

CARILLON BELLS

DECEMBER 19 (legislative day, DECEMBER 15, 1979).—Ordered to be printed

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

REPORT

[To accompany H.R. 1212]

The Committee on Finance, to which was referred the bill (H.R. 1212) to provide for the duty-free entry of carillon bells for the University of Florida, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is shown in the text of the bill in italic.

House bill.—H.R. 1212, as it passed the House, provided for the duty-free entry of carillon bells for the University of Florida.

Committee bill.—The committee amendment deletes the provision relating to the duty-free entry of carillon bells, and adds provisions relating to (1) tax treatment of gain on the sale of U.S. real property by foreign investors, (2) reforestation tax incentives and trust fund, (3) transfer of proven oil and gas properties to a controlled corporation, (4) extension of time to amend charitable split-interest trusts, (5) payment of excise tax on fishing equipment, (6) alternate estate tax valuation, (7) distributions from money purchase pension plans, (8) cash and deferred plan rules and money purchase pension plans, (9) withholding tax on pensions of certain nonresident aliens, (10) voting rights pass through requirement for defined contribution plans, (11) employee stock ownership plans, and (12) cafeteria plans and deferred compensation.

CONTENTS

	Page
I. Summary-----	3
II. Explanation of the Bill-----	10
A. Tax treatment of gain on sale of U.S. real property by foreign investors-----	10
B. Tax incentives for reforestation expenses and reforestation trust fund-----	20
C. Employee stock ownership plans-----	25
1. Cash distribution option and put option for stock bonus plans-----	25
2. Availability of additional investment credit percentage for tax credit employee stock ownership plans of public utilities-----	25
3. Special limitation for employee stock ownership plans-----	26
4. Valuation of employer securities in tax credit employee stock ownership plans-----	27
5. Participation of subsidiary corporation in a tax credit employee stock ownership plan-----	27
6. Retirement savings by tax credit employee stock ownership plan participants-----	28
D. Transfers of proven oil and gas properties to a controlled corporation-----	30
E. Extension of time to amend governing instruments of charitable split-interest trusts-----	33
F. Change of time for paying excise tax on fishing equipment-----	35
G. Election of estate tax alternate valuation-----	37
H. Certain distributions from money purchase pension plans-----	39
I. Extension of cash and deferred plan rules to salary reduction arrangements under money purchase pension plans-----	41
J. Elimination of withholding tax on pensions paid to certain nonresident aliens-----	43
K. Voting rights pass through for defined contribution plans-----	45
L. Cafeteria plans permitted to provide deferred compensation under rules applicable to cash or deferred profit-sharing and stock bonus plans--	46
III. Effect of the Bill on the Budget and Vote of the Committee in Reporting the Bill as Amended-----	47
IV. Regulatory Impact of the Bill-----	49
V. Changes in Existing Law By the Bill as Reported-----	50

I. SUMMARY

As passed by the House, this bill would provide for the duty-free entry of carillon bells for the University of Florida. (The committee added the substance of the House-passed bill as an amendment to H.R. 3122.) In lieu of the House bill provision, the committee approved an amendment in the nature of a substitute with the following tax provisions.

Title I. Tax Treatment of Gain on Sale of U.S. Real Property by Foreign Investors

Under present law, capital gains realized by foreign investors on the sale of U.S. property are generally not subject to U.S. tax unless the property is held in connection with a U.S. trade or business.

The committee amendment would subject foreign investors to tax at a rate equal to one-third of the equivalent taxation on gains on the sale or other disposition of U.S. real property. (When added together to similar taxes imposed at a rate equal to one-third of the equivalent taxation under committee amendments to H.R. 2297 and H.R. 1319, the three provisions would subject foreign investors to the full tax on the sale or other disposition of U.S. real estate.) Foreign investors also would be taxed at this rate on gains realized through the sale or exchange of an interest in a corporation, trust, or partnership formed or availed of to hold U.S. real property interests. Reporting requirements would be established to identify when taxable transactions had occurred. The tax would be collected through withholding requirements and related enforcement provisions.

