.—The decrease required under subparagraph (A) shall be allocated—

"(i) first to property which is similar or related in service or use to the converted property,

"(ii) second to depreciable property (as defined in section 1017(b)(3)(B)) not described in clause (i), and "(iii) then to other property.

"(D) SPECIAL RULES.—

"(i) REDUCTION NOT TO EXCEED ADJUSTED BASIS OF PROPERTY.—No reduction in the basis of any property under this paragraph shall exceed the adjusted basis of such property (determined without regard to such reduction).

"(ii) ALLOCATION OF REDUCTION AMONG PROPERTIES.—If more than 1 property is described in a clause of subparagraph (C), the reduction under this paragraph shall be allocated among such property in proportion to the adjusted bases of such property (as so determined)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to involuntary conversions occurring after September 13, 1995.

SEC. 12602. EXPANSION OF REQUIREMENT THAT INVOLUNTARILY CONVERTED PROPERTY BE REPLACED WITH PROPERTY ACQUIRED FROM AN UNRELATED PERSON.

(a) IN GENERAL.—Subsection (i) of section 1033 is amended to read as follows:

"(i) REPLACEMENT PROPERTY MUST BE ACQUIRED FROM UNRELATED PERSON IN CERTAIN CASES.—

"(1) IN GENERAL.—If the property which is involuntarily converted is held by a taxpayer to which this subsection applies, subsection (a) shall not apply if the replacement property or stock is acquired from a related person. The preceding sentence shall not apply to the extent that the related person acquired the replacement property or stock from an unrelated person during the period applicable under subsection (a)(2)(B).

"(2) TAXPAYERS TO WHICH SUBSECTION APPLIES.—This subsection shall apply to—

"(A) a C corporation,

"(B) a partnership in which 1 or more C corporations own, directly or indirectly (determined in accordance with section 707(b)(3)), more than 50 percent of the capital interest, or profits interest, in such partnership at the time of the involuntary conversion, and

"(C) any other taxpayer if, with respect to property which is involuntarily converted during the taxable year, the aggregate of the amount of realized gain on such property on which there is realized gain exceeds $100,000.

In the case of a partnership, subparagraph (C) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.

"(3) RELATED PERSON.—For purposes of this subsection, a person is related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to involuntary conversions occurring after September 13, 1995.

SEC. 12603. SPECIAL RULE FOR CROP INSURANCE PROCEEDS AND DISASTER PAYMENTS.

(a) IN GENERAL.—Section 451(d) (relating to special rule for crop insurance proceeds and disaster payments) is amended to read as follows:

"(d) SPECIAL RULE FOR CROP INSURANCE PROCEEDS AND DISASTER PAYMENTS.—

"(1) GENERAL RULE.—In the case of any payment described in paragraph (2), a taxpayer reporting on the cash receipts and disbursements method of accounting—

"(A) may elect to treat any such payment received in the taxable year of destruction or damage of crops as having been received in the following taxable year if the taxpayer establishes that, under the taxpayer's practice, income from such crops involved would have been reported in a following taxable year, or

"(B) may elect to treat any such payment received in a taxable year following the taxable year of the destruction or damage of crops as having been received in the taxable year of destruction or damage, if the taxpayer establishes that, under the taxpayer's practice, income from such crops involved would have been reported in the taxable year of destruction or damage.

"(2) PAYMENTS DESCRIBED.—For purposes of this subsection, a payment is described in this paragraph if such payment—

"(A) is insurance proceeds received on account of destruction or damage to crops, or

"(B) is disaster assistance received under any Federal law as a result of—

"(i) destruction or damage to crops caused by drought, flood, or other natural disaster, or

"(ii) inability to plant crops because of such a disaster."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) applies to payments received after December 31, 1992, as a result of destruction or damage occurring after such date.

SEC. 12604. APPLICATION OF INVOLUNTARY EXCLUSION RULES TO PRESIDENTIALLY DECLARED DISASTERS.

(a) IN GENERAL.—Section 1033(h) is amended by redesignating paragraphs (2) and (3) as paragraphs (3) and (4) and by inserting after paragraph (1) the following new paragraph:

"(2) TRADE OR BUSINESS AND INVESTMENT PROPERTY.—If a taxpayer's property held for productive use in a trade or business or for investment is compulsorily or involuntarily converted as a result of a Presidentially declared disaster, tangible property of a type held for productive use in a trade or business shall be treated for purposes of subsection (a) as property similar or related in use to the property so converted."

(b) CONFORMING AMENDMENTS.—Section 1033(h) is amended—

(1) by striking "residence" in paragraph (3) (as redesignated by subsection (a)) and inserting "property",

(2) by striking "Principal Residences" in the heading and inserting "Property", and

(3) by striking "(1) In general.—" and inserting "(1) Principal residences.—".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to disasters declared after December 31, 1994, in taxable years ending after such date.

Subtitle H—Exempt Organizations and Charitable Reforms

SEC. 12701. 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 composed 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, beginning after 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 organized and controlled by its members but 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 advisers, following reasonable notice, if members holding a majority of interest in the account managed by such adviser vote to remove such adviser,

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 (and such private foundation shall take into account its allocable share of the deductions referred to in section 4940(c)(3) of the organization).

"(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) CONFORMING AMENDMENTS.—

(1) Section 4945(d) is amended by adding at the end the following new flush sentence:

"Paragraph (4)(B) shall not apply to a grant to an organization described in section 501(n)."

(2) Section 4942(g)(1)(A) is amended by inserting "or an organization described in section 501(n)" after "subsection (j)(3))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after December 31, 1995.

SEC. 12702. EXCLUSION FROM UNRELATED BUSINESS TAXABLE INCOME FOR CERTAIN SPONSORSHIP PAYMENTS.

(a) IN GENERAL.—Section 513 (relating to unrelated trade or business income) is amended by adding at the end the following new subsection:

"(i) TREATMENT OF CERTAIN SPONSORSHIP PAYMENTS.—

"(1) IN GENERAL.—The term 'unrelated trade or business' does not include the activity of soliciting and receiving qualified sponsorship payments.

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

"(A) IN GENERAL.—The term 'qualified sponsorship payment' means any payment made by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgement of the name or logo (or product lines) of such person's trade or business in connection with the activities of the organization that receives such payment. Such a use or acknowledgement does not include advertising such person's products or services (including messages containing qualitative or comparative language, price information or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use such products or services).

"(B) LIMITATIONS.—

"(i) CONTINGENT PAYMENTS.—The term 'qualified sponsorship payment' does not include any payment if the amount of such payment is contingent upon the level of attendance at one or more events, broadcast ratings, or other factors indicating the degree of public exposure to one or more events.

"(ii) ACKNOWLEDGEMENTS OR ADVERTISING IN PERIODICALS.—The term 'qualified sponsorship payment' does not include any payment which entitles the payor to an acknowledgement or advertising in regularly scheduled and printed material that is not related to and primarily distributed in connection with a specific event conducted by the payee organization.

"(3) ALLOCATION OF PORTIONS OF SINGLE PAYMENT.—For purposes of this subsection, to the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, such portion of such payment and the other portion of such payment shall be treated as separate payments."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments solicited or received after December 31, 1995.

SEC. 12703. TREATMENT OF DUES PAID TO AGRICULTURAL OR HORTICULTURAL ORGANIZATIONS.

(a) GENERAL RULE.—Section 512 (defining unrelated business taxable income) is amended by adding at the end the following new subsection:

"(d) TREATMENT OF DUES OF AGRICULTURAL OR HORTICULTURAL ORGANIZATIONS.—

"(1) IN GENERAL.—If—

"(A) an agricultural or horticultural organization described in section 501(c)(5) requires annual dues to be paid in order to be a member of such organization, and

"(B) the amount of such required annual dues does not exceed $100,

in no event shall any portion of such dues be treated as derived by such organization from an unrelated trade or business by reason of any benefits or privileges to which members of such organization are entitled.

"(2) INDEXATION OF $100 AMOUNT.—In the case of any taxable year beginning in a calendar year after 1995, the $100 amount in paragraph (1) shall be increased by an amount equal to—

"(A) $100, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 1994' for 'calendar year 1992' in subparagraph (B) thereof.

"(3) DUES.—For purposes of this subsection, the term 'dues' means any payment required to be made in order to be recognized by the organization as a member of the organization."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1994.

SEC. 12704. REPEAL OF CREDIT FOR CONTRIBUTIONS TO COMMUNITY DEVELOPMENT CORPORATIONS.

(a) IN GENERAL.—Section 13311 of the Revenue Reconciliation Act of 1993 (relating to credit for contributions to certain community development corporations) is hereby repealed.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made after the date of the enactment of this Act (other than contributions made pursuant to a legally enforceable agreement which is effect on the date of the enactment of this Act).

SEC. 12705. REQUIRED NOTICES TO CHARITABLE BENEFICIARIES OF CHARITABLE REMAINDER TRUSTS.

(a) IN GENERAL.—Section 6036 (relating to notice of qualification as executor or receiver) is amended—

(1) by striking "Every receiver" and inserting "(a) GENERAL RULE.—Every receiver", and

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

"(b) SPECIAL RULE FOR TRANSFERS OF REMAINDER INTERESTS DESCRIBED IN SECTION 2055(e)(2)(A).—

"(1) IN GENERAL.—In the case of an estate claiming a charitable contribution deduction for the value of a transfer of a remainder interest in property described in section 2055(e)(2)(A), the executor or other fiduciary shall provide written notice of the name of the charitable remainder trust and the interest created by such trust to each charitable beneficiary described in section 2055(a) which has such an interest within 3 months of the due date for the filing of the Federal estate tax return on which the charitable contribution deduction is claimed (including extensions) in the manner required by form or regulation.

"(2) NOTICE TO CONTINGENT INTEREST HOLDERS NOT REQUIRED.—For purposes of paragraph (1), a remainder interest shall not include a contingent remainder interest (determined without regard to any contingency that any charitable beneficiary continue to be a tax-exempt organization)."

(b) ANNUAL NOTICES.—Section 6034A (relating to information to beneficiaries of estates and trusts) is amended by adding at the end the following new subsection:

"(c) ANNUAL NOTICE TO CHARITABLE REMAINDER BENEFICIARY.—

"(1) IN GENERAL.—The fiduciary of any charitable remainder trust required to file a return under chapter 61 for any taxable year shall provide a written notice each such year of the name of the charitable remainder trust and the interest created by such trust to each charitable beneficiary described in section 2055(a) which has such an interest, at the time and in the manner required by form or regulation.

"(2) EXCEPTIONS.—Unless otherwise prescribed by the Secretary, notice shall not be required by any fiduciary—

"(A) if such notice is not necessary to the efficient administration of the internal revenue laws,

"(B) if a corporate fiduciary, pursuant to State law or section 6036(b), previously notified the charitable beneficiary of its interest in the trust,

"(C) if the charitable beneficiary relieves the fiduciary from continuing to file such notice,

"(D) if the interest of the designated charitable beneficiary is a contingent interest (determined without regard to any contingency that any charitable beneficiary continue to be a tax-exempt organization), or

"(E) if the fiduciary, pursuant to State law, provides the charitable beneficiary with an annual accounting of the trust.

"(3) PENALTIES.—

"For provisions relating to the failure to furnish on a timely or complete basis the information required under paragraph (1), see section 6652(c)."

(c) PENALTIES.—Subsection (c) of section 6652 (relating to failure to file certain information returns, registration statements, etc.) is amended by adding at the end the following new paragraph:

"(2) NOTICES UNDER SECTION 6034A(C) OR 6036(b).—In the case of—

"(A) a failure to furnish any notice required under section 6034A(c) (relating to annual notice to charitable remainder beneficiary), or

"(B) a failure to furnish any notice required under section 6036(b) (relating to a qualification notice or tax return filing notice),

on the date and in the manner prescribed therefore, there shall be paid by the fiduciary failing to furnish such notice $10 for each day during which such failure continues, but the total amount imposed under this paragraph on any fiduciary for failure to furnish any 1 notice shall not exceed $5,000."

(d) EFFECTIVE DATES.—

(1) GENERAL NOTICES.—The amendments made by subsection (a) shall apply to estates of decedents dying after the date of the enactment of this Act.

(2) ANNUAL NOTICES.—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 1995.

(3) PENALTIES.—The amendment made by subsection (c) shall take effect on the date of the enactment of this Act.

SEC. 12706. CLARIFICATION OF TREATMENT OF QUALIFIED FOOTBALL COACHES PLANS.

(a) IN GENERAL.—Subparagraph (F) of section 3(37) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(37)(F)) is amended by redesignating clause (ii) as clause (iii) and by inserting after clause (i) the following new clause:

"(ii) For purposes of the Internal Revenue Code of 1986—

"(I) clause (i) shall apply, and

"(II) a qualified football coaches plan shall be treated as a multiemployer collectively bargained plan."

(b) IMPOSITION OF EXCISE TAX.—

(1) IN GENERAL.—For purposes of reinstatement as a qualified football coaches plan under the Internal Revenue Code of 1986, there is hereby imposed on the cash or deferred arrangement maintained by an organization described in section 501(c)(6) of such Code, an excise tax equal to $25,000, to be paid in the first plan year of the arrangement beginning after the date of the enactment of this Act.

(2) APPLICATION OF CERTAIN RULES.—For purposes of the Internal Revenue Code of 1986, the tax imposed under paragraph (1) shall be treated as a tax imposed under subtitle D of such Code.

(c) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to years beginning after December 22, 1987.

Subtitle I—Tax Reform and Other Provisions

CHAPTER 1—PROVISIONS RELATING TO BUSINESSES

SEC. 12801. TAX TREATMENT OF CERTAIN EXTRAORDINARY DIVIDENDS.

(a) TREATMENT OF EXTRAORDINARY DIVIDENDS IN EXCESS OF BASIS.—Paragraph (2) of section 1059(a) (relating to corporate shareholder's basis in stock reduced by nontaxed portion of extraordinary dividends) is amended to read as follows:

"(2) AMOUNTS IN EXCESS OF BASIS.—If the nontaxed portion of such dividends exceeds such basis, such excess shall be treated as gain from the sale or exchange of such stock for the taxable year in which the extraordinary dividend is received."

(b) TREATMENT OF REDEMPTIONS WHERE OPTIONS INVOLVED.—Paragraph (1) of section 1059(e) (relating to treatment of partial liquidations and non-pro rata redemptions) is amended to read as follows:

"(1) TREATMENT OF PARTIAL LIQUIDATIONS AND CERTAIN REDEMPTIONS.—Except as otherwise provided in regulations—

"(A) REDEMPTIONS.—In the case of any redemption of stock—

"(i) which is part of a partial liquidation (within the meaning of section 302(e)) of the redeeming corporation,

"(ii) which is not pro rata as to all shareholders, or

"(iii) which would not have been treated (in whole or in part) as a dividend if any options had not been taken into account under section 318(a)(4),

any amount treated as a dividend with respect to such redemption shall be treated as an extraordinary dividend to which paragraphs (1) and (2) of subsection (a) apply without regard to the period the taxpayer held such stock. In the case of a redemption described in clause (iii), only the basis in the stock redeemed shall be taken into account under subsection (a).

"(B) REORGANIZATIONS, ETC.—An exchange described in section 356(a)(1) which is treated as a dividend under section 356(a)(2) shall be treated as a redemption of stock for purposes of applying subparagraph (A)."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to distributions after May 3, 1995.

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution made pursuant to the terms of a written binding contract in effect on May 3, 1995, and at all times thereafter before such distribution.

(3) CERTAIN DIVIDENDS NOT PURSUANT TO CERTAIN REDEMPTIONS.—In determining whether the amendment made by subsection (a) applies to any extraordinary dividend other than a dividend treated as an extraordinary dividend under section 1059(e)(1) of the Internal Revenue Code of 1986 (as amended

by this Act), paragraphs (1) and (2) shall be applied by substituting "September 13, 1995" for "May 3, 1995".

SEC. 12802. REGISTRATION OF CONFIDENTIAL CORPORATE TAX SHELTERS.

(a) IN GENERAL.—Section 6111 (relating to registration of tax shelters) is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) CERTAIN CONFIDENTIAL ARRANGEMENTS TREATED AS TAX SHELTERS.—

"(1) IN GENERAL.—For purposes of this section, the term 'tax shelter' includes any entity, plan, arrangement, or transaction—

"(A) a significant purpose of the structure of which is the avoidance or evasion of Federal income tax for a participant which is a corporation,

"(B) which is offered to any potential participant under conditions of confidentiality, and

"(C) for which the tax shelter promoters may receive fees in excess of $100,000 in the aggregate.

"(2) CONDITIONS OF CONFIDENTIALITY.—For purposes of paragraph (1)(B), an offer is under conditions of confidentiality if—

"(A) the potential participant to whom the offer is made (or any other person acting on behalf of such participant) has an understanding or agreement with or for the benefit of any promoter of the tax shelter that such participant (or other person) will limit disclosure of the tax shelter or any significant tax features of the tax shelter, or

"(B) any promoter of the tax shelter—

"(i) claims, knows, or has reason to know,

"(ii) knows or has reason to know that any other person (other than the potential participant) claims, or

"(iii) causes another person to claim,

that the tax shelter (or any aspect thereof) is proprietary to any person other than the potential participant or is otherwise protected from disclosure to or use by others.

For purposes of this subsection, the term 'promoter' means any person or any related person (within the meaning of section 267 or 707) who participates in the organization, management, or sale of the tax shelter.

"(3) PERSONS OTHER THAN PROMOTER REQUIRED TO REGISTER IN CERTAIN CASES.—

"(A) IN GENERAL.—If—

"(i) the requirements of subsection (a) are not met with respect to any tax shelter (as defined in paragraph (1)) by any tax shelter promoter, and

"(ii) no tax shelter promoter is a United States person,

then each United States person who discussed participation in such shelter shall register such shelter under subsection (a).

"(B) EXCEPTION.—Subparagraph (A) shall not apply to a United States person who discussed participation in a tax shelter if—

"(i) such person notified the promoter in writing (not later than the close of the seventh day after the day on which such discussions began) that such person would not participate in such shelter, and

"(ii) such person does not participate in such shelter.

"(4) OFFER TO PARTICIPATE TREATED AS OFFER FOR SALE.—For purposes of subsections (a) and (b), an offer to participate in a tax shelter (as defined in paragraph (1)) shall be treated as an offer for sale."

(b) PENALTY.—Subsection (a) of section 6707 (relating to failure to furnish information regarding tax shelters) is amended by adding at the end the following new paragraph:

"(3) CONFIDENTIAL ARRANGEMENTS.—

"(A) IN GENERAL.—In the case of a tax shelter (as defined in section 6111(d)), the penalty imposed under paragraph (1) shall be an amount equal to the greater of—

"(i) 50 percent of the fees paid to any promoter of the tax shelter with respect to offerings made before the date such shelter is registered under section 6111, or

"(ii) $10,000.

Clause (i) shall be applied by substituting '75 percent' for '50 percent' in the case of an intentional failure or act described in paragraph (1).

"(B) SPECIAL RULE FOR PARTICIPANTS REQUIRED TO REGISTER SHELTER.—In the case of a person required to register such a tax shelter by reason of section 6111(d)(3)—

"(i) such person shall be required to pay the penalty under paragraph (1) only if such person actually participated in such shelter,

"(ii) the amount of such penalty shall be determined by taking into account under subparagraph (A)(i) only the fees paid by such person, and

"(iii) such penalty shall be in addition to the penalty imposed on any other person for failing to register such shelter."

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 6707(a) is amended by striking "The penalty" and inserting "Except as provided in paragraph (3), the penalty".

(2) Subparagraph (A) of section 6707(a)(1) is amended by striking "paragraph (2)" and inserting "paragraph (2) or (3), as the case may be".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to any tax shelter (as defined in section 6111(d) of the Internal Revenue Code of 1986, as amended by this section) interests in which are offered to potential participants after the date of the enactment of this Act.

(2) DUE DATE FOR REGISTRATION.—The due date for registering any tax shelter required to be registered by reason of the amendments made by this section shall be not earlier than the close of a reasonable period after the Secretary of the Treasury prescribes guidance with respect to meeting such requirements.

SEC. 12803. DENIAL OF DEDUCTION FOR INTEREST ON LOANS WITH RESPECT TO COMPANY-OWNED INSURANCE.

(a) IN GENERAL.—Paragraph (4) of section 264(a) is amended—

(1) by inserting ", or any endowment or annuity contracts owned by the taxpayer covering any individual," after "the life of any individual", and

(2) by striking all that follows "carried on by the taxpayer" and inserting a period.

(b) EXCEPTION FOR CONTRACTS RELATING TO KEY PERSONS; PERMISSIBLE INTEREST RATES.—Section 264 is amended—

(1) by striking "Any" in subsection (a)(4) and inserting "Except as provided in subsection (d), any", and

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

"(d) SPECIAL RULES FOR APPLICATION OF SUBSECTION (a)(4).—

"(1) EXCEPTION FOR KEY PERSONS.—Subsection (a)(4) shall not apply to any interest paid or accrued on any indebtedness with respect to policies or contracts covering an individual who is a key person to the extent that the aggregate amount of such indebtedness with respect to policies and contracts covering such individual does not exceed $50,000.

"(2) INTEREST RATE CAP ON KEY PERSONS AND PRE-1986 CONTRACTS.—No deduction shall be allowed by reason of paragraph (1) or the last sentence of subsection (a) with respect to interest paid or accrued for any month to the extent the amount of such interest exceeds the amount which would have been determined if the rate of interest for such month were the rate of interest described as Moody's Corporate Bond Yield Average-Monthly Average Corporates as published by Moody's Investors Service, Inc., or any successor thereto, for such month.