The provision would be effective for sales or other dispositions of U.S. real property interests occurring on or after January 1, 1980. However, to the extent that a provision conflicts with a U.S. treaty obligation, the provision would not take effect until after 1984.

Title II. Reforestation Tax Incentives and Trust Fund

Under present law, direct costs incurred in connection with reforestation of timberlands are treated as capital expenditures. Capitalized reforestation costs are not depreciable, but are recoverable through a depletion deduction when the timber is harvested. In addition, revenues from import duties on lumber and plywood are deposited in the general fund of the Treasury and are not dedicated for any particular purpose.

The committee amendment would allow the regular 10-percent investment credit and seven-year amortization for up to \$10,000 of forestation or reforestation expenditures by a private timber owner each year. In addition, the committee amendment would establish a trust fund for the reforestation of public lands, to be funded with up to \$30

million each year from existing tariff revenues from imported lumber and plywood.

The reforestation tax credit and amortization provisions would be effective for qualifying expenditures incurred after December 31, 1979, and the trust fund provisions would be effective for the period October 1, 1979, through September 30, 1985.

Title III. Employee Stock Ownership Plan Provisions

Sec. 301. Cash distribution option and put option for stock bonus plans

Tax-qualified stock bonus plans must generally distribute employer stock to participants entitled to a distribution. A tax credit employee stock ownership plan or an employee stock ownership plan which is a stock bonus plan, however, may distribute cash, subject to a participant's right to demand that benefits be distributed in the form of employer securities.

The committee amendment would provide that a qualified stock bonus plan may distribute cash to a participant entitled to a distribution, subject to the participant's right to demand that benefits be distributed in the form of stock. If a stock bonus plan provides for cash distributions and if stock which is distributed is not readily tradable on an established market, the participant would have the right to require the employer to repurchase the stock. This provision would be effective for plan years beginning after December 31, 1979.

Sec. 302. Availability of additional investment credit percentage for tax credit employee stock ownership plans of public utilities

Under present law, a corporation is allowed an additional investment tax credit of up to one and one-half percent if the corporation makes contributions in that amount to a tax credit employee stock ownership plan. However, the credit is not available to public utilities if the agencies which regulate them do not comply with the anti-flow through rules concerning the regular investment tax credit and the additional investment tax credit.

The committee amendment would allow a public utility the additional investment tax credit of up to one and one-half percent if the utility makes a contribution equal to the amount of additional investment tax credit to a tax credit employee stock ownership plan even if the utility is required to flow through the regular investment tax credit. Similarly, the regular credit would not be denied because the additional credit is required to be flowed through. This provision would be effective for taxable years beginning after December 31, 1979.

Sec. 303. Special limitation for employee stock ownership plans

Under present law, the dollar limitation on annual additions with respect to a participant in a tax credit employee stock ownership plan or in an employee stock ownership plan may be increased, provided certain requirements with respect to allocations of employer contributions are met. The amount of such increase is the lesser of (1) the usual limitation on annual additions to a participant's account, or (2) the amount of employer securities contributed to the plan.

The committee amendment would provide that the increase in the limitation on annual additions to a participant's account under a tax credit employee stock ownership plan or employee stock ownership plan would be the lesser of (1) the usual limitation on annual additions to a participant's account, or (2) the amount of employer securities (or cash used to acquire such securities) contributed to the plan. This provision would be effective for years beginning after December 31, 1979.

Sec. 304. Valuation of employer securities in tax credit employee stock ownership plans

Present law provides that the value of employer securities listed on a national exchange which are contributed to a tax credit employee stock ownership plan is the average of closing prices for such securities for the 20 consecutive trading days immediately preceding the due date for filing the employer's tax return for the year (including extensions).

The committee amendment would provide that the value of employer securities listed on a national exchange contributed to a tax credit employee stock ownership plan would be the average of the closing prices of such securities for the 20 consecutive trading days immediately preceding the date of contribution to the plan. This provision would be effective for taxable years beginning after December 31, 1979.

Sec. 305. Participation of subsidiary corporation in a tax credit employee stock ownership plan

Present law rules regarding tax credit employee stock ownership plans permit a 50-percent owned first-tier subsidiary of a parent corporation, and 80-percent owned second and lower-tier subsidiaries, to use the parent corporation's stock for their tax credit employee stock ownership plan contributions.