"(3) KEY PERSON.—For purposes of paragraph (1), the term 'key person' means an officer or 20-percent owner, except that the number of individuals who may be treated as key persons with respect to any taxpayer shall not exceed the greater of—

"(A) 5 individuals, or

"(B) the lesser of 5 percent of the total officers and employees of the taxpayer or 25 individuals.

"(4) 20-PERCENT OWNER.—For purposes of this subsection, the term '20-percent owner' means—

"(A) if the taxpayer is a corporation, any person who owns directly 20 percent or more of the outstanding stock of the corporation or stock possessing 20 percent or more of the total combined voting power of all stock of the corporation, or

"(B) if the taxpayer is not a corporation, any person who owns 20 percent or more of the capital or profits interest in the employer.

"(5) AGGREGATION RULES.—

"(A) IN GENERAL.—For purposes of paragraph (4)(A) and applying the $50,000 limitation in paragraph (1)—

"(i) all members of a controlled group shall be treated as 1 taxpayer, and

"(ii) such limitation shall be allocated among the members of such group in such manner as the Secretary may prescribe.

"(B) CONTROLLED GROUP.—For purposes of this paragraph, all persons treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414 shall be treated as members of a controlled group."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to interest paid or accrued after December 31, 1995.

(2) TRANSITION RULE FOR EXISTING INDEBTEDNESS.—

(A) IN GENERAL.—In the case of indebtedness incurred before January 1, 1996, the amendments made by this section shall not apply to qualified interest paid or accrued on such indebtedness after October 13, 1995, and before January 1, 2001.

(B) QUALIFIED INTEREST.—For purposes of subparagraph (A), the qualified interest with respect to any indebtedness for any month is the amount of interest which would be paid or accrued for such month on such indebtedness if the lesser of the following rates of interest were used for such month:

(i) The rate of interest specified under the terms of the indebtedness as in effect on October 13, 1995 (and without regard to modification of such terms after such date).

(ii) The applicable percentage rate of interest described as Moody's Corporate Bond Yield Average-Monthly Average Corporates as published by Moody's Investors Service, Inc., or any successor thereto, for such month.

(C) APPLICABLE PERCENTAGE.—For purposes of subparagraph (B), the applicable percentage is as follows:

"For calendar year:	The percentage is:
1995 or 1996	100 percent
1997	95 percent
1998	90 percent
1999	85 percent
2000	80 percent."

(3) SPECIAL RULE FOR GRANDFATHERED CONTRACTS.—This section shall not apply to any contract purchased on or before June 20, 1986, except that—

(A) paragraph (2) shall apply to interest on indebtedness incurred in connection with such contract which is paid or accrued after October 13, 1995, and before January 1, 1996, and

(B) section 264(d)(2) of the Internal Revenue Code of 1986 (as added by subsection (b)) shall apply to such interest paid or accrued after December 31, 1995.

(d) SPREAD OF INCOME INCLUSION ON SURRENDER, ETC. OF CONTRACTS.—

(1) IN GENERAL.—If any amount is received under any life insurance policy or endowment or annuity contract described in paragraph (4) of section 264(a) of the Internal Revenue Code of 1986—

(A) on the complete surrender, redemption, or maturity of such policy or contract during calendar year 1996, 1997, 1998, 1999, 2000, or 2001, or

(B) in full discharge during any such calendar year of the obligation under the policy or contract which is in the nature of a refund of the consideration paid for the policy or contract,

then (in lieu of any other inclusion in gross income) such amount shall be includible in gross income ratably over the 4-taxable year period beginning with the taxable year such amount would (but for this paragraph) be includible. The preceding sentence shall only apply to the extent the amount is includible in gross income for the taxable year in which the event described in subparagraph (A) or (B) occurs.

(2) SPECIAL RULES FOR APPLYING SECTION 264.—A contract shall not be treated as failing—

(A) to meet the requirement of section 264(c)(1) of the Internal Revenue Code of 1986, or

(B) to be treated as a single premium contract under section 264(b)(1) of such Code,

solely by reason of an occurrence described in subparagraph (A) or (B) of paragraph (1) of this subsection or solely by reason of no additional premiums being received under the contract by reason of a lapse occurring after October 13, 1995.

(3) SPECIAL RULE FOR DEFERRED ACQUISITION COSTS.—In the case of the occurrence of any event described in subparagraph (A) or (B) of paragraph (1) of this subsection with respect to any policy or contract—

(A) section 848 of the Internal Revenue Code of 1986 shall not apply to the unamortized balance (if any) of the specified policy acquisition expenses attributable to such policy or contract immediately before the insurance company's taxable year in which such event occurs, and

(B) there shall be allowed as a deduction to such company for such taxable year under chapter 1 of such Code an amount equal to such unamortized balance.

SEC. 12804. TERMINATION OF SUSPENSE ACCOUNTS FOR FAMILY CORPORATIONS REQUIRED TO USE ACCRUAL METHOD OF ACCOUNTING.

(a) IN GENERAL.—Subsection (i) of section 447 (relating to method of accounting for corporations engaged in farming) is amended by adding at the end the following new paragraph:

"(7) TERMINATION.—

"(A) IN GENERAL.—No suspense account may be established under this subsection by any corporation required by this section to change its method of accounting for any taxable year ending after September 13, 1995.

"(B) 20-YEAR PHASEOUT OF EXISTING SUSPENSE ACCOUNTS.—Each suspense account under this subsection shall be reduced (but not below zero) for each of the first 20 taxable years beginning after September 13, 1995, by an amount equal to the applicable portion of such account. Any reduction in a suspense account under this paragraph shall be included in gross income for the taxable year of the reduction. The amount of the reduction required under this paragraph for any taxable year shall be reduced (but not below zero) by the amount of any reduction required for such taxable year under any other provision of this subsection.

"(C) APPLICABLE PORTION.—For purposes of subparagraph (B), the term 'applicable portion' means, for any taxable year, the amount which would ratably reduce the amount in the account (after taking into account prior reductions) to zero over the period consisting of such taxable year and the remaining taxable years in such first 20 taxable years."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years ending after September 13, 1995.

SEC. 12805. TERMINATION OF PUERTO RICO AND POSSESSION TAX CREDIT.

(a) IN GENERAL.—Section 936 is amended by adding at the end the following new subsection:

"(j) TERMINATION.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, this section shall not apply to any taxable year beginning after December 31, 1995.

"(2) TRANSITION RULES FOR ACTIVE BUSINESS INCOME CREDIT.—

"(A) IN GENERAL.—In the case of an existing credit claimant with respect to a possession, the credit determined under subsection (a)(1)(A) for that possession shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 2002.

"(B) PHASEDOWN OF REDUCED CREDIT.—

"(i) IN GENERAL.—In the case of an existing credit claimant to which subsection (a)(4)(B) applies, the applicable percentage under clause (ii) thereof shall be reduced by—

"(I) 10 percentage points for taxable years beginning in 1999,

"(II) 20 percentage points for taxable years beginning in 2000, and

"(III) 30 percentage points for taxable years beginning in 2001.

"(ii) REDUCTION NOT TAKEN INTO ACCOUNT FOR LOCAL TAX DEDUCTION.—The reduction under clause (i) shall not be taken into account for purposes of the last sentence of subsection (a)(4)(B)(i).

"(iii) ELECTION IRREVOCABLE AFTER 1997.—An election under subsection (a)(4)(B)(iii) which is in effect for the taxpayer's last taxable year beginning before 1997 may not be revoked unless it is revoked for the taxpayer's first taxable year beginning in 1997 and all subsequent taxable years.

"(3) RESTRICTIONS ON QUALIFIED POSSESSION SOURCE INVESTMENT INCOME.—

"(A) IN GENERAL.—In the case of an existing credit claimant with respect to a possession, the credit determined under subsection (a)(1)(B) for that possession shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 2001, except that only qualified possession source investment income derived from a qualifying asset may be taken into account in computing the amount of such credit.

"(B) QUALIFYING ASSET.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'qualifying asset' means—

"(I) an asset held by the possession corporation on October 13, 1995, or

"(II) an asset which was purchased from the proceeds of an asset described in subclause (I) or this subclause.

"(ii) RESTRICTION ON REINVESTMENT.— An asset shall not be treated as a qualifying asset under clause (i) with respect to income derived from such asset for periods after the date on which the existing credit claimant has held such asset (and all prior assets the proceeds of which have been rolled into such asset) for the shortest period which results in the maximum reduction of possession taxes under the laws of the possession in effect on October 13, 1995.

"(4) SPECIAL RULES FOR CERTAIN POSSESSIONS.—

"(A) IN GENERAL.—In the case of an existing credit claimant with respect to an applicable possession, this section (other than the preceding paragraphs of this subsection) shall apply to taxable years beginning after December 31, 1995, and before January 1, 2006.

"(B) APPLICABLE POSSESSION.—For purposes of this paragraph, the term 'applicable possession' means Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

"(5) EXISTING CREDIT CLAIMANT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'existing credit claimant' means, with respect to any possession, a corporation—

"(i) which was actively conducting a trade or business in that possession on October 13, 1995, and

"(ii) with respect to which an election under this section was in effect for the corporation's taxable year which includes October 13, 1995.

"(B) NEW LINES OF BUSINESS PROHIBITED.—If, after October 13, 1995, a corporation which would (but for this subparagraph) be an existing credit claimant with respect to a possession adds a substantial new line of business with respect to a trade or business conducted in that possession, such corporation shall cease to be treated as an existing credit claimant with respect to that possession as of the close of the taxable year ending before the date of such addition.

"(C) BINDING CONTRACT EXCEPTION.—If, on October 13, 1995, and at all times thereafter, there is in effect with respect to a corporation a binding contract for the acquisition of assets to be used in, or for the sale of assets to be produced from, a trade or business within a possession, the corporation shall be treated for purposes of this paragraph as actively conducting such trade or business on October 13, 1995. The preceding sentence shall not apply if such trade or business is not actively conducted before January 1, 1996.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12806. DEPRECIATION UNDER INCOME FORECAST METHOD.

(a) GENERAL RULE.—Section 167 (relating to depreciation) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) DEPRECIATION UNDER INCOME FORECAST METHOD.—

"(1) IN GENERAL.—If the depreciation deduction allowable under this section to any taxpayer with respect to any property is determined under the income forecast method or any similar method—

"(A) in determining the amount of the depreciation deduction under such method, the estimated income from the property shall include all income earned in connection with the property before the close of the 10th taxable year following the taxable year in which the property was placed in service,

"(B) the adjusted basis of the property shall only include amounts with respect to which the requirements of section 461(h) are satisfied,

"(C) the depreciation deduction under such method for the 10th taxable year beginning after the taxable year in which the property was placed in service shall be equal to the adjusted basis of such property as of the beginning of such 10th taxable year, and

"(D) such taxpayer shall pay (or be entitled to receive) interest computed under the look-back method of paragraph (2) for any recomputation year.

"(2) LOOK-BACK METHOD.—The interest computed under the look-back method of this paragraph for any recomputation year shall be determined by—

"(A) first determining the depreciation deductions under this section with respect to such property which would have been allowable for prior taxable years if the determination of the amounts so allowable had been made on the basis of the sum of the following (instead of the estimated income with respect to such property)—

"(i) the actual income from such property for periods before the close of the recomputation year, and

"(ii) an estimate of the future income with respect to such property for periods after the recomputation year,

"(B) second, determining (solely for purposes of computing such interest) the overpayment or underpayment of tax for each such prior taxable year which would result solely from the application of subparagraph (A), and

"(C) then using the adjusted overpayment rate (as defined in section 460(b)(7)), compounded daily, on the overpayment or underpayment determined under subparagraph (B).

For purposes of the preceding sentence, any cost incurred after the property is placed in service (which is not treated as a separate property under paragraph (5)) shall be taken into account by discounting (using the Federal mid-term rate determined under section 1274(d) as of the time such cost is incurred) such cost to its value as of the date the property is placed in service. The taxpayer may elect with respect to any property to have the preceding sentence not apply to such property.

"(3) EXCEPTION FROM LOOK-BACK METHOD.—Paragraph (1)(D) shall not apply with respect to any property which, when placed in service by the taxpayer, had a basis of $100,000 or less.

"(4) RECOMPUTATION YEAR.—For purposes of this subsection, except as provided in regulations, the term 'recomputation year' means, with respect to any property, the third and the 10th taxable years beginning after the taxable year in which the property was placed in service, unless the actual income from the property for the period before the close of such third or 10th taxable year is within 10 percent of the estimated income from the property for such period which was taken into account under paragraph (1)(A).

"(5) SPECIAL RULES.—

"(A) CERTAIN COSTS TREATED AS SEPARATE PROPERTY.—For purposes of this subsection, the following costs shall be treated as separate properties:

"(i) Any costs incurred with respect to any property after the 10th taxable year beginning after the taxable year in which the property was placed in service.

"(ii) Any costs incurred after the property is placed in service and before the close of such 10th taxable year if such costs are significant and give rise to a significant increase in the income from the property which was not included in the estimated income from the property.

"(B) SYNDICATION INCOME FROM TELEVISION SERIES.—In the case of property which is an episode in a television series, income from syndicating such series shall not be required to be taken into account under this subsection before the earlier of—

"(i) the 4th taxable year beginning after the date the first episode in such series is placed in service, or

"(ii) the earliest taxable year in which the taxpayer has an arrangement relating to the future syndication of such series.

"(C) COLLECTION OF INTEREST.—For purposes of subtitle F (other than sections 6654 and 6655), any interest required to be paid by the taxpayer under paragraph (1) for any recomputation year shall be treated as an increase in the tax imposed by this chapter for such year.

"(D) DETERMINATIONS.—For purposes of this subsection, determinations of the amount of income from any property shall be determined in the same manner as for purposes of applying the income forecast method; except that any income from the disposition of such property shall be taken into account.

"(E) TREATMENT OF PASS-THRU ENTITIES.—Rules similar to the rules of section 460(b)(4) shall apply for purposes of this subsection."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to property placed in service after September 13, 1995.

(2) BINDING CONTRACTS.—The amendment made by subsection (a) shall not apply to any property produced or acquired by the taxpayer pursuant to a written contract which was binding on September 13, 1995, and at all times thereafter before such production or acquisition.

SEC. 12807. TRANSFERS OF EXCESS PENSION ASSETS.

(a) IN GENERAL.—Section 420 (relating to transfers of excess pension assets to retiree health accounts) is amended by adding at the end the following new subsection:

"(f) SIMILAR RULES TO APPLY TO OTHER TRANSFERS OF EXCESS PLAN ASSETS.—

"(1) IN GENERAL.—If there is a qualified employee benefit transfer of any excess pension assets of a defined benefit plan (other than a multiemployer plan) to an employer—

"(A) a trust which is part of such plan shall not be treated as failing to meet the requirements of section 401(a) solely by reason of such transfer (or any other action authorized under this section), and

"(B) such transfer shall not be treated as—

"(i) an employer reversion for purposes of section 4980, or

"(ii) a prohibited transaction for purposes of section 4975.

The gross income of the employer shall include the amount of any qualified employee benefit transfer made during the taxable year.

"(2) QUALIFIED EMPLOYEE BENEFIT TRANSFER.—For purposes of this section—

"(A) IN GENERAL.—The term 'qualified employee benefit transfer' means a transfer—

"(i) of excess pension assets of a defined benefit plan to the employer, and

"(ii) with respect to which—

"(I) the use requirements of paragraph (3) are met, and

"(II) the requirements of subsection (c)(2)(A) are met (determined by treating such transfer as a qualified transfer).

"(B) LIMITATION ON AMOUNTS TRANSFERRED.—The amount of excess pension assets which may be transferred in qualified employee benefit transfers during any taxable year shall not exceed the amount which is reasonably estimated to be the amount the employer maintaining the plan will pay (whether directly or through reimbursement) during the taxable year for qualified current employee benefit liabilities.

"(C) COORDINATION WITH TRANSFERS TO RETIREE HEALTH ACCOUNTS.—Such term shall not include any qualified transfer (as defined in subsection (b)).

"(D) EXPIRATION.—No transfer in any taxable year beginning after December 31, 2001, shall be treated as a qualified employee benefit transfer.

"(3) RESTRICTIONS ON USE OF TRANSFERRED ASSETS.—

"(A) IN GENERAL.—Any assets transferred to an employer in a qualified employee benefit transfer shall be used only to pay qualified current employee benefit liabilities for the taxable year of the transfer (whether directly or through reimbursement).

"(B) AMOUNTS NOT USED TO PAY BENEFITS.—An employer shall transfer to a plan an amount equal to any assets transferred out of the plan in a qualified employee benefit transfer which are not used as provided in subparagraph (A). Such amount shall be treated in the same manner as amounts are treated under subsection (c)(1)(B)(ii), except that allocable income shall be determined by using the Federal short-term rate under section 1274(d).

"(C) QUALIFIED CURRENT EMPLOYEE BENEFIT LIABILITIES.—For purposes of this subsection—

"(i) IN GENERAL.—The term 'qualified current employee benefit liabilities' means, with respect to any taxable year, the aggregate amounts (including administrative expenses) for which a deduction is allowable to the employer for such taxable year with respect to applicable employee benefits.

"(ii) APPLICABLE EMPLOYEE BENEFITS.—The term 'applicable employee benefits' means—

"(I) contributions to a trust described in section 401(a) which is exempt from tax under section 501(a),

"(II) benefits under an accident or health plan (within the meaning of section 105), "(III) disability benefits,

"(IV) benefits under an educational assistance program of the employer described in section 127(b), and

"(V) benefits under a dependent care assistance program of the employer described in section 129(d).

"(4) DEFINITION AND SPECIAL RULE.—For purposes of this subsection—

"(A) EXCESS PENSION ASSETS.—The term 'excess pension assets' has the meaning given such term by subsection (e)(2); except that—

"(i) the amount thereof shall be the lesser of—

"(I) the amount determined as of the most recent valuation date of the plan preceding the transfer, reduced by prior qualified employee benefit transfers and qualified transfers after such date, or

"(II) the amount determined as of January 1, 1995 (or, if January 1, 1995, is not a valuation date, the most recent prior valuation date), reduced by prior qualified employee benefit transfers and qualified transfers after such date, and

"(ii) subparagraph (B)(i) thereof shall in no event be less than the amount under section 412(c)(7)(E)(i)(I).

"(B) COORDINATION WITH SECTION 412.—In the case of a qualified employee benefit transfer—

"(i) any assets transferred in a plan year on or before the valuation date for such year (and any income allocable thereto) shall, for purposes of section 412, be treated as assets in the plan as of the valuation date for such year, and

"(ii) the plan shall be treated as having a net experience loss under section 412(b)(2)(B)(iv) in an amount equal to the amount of such transfer and for which amortization charges begin for the first plan year after the plan year in which such transfer occurs, except that such section shall be applied to such amount by substituting '10 plan years' for '5 plan years'."

(b) APPLICATION OF ERISA.—

(1) NOTICE.—Section 101(e) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021(e)) is amended—

(A) by inserting "or a qualified employee benefit transfer," after "to a health benefits account," in paragraphs (1) and (2)(A),

(B) by inserting "or qualified employee benefits" after "the amount of health benefits liabilities" in paragraph (1),

(C) by striking "January 1, 1995" in paragraph (3) and inserting "the date of the enactment of the Revenue Reconciliation Act of 1995", and

(D) by striking "TO HEALTH BENEFITS ACCOUNTS" in the heading.

(2) EXCLUSIVE BENEFIT.—Paragraph (1) of section 403(c) of such Act (29 U.S.C. 1103(c)(1)) is amended by striking "January 1, 1995" and inserting "the date of the enactment of the Revenue Reconciliation Act of 1995".

(3) EXEMPTION FROM PROHIBITED TRANSACTION.—Section 408(b) of such Act (29 U.S.C. 1108(b)) is amended by adding at the end the following new paragraph:

"(14) Any transfer in a taxable year beginning before January 1, 2001, of excess pension assets from a deferred benefit plan in a qualified employee benefit transfer permitted under section 420(f) of the Internal Revenue Code of 1986 (as in effect on the date of the enactment of the Revenue Reconciliation Act of 1995)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers on and after the date of the enactment of this Act.

SEC. 12808. REPEAL OF EXCLUSION FOR INTEREST ON LOANS USED TO ACQUIRE EMPLOYER SECURITIES.

(a) IN GENERAL.—Section 133 (relating to interest on certain loans used to acquire employer securities) is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (B) of section 291(e)(1) is amended by striking clause (iv) and by redesignating clause (v) as clause (iv).

(2) Section 812 is amended by striking subsection (g).

(3) Paragraph (5) of section 852(b) is amended by striking subparagraph (C).

(4) Paragraph (2) of section 4978(b) is amended by striking subparagraph (A) and all that follows and inserting the following:

"(A) first from qualified securities to which section 1042 applied acquired during the 3-year period ending on the date of the disposition, beginning with the securities first so acquired, and

"(B) then from any other employer securities.

If subsection (d) applies to a disposition, the disposition shall be treated as made from employer securities in the opposite order of the preceding sentence."

(5)(A) Section 4978B (relating to tax on disposition of employer securities to which section 133 applied) is hereby repealed.

(B) The table of sections for chapter 43 is amended by striking the item relating to section 4978B.

(6) Subsection (e) of section 6047 is amended by striking paragraphs (1), (2), and (3) and inserting the following new paragraphs:

"(1) any employer maintaining, or the plan administrator (within the meaning of section 414(g)) of, an employee stock ownership plan which holds stock with respect to which section 404(k) applies to dividends paid on such stock, or

"(2) both such employer or plan administrator,".

(7) Subsection (f) of section 7872 is amended by striking paragraph (12).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to loans made after October 13, 1995.

(2) REFINANCINGS.—The amendments made by this section shall not apply to loans made after October 13, 1995, to refinance securities acquisition loans (determined without regard to section 133(b)(1)(B) of the Internal Revenue Code of 1986, as in effect on the day before the date of the enactment of this Act) made on or before such date or to refinance loans described in this paragraph if—

(A) the refinancing loans meet the requirements of section 133 of such Code (as so in effect),

(B) immediately after the refinancing the principal amount of the loan resulting from the refinancing does not exceed the principal amount of the refinanced loan (immediately before the refinancing), and

(C) the term of such refinancing loan does not extend beyond the last day of the term of the original securities acquisition loan.

For purposes of this paragraph, the term "securities acquisition loan" includes a loan from a corporation to an employee stock ownership plan described in section 133(b)(3) of such Code (as so in effect).

CHAPTER 2—LEGAL REFORMS

SEC. 12811. REPEAL OF EXCLUSION FOR PUNITIVE DAMAGES AND FOR DAMAGES NOT ATTRIBUTABLE TO PHYSICAL INJURIES OR SICKNESS.

(a) IN GENERAL.—Paragraph (2) of section 104(a) (relating to compensation for injuries or sickness) is amended to read as follows:

"(2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness;".

(b) EMOTIONAL DISTRESS AS SUCH TREATED AS NOT PHYSICAL INJURY OR PHYSICAL SICKNESS.—Section 104(a) is amended by striking the last sentence and inserting the following new sentence: "For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness. The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts received after December 31, 1995, in taxable years ending after such date.

(2) EXCEPTION.—The amendments made by this section shall not apply to any amount received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

SEC. 12812. REPORTING OF CERTAIN PAYMENTS MADE TO ATTORNEYS.

(a) IN GENERAL.—Section 6045 (relating to returns of brokers) is amended by adding at the end the following new subsection:

"(f) RETURN REQUIRED IN THE CASE OF PAYMENTS TO ATTORNEYS.—

"(1) IN GENERAL.—Any person engaged in a trade or business and making a payment (in the course of such trade or business) to which this subsection applies shall file a return under subsection (a) and a statement under subsection (b) with respect to such payment.

"(2) APPLICATION OF SUBSECTION.—

"(A) IN GENERAL.—This subsection shall apply to any payment to an attorney in connection with legal services (whether or not such services are performed for the payor).

"(B) EXCEPTION.—This subsection shall not apply to the portion of any payment which is required to be reported under section 6041(a) (or would be so required but for the dollar limitation contained therein) or section 6051."

(b) REPORTING OF ATTORNEYS' FEES PAYABLE TO CORPORATIONS.—The regulations providing an exception under section 6041 of the Internal Revenue Code of 1986 for payments made to corporations shall not apply to payments of attorneys' fees.

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to payments made after December 31, 1995.

CHAPTER 3—REFORMS RELATING TO NONRECOGNITION PROVISIONS

SEC. 12821. NO ROLLOVER OR EXCLUSION OF GAIN ON SALE OF PRINCIPAL RESIDENCE WHICH IS ATTRIBUTABLE TO DEPRECIATION DEDUCTIONS.

(a) IN GENERAL.—Subsection (d) of section 1034 (relating to limitations) is amended by adding at the end the following new paragraph:

"(3) RECOGNITION OF GAIN ATTRIBUTABLE TO DEPRECIATION.—Subsection (a) shall not apply to so much of the gain from the sale of any residence as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after December 31, 1995, in respect of such residence."

(b) COMPARABLE TREATMENT UNDER 1-TIME EXCLUSION OF GAIN ON SALE OF PRINCIPAL RESIDENCE.—Subsection (d) of section 121 is amended by adding at the end the following new paragraph:

"(10) RECOGNITION OF GAIN ATTRIBUTABLE TO DEPRECIATION.—

"(A) IN GENERAL.—Subsection (a) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after December 31, 1995, in respect of such property.

"(B) COORDINATION WITH PARAGRAPH (5).—If this section does not apply to gain attributable to a portion of a residence by reason of paragraph (5), subparagraph (A) shall not apply to depreciation adjustments attributable to such portion."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after December 31, 1995.

SEC. 12822. NONRECOGNITION OF GAIN ON SALE OF PRINCIPAL RESIDENCE BY NONCITIZENS LIMITED TO NEW RESIDENCES LOCATED IN THE UNITED STATES.

(a) IN GENERAL.—Subsection (d) of section 1034 (relating to limitations) (as amended by section 12821) is amended by adding at the end the following new paragraph:

"(4) NEW RESIDENCE MUST BE LOCATED IN UNITED STATES IN CERTAIN CASES.—

"(A) IN GENERAL.—In the case of a sale of an old residence by a taxpayer—

"(i) who is not a citizen of the United States at the time of sale, and

"(ii) who is not a citizen or resident of the United States on the date which is 2 years after the date of the sale of such old residence,

subsection (a) shall apply only if the new residence is located in the United States or a possession of the United States.

"(B) PROPERTY HELD JOINTLY BY HUSBAND AND WIFE.—Subparagraph (A) shall not apply if—

"(i) the old residence is held by a husband and wife as joint tenants, tenants by the entirety, or community property,

"(ii) such husband and wife make a joint return for the taxable year of the sale or exchange, and

"(iii) one spouse is a citizen of the United States at the time of sale."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to sales of old residences after December 31, 1995.

(2) TREATMENT OF PURCHASES OF NEW RESIDENCES.—The amendment made by this section shall not apply to new residences—

(A) purchased before September 13, 1995, or

(B) purchased on or after such date pursuant to a binding contract in effect on such date and at all times thereafter before such purchase.

(3) CERTAIN RULES TO APPLY.—For purposes of this subsection, the rules of paragraphs (1), (2), and (3) of section 1034(c) of the Internal Revenue Code of 1986 shall apply.

CHAPTER 4—EXCISE TAX AND TAX-EXEMPT BOND PROVISIONS

SEC. 12831. REPEAL OF DIESEL FUEL TAX REBATE TO PURCHASERS OF DIESEL-POWERED AUTOMOBILES AND LIGHT TRUCKS.

(a) IN GENERAL.—Section 6427 (relating to fuels not used for taxable purposes) is amended by striking subsection (g).

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (3) of section 34(a) is amended to read as follows:

"(3) under section 6427 with respect to fuels used for nontaxable purposes or resold during the taxable year (determined without regard to section 6427(k))."

(2) Paragraphs (1) and (2)(A) of section 6427(i) are each amended—

(A) by striking "(g),", and

(B) by striking "(or a qualified diesel powered highway vehicle purchased)" each place it appears.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to vehicles purchased after December 31, 1995.

SEC. 12832. REPEAL OF WINE AND FLAVORS CONTENT CREDIT.

(a) IN GENERAL.—Section 5010 (relating to credit for wine content and for flavors content) is repealed.

(b) EFFECTIVE DATE.—The repeal made by this section shall take effect with respect to distilled spirits (as defined in section 5002(a)(8) of the Internal Revenue Code of 1986) removed from bonded premises (as defined in section 5002(a)(3) of such Code) after December 31, 1995.

SEC. 12833. MODIFICATIONS TO EXCISE TAX ON OZONE-DEPLETING CHEMICALS.

(a) IN GENERAL.—Section 4682(d)(1) (relating to recycling) is amended by inserting "(including any halon imported from any country which is a signatory to the Montreal Protocol on Substances that Deplete the Ozone Layer)" after "ozone-depleting chemical".

(b) CERTIFICATION SYSTEM.—The Secretary of the Treasury, after consultation with the Administrator of the Environmental Protection Agency, shall develop a certification system to ensure compliance with the recycling requirement for imported halon under section 4682(d)(1) of the Internal Revenue Code of 1986, as amended by subsection (a).

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 12834. ELECTION TO AVOID TAX-EXEMPT BOND PENALTIES FOR LOCAL FURNISHERS OF ELECTRICITY AND GAS.

Section 142(f) (relating to local furnishing of electric energy or gas) is amended by adding at the end the following new paragraphs:

"(3) ELECTION TO AVOID PENALTIES FOR CERTAIN FURNISHERS.—

"(A) IN GENERAL.—If—

"(i) the principal user of facilities for the local furnishing of electric energy or gas financed such facilities in whole or in part with exempt facility bonds described in subsection (a)(8) issued before the date of the enactment of this paragraph,

"(ii) such bonds would (but for this paragraph) cease to be tax-exempt by reason of such user failing to meet the local furnishing requirement of such section as a result of a service area expansion by such user, and "(iii) an election described in subparagraph (B) is made by such user with respect to all such facilities of the user,

then such bonds shall not cease to be tax-exempt by reason of such expansion (and section 150(b)(4) shall not apply to interest on such bonds).

"(B) ELECTION.—An election is described in this subparagraph if it is an election made in such manner as the Secretary prescribes, and such user agrees that—

"(i) no bonds exempt from tax under section 103 may be issued on or after the date of the enactment of this paragraph with respect to the facilities or any other facilities with respect to which such user is a principal user,

"(ii) the expansion of the service area—

"(I) is not financed with the proceeds of any exempt facility bond described in subsection (a)(8), and

"(II) is not treated as a nonqualifying use under the rules of paragraph (2), and

"(iii) all outstanding bonds used to finance the facilities are redeemed not later than 6 months after the later of—

"(I) the earliest date on which such bonds may be redeemed, or

"(II) the date of the agreement.

"(C) PRINCIPAL USER.—For purposes of this paragraph, the term 'principal user' means any person or a group of related persons (within the meaning of section 144(a)(3)) which includes such person.

"(4) APPLICATION OF SECTION.—For purposes of this section, no person may qualify as a local furnisher of electric energy or gas unless such person is such a local furnisher on the date of the enactment of this paragraph."

SEC. 12835. TAX-EXEMPT BONDS FOR SALE OF ALASKA POWER ADMINISTRATION FACILITY.

Sections 142(f)(4) (as added by section 12834(a)) and 147(d) of the Internal Revenue Code of 1986 shall not apply with respect to any private activity bond issued after the date of the enactment of this Act and used to finance the acquisition of the Snettisham hydroelectric project from the Alaska Power Administration in determining if such bond is a qualified bond for purposes of such Code.

CHAPTER 5—FOREIGN TRUST TAX COMPLIANCE

SEC. 12841. IMPROVED INFORMATION REPORTING ON FOREIGN TRUSTS.

(a) IN GENERAL.—Section 6048 (relating to returns as to certain foreign trusts) is amended to read as follows:

"SEC. 6048. INFORMATION WITH RESPECT TO CERTAIN FOREIGN TRUSTS.

"(a) NOTICE OF CERTAIN EVENTS.—

"(1) GENERAL RULE.—On or before the 90th day (or such later day as the Secretary may prescribe) after any reportable event, the responsible party shall provide written notice of such event to the Secretary in accordance with paragraph (2).

"(2) CONTENTS OF NOTICE.—The notice required by paragraph (1) shall contain such information as the Secretary may prescribe, including—

"(A) the amount of money or other property (if any) transferred to the trust in connection with the reportable event, and

"(B) the identity of the trust and of each trustee and beneficiary (or class of beneficiaries) of the trust.

"(3) REPORTABLE EVENT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'reportable event' means—

"(i) the creation of any foreign trust by a United States person,

"(ii) the transfer of any money or property (directly or indirectly) to a foreign trust by a United States person, including a transfer by reason of death, and

"(iii) the death of a citizen or resident of the United States if—

"(I) the decedent was treated as the owner of any portion of a foreign trust under the rules of subpart E of part I of subchapter J of chapter 1, or

"(II) any portion of a foreign trust was included in the gross estate of the decedent.

"(B) EXCEPTIONS.—

"(i) FAIR MARKET VALUE SALES.—Subparagraph (A)(ii) shall not apply to any transfer of property to a trust in exchange for consideration of at least the fair market value of the transferred property. For purposes of the preceding sentence, consideration other than cash shall be taken into account at its fair market value and the rules of section 679(a)(3) shall apply.

"(ii) PENSION AND CHARITABLE TRUSTS.—Subparagraph (A) shall not apply with respect to a trust which is—

"(I) described in section 404(a)(4) or 404A, or

"(II) determined by the Secretary to be described in section 501(c)(3).

"(4) RESPONSIBLE PARTY.—For purposes of this subsection, the term 'responsible party' means—

"(A) the grantor in the case of the creation of an inter vivos trust,

"(B) the transferor in the case of a reportable event described in paragraph (3)(A)(ii) other than a transfer by reason of death, and

"(C) the executor of the decedent's estate in any other case.

"(b) UNITED STATES GRANTOR OF FOREIGN TRUST.—

"(1) IN GENERAL.—If, at any time during any taxable year of a United States person, such person is treated as the owner of any portion of a foreign trust under the rules of subpart E of part I of subchapter J of chapter 1, such person shall be responsible to ensure that—

"(A) such trust makes a return for such year which sets forth a full and complete accounting of all trust activities and operations for the year, the name of the United States agent for such trust, and such other information as the Secretary may prescribe, and

"(B) such trust furnishes such information as the Secretary may prescribe to each United States person (i) who is treated as the owner of any portion of such trust or (ii) who receives (directly or indirectly) any distribution from the trust.

"(2) TRUSTS NOT HAVING UNITED STATES AGENT.—

"(A) IN GENERAL.—If the rules of this paragraph apply to any foreign trust, the determination of amounts required to be taken into account with respect to such trust by a United States person under the rules of subpart E of part I of subchapter J of chapter 1 shall be determined by the Secretary in the Secretary's sole discretion from the Secretary's own knowledge or from such information as the Secretary may obtain through testimony or otherwise.

"(B) UNITED STATES AGENT REQUIRED.—The rules of this paragraph shall apply to any foreign trust to which paragraph (1) applies unless such trust agrees (in such manner, subject to such conditions, and at such time as the Secretary shall prescribe) to authorize a United States person to act as such trust's limited agent solely for purposes of applying sections 7602, 7603, and 7604 with respect to—

"(i) any request by the Secretary to examine records or produce testimony related to the proper treatment of amounts required to be taken into account under the rules referred to in subparagraph (A), or

"(ii) any summons by the Secretary for such records or testimony.

The appearance of persons or production of records by reason of a United States person being such an agent shall not subject such persons or records to legal process for any purpose other than determining the correct treatment under this title of the amounts required to be taken into account under the rules referred to in subparagraph (A). A foreign trust which appoints an agent described in this subparagraph shall not be considered to have an office or a permanent establishment in the United States, or to be engaged in a trade or business in the United States, solely because of the activities of such agent pursuant to this subsection.

"(C) OTHER RULES TO APPLY.—Rules similar to the rules of paragraphs (2) and (4) of section 6038A(e) shall apply for purposes of this paragraph.

"(c) REPORTING BY UNITED STATES BENEFICIARIES OF FOREIGN TRUSTS.—

"(1) IN GENERAL.—If any United States person receives (directly or indirectly) during any taxable year of such person any distribution from a foreign trust, such person shall make a return with respect to such trust for such year which includes—

"(A) the name of such trust,

"(B) the aggregate amount of the distributions so received from such trust during such taxable year, and

"(C) such other information as the Secretary may prescribe.

"(2) INCLUSION IN INCOME IF RECORDS NOT PROVIDED.—If adequate records are not provided to the Secretary to determine the proper treatment of any distribution from a foreign trust, such distribution shall be treated as an accumulation distribution includible in the gross income of the distributee under chapter 1. To the extent provided in regulations, the preceding sentence shall not apply if the foreign trust elects to be subject to rules similar to the rules of subsection (b)(2)(B).

"(d) SPECIAL RULES.—

"(1) DETERMINATION OF WHETHER UNITED STATES PERSON RECEIVES DISTRIBUTION.—For purposes of this section, in determining whether a United States person receives a distribution from a foreign trust, the fact that a portion of such trust is treated as owned by another person under the rules of subpart E of part I of subchapter J of chapter 1 shall be disregarded.

"(2) DOMESTIC TRUSTS WITH FOREIGN ACTIVITIES.—To the extent provided in regulations, a trust which is a United States person shall be treated as a foreign trust for purposes of this section and section 6677 if such trust has substantial activities, or holds substantial property, outside the United States.

"(3) TIME AND MANNER OF FILING INFORMATION.—Any notice or return required under this section shall be made at such time and in such manner as the Secretary shall prescribe.

"(4) MODIFICATION OF RETURN REQUIREMENTS.—The Secretary is authorized to suspend or modify any requirement of this section if the Secretary determines that the United States has no significant tax interest in obtaining the required information."

(b) INCREASED PENALTIES.—Section 6677 (relating to failure to file information returns with respect to certain foreign trusts) is amended to read as follows:

"SEC. 6677. FAILURE TO FILE INFORMATION WITH RESPECT TO CERTAIN FOREIGN TRUSTS.

"(a) CIVIL PENALTY.—In addition to any criminal penalty provided by law, if any notice or return required to be filed by section 6048—

"(1) is not filed on or before the time provided in such section, or

"(2) does not include all the information required pursuant to such section or includes incorrect information,

the person required to file such notice or return shall pay a penalty equal to 35 percent of the gross reportable amount. If any failure described in the preceding sentence continues for more than 90 days after the day on which the Secretary mails notice of such failure to the person required to pay such penalty, such person shall pay a penalty (in addition to the amount determined under the preceding sentence) of $10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of such 90-day period. In no event shall the penalty under this subsection with respect to any failure exceed the gross reportable amount.

"(b) SPECIAL RULES FOR RETURNS UNDER SECTION 6048(b).—In the case of a return required under section 6048(b)—

"(1) the United States person referred to in such section shall be liable for the penalty imposed by subsection (a), and

"(2) subsection (a) shall be applied by substituting '5 percent' for '35 percent'.

"(c) GROSS REPORTABLE AMOUNT.—For purposes of subsection (a), the term 'gross reportable amount' means—

"(1) the gross value of the property involved in the event (determined as of the date of the event) in the case of a failure relating to section 6048(a),

"(2) the gross value of the portion of the trust's assets at the close of the year treated as owned by the United States person in the case of a failure relating to section 6048(b)(1), and

"(3) the gross amount of the distributions in the case of a failure relating to section 6048(c).

"(d) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed by this section on any failure which is shown to be due to reasonable cause and not due to willful neglect. The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause.

"(e) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a)."

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 6724(d), as amended by section 12203, is amended by striking "or" at the end of subparagraph (U), by striking the period at the end of subparagraph (V) and inserting ", or", and by inserting after subparagraph (V) the following new subparagraph:

"(W) section 6048(b)(1)(B) (relating to foreign trust reporting requirements)."

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by striking the item relating to section 6048 and inserting the following new item:

"Sec. 6048. Information with respect to certain foreign trusts."

(3) The table of sections for part I of subchapter B of chapter 68 is amended by striking the item relating to section 6677 and inserting the following new item:

"Sec. 6677. Failure to file information with respect to certain foreign trusts."

(d) EFFECTIVE DATES.—

(1) REPORTABLE EVENTS.—To the extent related to subsection (a) of section 6048 of the Internal Revenue Code of

1986, as amended by this section, the amendments made by this section shall apply to reportable events (as defined in such section 6048) occurring after the date of the enactment of this Act.

(2) GRANTOR TRUST REPORTING.—To the extent related to subsection (b) of such section 6048, the amendments made by this section shall apply to taxable years of United States persons beginning after the date of the enactment of this Act.

(3) REPORTING BY UNITED STATES BENEFICIARIES.—To the extent related to subsection (c) of such section 6048, the amendments made by this section shall apply to distributions received after the date of the enactment of this Act.

SEC. 12842. MODIFICATIONS OF RULES RELATING TO FOREIGN TRUSTS HAVING ONE OR MORE UNITED STATES BENEFICIARIES.

(a) TREATMENT OF TRUST OBLIGATIONS, ETC.—

(1) Paragraph (2) of section 679(a) is amended by striking subparagraph (B) and inserting the following:

"(B) TRANSFERS AT FAIR MARKET VALUE.—To any transfer of property to a trust in exchange for consideration of at least the fair market value of the transferred property. For purposes of the preceding sentence, consideration other than cash shall be taken into account at its fair market value."

(2) Subsection (a) of section 679 (relating to foreign trusts having one or more United States beneficiaries) is amended by adding at the end the following new paragraph:

"(3) CERTAIN OBLIGATIONS NOT TAKEN INTO ACCOUNT UNDER FAIR MARKET VALUE EXCEPTION.—

"(A) IN GENERAL.—In determining whether paragraph (2)(B) applies to any transfer by a person described in clause (ii) or (iii) of subparagraph (C), there shall not be taken into account—

"(i) except as provided in regulations, any obligation of a person described in subparagraph (C), and

"(ii) to the extent provided in regulations, any obligation which is guaranteed by a person described in subparagraph (C).

"(B) TREATMENT OF PRINCIPAL PAYMENTS ON OBLIGATION.—Principal payments by the trust on any obligation referred to in subparagraph (A) shall be taken into account on and after the date of the payment in determining the portion of the trust attributable to the property transferred.

"(C) PERSONS DESCRIBED.—The persons described in this subparagraph are—

"(i) the trust,

"(ii) any grantor or beneficiary of the trust, and

"(iii) any person who is related (within the meaning of section 643(i)(2)(B)) to any grantor or beneficiary of the trust."