The committee amendment would provide that a corporation which is a second-tier subsidiary of a parent corporation and which is at least 50-percent owned by a first-tier subsidiary of a parent corporation may, if the parent corporation owns 100 percent of the first-tier subsidiary, use stock of the parent corporation in its tax credit employee stock ownership plan. This provision would be effective as if it had been included in section 141 of the Revenue Act of 1978.

Sec. 306. Retirement savings by tax credit employee stock ownership plan participants

Present law provides that an employee who is an active participant in a tax-qualified plan during a year is not eligible to make deductible contributions to an IRA (an individual retirement account, individual retirement annuity, or a retirement bond). An employer may allow an employee to elect not to participate in a tax credit employee stock ownership plan in order for the individual to establish an IRA, however, the plan is subject to certain minimum coverage requirements.

The committee amendment would provide that the minimum coverage requirements for tax credit employee stock ownership plans would be changed in the event that such a plan is the only tax-qualified plan maintained by an employer. If employees are permitted to elect out of such a tax credit employee stock ownership plan for the purpose of establishing IRAs, the tax credit employee stock ownership plan would

not fail to meet the minimum coverage requirements of the Code if the plan benefits at least 50 percent of all employees, and if the total allocations under the plan are equal to no more than two percent of the compensation of participating employees. This provision would be effective for plan years beginning after December 31, 1979.

Title IV. Other Tax Provisions

Sec. 401. Transfers of proven oil and gas properties to a controlled corporation

Under present law, independent producers and royalty owners are permitted to claim a deduction for percentage depletion with respect to a limited amount of production. Generally, the otherwise allowable percentage depletion deduction is denied with respect to post-1974 transfers of proven oil and gas properties. Such a transfer, however, generally does not preclude the deduction if the transferee and transferor must allocate one depletable quantity. Existing law contains no provision whereby an individual and his or her controlled corporation may allocate one depletable quantity in order to come within this exception.

The committee amendment would permit proven oil and gas properties to be transferred by an individual to his or her controlled corporation, without the loss of the percentage depletion deduction, if the depletable quantity must be allocated between the transferor and the corporation after the transfer. This provision generally would apply to production after December 31, 1979 from properties transferred after December 31, 1974.

Sec. 402. Extension of time to amend governing instruments of charitable split-interest trusts

The Tax Reform Act of 1969 imposed new requirements which must be satisfied by a charitable lead and remainder trusts in order for an income, gift, or estate tax deduction to be allowed for the transfer of an income interest or a remainder interest to charity. However, certain exceptions were provided in the case of wills executed, or property transferred in trust, on or before October 9, 1969, in order to allow a reasonable period of time to take the new rules into account.

The committee amendment would extend for two years, until December 31, 1980, the time to amend, or commence judicial proceedings to amend, instruments of both charitable lead trusts or charitable remainder trusts which were executed before December 31, 1977, in order to conform such instruments to the 1969 Act requirements for a charitable deduction to be allowed for income, gift, or estate tax purposes.

Sec. 403. Change of time for paying excise tax on fishing equipment

Present law imposes a 10-percent excise tax upon the sale of fishing rods, creels, reels and artificial lures, baits, and flies by a manufacturer, producer, or importer. Treasury Department regulations prescribe the time for paying the tax and generally require the tax to be deposited by the end of the month following the month in which the fishing equipment is sold.

The committee amendment would set the time for payment of the excise tax on fishing equipment according to the following schedule:

For articles sold during the quarter ending—

Payment of the tax is due by—

December 31-----	March 31.
March 31-----	June 30.
June 30-----	September 24.
September 30-----	According to Treasury Regulations.

(This provision is the same as section 7 of H.R. 5505 as passed the House.)

Sec. 404. Election of alternate estate tax valuation

Under present law, the executor of a decedent's estate may value the property in the gross estate as of the date of the decedent's death or the "alternate valuation date," generally 6 months after the date of the decedent's death. Alternate valuation must be elected by the executor on an estate tax return filed within 9 months of the date of death or any period of extension granted by the IRS.