(b) EXEMPTION OF TRANSFERS TO CHARITABLE TRUSTS.—Subsection (a) of section 679 is amended by striking "section 404(a)(4) or 404A" and inserting "section 6048(a)(3)(B)(ii)".

(c) OTHER MODIFICATIONS.—Subsection (a) of section 679 is amended by adding at the end the following new paragraphs:

"(4) SPECIAL RULES APPLICABLE TO FOREIGN GRANTOR WHO LATER BECOMES A UNITED STATES PERSON.—

"(A) IN GENERAL.—If a nonresident alien individual has a residency starting date within 5 years after directly or indirectly transferring property to a foreign trust, this section and section 6048 shall be applied as if such individual transferred to such trust on the residency starting date an amount equal to the portion of such trust attributable to the property transferred by such individual to such trust in such transfer.

"(B) TREATMENT OF UNDISTRIBUTED INCOME.—For purposes of this section, undistributed net income for periods before such individual's residency starting date shall be taken into account in determining the portion of the trust which is attributable to property transferred by such individual to such trust but shall not otherwise be taken into account.

"(C) RESIDENCY STARTING DATE.—For purposes of this paragraph, an individual's residency starting date is the residency starting date determined under section 7701(b)(2)(A).

"(5) OUTBOUND TRUST MIGRATIONS.—If—

"(A) an individual who is a citizen or resident of the United States transferred property to a trust which was not a foreign trust, and

"(B) such trust becomes a foreign trust while such individual is alive,

then this section and section 6048 shall be applied as if such individual transferred to such trust on the date such trust becomes a foreign trust an amount equal to the portion of such trust attributable to the property previously transferred by such individual to such trust. A rule similar to the rule of paragraph (4)(B) shall apply for purposes of this paragraph."

(d) MODIFICATIONS RELATING TO WHETHER TRUST HAS UNITED STATES BENEFICIARIES.—Subsection (c) of section 679 is amended by adding at the end the following new paragraphs:

"(3) CERTAIN UNITED STATES BENEFICIARIES DISREGARDED.—A beneficiary shall not be treated as a United States person in applying this section with respect to any transfer of property to foreign trust if such beneficiary first became a United States person more than 5 years after the date of such transfer.

"(4) TREATMENT OF FORMER UNITED STATES PERSONS.—To the extent provided by the Secretary, for purposes of this subsection, the term 'United States person' includes any person who was a United States person at any time during the existence of the trust."

(e) TECHNICAL AMENDMENT.—Subparagraph (A) of section 679(c)(2) is amended to read as follows:

"(A) in the case of a foreign corporation, such corporation is a controlled foreign corporation (as defined in section 957(a)),".

(f) REGULATIONS.—Section 679 is amended by adding at the end the following new subsection:

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

(g) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers of property after February 6, 1995.

SEC. 12843. FOREIGN PERSONS NOT TO BE TREATED AS OWNERS UNDER GRANTOR TRUST RULES.

(a) GENERAL RULE.—

(1) Subsection (f) of section 672 (relating to special rule where grantor is foreign person) is amended to read as follows:

"(f) SUBPART NOT TO RESULT IN FOREIGN OWNERSHIP.—

"(1) IN GENERAL.—Notwithstanding any other provision of this subpart, this subpart shall apply only to the extent such application results in an amount being currently taken into account (directly or through 1 or more entities) under this chapter in computing the income of a citizen or resident of the United States or a domestic corporation.

"(2) EXCEPTIONS.—

"(A) CERTAIN REVOCABLE AND IRREVOCABLE TRUSTS.—

"(i) IN GENERAL.—Except as provided in clause (ii), paragraph (1) shall not apply to any trust if—

"(I) the power to revest absolutely in the grantor title to the trust property is exercisable solely by the grantor without the approval or consent of any other person or with the consent of a related or subordinate party who is subservient to the grantor, or

"(II) the only amounts distributable from such trust (whether income or corpus) during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor.

"(ii) EXCEPTION.—Clause (i) shall not apply to any trust which has a beneficiary who is a United States person to the extent such beneficiary has made transfers of property by gift (directly or indirectly) to a foreign person who is the grantor of such trust. For purposes of the preceding sentence, any gift shall not be taken into account to the extent such gift is excluded from taxable gifts under section 2503(b).

"(B) COMPENSATORY TRUSTS.—Except as provided in regulations, paragraph (1) shall not apply to any portion of a trust distributions from which are taxable as compensation for services rendered.

"(3) SPECIAL RULES.—Except as otherwise provided in regulations prescribed by the Secretary—

"(A) a controlled foreign corporation (as defined in section 957) shall be treated as a domestic corporation for purposes of paragraph (1), and

"(B) paragraph (1) shall not apply for purposes of applying part III of subchapter G (relating to foreign personal holding companies) and part VI of subchapter P (relating to treatment of certain passive foreign investment companies).

"(4) RECHARACTERIZATION OF PURPORTED GIFTS.—In the case of any transfer directly or indirectly from a partnership or foreign corporation which the transferee treats as a gift or bequest, the Secretary may recharacterize such transfer in such circumstances as the Secretary determines to be appropriate to prevent the avoidance of the purposes of this subsection.

"(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations providing that paragraph (1) shall not apply in appropriate cases."

(2) The last sentence of subsection (c) of section 672 of such Code is amended by inserting "subsection (f) and" before "sections 674".

(b) CREDIT FOR CERTAIN TAXES.—Paragraph (2) of section 665(d) is amended by adding at the end the following new sentence: "Under rules or regulations prescribed by the Secretary, in the case of any foreign trust of which the settlor or another person would be treated as owner of any portion of the trust under subpart E but for section 672(f), the term 'taxes imposed on the trust' includes the allocable amount of any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on the settlor or such other person in respect of trust gross income."

(c) DISTRIBUTIONS BY CERTAIN FOREIGN TRUSTS THROUGH NOMINEES.—

(1) Section 643 is amended by adding at the end the following new subsection:

"(h) DISTRIBUTIONS BY CERTAIN FOREIGN TRUSTS THROUGH NOMINEES.—For purposes of this part, any amount paid to a United States person which is derived directly or indirectly from a foreign trust of which the payor is not the grantor shall be deemed in the year of payment to have been directly paid by the foreign trust to such United States person."

(2) Section 665 is amended by striking subsection (c).

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided by paragraph (2), the amendments made by this section shall take effect on the date of the enactment of this Act.

(2) EXCEPTION FOR CERTAIN TRUSTS.—The amendments made by this section shall not apply to any trust—

(A) which is treated as owned by the grantor or another person under section 676 or 677 (other than subsection (a)(3) thereof) of the Internal Revenue Code of 1986, and

(B) which is in existence on September 19, 1995.

The preceding sentence shall not apply to the portion of any such trust attributable to any transfer to such trust after September 19, 1995.

(e) TRANSITIONAL RULE.—If—

(1) by reason of the amendments made by this section, any person other than a United States person ceases to be treated as the owner of a portion of a domestic trust, and

(2) before January 1, 1997, such trust becomes a foreign trust, or the assets of such trust are transferred to a foreign trust,

no tax shall be imposed by section 1491 of the Internal Revenue Code of 1986 by reason of such trust becoming a foreign trust or the assets of such trust being transferred to a foreign trust.

SEC. 12844. INFORMATION REPORTING REGARDING FOREIGN GIFTS.

(a) IN GENERAL.—Subpart A of part III of subchapter A of chapter 61, as amended by section 12442, is amended by inserting after section 6039F the following new section:

"SEC. 6039G. NOTICE OF GIFTS RECEIVED FROM FOREIGN PERSONS.

"(a) IN GENERAL.—If the value of the aggregate foreign gifts received by a United States person (other than an organization described in section 501(c) and exempt from tax under section 501(a)) during any taxable year exceeds $10,000, such United States person shall furnish (at such time and in such manner as the Secretary shall prescribe) such information as the Secretary may prescribe regarding each foreign gift received during such year.

"(b) FOREIGN GIFT.—For purposes of this section, the term 'foreign gift' means any amount received from a person other than a United States person which the recipient treats as a gift or bequest. Such term shall not include any qualified transfer (within the meaning of section 2503(e)(2)).

"(c) PENALTY FOR FAILURE TO FILE INFORMATION.—

"(1) IN GENERAL.—If a United States person fails to furnish the information required by subsection (a) with respect to any foreign gift within the time prescribed therefor (including extensions)—

"(A) the tax consequences of the receipt of such gift shall be determined by the Secretary in the Secretary's sole discretion from the Secretary's own knowledge or from such information as the Secretary may obtain through testimony or otherwise, and

"(B) such United States person shall pay (upon notice and demand by the Secretary and in the same manner as tax) an amount equal to 5 percent of the amount of such foreign gift for each month for which the failure continues (not to exceed 25 percent of such amount in the aggregate).

"(2) REASONABLE CAUSE EXCEPTION.— Paragraph (1) shall not apply to any failure to report a foreign gift if the United States person shows that the failure is due to reasonable cause and not due to willful neglect.

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

(b) CLERICAL AMENDMENT.—The table of sections for such subpart is amended by inserting after the item relating to section 6039F the following new item:

"Sec. 6039G. Notice of large gifts received from foreign persons."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts received after the date of the enactment of this Act in taxable years ending after such date.

SEC. 12845. MODIFICATION OF RULES RELATING TO FOREIGN TRUSTS WHICH ARE NOT GRANTOR TRUSTS.

(a) MODIFICATION OF INTEREST CHARGE ON ACCUMULATION DISTRIBUTIONS.—Subsection (a) of section 668 (relating to interest charge on accumulation distributions from foreign trusts) is amended to read as follows:

"(a) GENERAL RULE.—For purposes of the tax determined under section 667(a)—

"(1) INTEREST DETERMINED USING UNDERPAYMENT RATES.—The interest charge determined under this section with respect to any distribution is the amount of interest which would be determined on the partial tax computed under section 667(b) for the period described in paragraph (2) using the rates and the method under section 6621 applicable to underpayments of tax.

"(2) PERIOD.—For purposes of paragraph (1), the period described in this paragraph is the period which begins on the date which is the applicable number of years before the date of the distribution and which ends on the date of the distribution.

"(3) APPLICABLE NUMBER OF YEARS.—For purposes of paragraph (2)—

"(A) IN GENERAL.—The applicable number of years with respect to a distribution is the number determined by dividing—

"(i) the sum of the products described in subparagraph (B) with respect to each undistributed income year, by

"(ii) the aggregate undistributed net income.

The quotient determined under the preceding sentence shall be rounded under procedures prescribed by the Secretary.

"(B) PRODUCT DESCRIBED.—For purposes of subparagraph (A), the product described in this subparagraph with respect to any undistributed income year is the product of—

"(i) the undistributed net income for such year, and

"(ii) the sum of the number of taxable years between such year and the taxable year of the distribution (counting in each case the undistributed income year but not counting the taxable year of the distribution).

"(4) UNDISTRIBUTED INCOME YEAR.—For purposes of this subsection, the term 'undistributed income year' means any prior taxable year of the trust for which there is undistributed net income, other than a taxable year during all of which the beneficiary receiving the distribution was not a citizen or resident of the United States.

"(5) DETERMINATION OF UNDISTRIBUTED NET INCOME.—Notwithstanding section 666, for purposes of this subsection, an accumulation distribution from the trust shall be treated as reducing proportionately the undistributed net income for undistributed income years.

"(6) PERIODS BEFORE 1996.—Interest for the portion of the period described in paragraph (2) which occurs before January 1, 1996, shall be determined—

"(A) by using an interest rate of 6 percent, and

"(B) without compounding until January 1, 1996."

(b) ABUSIVE TRANSACTIONS.—Section 643(a) is amended by inserting after paragraph (6) the following new paragraph:

"(7) ABUSIVE TRANSACTIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part, including regulations to prevent avoidance of such purposes."

(c) TREATMENT OF LOANS FROM TRUST PROPERTY.—

(1) IN GENERAL.—Section 643 (relating to definitions applicable to subparts A, B, C, and D) is amended by adding at the end the following new subsection:

"(i) LOANS FROM FOREIGN TRUSTS.—For purposes of subparts B, C, and D—

"(1) GENERAL RULE.—If a foreign trust makes a loan of cash or marketable securities directly or indirectly to—

"(A) any grantor or beneficiary of such trust who is a United States person, or

"(B) any United States person not described in subparagraph (A) who is related to such grantor or beneficiary,

the amount of such loan shall be treated as a distribution by such trust to such grantor or beneficiary (as the case may be).

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

"(A) CASH.—The term 'cash' includes foreign currencies and cash equivalents.

"(B) RELATED PERSON.—

"(i) IN GENERAL.—A person is related to another person if the relationship between such persons would result in a disallowance of losses under section 267 or 707(b). In applying section 267 for purposes of the preceding sentence, section 267(c)(4) shall be applied as if the family of an individual includes the spouses of the members of the family.

"(ii) ALLOCATION OF USE.—If any person described in paragraph (1)(B) is related to more than one person, the grantor or beneficiary to whom the treatment under this subsection applies shall be determined under regulations prescribed by the Secretary.

"(C) EXCLUSION OF TAX-EXEMPTS.—The term 'United States person' does not include any entity exempt from tax under this chapter.

"(D) TRUST NOT TREATED AS SIMPLE TRUST.—Any trust which is treated under this subsection as making a distribution shall be treated as not described in section 651.

"(3) SUBSEQUENT TRANSACTIONS REGARDING LOAN PRINCIPAL.—If any loan is taken into account under paragraph (1), any subsequent transaction between the trust and the original borrower regarding the principal of the loan (by way of complete or partial repayment, satisfaction, cancellation, discharge, or otherwise) shall be disregarded for purposes of this title."

(2) TECHNICAL AMENDMENT.—Paragraph (8) of section 7872(f) is amended by inserting ", 643(i)," before "or 1274" each place it appears.

(d) EFFECTIVE DATES.—

(1) INTEREST CHARGE.—The amendment made by subsection (a) shall apply to distributions after the date of the enactment of this Act.

(2) ABUSIVE TRANSACTIONS.—The amendment made by subsection (b) shall take effect on the date of the enactment of this Act.

(3) USE OF TRUST PROPERTY.—The amendment made by subsection (c) shall apply to loans of cash or marketable securities after September 19, 1995.

SEC. 12846. RESIDENCE OF ESTATES AND TRUSTS, ETC.

(a) TREATMENT AS UNITED STATES PERSON.—

(1) IN GENERAL.—Paragraph (30) of section 7701(a) is amended by striking subparagraph (D) and by inserting after subparagraph (C) the following:

"(D) any estate or trust if—

"(i) a court within the United States is able to exercise primary supervision over the administration of the estate or trust, and

"(ii) in the case of a trust, one or more United States fiduciaries have the authority to control all substantial decisions of the trust."

(2) CONFORMING AMENDMENT.—Paragraph (31) of section 7701(a) is amended to read as follows:

"(31) FOREIGN ESTATE OR TRUST.—The term 'foreign estate' or 'foreign trust' means any estate or trust other than an estate or trust described in section 7701(a)(30)(D)."

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply—

(A) to taxable years beginning after December 31, 1996, or

(B) at the election of the trustee of a trust, to taxable years ending after the date of the enactment of this Act.

Such an election, once made, shall be irrevocable.

(b) DOMESTIC TRUSTS WHICH BECOME FOREIGN TRUSTS.—

(1) IN GENERAL.—Section 1491 (relating to imposition of tax on transfers to avoid income tax) is amended by adding at the end the following new flush sentence:

"If a trust which is not a foreign trust becomes a foreign trust, such trust shall be treated for purposes of this section as having transferred, immediately before becoming a foreign trust, all of its assets to a foreign trust."

(2) PENALTY.—Section 1494 is amended by adding at the end the following new subsection:

"(c) PENALTY.—In the case of any failure to file a return required by the Secretary with respect to any transfer described in section 1491 with respect to a trust, the person required to file such return shall be liable for the penalties provided in section

6677 in the same manner as if such failure were a failure to file a return under section 6048(a)."

(3) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on the date of the enactment of this Act.

CHAPTER 6—FINANCIAL ASSET SECURITIZATION INVESTMENTS

SEC. 12851. FINANCIAL ASSET SECURITIZATION INVESTMENT TRUSTS.

(a) IN GENERAL.—Subchapter M of chapter 1 is amended by adding at the end the following new part:

"PART V—FINANCIAL ASSET SECURITIZATION INVESTMENT TRUSTS

"SEC. 860H. TAXATION OF FASIT'S.

"(a) GENERAL RULE.—Except as otherwise provided in this part, solely for purposes of this title, a FASIT shall be treated as a partnership and shall not be treated as a taxable mortgage pool.

"(b) INCOME TAXABLE TO HOLDERS.—The income of any FASIT shall be taxable to the holder of the ownership interest in such FASIT as provided in this part.

"SEC. 860I. TAXATION OF HOLDERS OF REGULAR INTERESTS.

"(a) GENERAL RULE.—In determining the tax under this chapter of any holder of a regular interest in a FASIT, such interest shall be treated—

"(1) if not otherwise a debt instrument, as a debt instrument, and

"(2) for purposes of section 165(g), as issued by a corporation.

"(b) HOLDERS MUST USE ACCRUAL METHOD.—The amounts includible in gross income with respect to any regular interest in a FASIT shall be determined under the accrual method of accounting.

"SEC. 860J. TAXATION OF HOLDER OF OWNERSHIP INTEREST.

"(a) GENERAL RULE.—Except as otherwise provided in this subtitle, the tax under this chapter of the holder of the ownership interest in a FASIT shall be determined as if—

"(1) such holder were a partner in such FASIT, and

"(2) such FASIT had filed an election under section 754.

"(b) CERTAIN PROVISIONS OF SUBCHAPTER K NOT TO APPLY.—The following provisions shall not apply under subsection (a): Section 704 (other than subsection (d)) and sections 708, 721, 724, 735, 737, and 751.

"(c) OTHER RULES FOR DETERMINING TAXABLE INCOME OF FASIT.—For purposes of this subtitle, the taxable income of a FASIT shall be determined under an accrual method of accounting, and in determining such taxable income—

"(1) regular interests in such FASIT (if not otherwise debt instruments) shall be treated as indebtedness of such FASIT,

"(2) the constant yield method (including the rules of section 1272(a)(6)) shall be applied in determining all interest, acquisition discount, original issue discount, and market discount and all premium deductions or adjustments with respect to all debt instruments held by the FASIT,

"(3) the amount of the tax imposed by section 860M(e) (relating to tax on income from foreclosure property) shall be allowed as a deduction, and

"(4) there shall not be taken into account any item of income, gain, loss, or deduction allocable to prohibited income.

"(d) RECOGNITION OF GAIN ON CONTRIBUTIONS TO FASIT.—

"(1) IN GENERAL.—If property is contributed to a FASIT by the holder of the ownership interest in such FASIT—

"(A) notwithstanding any other provision of this subtitle, gain shall be recognized to the holder of such interest in the same manner as if such holder had sold such property to the FASIT at its fair market value on the date of such contribution, and

"(B) the basis of the FASIT in such property shall be such fair market value.

To the extent provided in regulations, gain recognized under the preceding sentence shall not be includible in gross income before the earliest date on which such property supports any regular interest in such FASIT or any indebtedness of the holder of the ownership interest (or by any person related to such holder).

"(2) GAIN RECOGNITION ON PROPERTY SUPPORTING REGULAR INTERESTS.—Solely for purposes of determining gain, property held by the holder of the ownership interest in a FASIT (or by any person related to such holder) which supports any regular interest in such FASIT shall be treated as sold on the earliest date such property supports such an interest at its fair market value on such date and as reacquired by such holder (or person) immediately thereafter.

"(3) VALUATION OF PROPERTY.—For purposes of this subsection and subsection (e)—

"(A) IN GENERAL.—In the case of any property contributed to a FASIT (other than cash equivalents), the fair market value of such property shall be equal to the sum of the present values of the reasonably expected payments under such property determined in the manner provided by regulations prescribed by the Secretary—

"(i) as of the date of the contribution or the earliest date of such support (as the case may be), and

"(ii) by using a discount rate equal to 130 percent of the applicable Federal rate (as defined in section 1274(d)), or such other discount rate specified in such regulations, compounded semiannually.

"(B) SPECIAL RULE FOR REVOLVING LOAN ACCOUNTS.—For purposes of subparagraph (A), in the case of extensions of credit on revolving loan accounts having substantially the same terms—

"(i) each extension of credit shall be treated as a separate debt instrument, and

"(ii) the reasonably expected payments under such an instrument shall be determined using a periodic principal payment rate equal to the reasonably anticipated periodic rate at which principal payments on the accounts will be made, as a proportion of their aggregate outstanding principal balances.

"(e) GAIN RECOGNITION ON CERTAIN DISTRIBUTIONS.—If a FASIT makes a distribution of property with respect to any regular or ownership interest—

"(1) notwithstanding any other provision of this subtitle, gain shall be recognized to such FASIT on the distribution in the same manner as if the FASIT had sold such property to the distributee at its fair market value on the date of such distribution, and

"(2) the basis of the distributee in such property shall be such fair market value.

"(f) TAX-EXEMPT INTEREST LOSES CHARACTER.—Interest accrued by the FASIT which is exempt from tax imposed by this subtitle shall, when taken into account by the holder of the ownership interest in the FASIT, be treated as ordinary income.

"SEC. 860K. NON-FASIT LOSSES NOT TO OFFSET CERTAIN FASIT INCLUSIONS.

"(a) IN GENERAL.—The taxable income of the holder of the ownership interest or high-yield interest in a FASIT for any taxable year shall in no event be less than such holder's taxable income determined solely with respect to such interests.

"(b) COORDINATION WITH SECTION 172.—Any increase in the taxable income of any holder of an ownership interest or high-yield interest in a FASIT for any taxable year by reason of subsection (a) shall be disregarded—

"(1) in determining under section 172 the amount of any net operating loss for such taxable year, and

"(2) in determining taxable income for such taxable year for purposes of the 2nd sentence of section 172(b)(2).

"(c) COORDINATION WITH MINIMUM TAX.—For purposes of part VI of subchapter A of this chapter—

"(1) the reference in section 55(b)(2) to taxable income shall be treated as a reference to taxable income determined without regard to this section,

"(2) the alternative minimum taxable income of any holder of the ownership interest or high-yield interest in a FASIT for any taxable year shall in no event be less than such holder's taxable income determined solely with respect to such interests, and

"(3) any increase in taxable income under this section shall be disregarded for purposes of computing the alternative tax net operating loss deduction.

"SEC. 860L. TREATMENT OF TRANSFERS OF HIGH-YIELD INTERESTS TO DISQUALIFIED HOLDERS.

"(a) GENERAL RULE.—If any high-yield interest is held by a disqualified holder, this chapter shall be applied as if the transferor of such interest to such holder had not transferred such interest.

"(b) EXCEPTIONS.—Rules similar to the rules of paragraphs (4) and (7) of section 860E(e) shall apply to the tax imposed by reason of subsection (a).

"(c) DISQUALIFIED HOLDER.—For purposes of this section, the term 'disqualified holder' means any holder other than an eligible corporation (as defined in section 860M(a)(2)).

"(d) TREATMENT OF INTERESTS HELD BY CERTAIN DEALERS.—

"(1) IN GENERAL.—Subsection (a) shall not apply to any high-yield interest held by a disqualified holder if—

"(A) such holder is a dealer in goods or services and such interest exclusively represents an interest supported by—

"(i) loans made by the dealer to finance a customer's acquisition of goods or services from such dealer in the ordinary course of business, and

"(ii) assets described in section 860M(c)(1)(D) that are incidental to the securitization of such loans, or

"(B) such holder is a dealer in securities who acquired such interest exclusively for sale to customers in the ordinary course of business (and not for investment).

"(2) CHANGE IN DEALER STATUS.—

"(A) IN GENERAL.—In the case of a dealer described in paragraph (1)(B) which is not an eligible corporation (as defined in section 860M(a)(2)), if—

"(i) such dealer ceases to be a dealer in securities, or

"(ii) such dealer commences holding the high-yield interest for investment,

there is hereby imposed (in addition to other taxes) an excise tax equal to the product of the highest rate of tax specified in section 11(b)(1) and the income of such dealer attributable to such interest for periods after the date of such cessation or commencement.

"(B) HOLDING FOR 31 DAYS OR LESS.—For purposes of subparagraph (A)(ii), a dealer shall not be treated as holding an interest for investment before the 32d day after the date such dealer acquired such interest unless such interest is so held as part of a plan to avoid the purposes of this paragraph.

"(C) ADMINISTRATIVE PROVISIONS.—The deficiency procedures of subtitle F shall apply to the tax imposed by this paragraph.

"SEC. 860M. DEFINITIONS AND OTHER RULES.

"(a) FASIT.—

"(1) IN GENERAL.—For purposes of this title, the terms 'financial asset securitization investment trust' and 'FASIT' mean any entity—

"(A) for which an election to be treated as a FASIT applies for the taxable year and all prior taxable years, "(B) all of the interests in which are regular interests or the ownership interest,

"(C) which has 1 (and only 1) ownership interest and such ownership interest is held directly by an eligible corporation,

"(D) as of the close of the 3rd month beginning after the day of its formation and at all times thereafter, substantially all of the assets of which consist of permitted assets,

"(E) which has a taxable year which is the taxable year of the holder of the ownership interest in the FASIT, and

"(F) which is not described in section 851(a).

A rule similar to the rule of the last sentence of section 860D(a) shall apply for purposes of this paragraph.

"(2) ELIGIBLE CORPORATION.—For purposes of paragraph (1)(C), the term 'eligible corporation' means any domestic C corporation other than—

"(A) a corporation which is exempt from tax under this chapter, and

"(B) an entity described in section 851(a) or 856(a).

"(3) FAILURE TO QUALIFY AS FASIT IF RIGHTS TO EXCESSIVE SERVICING FEES HELD BY OTHERS.—For purposes of this subtitle, an entity shall not be treated as a FASIT if any person (other than such entity) retains a stripped interest or has a right to receive excessive servicing fees with respect to any debt instrument held by such entity. A right is described in the preceding sentence only if such right was created at the time such instrument was contributed to such entity (or in anticipation of such right being contributed) or is held by the contributor of such instrument or by any person who is related to such contributor.

"(4) ELECTION.—An entity (otherwise meeting the requirements of paragraph (1)) may elect to be treated as a FASIT for its 1st taxable year. Such an election shall be made on its return for such 1st taxable year. Except as provided in paragraph (5), such an election shall apply to the taxable year for which made and all subsequent taxable years.

"(5) TERMINATION.—If any entity ceases to be a FASIT at any time during the taxable year, such entity shall not be treated as a FASIT for such taxable year or any succeeding taxable year.

"(6) INADVERTENT TERMINATIONS, ETC.—Rules similar to the rules of section 860D(b)(2)(B) shall apply to inadvertent failures to qualify or remain qualified as a FASIT.

"(b) INTERESTS IN FASIT.—For purposes of this subpart—

"(1) REGULAR INTEREST.—

"(A) IN GENERAL.—The term 'regular interest' means any interest which is issued by a FASIT with fixed terms and which is designated as a regular interest if—

"(i) such interest unconditionally entitles the holder to receive a specified principal amount (or other similar amount), "(ii) except as otherwise provided by the Secretary—

"(I) in the case of a FASIT which would be treated as a REMIC if an election under section 860D(b) had been made, interest payments (or other similar amounts), if any, with respect to such interest at or before maturity meet the requirements applicable under clause (i) or (ii) of section 860G(a)(1)(B), or

"(II) in the case of any other FASIT, interest payments (or other similar amounts), if any, with respect to such interest would not be treated as contingent payments (as defined in regulations prescribed by the Secretary under section 1275,

"(iii) such interest does not have a stated maturity (including options to renew) greater than 30 years (or such longer period as may be permitted by regulations),

"(iv) the issue price of such interest does not exceed 125 percent of its stated principal amount, and

"(v) the yield to maturity on such interest is less than the sum determined under section 163(i)(1)(B) with respect to such interest.

Interest shall not fail to meet the requirements of clause (i) merely because the timing (but not the amount) of the principal payments (or other similar amounts) may be contingent on the extent that payments on debt instruments held by the FASIT are made in advance of anticipated payments and on the amount of income from permitted assets.

"(B) HIGH-YIELD INTERESTS.—

"(i) IN GENERAL.—The term 'regular interest' includes any high-yield interest.

"(ii) HIGH-YIELD INTEREST.—The term 'high-yield interest' means any interest which would be described in subparagraph (A) but for failing to meet the requirements of one or more of clauses (i), (iv), or (v) thereof.

"(2) OWNERSHIP INTEREST.—The term 'ownership interest' means the interest issued by a FASIT which is designated as an ownership interest and which is not a regular interest.

"(c) PERMITTED ASSETS.—For purposes of this part—

"(1) IN GENERAL.—The term 'permitted asset' means—

"(A) any investment of amounts received under debt instruments described in subparagraph (B) for a temporary period before distribution to holders of interests in the FASIT,

"(B) debt instruments (as defined in section 1275(a)(1)) under which interest, if any, is payable—

"(i) at a fixed rate,

"(ii) at a qualified variable rate (as defined in regulations prescribed by the Secretary under section 860G(a)(1)(B)(i), or

"(iii) at any other varying rate permitted under regulations prescribed by the Secretary, "(C) foreclosure property,

"(D) any asset—

"(i) which is an interest rate or foreign currency notional principal contract, letter of credit, insurance, guarantee against payment defaults, or other similar instrument, permitted by the Secretary, and

"(ii) which is a reasonably required to guarantee or hedge against the FASIT's risks associated with being the obligor on interests issued by the FASIT,

"(E) any interest in a partnership if—

"(i) all of the assets of the partnership are debt instruments described in subparagraph (B), and

"(ii) such interest is an undivided pro rata interest in such assets, and

"(F) contract rights to acquire debt instruments described in subparagraph (B) or assets described in subparagraph (D).

"(2) DEBT ISSUED BY HOLDER OF OWNERSHIP INTEREST NOT PERMITTED ASSET.—The term 'permitted asset' shall not include any debt instrument issued by the holder of the ownership interest in the FASIT or by any person related to such holder or any direct or indirect interest in such a debt instrument.

"(3) FORECLOSURE PROPERTY.—The term 'foreclosure property' means property—

"(A) which would be foreclosure property under section 856(e) (determined without regard to paragraph (5) thereof) if acquired by a real estate investment trust, and

"(B) which is acquired in connection with the default or imminent default of a debt instrument held by the FASIT unless the security interest in such property was created for the principal purpose of permitting the FASIT to invest in such property.

Solely for purposes of subsection (a)(1), the determination of whether any property is foreclosure property shall be made without regard to section 856(e)(4).

"(d) TAX ON PROHIBITED TRANSACTIONS.—

"(1) IN GENERAL.—There is hereby imposed for each taxable year of a FASIT a tax equal to 100 percent of the net income derived from prohibited transactions.

"(2) PROHIBITED TRANSACTIONS.—For purposes of this part, the term 'prohibited transaction' means—

"(A) the receipt of any income derived from any asset that is not a permitted asset,

"(B) except as provided in paragraph (3), the disposition of any permitted asset,

"(C) the receipt of any income derived from any activity other than—

"(i) the acquisition of existing debt instruments,

"(ii) the holding of existing debt instruments, and

"(iii) the processing of payments received on debt instruments held by the FASIT and the distribution of amounts to holders of interests in the FASIT, and

"(D) the receipt of any income representing a fee or other compensation for services (other than any fee received as compensation for a waiver, amendment, or consent under permitted assets (other than foreclosure property) held by the FASIT).

"(3) EXCEPTION FOR INCOME FROM CERTAIN DISPOSITIONS.—

"(A) IN GENERAL.—Paragraph (2)(B) shall not apply to a disposition which would not be a prohibited transaction (as defined in section 860F(a)(2)) by reason of—

"(i) clause (ii), (iii), or (iv) of section 860F(a)(2)(A), or

"(ii) section 860F(a)(5),

if the FASIT were treated as a REMIC and debt instruments described in subsection (c)(1)(B) were treated as qualified mortgages.

"(B) SUBSTITUTION OF DEBT INSTRUMENTS; REDUCTION OF OVER-COLLATERALIZATION.—Paragraph (2)(B) shall not apply to—

"(i) the substitution of a debt instrument described in subsection (c)(1)(B) for another debt instrument which is a permitted asset, or

"(ii) the distribution of a debt instrument contributed by the holder of the ownership interest to such holder in order to reduce over-collateralization of the FASIT,

but only if a principal purpose of acquiring the debt instrument which is disposed of was not the recognition of gain (or the reduction of an loss) as a result of an increase in the market value of the debt instrument after its acquisition by the FASIT.

"(C) LIQUIDATION OF CLASS OF REGULAR INTERESTS.—Paragraph (2)(B) shall not apply to the complete liquidation of any class of regular interests.

"(4) NET INCOME.—For purposes of this subsection, net income shall be determined in accordance with section 860F(a)(3).

"(e) TAX ON INCOME FROM FORECLOSURE PROPERTY.—

"(1) IN GENERAL.—A tax is hereby imposed for each taxable year on the net income from foreclosure property of each FASIT. Such tax shall be computed by multiplying the net income from foreclosure property by the highest rate of tax specified in section 11(b).

"(2) NET INCOME FROM FORECLOSURE PROPERTY.—For purposes of this part, the term 'net income from foreclosure property' means the amount which would be the FASIT's net income from foreclosure property under section 857(b)(4)(B) if the FASIT were a real estate investment trust.

"(f) COORDINATION WITH WASH SALES RULES.—Rules similar to the rules of section 860F(d) shall apply to the ownership interest in a FASIT.

"(g) RELATED PERSON.—For purposes of this part, a person (hereinafter in this subsection referred to as the 'related person') is related to any person if—

"(1) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

"(2) the related person and such person are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52).

For purposes of paragraph (1), in applying section 267(b) or 707(b)(1), '20 percent' shall be substituted for '50 percent'.

"(h) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part, including regulations to prevent the abuse of the purposes of this part through transactions which are not primarily related to securitization of debt instruments by a FASIT."

(b) TECHNICAL AMENDMENTS.—

(1) Paragraph (2) of section 26(b) is amended by striking "and" at the end of subparagraph (M), by striking the period at the end of subparagraph (N) and inserting ", and", and by adding at the end the following new subparagraph:

"(O) section 860L (relating to treatment of transfers of high-yield interests to disqualified holders)."

(2) Paragraph (6) of section 56(g) is amended by striking "or REMIC" and inserting "REMIC, or FASIT".

(3) Clause (ii) of section 382(l)(4)(B) is amended by striking "or a REMIC to which part IV of subchapter M applies" and inserting "a REMIC to which part IV of subchapter M applies, or a FASIT to which part V of subchapter M applies".

(4) Paragraph (1) of section 582(c) is amended by inserting ", and any regular or ownership interest in a FASIT," after "REMIC".

(5) Paragraph (4) of section 593(d) is amended—

(A) by adding at the end the following new sentence: "References in the preceding provisions of this paragraph to a REMIC shall be treated as including a reference to a FASIT.", and

(B) by inserting "OR FASIT'S" after "REMIC'S" in the heading.

(6) Subparagraph (E) of section 856(c)(6) is amended by adding at the end the following new sentence: "References in the preceding provisions of this subparagraph to a REMIC shall be treated as including a reference to a FASIT."

(7) Subparagraph (C) of section 1202(e)(4) is amended by striking "or REMIC" and inserting "REMIC, or FASIT".

(8) Clause (xi) of section 7701(a)(19)(C) is amended to read as follows:

"(xi) any regular or residual interest in a REMIC, and any regular or ownership interest in a FASIT, but only in the proportion which the assets of such REMIC or FASIT consist of property described in any of the preceding clauses of this subparagraph; except that if 95 percent or more of the assets of such REMIC or FASIT are assets described in clauses (i) through (x), the entire interest in the REMIC or FASIT shall qualify."

(9) Subparagraph (A) of section 7701(i)(2) is amended by inserting "or a FASIT" after "a REMIC".

(c) CLERICAL AMENDMENT.—The table of parts for subchapter M of chapter 1 is amended by adding at the end the following new item:

"Part V. Financial asset securitization investment trusts."

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

CHAPTER 7—DEPRECIATION PROVISIONS

SEC. 12861. TREATMENT OF CONTRIBUTIONS IN AID OF CONSTRUCTION.

(a) TREATMENT OF CONTRIBUTIONS IN AID OF CONSTRUCTION.—

(1) IN GENERAL.—Section 118 (relating to contributions to the capital of a corporation) is amended—

(A) by redesignating subsection (c) as subsection (e), and

(B) by inserting after subsection (b) the following new subsections:

"(c) SPECIAL RULES FOR WATER AND SEWAGE DISPOSAL UTILITIES.—

"(1) GENERAL RULE.—For purposes of this section, the term 'contribution to the capital of the taxpayer' includes any amount of money or other property received from any person (whether or not a shareholder) by a regulated public utility which provides water or sewerage disposal services if—

"(A) such amount is a contribution in aid of construction,

"(B) in the case of contribution of property other than water or sewerage disposal facilities, such amount meets the requirements of the expenditure rule of paragraph (2), and

"(C) such amount (or any property acquired or constructed with such amount) is not included in the taxpayer's rate base for ratemaking purposes.

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

"(A) an amount equal to such amount is expended for the acquisition or construction of tangible property described in section 1231(b)—

"(i) which is the property for which the contribution was made or is of the same type as such property, and

"(ii) which is used predominantly in the trade or business of furnishing water or sewerage disposal services,

"(B) the expenditure referred to in subparagraph (A) occurs before the end of the second taxable year after the year in which such amount was received, and

"(C) accurate records are kept of the amounts contributed and expenditures made, the expenditures to which contributions are allocated, and the year in which the contributions and expenditures are received and made.

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

"(A) CONTRIBUTION IN AID OF CONSTRUCTION.—The term 'contribution in aid of construction' shall be defined by regulations prescribed by the Secretary, except that such term shall not include amounts paid as service charges for starting or stopping services.

"(B) PREDOMINANTLY.—The term 'predominantly' means 80 percent or more.

"(C) REGULATED PUBLIC UTILITY.—The term 'regulated public utility' has the meaning given such term by section 7701(a)(33), except that such term shall not include any utility which is not required to provide water or sewerage disposal services to members of the general public in its service area.

"(4) DISALLOWANCE OF DEDUCTIONS AND CREDIT; ADJUSTED BASIS.—Notwithstanding any other provision of this subtitle, no deduction or credit shall be allowed for, or by reason of, any expenditure which constitutes a contribution in aid of construction to which this subsection applies. The adjusted basis of any property acquired with contributions in aid of construction to which this subsection applies shall be zero.

"(d) STATUTE OF LIMITATIONS.—If the taxpayer for any taxable year treats an amount as a contribution to the capital of the taxpayer described in subsection (c), then—

"(1) the statutory period for the assessment of any deficiency attributable to any part of such amount shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of—

"(A) the amount of the expenditure referred to in subparagraph (A) of subsection (c)(2),

"(B) the taxpayer's intention not to make the expenditures referred to in such subparagraph, or

"(C) a failure to make such expenditure within the period described in subparagraph (B) of subsection (c)(2); and

"(2) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.".

(2) CONFORMING AMENDMENT.—Section 118(b) is amended by inserting "except as provided in subsection (c)," before "the term".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to amounts received after the date of the enactment of this Act.

(b) RECOVERY METHOD AND PERIOD FOR WATER UTILITY PROPERTY.—

(1) REQUIREMENT TO USE STRAIGHT LINE METHOD.—Section 168(b)(3) is amended by adding at the end the following new subparagraph:

"(F) Water utility property described in subsection (e)(5)."

(2) 25-YEAR RECOVERY PERIOD.—The table contained in section 168(c)(1) is amended by inserting the following item after the item relating to 20-year property:

"Water utility property .... 25 years".

(3) WATER UTILITY PROPERTY.—

(A) IN GENERAL.—Section 168(e) is amended by adding at the end the following new paragraph:

"(5) WATER UTILITY PROPERTY.—The term 'water utility property' means property—

"(A) which is an integral part of the gathering, treatment, or commercial distribution of water, and which, without regard to this paragraph, would be 20-year property, and

"(B) any municipal sewer."

(B) CONFORMING AMENDMENTS.—Section 168 is amended—

(i) by striking subparagraph (F) of subsection (e)(3), and

(ii) by striking the item relating to subparagraph (F) in the table in subsection (g)(3).

(4) ALTERNATIVE SYSTEM.—Clause (iv) of section 168(g)(2)(C) is amended by inserting "or water utility property" after "tunnel bore".

(5) EFFECTIVE DATE.—The amendments made by this subsection shall apply to property placed in service after the date of the enactment of this Act, other than property placed in service pursuant to a binding contract in effect on such date and at all times thereafter before the property is placed in service.

SEC. 12862. DEDUCTION FOR CERTAIN OPERATING AUTHORITY.

(a) GENERAL RULE.—For purpose of chapter 1 of the Internal Revenue Code of 1986, in computing the taxable income of a taxpayer who, on January 1, 1995, held one or more operating authorities preempted by section 601 of the Federal Aviation Administration Authorization Act of 1994, the taxpayer shall be entitled to deduct ratably over the 36-month period beginning with January 1995 an amount equal to the aggregate adjusted bases of such operating authorities held by the taxpayer on January 1, 1995.

(b) TREATMENT AS DEPRECIATION.—Any deduction under subsection (a) shall be treated as a deduction for depreciation for purposes of the Internal Revenue Code of 1986.

(c) EFFECTIVE DATE.—The provisions of this section shall apply to taxable years ending after December 31, 1994.

SEC. 12863. CLASS LIFE FOR GAS STATION CONVENIENCE STORES AND SIMILAR STRUCTURES.

(a) IN GENERAL.—Section 168(e)(3)(E) (classifying certain property as 15-year property) is amended by striking "and" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", and", and by adding at the end the following new clause:

"(iii) any section 1250 property which is a retail motor fuels outlet (whether or not food or other convenience items are sold at the outlet)."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to property which is placed in service on or after the date of the enactment of this Act and to which section 168 of the Internal Revenue Code of 1986 applies after the amendment made by section 201 of the Tax Reform Act of 1986. A taxpayer may elect to have such amendments apply with respect to any property placed in service before such date and to which such section so applies.

CHAPTER 8—OTHER PROVISIONS

SEC. 12871. APPLICATION OF FAILURE-TO-PAY PENALTY TO SUBSTITUTE RETURNS.

(a) GENERAL RULE.—Section 6651 (relating to failure to file tax return or to pay tax) is amended by adding at the end the following new subsection:

"(g) 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. 12872. EXTENSION OF WITHHOLDING TO CERTAIN GAMBLING WINNINGS.