The committee amendment would permit the election of alternate valuation on a timely filed estate tax return or the first late return filed. This provision would apply generally to estates of decedents dying after December 31, 1977. The amendment also includes a transitional rule applicable to estates of decedents dying before January 1, 1978.

Sec. 405. Certain distributions from money purchase pension plans

An employee (or spouse of an employee) who receives a lump sum distribution from a tax-qualified pension, profit-sharing, or stock bonus plan may defer tax on the distribution by rolling over the proceeds (net of any employee contributions) within 60 days of receipt (1) to an IRA (an individual retirement account, annuity, or bond), or (2) to another qualified pension, etc., plan. A lump sum distribution from a qualified plan is eligible for favorable income tax treatment (e.g., 10-year income-averaging) if no portion of the distribution is rolled over.

If an employer maintains more than one qualified plan of the same type, the plans are aggregated for the purpose of determining whether the entire balance due an employee has been distributed. Under the aggregation rules, all pension plans (defined benefit and money purchase) maintained by the employer are treated as a single plan, all profit-sharing plans maintained by the employer are treated as a single plan, and all stock bonus plans maintained by the employer are treated as a single plan.

The committee amendment would allow an employee (or spouse of an employee) who receives a total distribution from a money purchase pension plan to roll over the distribution to an IRA or to another qualified plan even though the employer also maintains a defined benefit pension plan covering the employee and a total distribution is not made from the defined benefit plan in the same taxable year. If the recipient rolls over a total distribution from a money purchase pen-

sion plan and, in a subsequent taxable year, receives a total distribution from a defined benefit pension plan maintained by the employer, the later plan distribution could be rolled over tax-free but would not otherwise be eligible for the favorable income tax treatment accorded lump sum distributions.

Generally, this provision would apply to taxable years beginning after December 31, 1978. A transitional rule for distributions received during 1979 and 1980 would also be provided.

Sec. 406. Extension of cash and deferred plan rules to salary reduction arrangements under money purchase pension plans

The Revenue Act of 1978 provided rules for new and old profit-sharing and stock bonus plans with cash and deferred arrangements. No rules were provided for or money purchase pension plans with salary reduction arrangements.

The committee amendment would provide that salary reduction arrangements under money purchase pension plans which were in existence on June 27, 1974, would be included under the 1978 Revenue Act rules applicable to cash-and-deferred arrangements under profit-sharing and stock bonus plans. However, the percentage-of-compensation contribution formula in money purchase pension plans in existence on June 27, 1974, may not be higher than it was on that date.

Sec. 407. Elimination of withholding tax on pensions paid to certain nonresident aliens

Under present law, a nonresident alien is not subject to U.S. tax on compensation for services performed outside the United States. A nonresident alien is, however, generally subject to a tax of 30 percent on investment income (interest, dividends, etc.) from U.S. sources. If a nonresident alien receives a pension in the form of an annuity from a qualified trust or under a qualified annuity plan, it would generally be subject to the 30-percent withholding tax on the portion of the annuity attributable to U.S. source investment income earned on the contributions while they were held by the trust, unless a statutory or treaty exemption applies. Currently, there is a statutory exemption from tax on a pension paid to a nonresident alien for services performed outside the United States, if, at the time the annuity payments begin, 90 percent or more of the employees for whom contributions or benefits are provided by the plan are citizens or residents of the United States. Also, a number of U.S. tax treaties provide reciprocally that pensions and annuities received by a resident of one country from sources in the other are taxable only by the country of residence.

The committee amendment would expand the statutory exemption from tax for pensions and annuities by making it available to an individual if (1) the recipient's country of residence grants a substantially equivalent exclusion to citizens and residents of the United States or (2) the recipient's country of residence is a "beneficiary developing country" under section 502 of the Trade Act of 1974. This provision would apply to amounts received after July 1, 1979.

Sec. 408. Voting rights pass through requirement for defined contribution plans

A tax-qualified defined contribution plan is required to pass through voting rights on employer securities to plan participants with respect to major corporate issues in certain circumstances. The vote pass-through applies if (1) the employer which established the plan does not have a class of publicly traded stock, (2) the plan acquired employer securities after December 31, 1979, and (3) after the acquisition of such securities, more than 10 percent of the plan's assets are invested in employer securities.

The committee amendment would repeal the provision of present law which, after December 31, 1979, would require certain defined contribution plans which hold more than 10 percent of their assets in employer securities to pass through voting rights to participants on major corporate issues. This provision would be effective for securities acquired after December 31, 1979.

Sec. 409. Cafeteria plans and deferred compensation

A cafeteria plan is an employee benefit plan under which a participant may choose between taxable benefits and one or more nontaxable fringe benefits. A cafeteria plan may not include deferred compensation.

The committee amendment would permit a cafeteria plan to include deferred compensation under the rules applicable to cash or deferred profit-sharing and stock bonus plans. This provision would be effective for taxable years beginning after December 31, 1979.

II. EXPLANATION OF THE BILL

A. Tax Treatment of Gain on Sale of U.S. Real Property by Foreign Investors

(Title I of the bill and New Secs. 897 and 1444 of the Code)

Present Law

General

Under the Code, nonresident aliens and foreign corporations engaged in a U.S. trade or business are generally taxed on the U.S. source income of that business in the same manner, and at the same rates, as U.S. persons. (However, their foreign source income not connected with that business is not taken into account in determining the applicable rates of U.S. tax.)

In contrast, the U.S. source income of a nonresident alien or foreign corporation which is not effectively connected with a U.S. business is generally subject to a different tax regime. The Code provides that a foreign individual or corporation is ordinarily subject to a 30-percent withholding tax on the *gross* amount of certain passive income such as rents, dividends, and interest, which is received from U.S. sources and is not effectively connected with a U.S. business. This withholding tax generally satisfies the taxpayer's U.S. income tax liability on the income. Capital gains not effectively connected with a U.S. business are not subject to any U.S. income tax, except in the limited situation of nonresident individuals who were present in the United States 183 days or more during the year, who are taxed at the flat rate of 30 percent on the gains.

Foreign investment in U.S. property

Whether a foreign investor in U.S. real property is engaged in a U.S. trade or business depends on all the facts and circumstances. For example, a foreign investor who enters into a single long-term net lease (under which the lessee is responsible for operation of the property and pays the expenses) probably would not be engaged in a U.S. trade or business, whereas a taxpayer who owns and manages a number of commercial buildings would be so engaged.

If a foreign taxpayer is not actually engaged in a U.S. trade or business, he is permitted under the Code to elect to be treated as if he were so engaged with respect to all his real property held for the production of income. This election is provided because rental income, unlike other types of passive income, ordinarily has associated with it significant expenses. Therefore, a tax equal to 30 percent of the gross rentals could frequently exceed the entire economic income from the property. If the election is made, the taxpayer may reduce his gross income from the real property by the deductible expenses, such as

depreciation, mortgage interest, and real property taxes. The taxpayer is then taxed on the net income at the graduated rates which generally apply to U.S. taxpayers rather than paying 30 percent on his gross rental income. Often, as a result of the election, the investor will pay no tax on the current income because depreciation, mortgage interest, real property taxes and other expenses exceed gross income. (This result would be the same if a U.S. person owned the property.) However, by making the election, the taxpayer will also subject himself to U.S. tax on any capital gains from the sale or exchange of the property. The election, once made, is binding on the taxpayer in all subsequent years unless consent to revoke it is obtained from the Internal Revenue Service.

Apart from the Code election, a number of planning techniques exist whereby a foreign investor may obtain the advantages of being taxed on current income from real property on a net basis. However, unlike the Code election, these techniques also offer the opportunity to avoid tax on the capital gain which would result on the sale of the property. Also, unlike the Code election, they may be employed on a property-by-property basis. For example, a foreign investor who is actually engaged in a U.S. real estate business will be taxed on current income from the property on a net basis (which might result in no current tax because of the allowable deductions). He may sell the property on the installment basis and receive most or all of the payments in years following the year of the sale. If he is not actually engaged in a U.S. trade or business in later years when the installment payments are received (and has not made the election to be treated as if he were), the gain would not be treated as effectively connected with a trade or business in the later years and would therefore go untaxed.