(a) REPEAL OF EXEMPTION FOR BINGO AND KENO.—Paragraph (5) of section 3402(q) is amended to read as follows:

"(5) EXEMPTION FOR SLOT MACHINES.—The tax imposed under paragraph (1) shall not apply to winnings from a slot machine."

(b) THRESHOLD AMOUNT.—Paragraph (3) of section 3402(q) is amended—

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

(2) by adding at the end the following new subparagraph:

"(D) BINGO AND KENO.—Proceeds of more than $5,000 from a wager placed in a bingo or keno game."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1996.

SEC. 12873. LOSSES FROM FORECLOSURE PROPERTY.

(a) IN GENERAL.—Section 818(b) is amended by adding at the end the following new paragraph:

"(2) LOSSES FROM FORECLOSURE PROPERTY.—

"(A) IN GENERAL.—In the case of any loss arising from the sale or exchange of foreclosure property which (without regard to this paragraph) is treated as a capital loss—

"(i) only 15 percent of the amount of such loss shall be treated as a capital loss, and

"(ii) the remainder shall be treated as a loss from the sale or exchange of real property used in carrying on an insurance business which is recognized ratably over the 10-taxable year period beginning with the taxable year following the taxable year in which the sale or exchange of the foreclosure property occurred.

"(B) FORECLOSURE PROPERTY.—For purposes of this paragraph, the term "foreclosure property" means any real property used in a trade or businesses (as defined in section 1231(b) without regard to this subsection) which is acquired by a life insurance company as the result of—

"(i) such company having bid on such property at foreclosure, or

"(ii) such company having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default (or default was imminent) on indebtedness which such property secured."

(b) CONFORMING AMENDMENTS.—Section 818(b) is amended—

(1) by striking "In the" and inserting:

"(1) IN GENERAL.—In the ", and

(2) by redesignating paragraphs (1) and (2) and subparagraphs (A) and (B) of paragraph (1) as subparagraphs (A) and (B) and clauses (i) and (ii) of subparagraph (A), respectively.

(c) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1994.

SEC. 12874. COAL INDUSTRY RETIREE HEALTH EQUITY.

(a) IN GENERAL.—Paragraph (3) of section 9704(e) (relating to shortfalls and surpluses) is amended to read as follows:

"(3) SHORTFALLS AND SURPLUSES.—

"(A) DETERMINATIONS.—

"(i) IN GENERAL.—The trustees of the Combined Fund shall, as of the close of any plan year ending on or after September 30, 1995—

"(I) determine any shortfall or surplus in any premium account established under paragraph (1) and, to the maximum extent possible, reduce or eliminate any shortfall in any such account by transferring amounts to it from any surplus in any other such account, and

"(II) determine, after any transfers under subclause (I), the aggregate shortfall or surplus in the Combined Fund, taking into account all receipts of any kind during the plan year from all sources.

"(ii) DETERMINATIONS MADE ON CASH FLOW BASIS.—

"(I) IN GENERAL.—Subject to the provisions of subclause (II) and clause (iii), any determination under clause (i) for any plan year shall be determined under the cash receipts and disbursements method of accounting, taking into account only receipts and disbursements for the plan year.

"(II) CERTAIN PRIOR YEAR SURPLUSES.—For purposes of applying subclause (I) for any plan year, any surplus determined under subparagraph (A)(i)(II) as of the close of the preceding plan year, including any portion used as provided in subparagraph (B), shall be treated as received in the Combined Fund as of the beginning of the plan year.

"(iii) DISREGARD OF TRANSFERRED AMOUNTS.—For purposes of this subparagraph—

"(I) no amount transferred to the Combined Fund under section 9705, and no disbursements made from such amount, shall be taken into account in making any determination under subparagraph (A) for the plan year of the transfer or any subsequent plan year, and

"(II) any amount in a premium account which was transferred to the Combined Fund under section 9705 may not be transferred to another account under clause (i)(I).

"(B) TREATMENT OF SURPLUS.—

"(i) NONPREMIUM ADJUSTMENTS.—Any surplus determined under subparagraph (A)(i)(II) for any plan year shall be used first for purposes of the carryover under section 9703(b)(2)(C), but only to the extent the amount of such carryover does not exceed 10 percent of the benefits and administrative costs paid by the Combined Fund during the plan year (determined without regard to benefits paid from transfers under section 9705).

"(ii) PREMIUM ADJUSTMENTS.—In the case of the plan year beginning October 1, 1995, or October 1, 1996, the annual premium for such plan year for each assigned operator which is not a 1988 agreement operator shall be reduced by an amount which bears the same ratio to the surplus determined under subparagraph (A)(i)(II) as of the close of the preceding plan year (reduced as provided under clause (i)) as—

"(I) such assigned operator's applicable percentage (expressed as a whole number), bears to

"(II) the sum of the applicable percentages (expressed as whole numbers) of all assigned operators which are not 1988 agreement operators.

The reduction in any annual premium under this clause shall be allocated to the premium accounts established under paragraph (1) in the same manner as the annual premium would have been allocated without regard to this clause, and in the case of assigned operators which sought protection under title 11 of the United States Code before October 24, 1992, without regard to section 9706(b)(1)(A).

"(C) SHORTFALLS.—If a shortfall is determined under subparagraph (A)(i)(II) for any plan year, the annual premium for each assigned operator shall be increased by an amount equal to such assigned operator's applicable percentage of the shortfall. Any increase under this subparagraph shall be allocated to each premium account with a shortfall.

"(D) NO AUTHORITY FOR INCREASE.—Nothing in this paragraph shall be construed to allow expenditures for health care benefits in any plan year in excess of the limit under section 9703(b)(2)."

(b) AMOUNT OF PER BENEFICIARY PREMIUM.—Paragraph (2) of section 9704(b) (defining per beneficiary premium) is amended—

(1) by striking subparagraph (A) and inserting:

"(A) $2,116.67, plus", and

(2) by striking "the amount determined under subparagraph (A)" in subparagraph (B) and inserting "$2,116.67,".

(c) DISCLOSURE REQUIREMENTS.—

(1) IN GENERAL.—Section 9704(h) (relating to information) is amended by adding at the end the following new paragraph:

"(2) INFORMATION TO CONTRIBUTORS.—

"(A) IN GENERAL.—The trustees of the Combined Fund shall, within 30 days of a written request, make available to any person required to make contributions to the Combined Fund or their agent—

"(i) all documents which reflect its financial and operational status, including documents under which it is operated, and

"(ii) all documents prepared at the request of the trustees or staff of the Combined Fund which form the basis for any of its actions or reports, including the eligibility of participants in predecessor plans.

"(B) FEES.—The trustees may charge reasonable fees (not in excess of actual expenses) for providing documents under this paragraph."

(2) CONFORMING AMENDMENT.—Section 9704(h) is amended by striking "(h) INFORMATION.—The" and inserting:

"(h) INFORMATION.—

"(1) INFORMATION TO SECRETARY.—The".

(d) CONFORMING AMENDMENT.—Clause (ii) of section 9703(b)(2)(A) is amended by inserting "(without regard to any reduction under section 9704(e)(3)(B)(ii))" after "for the plan year".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after September 30, 1995.

SEC. 12875. NEWSPAPER DISTRIBUTORS TREATED AS DIRECT SELLERS.

(a) IN GENERAL.—Section 3508(b)(2)(A) in amended by striking "or" at the end of clause (i), by inserting "or" at the end of clause (ii), and by inserting after clause (ii) the following new clause:

"(iii) is engaged in the trade or business of the delivering or distribution of newspapers or shopping news (including any services directly related to such trade or business),".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to services performed after December 31, 1995.

SEC. 12876. 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) pursuant to a single plan, a common trust fund transfers substantially all of its assets to one or more regulated investment companies in exchange solely for stock in the company or companies to which such assets are so transferred, and

"(B) such stock is distributed by such common trust fund to participants in such common trust fund in exchange solely 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 the stock which is received in an exchange referred to in paragraph (1)(B) shall be the same as that of the property exchanged. If stock in more than one regulated investment company is received in such exchange, the basis determined under the preceding sentence shall be allocated among the stock in each such company on the basis of respective fair market values.

"(3) TREATMENT OF ASSUMPTIONS OF LIABILITY.—

"(A) IN GENERAL.—In determining whether the transfer referred to in paragraph (1)(A) is in exchange solely for stock in one or more regulated investment companies, the assumption by any such company of a liability of the common trust fund, and the fact that any property transferred by the common trust fund is subject to a liability, shall be disregarded.

"(B) SPECIAL RULE WHERE ASSUMED LIABILITIES EXCEED BASIS.—

"(i) IN GENERAL.—If, in any transfer referred to in paragraph (1)(A), the assumed liabilities exceed the aggregate adjusted bases (in the hands of the common trust fund) of the assets transferred to the regulated investment company or companies—

"(I) notwithstanding paragraph (1), gain shall be recognized to the common trust fund on such transfer in an amount equal to such excess,

"(II) the basis of the assets received by the regulated investment company or companies in such transfer shall be increased by the amount so recognized, and

"(III) any adjustment to the basis of a participant's interest in the common trust fund as a result of the gain so recognized shall be treated as occurring immediately before the exchange referred to in paragraph (1)(B).

If the transfer referred to in paragraph (1)(A) is to two or more regulated investment companies, the basis increase under subclause (II) shall be allocated among such companies on the basis of the respective fair market values of the assets received by each of such companies.

"(ii) ASSUMED LIABILITIES.—For purposes of clause (i), the term 'assumed liabilities' means the aggregate of—

"(I) any liability of the common trust fund assumed by any regulated investment company in connection with the transfer referred to in paragraph (1)(A), and

"(II) any liability to which property so transferred is subject.

"(4) 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. For purposes of the preceding sentence, Government securities shall not be treated as securities of an issuer in applying the 25-percent and 50-percent test and such securities shall not be excluded for purposes of determining total assets under clause (iv) of section 368(a)(2)(F)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to transfers after December 31, 1995.

SEC. 12877. TREATMENT OF CERTAIN INSURANCE CONTRACTS ON RETIRED LIVES.

(a) GENERAL RULE.—

(1) Paragraph (2) of section 817(d) (defining variable contract) is amended by striking "or" at the end of subparagraph (A), by striking "and" at the end of subparagraph (B) and inserting "or", and by inserting after subparagraph (B) the following new subparagraph:

"(C) provides for funding of insurance on retired lives as described in section 807(c)(6), and".

(2) Paragraph (3) of section 817(d) 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 inserting after subparagraph (B) the following new subparagraph:

"(C) in the case of funds held under a contract described in paragraph (2)(C), the amounts paid in, or the amounts paid out, reflect the investment return and the market value of the segregated asset account."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12878. TREATMENT OF MODIFIED GUARANTEED CONTRACTS.

(a) GENERAL RULE.—Subpart E of part I of subchapter L of chapter 1 (relating to definitions and special rules) is amended by inserting after section 817 the following new section:

"SEC. 817A. SPECIAL RULES FOR MODIFIED GUARANTEED CONTRACTS.

"(a) COMPUTATION OF RESERVES.—In the case of a modified guaranteed contract, clause (ii) of section 807(e)(1)(A) shall not apply.

"(b) SEGREGATED ASSETS UNDER MODIFIED GUARANTEED CONTRACTS MARKED TO MARKET.—

"(1) IN GENERAL.—In the case of any life insurance company, for purposes of this subtitle—

"(A) Any gain or loss with respect to a segregated asset shall be treated as ordinary income or loss, as the case may be.

"(B) If any segregated asset is held by such company as of the close of any taxable year—

"(i) such company shall recognize gain or loss as if such asset were sold for its fair market value on the last business day of such taxable year, and

"(ii) any such 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 subparagraph at times other than the times provided in this subparagraph.

"(2) SEGREGATED ASSET.—For purposes of paragraph (1), the term 'segregated asset' means any asset held as part of a segregated account referred to in subsection (d)(1) under a modified guaranteed contract.

"(c) SPECIAL RULE IN COMPUTING LIFE INSURANCE RESERVES.—For purposes of applying section 816(b)(1)(A) to any modified guaranteed contract, an assumed rate of interest shall include a rate of interest determined, from time to time, with reference to a market rate of interest.

"(d) MODIFIED GUARANTEED CONTRACT DEFINED.—For purposes of this section, the term 'modified guaranteed contract' means a contract not described in section 817—

"(1) all or part of the amounts received under which are allocated to an account which, pursuant to State law or regulation, is segregated from the general asset accounts of the company and is valued from time to time with reference to market values,

"(2) which—

"(A) provides for the payment of annuities,

"(B) is a life insurance contract, or

"(C) is a pension plan contract which is not a life, accident, or health, property, casualty, or liability contract,

"(3) for which reserves are valued at market for annual statement purposes, and

"(4) which provides for a net surrender value or a policyholder's fund (as defined in section 807(e)(1)).

If only a portion of a contract is not described in section 817, such portion shall be treated for purposes of this section as a separate contract.

"(e) REGULATIONS.—The Secretary may prescribe regulations—

"(1) to provide for the treatment of market value adjustments under sections 72, 7702, 7702A, and 807(e)(1)(B),

"(2) to determine the interest rates applicable under sections 807(c)(3), 807(d)(2)(B), and 812 with respect to a modified guaranteed contract annually, in a manner appropriate for modified guaranteed contracts and, to the extent appropriate for such a contract, to modify or waive the applicability of section 811(d),

"(3) to provide rules to limit ordinary gain or loss treatment to assets constituting reserves for modified guaranteed contracts (and not other assets) of the company,

"(4) to provide appropriate treatment of transfers of assets to and from the segregated account, and

"(5) as may be necessary or appropriate to carry out the purposes of this section."

(b) CLERICAL AMENDMENT.—The table of sections for subpart E of part I of subchapter L of chapter 1 is amended by inserting after the item relating to section 817 the following new item:

"Sec. 817A. Special rules for modified guaranteed contracts."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

(2) TREATMENT OF NET ADJUSTMENTS.—In the case of any taxpayer required by the amendments made by this section to change its calculation of reserves to take into account market value adjustments and to mark segregated assets to market for any taxable year—

(A) such changes shall be treated as a change in method of accounting initiated by the taxpayer,

(B) such changes shall be treated as made with the consent of the Secretary, and

(C) the adjustments required by reason of section 481 of the Internal Revenue Code of 1986 shall be taken into account as ordinary income or loss by the taxpayer for the taxpayer's first taxable year beginning after December 31, 1995.

Subtitle J—Pension Simplification

CHAPTER 1—GENERAL PROVISIONS

Subchapter A—Simplification of Nondiscrimination Provisions

SEC. 12901. DEFINITION OF HIGHLY COMPENSATED EMPLOYEES; REPEAL OF FAMILY AGGREGATION.

(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,

"(B) had compensation for the preceding year from the employer in excess of $80,000, or

"(C) was the most highly compensated officer of the employer for the preceding year.

The Secretary shall adjust the $80,000 amount under subparagraph (B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1996."

(b) SPECIAL RULE FOR TAX EXEMPT AND GOVERNMENTAL PLANS.—Paragraph (2) of section 414(q) is amended to read as follows:

"(2) SPECIAL RULE FOR TAX EXEMPT AND GOVERNMENTAL PLANS.—Solely for purposes of applying subsections (k) and (m) of section 401, paragraph (1)(C) shall not apply to a plan maintained by—

"(A) a State or local government or political subdivision thereof, or any agency or instrumentality thereof, or

"(B) any organization exempt from tax under this subtitle."

(c) REPEAL OF FAMILY AGGREGATION RULES.—

(1) IN GENERAL.—Paragraph (6) of section 414(q) is hereby repealed.

(2) COMPENSATION LIMIT.—Paragraph (17)(A) of section 401(a) is amended by striking the last sentence.

(3) DEDUCTION.—Subsection (l) of section 404 is amended by striking the last sentence.

(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 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) Section 1114(c)(4) of the Tax Reform Act of 1986 is amended by adding at the end the following new sentence: "Any reference in this paragraph to section 414(q) shall be treated as a reference to such section as in effect before the Revenue Reconciliation Act of 1995."

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to years beginning after December 31, 1996, except that in determining whether an employee is a highly compensated employee for years beginning in 1997, such amendments shall be treated as having been in effect for years beginning in 1996.

(2) FAMILY AGGREGATION.—The amendments made by subsection (c) shall apply to years beginning after December 31, 1995.

SEC. 12902. DEFINITION OF COMPENSATION FOR SECTION 415 PURPOSES.

(a) GENERAL RULE.—Section 415(c)(3) (defining participant's compensation) is amended by adding at the end the following new subparagraph:

"(D) CERTAIN DEFERRALS INCLUDED.—The term 'participant's compensation' shall include—

"(i) any elective deferral (as defined in section 402(g)(3)), and

"(ii) any amount which is contributed by the employer of the election of the employee and which is not includible in the gross income of the employee under section 125 or 457."

(b) CONFORMING AMENDMENTS.—

(1) Section 414(q)(7) is amended to read as follows:

"(7) COMPENSATION.—For purposes of this subsection, the term 'compensation' has the meaning given such term by section 415(c)(3)."

(2) Section 414(s)(2) is amended by inserting "not" after "elect" in the text and heading thereof.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1997.

SEC. 12903. 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 DATE.—The amendment made by this section shall apply to years beginning after December 31, 1995.

SEC. 12904. 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), as amended by this Act, is amended by adding at the end the following new paragraph:

"(12) ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—

"(A) IN GENERAL.—A cash or deferred arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement—

"(i) meets the contribution requirements of subparagraph (B) or (C), and

"(ii) meets the notice requirements of subparagraph (D).

"(B) MATCHING CONTRIBUTIONS.—

"(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement, the employer makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount equal to—

"(I) 100 percent of the elective contributions of the employee to the extent such elective 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 contributions exceed 3 percent but do not exceed 5 percent of the employee's compensation.

"(ii) RATE FOR HIGHLY COMPENSATED EMPLOYEES.—The requirements of this subparagraph are not met if, under the arrangement, the 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 all employer contributions (including matching 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), as amended by this Act, is amended by redesignating paragraph (10) as paragraph (11) and by adding after paragraph (9) the following new paragraph:

"(11) ALTERNATIVE METHOD OF SATISFYING TESTS.—

"(A) IN GENERAL.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

"(i) meets the contribution requirements of subparagraph (B) or (C) of subsection (k)(12),

"(ii) meets the notice requirements of subsection (k)(12)(D), and

"(iii) meets the requirements of subparagraph (B).

"(B) LIMITATION ON MATCHING CONTRIBUTIONS.—The requirements of this subparagraph are met if—

"(i) matching contributions on behalf of any employee may not be made with respect to an employee's contributions or elective deferrals in excess of 6 percent of the employee's compensation,

"(ii) the 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",

(B) by striking "for such plan year" and inserting "the preceding plan year", and

(C) by adding at the end the following new sentence: "An arrangement may apply this clause by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary."

(2) MATCHING AND EMPLOYEE CONTRIBUTIONS.—Section 401(m)(2)(A) is amended—

(A) by inserting "for such plan year" after "highly compensated employee",

(B) by inserting "for the preceding plan year" after "eligible employees" each place it appears in clause (i) and clause (ii), and

(C) by adding at the end the following flush sentence: "This subparagraph may be applied by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided the Secretary."

(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 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 actual deferral percentage of nonhighly compensated employees for the preceding plan year shall be—

"(i) 3 percent, or

"(ii) if the employer makes an election under this subclause, the actual deferral percentage of nonhighly compensated employees determined for such first plan year."

(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) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1998.

Subchapter B—Simplified Distribution Rules

SEC. 12911. REPEAL OF 5-YEAR INCOME AVERAGING FOR LUMP-SUM DISTRIBUTIONS.

(a) IN GENERAL.—Subsection (d) of section 402 (relating to taxability of beneficiary of employees' trust) is amended to read as follows:

"(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)."

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (D) of section 402(e)(4) (relating to other rules applicable to exempt trusts) is amended to read as follows:

"(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)),

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a).

Subclause (III) of this clause shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and subclause (IV) shall be applied only with respect to an employee within the meaning of section 401(c)(1). For purposes of this clause, a distribution to two or more trusts shall be treated as a distribution to one recipient. For purposes of this paragraph, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)).

"(ii) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under clause (i)—

"(I) all trusts which are part of a plan shall be treated as a single trust, all pension plans maintained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

"(II) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

"(iii) COMMUNITY PROPERTY LAWS.—The provisions of this paragraph shall be applied without regard to community property laws.

"(iv) AMOUNTS SUBJECT TO PENALTY.—This paragraph shall not apply to amounts described in subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

"(v) BALANCE TO CREDIT OF EMPLOYEE NOT TO INCLUDE AMOUNTS PAYABLE UNDER QUALIFIED DOMESTIC RELATIONS ORDER.—For purposes of this paragraph, the balance to the credit of an employee shall not include any amount payable to an alternate payee under a qualified domestic relations order (within the meaning of section 414(p)).

"(vi) TRANSFERS TO COST-OF-LIVING ARRANGEMENT NOT TREATED AS DISTRIBUTION.—For purposes of this paragraph, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan.

"(vii) LUMP-SUM DISTRIBUTIONS OF ALTERNATE PAYEES.—If any distribution or payment of the balance to the credit of an employee would be treated as a lump-sum distribution, then, for purposes of this paragraph, the payment under a qualified domestic relations order (within the meaning of section 414(p)) of the balance to the credit of an alternate payee who is the spouse or former spouse of the employee shall be treated as a lump-sum distribution. For purposes of this clause, the balance to the credit of the alternate payee shall not include any amount payable to the employee."