Secondly, a foreign investor could generally exchange his U.S. real property held for productive use or investment for other property of a like kind, whether within or without the U.S., without recognition of gain. If the property he acquired in the exchange were outside the U.S., the gain he would recognize on the ultimate sale of the property received in the exchange would not be subject to U.S. tax. This would be the case even if the investor were actually engaged in a U.S. trade or business or had made the election to be so treated.

A taxpayer may also obtain the benefits of current taxation on a net basis and exemption from tax on the gain by investing in U.S. real property indirectly through a foreign holding company which either is actually engaged in U.S. business or makes the election. The holding company would be subject to tax on the income it receives from the property, but, as noted earlier, often there would be no taxable income on a current basis. Moreover, the corporation often could reduce or eliminate its taxable income by paying deductible interest to its investors. Ordinarily, dividends and interest paid by a foreign corporation deriving most of its income from U.S. sources are subject to U.S. withholding taxes. However, these taxes are sometimes waived on a reciprocal basis under tax treaties between the United States and other countries. If the corporation is entitled to such a treaty benefit, income paid currently by the corporation would escape that U.S. tax. (Foreign investors frequently utilize U.S. treaties applicable to the Netherlands Antilles and British Virgin Islands because the

treaties contain the necessary waivers or reductions and because these jurisdictions impose low or no taxes on the income.)

The investors in the holding company could avoid U.S. tax on the gain from the sale of the property by either of two methods. First, if the corporation sells the property and follows a plan of liquidation meeting certain requirements, the corporation will not be taxable on the gain under a general rule of the Code which exempts liquidating corporations from tax on gains from the sale of property (sec. 337). Moreover, the shareholders and security holders will generally not be taxable when they exchange their stock and securities in liquidation for the proceeds of the sale of the real property because as foreign investors, they generally are not subject to U.S. capital gains tax. Even though the corporation is engaged in a U.S. trade or business, that business is not imputed to its investors. Since mere ownership or sale of stock is generally not a trade or business, the gains ordinarily would not be effectively connected with a U.S. business and thus would escape U.S. tax.

Second, if the investors instead sell their stock or securities, they would generally not be subject to tax on the gain for the same reasons that they would generally not recognize gain in a liquidation. Assuming that the sales price reflected the appreciated value of the real property, the purchaser of the corporation, even if a U.S. person, could then liquidate it without realizing a gain subject to U.S. tax because his basis in the stock for purposes of determining his gain on the liquidation would be his purchase price for the stock. He would also get a stepped-up basis for the real property equal to his purchase price for the stock.

Finally, some U.S. tax treaties (such as the treaties with the Netherlands Antilles and the British Virgin Islands) provide for a real property election similar to that in the Code, but the election may be made on a year-by-year basis. A foreign investor entitled to the benefits of such a treaty and not actually engaged in a U.S. business could use the treaty election to be taxed on a net basis in years prior to the year of sale. In the year of sale, the taxpayer would not make the treaty election and would not be taxed on the gain on the sale of the property because of the absence of a U.S. trade or business.

A number of U.S. tax treaties (not including, however, the protocols with the Netherlands Antilles or the British Virgin Islands) contain reciprocal provisions which prevent the United States from taxing certain types of U.S. source capital gains of foreign investors who are entitled to the treaty benefits. While these provisions reciprocally exempting capital gains generally do not apply with respect to real estate (that is, they do not restrict either country from taxing gains on sales of its real estate derived by residents of the other), they generally would apply with respect to stock in corporations formed or availed of to hold real estate. The Code provides that these treaty exemptions are to prevail if they require the exclusion from gross income of gains which the United States would otherwise tax (sec. 894(a); cf. also sec. 7852(d)).

Reasons for Change

The committee believes that it is essential to establish equity of tax treatment in U.S. real property between foreign and domestic invest-

ors. The committee does not intend by the provisions of this bill to impose a penalty on foreign investors or to discourage foreign investors from investing in the United States. However, the committee believes that the United States should not continue to provide an inducement through the tax laws for foreign investment in U.S. real property which affords the foreign investor a number of mechanisms to minimize or eliminate his tax on income from the property while at the same time effectively exempting him from U.S. tax on the gain realized on disposition of the property.