(2) Section 402(c) (relating to rules applicable to rollovers from exempt trusts) is amended by striking paragraph (10).

(3) Paragraph (1) of section 55(c) (defining regular tax) is amended by striking "shall not include any tax imposed by section 402(d) and".

(4) Paragraph (8) of section 62(a) (relating to certain portion of lump-sum distributions from pension plans taxed under section 402(d)) is hereby repealed.

(5) Section 401(a)(28)(B) (relating to coordination with distribution rules) is amended by striking clause (v).

(6) 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."

(7) 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.

(8) 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.

(9) Section 691(c) (relating to deduction for estate tax) is amended by striking paragraph (5).

(10) Paragraph (1) of section 871(b) (relating to imposition of tax) is amended by striking "section 1, 55, or 402(d)(1)" and inserting "section 1 or 55".

(11) Subsection (b) of section 877 (relating to alternative tax) is amended by striking "section 1, 55, or 402(d)(1)" and inserting "section 1 or 55".

(12) Section 4980A(c)(4) is amended—

(A) by striking "to which an election under section 402(d)(4)(B) applies" and inserting "(as defined in section 402(e)(4)(D)) with respect to which the individual elects to have this paragraph apply",

(B) by adding at the end the following new flush sentence:

"An individual may elect to have this paragraph apply to only one lump-sum distribution.", and

(C) by striking the heading and inserting:

"(4) SPECIAL ONE-TIME ELECTION.—".

(13) Section 402(e) is amended by striking paragraph (5).

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1998.

(2) RETENTION OF CERTAIN TRANSITION RULES.—Notwithstanding any other provision of this section, the amendments

made by this section shall not apply to any distribution for which the taxpayer elects the benefits of section 1122 (h)(3) or (h)(5) of the Tax Reform Act of 1986. For purposes of the preceding sentence, the rules of sections 402(c)(10) and 402(d) of the Internal Revenue Code of 1986 (as in effect before the amendments made by this Act) shall apply.

SEC. 12912. REPEAL OF $5,000 EXCLUSION OF EMPLOYEES' DEATH BENEFITS.

(a) IN GENERAL.—Subsection (b) of section 101 is hereby repealed.

(b) CONFORMING AMENDMENT.—Subsection (c) of section 101 is amended by striking "subsection (a) or (b)" and inserting "subsection (a)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12913. 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	360
More than 55 but not more than 60	310
More than 60 but not more than 65	260
More than 65 but not more than 70	210

More than 70 160

"(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, 1995.

SEC. 12914. 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, or

"(II) the calendar year in which the employee retires.

"(ii) EXCEPTION.—Subclause (II) of clause (i) shall not apply—

"(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 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, 1995.

(c) DATE FOR ADOPTION OF PLAN AMENDMENTS.—If any amendment made by this section or any other provision of this subtitle requires an amendment to any plan, such plan amendment shall not be required to be made before the first day of the first plan year beginning on or after January 1, 1997, 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.

In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), this subsection shall be applied by substituting "1999" for "1997".

Subchapter C—Targeted Access to Pension Plans For Small Employers

SEC. 12916. CREDIT FOR PENSION PLAN START-UP COSTS OF SMALL EMPLOYERS.

(a) ALLOWANCE OF CREDIT.—Section 38(b) (defining current year business credit), as amended by this Act, is amended by striking "plus" at the end of paragraph (11), by striking the period at the end of paragraph (12), and inserting ", plus", and by adding at the end the following new paragraph:

"(13) the small employer pension plan start-up cost credit."

(b) SMALL EMPLOYER PENSION PLAN START-UP COST CREDIT.—Subpart D of part IV of subchapter A of chapter 1 (relating to business related credits), as amended by this Act, is amended by adding at the end the following new section:

"SEC. 45D. SMALL EMPLOYER PENSION PLAN START-UP COST CREDIT.

"(a) AMOUNT OF CREDIT.—For purposes of section 38—

"(1) IN GENERAL.—The small employer pension plan start-up cost credit for any taxable year is an amount equal to 50 percent of the qualified start-up costs of an eligible employer in establishing a qualified pension plan.

"(2) AGGREGATE LIMITATION.—The amount of the credit under paragraph (1) for any taxable year shall not exceed $500, reduced by the aggregate amount determined under this section for all preceding taxable years of the taxpayer.

"(b) QUALIFIED START-UP COSTS; QUALIFIED PENSION PLAN.—For purposes of this section—

"(1) QUALIFIED START-UP COSTS.—The term 'qualified start-up costs' means any ordinary and necessary expenses of an eligible employer which—

"(A) are paid or incurred in connection with the establishment of a qualified pension plan, and

"(B) are of a nonrecurring nature.

"(2) QUALIFIED PENSION PLAN.—The term 'qualified pension plan' means—

"(A) a qualified salary reduction arrangement described in section 408(p) (relating to simple retirement accounts), or

"(B) an arrangement described in section 401(k)(11).

"(c) ELIGIBLE EMPLOYER.—For purposes of this section—

"(1) IN GENERAL.—The term 'eligible employer' means an employer which did not make any contributions on behalf of any employee to—

"(A) a qualified pension plan,

"(B) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a), or

"(C) a simplified employee pension (as defined in section 408(k)),

during the 2 taxable years immediately preceding the taxable year.

"(2) PROFESSIONAL SERVICE EMPLOYERS EXCLUDED.—Such term shall not include an employer substantially all of the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, financial services, or consulting.

"(d) SPECIAL RULES.—For purposes of this section—

"(1) AGGREGATION RULES.—All persons treated as a single employer under subsection (a) or (b) of section 52 or subsection (n) or (o) of section 414 shall be treated as one person.

"(2) DISALLOWANCE OF DEDUCTION.—No deduction shall be allowable under this chapter for any qualified start-up costs for which a credit is allowable under subsection (a)."

(c) CONFORMING AMENDMENTS.—

(1) Section 39(d) is amended by adding at the end the following new paragraph:

"(8) NO CARRYBACK OF PENSION CREDIT.—No portion of the unused business credit for any taxable year which is attributable to the small employer pension plan start-up cost credit determined under section 45D may be carried back to a taxable year ending before the date of the enactment of section 45D."

(2) The table of sections for subpart D of part IV of subchapter A of chapter 1 is amended by adding at the end the following new item:

"Sec. 45D. Small employer pension plan start-up cost credit."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to costs incurred after the date of the enactment of this Act in taxable years ending after such date.

SEC. 12917. TAX-EXEMPT ORGANIZATIONS ELIGIBLE UNDER SECTION 401(k).

(a) GENERAL RULE.—Clause (ii) of section 401(k)(4)(B) is amended to read as follows:

"(ii) any organization described in section 501(c)(3) which is exempt from tax under section 501(a)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to plan years beginning after December 31, 1997, 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.

Subchapter D—Paperwork Reduction

SEC. 12921. LIMITATION ON COMBINED SECTION 415 LIMIT.

(a) IN GENERAL.—Section 415(e) (relating to limitation in case of defined benefit plan and defined contribution plan for same employee) is amended by adding at the end the following new paragraph:

"(7) LIMITATION ON APPLICATION OF SUBSECTION.—In the case of years beginning after December 31, 1998, this subsection shall only apply to plans maintained by an employer described in section 45D(c)(2)."

(b) EXCESS DISTRIBUTIONS.—Section 4980A is amended by adding at the end the following new subsection:

"(g) LIMITATION ON APPLICATION.—This section shall not apply to distributions during years beginning after December 31, 1995, and before January 1, 1999, and such distributions shall be treated as made first from amounts not described in subsection (f)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1995.

Subchapter E—Miscellaneous Simplification

SEC. 12931. 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 primary direction or control by the recipient."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1995, 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. 12932. 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, 1995.

SEC. 12933. ELIMINATION OF SPECIAL VESTING RULE FOR MULTIEMPLOYER PLANS.

(a) IN GENERAL.—Paragraph (2) of section 411(a) (relating to minimum vesting standards) is amended—

(1) by striking "subparagraph (A), (B), or (C)" and inserting "subparagraph (A) or (B)"; and

(2) by striking subparagraph (C).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning on or after the earlier of—

(1) the later of—

(A) January 1, 1996, or

(B) the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates (determined without regard to any extension thereof after the date of the enactment of this Act), or

(2) January 1, 1998.

Such amendments shall not apply to any individual who does not have more than 1 hour of service under the plan on or after the 1st day of the 1st plan year to which such amendments apply.

SEC. 12934. FULL-FUNDING LIMITATION OF MULTIEMPLOYER PLANS.

(a) FULL-FUNDING LIMITATION.—Section 412(c)(7)(C) (relating to full-funding limitation) is amended—

(1) by inserting "or in the case of a multiemployer plan," after "paragraph (6)(B),", and

(2) by inserting "AND MULTIEMPLOYER PLANS" after "PARAGRAPH (6)(B)" in the heading thereof.

(b) VALUATION.—Section 412(c)(9) is amended—

(1) by inserting "(3 years in the case of a multiemployer plan)" after "year", and

(2) by striking "ANNUAL VALUATION" in the heading and inserting "VALUATION".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1997.

SEC. 12935. TREATMENT OF GOVERNMENTAL AND MULTIEMPLOYER PLANS UNDER SECTION 415.

(a) 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 AND MULTIEMPLOYER PLANS.—In the case of a governmental plan (as defined in section 414(d)) or a multiemployer plan, subparagraph (B) of paragraph (1) shall not apply. This paragraph shall not apply to any benefit provided under the plan to a State or local legislator."

(b) TREATMENT OF CERTAIN EXCESS BENEFIT PLANS.—

(1) IN GENERAL.—Section 415 is amended by adding at the end 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 the following new paragraph:

"(14) 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 ", and", and by adding at the end the following new subparagraph:

"(E) a qualified governmental excess benefit arrangement described in section 415(m)."

(c) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS.—Paragraph (2) of section 415(b) is amended by adding at the end the following new subparagraph:

"(I) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS PROVIDED UNDER GOVERNMENTAL AND ENVIRONMENTAL 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)) or a multiemployer plan 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 either such plan by the beneficiaries, survivors, or the estate of an employee as the result of the death of the employee."

(d) REVOCATION OF GRANDFATHER ELECTION.—

(1) IN GENERAL.—Subparagraph (C) of section 415(b)(10) is amended by adding at the end the following new clause:

"(ii) REVOCATION OF ELECTION.—An election under clause (i) may be revoked not later than the last day of the third plan year beginning after the date of the enactment of this clause. The revocation shall apply to all plan years to which the election applied and to all subsequent plan years. Any amount paid by a plan in a taxable year ending after the revocation shall be includible in income in such taxable year under the rules of this chapter in effect for such taxable year, except that, for purposes of applying the limitations imposed by this section, any portion of such amount which is attributable to any taxable year during which the election was in effect shall be treated as received in such taxable year."

(2) CONFORMING AMENDMENT.—Subparagraph (C) of section 415(b)(10) is amended by striking "This" and inserting:

"(i) IN GENERAL.—This".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by subsections (a), (b), and (c) shall apply to years beginning after December 31, 1995. The amendments made by subsection (d) shall apply

with respect to revocations adopted after the date of the enactment of this Act.

(2) TREATMENT FOR YEARS BEGINNING BEFORE DATE OF ENACTMENT.—Nothing in the amendments made by this section shall be construed to infer that a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986) fails to satisfy the requirements of section 415 of such Code for any taxable year beginning before the date of the enactment of this Act.

(3) MULTIEMPLOYER PLANS.—In the case of a multiemployer plan, the amendments made by subsections (a) and (c) shall apply to years beginning after December 31, 1995.

SEC. 12936. 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, as amended by section 12935(b)(2), is amended by adding at the end the following new paragraph:

"(15) 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), except that the base period shall be the calendar quarter ending September 30, 1994."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 12937. CONTRIBUTIONS ON BEHALF OF DISABLED EMPLOYEES.

(a) ALL DISABLED PARTICIPANTS RECEIVING CONTRIBUTIONS.—Section 415(c)(3)(C) is amended by adding at the end 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, 1995.

SEC. 12938. DISTRIBUTIONS UNDER RURAL COOPERATIVE PLANS.

(a) DISTRIBUTIONS FOR HARDSHIP OR AFTER A CERTAIN AGE.—Section 401(k)(7) is amended by adding at the end 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) or of paragraph (2) merely by reason of a hardship distribution or a distribution to a participant after attainment of age 59½. For purposes of this section, the term 'hardship distribution' means a distribution described in paragraph (2)(B)(i)(IV) (without regard to the limit of its application to profit-sharing or stock bonus plans)."

(b) DEFINITION OF RURAL COOPERATIVE PLANS.—

(1) PUBLIC UTILITY DISTRICTS.—Clause (i) of section 401(k)(7)(B) (defining rural cooperative) is amended to read as follows:

"(i) any organization which—

"(I) is engaged primarily in providing electric service on a mutual or cooperative basis, or

"(II) is engaged primarily in providing electric service to the public in its area of service and which is exempt from tax under this subtitle or which is a State or local government (or an agency or instrumentality thereof), other than a municipality (or an agency or instrumentality thereof)."

(2) RELATED ORGANIZATIONS.—Subparagraph (B) of section 401(k)(7), as amended by paragraph (1), is amended by striking clause (iv) and inserting the following new clauses:

"(iv) an organization which is a national association of organizations described in any other clause of this subparagraph, or

"(v) any other organization which provides services which are related to the activities of an organization described in clause (i), (ii), (iii), or (iv), but only in the case of a plan with respect to which substan tially all of the organizations maintaining it are described in clause (i), (ii), (iii), or (iv)."

(c) EFFECTIVE DATES.—

(1) DISTRIBUTIONS.—The amendments made by subsection (a) shall apply to distributions after the date of the enactment of this Act.

(2) RURAL COOPERATIVE.—The amendments made by subsection (b) shall apply to plan years beginning after December 31, 1994.

SEC. 12939. TENURED FACULTY.

(a) IN GENERAL.—Section 457(e)(11) is amended by inserting "eligible faculty voluntary retirement incentive pay," after "disability pay,".

(b) DEFINITION.—Section 457(e), as amended by sections 12935(b)(2) and 12936(b), is amended by adding at the end the following new paragraph:

"(16) DEFINITION OF ELIGIBLE FACULTY VOLUNTARY RETIREMENT INCENTIVE PAY.—For purposes of this section, the term 'eligible faculty voluntary retirement incentive pay' means payments under a plan established for employees serving under contracts of unlimited tenure (or similar arrangements providing for unlimited tenure) at an institution of higher education (as defined in section 1201(a) of the Higher Education Act of 1965 (20 U.S.C. 1141(a))) which—

"(A) provides—

"(i) payment to employees electing to retire during a specified period of time of limited duration, or

"(ii) payment to employees who elect to retire prior to normal retirement age,

"(B) provides that the total amount of payments to an employee does not exceed the equivalent of twice the employee's annual compensation (within the meaning of section 415(c)(3)) during the year immediately preceding the employee's termination of service, and

"(C) provides that all payments to an employee must be completed within 5 years after the employee's termination of service."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1995.

SEC. 12940. 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 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, 1995.

SEC. 12941. MODIFICATIONS OF SECTION 403(b).

(a) MULTIPLE SALARY REDUCTION AGREEMENTS PERMITTED.—

(1) GENERAL RULE.—For purposes of section 403(b) of the Internal Revenue Code of 1986, the frequency that an employee is permitted to enter into a salary reduction agreement, the salary to which such an agreement may apply, and the ability to revoke such an agreement shall be determined under the rules applicable to cash or deferred elections under section 401(k) of such Code.

(2) EFFECTIVE DATE.—This subsection shall apply to taxable years beginning after December 31, 1995.

(b) TREATMENT OF INDIAN TRIBAL GOVERNMENTS.—In the case of any contract purchased in a plan year beginning before January 1, 1995, section 403(b) of the Internal Revenue Code of 1986 shall be applied as if any reference to an employer described in section 501(c)(3) of the Internal Revenue Code of 1986 which is exempt from tax under section 501 of such Code included a reference to an employer which is an Indian tribal government (as defined by section 7701(a)(40) of such Code), a subdivision of an Indian tribal government (determined in accordance with section 7871(d) of such Code), an agency or instrumentality of an Indian tribal government or subdivision thereof, or a corporation chartered under Federal, State, or tribal law which is owned in whole or in part by any of the foregoing.

(c) ELECTIVE DEFERRALS.—

(1) IN GENERAL.—Section 403(b)(1) is amended by inserting "and" at the end of subparagraph (C), by striking "and" at the end of subparagraph (D), and by striking subparagraph (E).

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 1995.

SEC. 12942. TAX ON PROHIBITED TRANSACTIONS.

(a) IN GENERAL.—Section 4975(a) is amended by striking "5 percent" and inserting "10 percent".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to prohibited transactions occurring after December 31, 1995.

SEC. 12943. EXTENSION OF INTERNAL REVENUE SERVICE USER FEES.

Subsection (c) of section 10511 of the Revenue Act of 1987 is amended by striking "October 1, 2000" and by inserting "October 1, 2002".

CHAPTER 2—CHURCH PLANS

SEC. 12951. NEW QUALIFICATION PROVISION FOR CHURCH PLANS.

(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 adding after section 401 the following new section:

"SEC. 401A. QUALIFIED CHURCH PLAN.

"(a) GENERAL RULE.—For purposes of all Federal laws, including this title, a qualified church plan shall be treated as satisfying the requirements of section 401(a), and all references in (or pertaining to) this title and such laws to a plan described in section 401(a) shall include a qualified church plan. Except as otherwise provided in this section, no paragraph of section 401(a) shall apply to a qualified church plan.

"(b) DEFINITION OF QUALIFIED CHURCH PLAN.—A plan is a qualified church plan if such plan meets the following requirements:

"(1) CHURCH PLAN REQUIREMENT.—The plan is a church plan (within the meaning of section 414(e)), and the election provided by section 410(d) has not been made with respect to such plan.

"(2) EMPLOYEE CONTRIBUTIONS ARE NONFORFEITABLE.—An employee's rights in the employee's accrued benefit derived from the employee's own contributions are nonforfeitable.

"(3) VESTING REQUIREMENTS.—The plan satisfies the requirements of subparagraph (A) or (B).

"(A) 10-YEAR VESTING.—A plan satisfies the requirements of this paragraph if an employee who has at least 10 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

"(B) 5- TO 15-YEAR VESTING.—A plan satisfies the requirements of this paragraph if an employee who has completed at least 5 years of service has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions which is not less than the percentage determined under the following table:

"Years of service	Nonforfeitable percentage
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100.

"(C) YEARS OF SERVICE.—For purposes of this paragraph, an employee's years of service shall be determined in accordance with any reasonable method selected by the plan administrator.

"(4) FUNDING REQUIREMENTS.—The plan meets the funding requirements of section 401(a)(7) as in effect on September 1, 1974.

"(5) ADDITIONAL REQUIREMENTS.—

"(A) The plan meets the requirements of paragraphs (1), (2), (8), (9), (16), (17), (25), (27), and (30) of section 401(a).

"(B) If the plan includes employees of an organization which is not a church, the plan meets the requirements of sections 401(a)(3) and 401(a)(6) (as in effect on September 1, 1974) and sections 401(a)(4), 401(a)(5), and 401(m).

For purposes of subparagraph (B), the plan administrator may elect to treat the portion of the plan maintained by any organization (or organizations) described in subparagraph (B) as a separate plan (or plans).

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) CHURCH.—For purposes of this section, the term 'church' means a church or a convention or association of churches, including an organization described in section 414(e)(3)(A) and an organization described in section 414(e)(3)(B)(ii), other than—

"(A) an organization described in section 170(b)(1)(A)(ii) above the secondary school level (other than a school for religious training), or

"(B) an organization described in section 170(b)(1)(A)(iii)—

"(i) which provides community service for inpatient medical care of the sick or injured (including obstetrical care); and

"(ii) not more than 50 percent of the total patient days of which during any year are customarily assignable to the categories of chronic convalescent and rest, drug and alcoholic, epileptic, mentally deficient, mental, nervous and mental, and tuberculosis, and care for the aged.

"(2) SATISFACTION OF TRUST PROVISION.—A plan shall not fail to be described in this section merely because such plan is funded through an organization described in section 414(e)(3)(A) if—

"(A) such organization is subject to fiduciary requirements under applicable State law;

"(B) such organization is separately incorporated from the church or convention or association of churches which controls it or with which it is associated;

"(C) the assets which equitably belong to the plan are separately accounted for; and

"(D) under the plan, at any time prior to the satisfaction of all liabilities with respect to participants and their beneficiaries, such assets cannot be used for, or diverted to, purposes other than for the exclusive benefit of participants and their beneficiaries (except that this paragraph shall not be construed to preclude the use of plan assets to defray the reasonable costs associated with administering the plan and informing employees and employers of the availability of the plan).

"(3) CERTAIN SECTIONS APPLY.—Section 401 (b), (c), and (h) shall apply to a qualified church plan.

"(4) FAILURE OF ONE ORGANIZATION MAINTAINING PLAN NOT TO DISQUALIFY PLAN.—If one or more organizations maintaining a church plan fail to satisfy the requirements of subsection (b), such plan shall not be treated as failing to satisfy the requirements of this section with respect to other organizations maintaining such plan.

"(5) CERTAIN EMPLOYEES NOT CONSIDERED HIGHLY COMPENSATED AND EXCLUDED EMPLOYEES.—For purposes of this section, no employee shall be considered an officer, person whose principal duties consist in supervising the work of other employees, or highly compensated employee if such employee during the year or the preceding year received compensation from the employer of less than $50,000. For purposes of this section, there shall be excluded from consideration employees described in section 410(b)(3)(A). The Secretary shall adjust the $50,000 amount under this paragraph at the same time and in the same manner as under section 415(d).

"(6) TIME FOR DETERMINATION OF APPLICABLE LAW.—Except where otherwise specified, the determination of whether a plan meets the requirements of subsection (b) shall be made in accordance with the provisions of this title as in effect immediately following enactment of the Revenue Reconciliation Act of 1995.".

(b) EFFECT ON EXISTING PLANS.—A church plan (within the meaning of section 414(e) of the Internal Revenue Code of 1986) which is otherwise subject to the applicable requirements of section 401(a) of such Code and which has not made the election provided by section 410(d) of such Code shall not be subject to section 401A of such Code, and shall remain subject to the applicable requirements of section 401(a) of such Code, unless the board of directors or trustees of an organization described in section 414(e)(3)(A) of such Code, or other appropriate governing body responsible for maintaining the plan, adopts a resolution under which the church plan is made subject to section 401A of such Code.

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by this section shall be effective for years beginning after December 31, 1994, except that the provisions of section 401A(b)(3) of the Internal Revenue Code of 1986 shall be effective for years beginning after December 31, 1996. No regulation or ruling under section 401(a) of such Code issued after December 31, 1994, shall apply to a qualified church plan described in section 401A of such Code unless such regulation or ruling is specifically made applicable by its terms to qualified church plans.

(2) PRIOR YEARS.—Nothing in the amendment made by this section shall be construed to infer that a church plan (within the meaning of section 414(e) of such Code) fails to satisfy the applicable requirements of section 401(a) of such Code for any year beginning prior to January 1, 1995.

SEC. 12952. RETIREMENT INCOME ACCOUNTS OF CHURCHES.

(a) IN GENERAL.—Section 403(b)(9) is amended to read as follows:

"(9) RETIREMENT INCOME ACCOUNTS PROVIDED BY CHURCHES, ETC.—

"(A) AMOUNTS PAID TREATED AS CONTRIBUTIONS.—For purposes of this title—

"(i) a retirement income account shall be treated as an annuity contract described in this subsection, and "(ii) amounts paid by an employer described in paragraph (1)(A) or by a church or a convention or association of churches, including an organization described in section 414(e)(3)(A) or 414(e)(3)(B)(ii), to a retirement income account shall be treated as amounts contributed by the employer for an annuity contract for the employee on whose behalf such account is maintained.

"(B) RETIREMENT INCOME ACCOUNT.—For purposes of this paragraph, the term 'retirement income account' means a program established or maintained by a church, a convention or association of churches, including an organization described in section 414(e)(3)(A), to provide benefits under this subsection for an employee described in paragraph (1) or an individual described in paragraph (13)(F), or their beneficiaries.".

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by this section shall be effective for years beginning after December 31, 1994.

(2) PRIOR YEARS.—Nothing in the amendment made by this section shall be construed to infer that a church plan (within the meaning of section 414(e)) fails to satisfy the applicable requirements of section 403(b) for any year beginning prior to January 1, 1995.

SEC. 12953. CONTRACTS PURCHASED BY A CHURCH.

(a) CLARIFICATION OF APPLICABLE NONDISCRIMINATION REQUIREMENTS.—Subparagraph (D) of section 403(b)(1) is amended to read as follows:

"(D) except in the case of a contract purchased by a church, such contract is purchased under a plan which meets the nondiscrimination requirements of paragraph (12)(A), and".

(b) CERTAIN COVERAGE RULES APPLY.—Subparagraph (B) of section 403(b)(12) is amended to read as follows:

"(B) CERTAIN REQUIREMENTS.—If a contract purchased by a church is purchased under a church plan (within the meaning of section 414(e)) by—

"(i) an organization described in section 170(b)(1)(A)(ii) above the secondary school level (other than a school for religious training), or

"(ii) an organization described in section 170(b)(1)(A)(iii)—

"(I) which provides community service for inpatient medical care of the sick or injured (including obstetrical care), and

"(II) no more than 50 percent of the total patient days of which during any year are customarily assignable to the categories of chronic convalescent and rest, drug and alcoholic, epileptic, mentally deficient, mental, nervous and mental, and tuberculosis, and care for the aged,

the plan meets the requirements of sections 401(a)(3) and 401(a)(6), as in effect on September 1, 1974, and sections 401(a)(4), 401(a)(5), 401(a)(17), and 401(m).

For purposes of this subparagraph, the plan administrator may elect to treat the portion of the plan maintained by any organization (or organizations) described in this subparagraph as a separate plan (or plans).".

(c) SPECIAL RULES FOR CHURCHES.—Section 403(b) is amended by adding at the end the following new paragraph:

"(13) DEFINITIONS AND SPECIAL RULES.—

"(A) CONTRACT PURCHASED BY A CHURCH.—For purposes of this subsection, the term 'contract purchased by a church' includes an annuity described in section 403(b)(1), a custodial account described in section 403(b)(7), and a retirement income account described in section 403(b)(9).

"(B) CHURCH.—For purposes of this subsection, the term 'church' means a church or a convention or association of churches, including an organization described in section 414(e)(3)(A) or section 414(e)(3)(B)(ii).

"(C) VESTING.—In the case of a contract purchased by a church under a church plan (within the meaning of section 414(e))—

"(i) sections 403(b)(1)(C) and 403(b)(6) shall not apply;

"(ii) such contract is not described in this subsection unless an employee's rights in the employee's accrued benefit under such contract which is attributable to contributions made pursuant to a salary reduction agreement are nonforfeitable; and

"(iii) such contract is not described in this subsection unless the plan satisfies the requirements of either of the following:

"(I) The plan provides that an employee who has at least 10 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

"(II) The plan provides that an employee who has completed at least 5 years of service has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions which percentage is not less than the percentage determined under the following table:

"Years of service	Nonforfeitable percentage
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100.

For purposes of clause (iii), an employee's years of service shall be determined in accordance with any reasonable method selected by the plan administrator.

"(D) FAILURE OF ONE ORGANIZATION MAINTAINING PLAN NOT TO DISQUALIFY PLAN.—In the case of a contract purchased by a church under a church plan (within the meaning of section 414(e)), if one or more organizations maintaining the church plan fails to satisfy the requirements of this section, such plan shall not be treated as failing to satisfy the requirements of this section with respect to other organizations maintaining such plan.

"(E) CERTAIN EMPLOYEES NOT CONSIDERED HIGHLY COMPENSATED AND EXCLUDED EMPLOYEES.—For purposes of this subsection, no employee for whom a contract is purchased by a church shall be considered an officer, person whose principal duties consist in supervising the work of other employees, or highly compensated employee if such employee during the year or the preceding year received compensation from the employer of less than $50,000. For purposes of this subsection, there shall be excluded employees described in section 410(b)(3)(A). The Secretary shall adjust the $50,000 amount under this subparagraph at the same time and in the same manner as under section 415(d).

"(F) CERTAIN MINISTERS MAY PARTICIPATE.—For purposes of this subsection—

"(i) IN GENERAL.—The term 'employee' shall include a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry who is a self-employed individual (within the meaning of section 401(c)(1)(B)) or any duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry who is employed by an organization other than an organization described in section 501(c)(3).

"(ii) TREATMENT AS EMPLOYER AND EMPLOYEE.—A self-employed minister described in clause (i) shall be treated as his or her own employer which is an organization described in section 501(c)(3) and which is exempt from tax under section 501(a). Such an employee who is employed by an organization other than an organization described in section 501(c)(3) shall be treated as employed by an organization described in section 501(c)(3) and which is exempt from tax under section 501(a).

"(iii) COMPENSATION.—In determining the compensation of a self-employed minister described in clause (i), the earned income (within the meaning of section 401(c)(2)) of such minister shall be substituted for 'the amount of compensation which is received from the employer' under paragraph (3).

In determining the years of service of a self-employed minister described in clause (i), the years (and portions of years) in which such minister was a self-employed individual (within the meaning of section 401(c)(1)(B)) shall be included for purposes of paragraph (4).

"(G) TIME FOR DETERMINATION OF APPLICABLE LAW.—Except where otherwise specified, the determination of whether a contract purchased by a church meets the requirements of this subsection shall be made in accordance with the provisions of this title as in effect immediately following enactment of the Revenue Reconciliation Act of 1993.".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall be effective for years beginning after December 31, 1994, except that the provisions of section 403(b)(13)(C)(iii) of the Internal Revenue Code of 1986 shall be effective for years beginning after December 31, 1996. No regulation or ruling issued under section 401(a) or 403(b) of such Code after December 31, 1994, shall apply to a contract purchased by a church unless such regulation or ruling is specifically made applicable by its terms to such contracts. For purposes of applying the exclusion allowance of section 403(b)(2) of such Code and the limitations of section 415 of such Code, any contribution made after December 31, 1996, which is forfeitable pursuant to section 403(b)(13)(C) of such Code shall be treated as an amount contributed to the contract in the year for which such contribution is made and not in the year the contribution becomes nonforfeitable.

(2) PRIOR YEARS.—Nothing in the amendments made by this section shall be construed to infer that a church plan (within the meaning of section 414(e) of such Code) fails to satisfy the applicable requirements of section 403(b) of such Code for any year beginning prior to January 1, 1995.

SEC. 12954. CHANGE IN DISTRIBUTION REQUIREMENT FOR RETIREMENT INCOME ACCOUNTS.

(a) IN GENERAL.—Subparagraph (A) of section 403(b)(11) is amended by inserting "or, in the case of a retirement income account described in paragraph (9), within the meaning of section 401(k)(2)" after "section 72(m)(7)".

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective for years beginning after December 31, 1994.

SEC. 12955. REQUIRED BEGINNING DATE FOR DISTRIBUTIONS UNDER CHURCH PLANS.

(a) IN GENERAL.—Subparagraph (C) of section 401(a)(9) is amended by striking the last sentence and inserting the following new sentence: "For purposes of this subparagraph, the term 'church plan' has the meaning given such term by section 414(e)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years after December 31, 1994.

SEC. 12956. PARTICIPATION OF MINISTERS IN CHURCH PLANS.

(a) IN GENERAL.—Section 414 is amended by adding the following new subsection:

"(u) SPECIAL RULES FOR MINISTERS.—Notwithstanding any other provision of this title, if a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry participates in a church plan (within the meaning of section 414(e)), then—

"(1) such minister shall be excluded from consideration for purposes of applying sections 401(a)(3), 401(a)(4), and 401(a)(5), as in effect on September 1, 1974, and sections 401(a)(4), 401(a)(5), 401(a)(26), 401(k)(3), 401(m), 403(b)(1)(D) (including section 403(b)(12)), and 410 to any stock bonus, pension, profit-sharing, or annuity plan (including an annuity described in section 403(b) or a retirement income account described in section 403(b)(9)) described in this part. For purposes of this part, the church plan in which such minister participates shall be treated as a plan or contract meeting the requirements of section 401(a), 401A, or 403(b) (including section 403(b)(9)) with respect to such minister's participation; and

"(2) such minister shall be excluded from consideration for purposes of applying an applicable section to any plan providing benefits described in an applicable section.

For purposes of paragraph (2), the term 'applicable section' means section 79(d), section 105(h), paragraphs (1), (2), and (3) of section 120(c), section 125(b), section 127(b)(2), and paragraphs (2), (3), and (8) of section 129(d).".

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective for years beginning after December 31, 1995.

SEC. 12957. CERTAIN RULES AGGREGATING EMPLOYEES NOT TO APPLY TO CHURCHES, ETC.

(a) IN GENERAL.—Section 414 is amended by adding at the end the following new subsection:

"(v) CERTAIN RULES AGGREGATING EMPLOYEES NOT TO APPLY TO CHURCHES, ETC.—

"(1) IN GENERAL.—If the election provided by paragraph (3) is made, for purposes of sections 401(a)(3), 401(a)(4), and 401(a)(5), as in effect on September 1, 1974, and sections 401(a)(4), 401(a)(5), 401(a)(17), 401(a)(26), 401(h), 401(m), 410(b), 411(d)(1), and 416, subsections (b), (c), (m), (o), and (t) of this section shall not apply to treat the employees of church-related organizations as employed by a single employer, except in the case of employees of church-related organizations which are not exempt from tax under section 501(a) and which have a common, immediate parent.

"(2) DEFINITION OF CHURCH-RELATED ORGANIZATION.—For purposes of this subsection, the term 'church-related organization' means a church or a convention or association of churches, an organization described in section 414(e)(3)(A), an organization described in section 414(e)(3)(B)(ii), or an organization the employees of which would be aggregated with the employees of such organizations but for the election provided by paragraph (3).

"(3) ELECTION TO DISAGGREGATE.—The provisions of this subsection shall apply if a church-related organization makes an election for itself and other church-related organizations (in such form and manner as the Secretary may by regulations prescribe) on or before the last day of the first plan year beginning on or after January 1, 1998.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 1994.

SEC. 12958. SELF-EMPLOYED MINISTERS TREATED AS EMPLOYEES FOR PURPOSES OF CERTAIN WELFARE BENEFIT PLANS AND RETIREMENT INCOME ACCOUNTS.

(a) IN GENERAL.—Section 7701(a)(20) is amended to read as follows:

"(20) EMPLOYEE.—For the purpose of applying the provisions of section 79 with respect to group-term life insurance purchased for employees, for the purpose of applying the provisions of sections 104, 105, and 106 with respect to accident or health insurance or accident or health plans, for the purpose of applying the provisions of section 101(b) with respect to employees' death benefits, for the purpose of applying the provisions of subtitle A with respect to contributions to or under a stock bonus, pension, profit-sharing, or annuity plan, and with respect to distributions under such a plan, or by a trust forming part of such a plan, and for purposes of applying section 125 with respect to cafeteria plans, the term 'employee' shall include a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry who is a self-employed individual (within the meaning of section 401(c)(1)(B)) or a full-time life insurance salesman who is considered an employee for the purpose of chapter 21, or in the case of services performed before January 1, 1951, who would be considered an employee if his services were performed during 1951.".

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective for years beginning after December 31, 1994.

SEC. 12959. DEDUCTIONS FOR CONTRIBUTIONS BY CERTAIN MINISTERS TO RETIREMENT INCOME ACCOUNTS.

(a) IN GENERAL.—Section 404(a) is amended by adding the following new paragraph:

"(10) CONTRIBUTIONS BY CERTAIN MINISTERS TO RETIREMENT INCOME ACCOUNTS.—If contributions are made by a minister described in section 403(b)(13)(F) to a retirement income account described in section 403(b)(9) and not by a person other than such minister, such contributions shall be treated as made to a trust which is exempt from tax under section 501(a) which is part of a plan which is described in section 401(a) and shall be deductible under this subsection to the extent such contributions do not exceed the exclusion allowance of such minister, determined under section 403(b)(2)."

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective for years beginning after December 31, 1994.

SEC. 12960. MODIFICATION FOR CHURCH PLANS OF RULES FOR PLANS MAINTAINED BY MORE THAN ONE EMPLOYER.

(a) IN GENERAL.—Section 413(c) is amended by adding at the end the following new paragraph:

"(8) CHURCH PLANS MAINTAINED BY MORE THAN ONE EMPLOYER.—A church plan (within the meaning of section 414(e)) maintained by more than one employer, and with respect to which the election provided by section 410(d) has not been made, which commingles assets solely for purposes of investment and pooling for mortality experience to provide to participants annuities computed with reference to the balance in the participants' accounts when such accounts become payable shall not be treated as a single plan maintained by more than one employer under this subsection. The rules provided by this paragraph shall apply for purposes of applying section 403(b)(12) to such church plan.".

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective for years beginning after December 31, 1994.

SEC. 12961. SECTION 457 NOT TO APPLY TO DEFERRED COMPENSATION OF A CHURCH.

(a) IN GENERAL.—Paragraph (13) of section 457(e) is amended to read as follows:

"(13) SPECIAL RULE FOR CHURCHES.—The term 'eligible employer' shall not include a church (within the meaning of section 401A(c)(1)).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1994.

SEC. 12962. CHURCH PLAN MODIFICATION TO SEPARATE ACCOUNT REQUIREMENT OF SECTION 401(h).

(a) EXCEPTION TO SEPARATE ACCOUNT REQUIREMENT.—Section 401(h) is amended by adding at the end the following new sentence: "Notwithstanding the preceding sentence, in the case of a pension or annuity plan that is a church plan (within the meaning of section 414(e)) which is maintained by more than one employer, paragraph (6) shall not apply to an employee who is a key employee for purposes of section 416 solely because such employee is described in section 416(i)(1)(A)(i) (relating to officers having an annual compensation greater than 150 percent of the amount in effect under section 415(c)(1)(A))."

(b) APPLICATION OF SECTION 415(l).—Section 415(l)(1) is amended to read as follows:

"(1) IN GENERAL.—For purposes of this section, the following shall be treated as an annual addition to a defined contribution plan for purposes of subsection (c):

"(A) Contributions allocated to any individual medical account which is part of a pension or annuity plan.

"(B) The actuarially determined amount of prefunding for the insurance value of benefits which are—

"(i) described in section 401(h);

"(ii) paid under a pension or annuity plan that is a church plan (within the meaning of section 414(e));

"(iii) paid under a plan maintained by more than one employer; and

"(iv) payable solely to an employee who is a key employee for purposes of section 415 solely because such employee is described in section 416(i)(1)(A)(i) (relating to officers having an annual compensation greater than 150 percent of the amount in effect under section 415(c)(1)(A)), his spouse, or his dependents.

Subparagraph (B) of section (c)(1) shall not apply to any amount treated as an annual addition under the preceding sentence.".

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 1994.

SEC. 12963. RULE RELATING TO INVESTMENT IN CONTRACT NOT TO APPLY TO FOREIGN MISSIONARIES.

(a) IN GENERAL.—The last sentence of section 72(f) is amended to read as follows: "The preceding sentence shall not apply to amounts which were contributed by the employer, as determined under regulations prescribed by the Secretary, to provide pension or annuity credits, to the extent such credits are attributable to services performed before January 1, 1963, and are provided pursuant to pension or annuity plan provisions in existence on March 12, 1962, and on that date applicable to such services, or to provide pension or annuity credits for foreign missionaries (within the meaning of section 403(b)(2)(D)(iii))."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1994.

SEC. 12964. REPEAL OF ELECTIVE DEFERRAL CATCH-UP LIMITATION FOR RETIREMENT INCOME ACCOUNTS.

(a) IN GENERAL.—Clause (iii) of section 402(g)(8)(A) is amended to read as follows:

"(iii) except in the case of elective deferrals under a retirement income account described in section 403(b)(9), the excess of $5,000 multiplied by the number of years of service of the employee with the qualified organization over the employer contributions described in paragraph (3) made by the organization on behalf of such employee for prior taxable years (determined in the manner prescribed by the Secretary).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 1994.

SEC. 12965. CHURCH PLANS MAY ANNUITIZE BENEFITS.

(a) IN GENERAL.—A retirement income account described in section 403(b)(9) of the Internal Revenue Code of 1986, a church plan (within the meaning of section 414(e) of such Code) that is a plan described in section 401(a) or 401A of such Code, or an account which consists of qualified voluntary employee contributions described in section 219(e)(2) of such Code (as in effect before the date of the enactment of the Tax Reform Act of 1986) and earnings thereon, shall not fail to be described in such sections merely because it pays benefits to participants (and their beneficiaries) from a pool of assets administered or funded by an organization described in section 414(e)(3)(A) of such Code, rather than through the purchase of annuities from an insurance company.

(b) EFFECTIVE DATE.—This provision shall be effective for years beginning after December 31, 1994.

SEC. 12966. CHURCH PLANS MAY INCREASE BENEFIT PAYMENTS.

(a) IN GENERAL.—A retirement income account described in section 403(b)(9) of the Internal Revenue Code of 1986, a church plan (within the meaning of section 414(e) of such Code) that is a plan described in section 401(a) or 401A of such Code, or an account which consists of qualified voluntary employee contributions described in section 219(e)(2) of such Code (as in effect before the date of the enactment of the Tax Reform Act of 1986) and earnings thereon, shall not fail to be described in such sections merely because it provides benefit payments to participants (and their beneficiaries)—

(1) to take into account the investment performance of the underlying assets or favorable interest or mortality experience, or

(2) that increase in an amount not in excess of 5 percent per year.

(b) EFFECTIVE DATE.—This provision shall be effective for years beginning after December 31, 1994.

SEC. 12967. RULES APPLICABLE TO SELF-INSURED MEDICAL REIMBURSEMENT PLANS NOT TO APPLY TO PLANS OF CHURCHES.

(a) IN GENERAL.—Section 105(h) is amended by adding at the end the following new paragraph:

"(11) PLANS OF CHURCHES.—This subsection shall not apply to a plan maintained by a church (within the meaning of section 401A(c)(1))."

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective for years beginning after December 31, 1994.

SEC. 12968. RETIREMENT BENEFITS OF MINISTERS NOT SUBJECT TO TAX ON NET EARNINGS FROM SELF-EMPLOYMENT.

(a) IN GENERAL.—Section 1402(a)(8) (defining net earning from self-employment) is amended by inserting ", but shall not include in such net earning from self-employment any retirement benefit received by such individual from a church plan (as defined in section 414(e))" before the semicolon at the end.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning before, on, or after December 31, 1994.

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