The committee further believes that the tax should generally be imposed at a flat rate of one-third of 28 percent, currently the maximum rate which a U.S. investor would pay on long-term capital gains. It is not appropriate to allow foreign investors to be taxed on part or all of the gain at the lower graduated rates at which a U.S. investor might pay tax because foreign investors generally are taxed only on their U.S. source income. Their foreign source income would not be taken into account in determining the rates at which the U.S. tax would be imposed. However, if because part or all of the gain is treated as ordinary income, tax at one-third of the amount of tax which would be imposed if the full amount of the gain were subject to tax at graduated rates would be higher than one-third of 28 percent, tax at the lower flat rate allowed for long-term capital gain would be inappropriate.

In order to impose a tax on gains from the sale of U.S. real estate, it is also necessary to impose a similar tax on gain from the disposition of interests in entities which hold substantial U.S. real property. Otherwise, a foreign investor could, as under present law, avoid tax on the gain by holding the real estate through a corporation, partnership, or trust and disposing of his interest in that entity rather than having the entity itself sell the real estate.

Finally, the committee believes that, to assure effective enforcement, it is necessary to provide for withholding of the tax by the purchaser. This withholding mechanism is similar in many respects to the withholding system now in effect for other types of investment income, such as interest and dividends, paid to foreign investors. However, to protect the U.S. purchaser from liability in cases of unintentional failure to withhold, the obligation only arises if he knows that the seller is a foreign investor or receives a notice to that effect. Moreover, to prevent interference with routine transactions, the withholding obligation will not apply in the case of certain sales of personal residences or the trading of stock in an established securities market.

Explanation of Provisions

General

Under the provision, foreign investors would be taxed on gains on the disposition of U.S. real property. Foreign investors would also be taxed on gains realized through the sale or exchange of an interest in a real property holding organization (RPHO). An RPHO generally is a closely held corporation, trust, or partnership at least half of the assets of which are U.S. real property interests. Reporting requirements would be established to identify when taxable transactions had occurred.

The tax would be collected through withholding requirements and related enforcement provisions. Foreign investors would be required

to notify purchasers of their U.S. real property interests of their status prior to the sale. Where such notice is given (or where the purchaser knows that the seller is a foreign person), the purchaser generally would be required to withhold the smallest of (a) one-third of 28 percent of the purchase price, (b) one-third of the tax on the seller's gain plus the full amount of any tax which was not paid on a previous sale of the property by a foreign person, or (c) the proceeds under his control. This withholding requirement could be waived (or reduced) if a certificate were obtained from the IRS indicating that no tax was due (e.g., there was no gain on the sale or adequate security had been provided to the IRS) or allowing withholding in a reduced amount.

No withholding would be required in the case of a sale of a single-family residence to be used as the purchaser's principal residence unless the gross sales price exceeded \$150,000. No withholding would be required in the case of RPHO stock sold on an established securities market.

Tax imposed on seller

Amount of tax

In the case of any nonresident alien individual or foreign corporation, the tax imposed by the provision for each taxable year generally is equal to one-third of 28 percent of the excess (if any) of (i) the amount of the gain realized by the taxpayer during the taxable year from the sale of U.S. real property interests, over (ii) the amount of the loss realized by the taxpayer during the taxable year from the sale of U.S. real property interests. However, no tax is due if the excess is \$5,000 or less. Gains of certain related parties are aggregated for purposes of the \$5,000 exception. In the case of an installment sale, the entire amount to be realized is taken into account in the year of the sale for purposes of one exception.

"U.S. real property interests" include both U.S. real property held directly and interests in U.S. real property holding organizations, as described below. The tax is imposed separately from, and in addition to, other U.S. taxes which may be imposed on the foreign investor's income. In order to prevent double taxation in the case of a sale of a U.S. real property interest which is effectively connected with a U.S. trade or business (or which the foreign investor has elected to have so treated), any gain or loss realized on the sale of a U.S. real property interest is not to be taken into account for purposes of applying the provisions governing effectively connected gains (secs. 871 and 882). However, in order to prevent a foreign investor from paying less tax than one-third of the amount that he would have been required to pay if the gain were treated as effectively connected with a U.S. trade or business, the tax imposed under the provision will be at least equal to one-third of the tax that would be paid if the income were effectively connected and subject to graduated tax rates (after allowance of the long-term capital gains deduction where it is appropriate).

For purposes of imposing the tax, any disposition of a U.S. real property interest will be treated as a sale. Moreover, because the tax is imposed on the amount realized, the tax is imposed without regard to any provisions of the Code providing for nonrecognition of realized income unless nonrecognition for purposes of this tax is provided for

by regulations. It is anticipated that, for example, if nonrecognition treatment is otherwise available, and if collection of the tax imposed by the provision would not be jeopardized, a foreign person would be permitted under the regulations to exchange one U.S. real property interest for another without recognition of gain and payment of the tax. The tax would not be payable on dispositions by gift or inheritance because there is no amount realized.

The tax is imposed on the beneficial owner of the property, rather than the nominee, trustee, executor, etc., who holds record title. However, the record title holder may be a "seller's agent" under the withholding provisions (discussed below).

Direct interest in U.S. real property

The tax is imposed on gains from the sale of interests in real property (including an interest in a mine, well, or other natural deposit) located in the United States. The term "interest in real property" includes fee ownership and co-ownership of land or improvements, easements, and options to acquire leaseholds of land or improvements. Such an interest would, for example, include a mineral royalty. Moreover, the term includes partial interests such as life estates, remainders, reversions, and rights of refusal in real property. Movable walls, furnishings, and other similar personal property associated with the use of real property are considered real property for purposes of the bill.

U.S. real property holding organizations

Also included in the definition of U.S. real property interests are certain holdings in a U.S. real property holding organization (RPHO). Thus, gain on the sale of such holdings would be subject to the tax.

Generally, the holdings subject to the tax are stock in a corporation, or an interest (other than solely as a creditor) in a partnership or trust, which, during the shorter of the period during which the taxpayer held his interest or the 5 years preceding his sale of the interest, is or was an RPHO. However, the interest would not be a U.S. real property interest if the RPHO recognized gain on all its U.S. real property interests prior to sale of the interest in the RPHO. Since convertible debt of an RPHO is an interest in an RPHO other than solely as a creditor, such convertible debt would be a U.S. real property interest.

An RPHO is a corporation, partnership, or trust, whether domestic or foreign, if at any time during the taxable year, (i) a controlling interest in the organization is owned by or for not more than 10 persons, and (ii) U.S. real property interests constituted at least 50 percent of the assets of the organization. For purposes of 10-owner rule, if the organization cannot identify holders of interests (e.g., bearer shares), it is intended that the unidentified interests will be presumed to be held by one person unless shown otherwise. In addition, to the extent that their effect is to make an organization an RPHO, attribution rules similar to those applied to ownership of personal holding companies will be applied under regulations. A "controlling interest" is, in the case of a corporation, 50 percent or more of the total combined voting power of all classes of stock or 50 percent or more of the fair

market value of all classes of stock; in the case of a partnership, 50 percent or more of the capital or profits interest; and, in the case of a trust, 50 percent or more of the beneficial interests (actuarially determined). For purposes of applying the assets test, cash, certain savings deposits, marketable securities, accounts or notes receivable, or other assets which are readily marketable, in excess of a reasonable amount of working capital, are not counted. This rule is intended to prevent the investors in an RPHO from converting it into a non-RPHO merely by infusing liquid assets.

The Treasury Department is to prescribe regulations setting forth "look through" rules under which, if a person controls an entity, that person is deemed to own directly a pro rata share of the assets of the entity.

Tax withheld by purchaser

Requirement of withholding

To enforce the provision, withholding obligations are imposed on purchasers of a United States real property interest (and certain other persons involved in the transactions) who know or receive a notice (described below) that the seller is foreign. As discussed below, in certain situations a withholding obligation is also imposed on certain other persons involved in the disposition of a U.S. real property interest. The purchaser or other withholding agent is to deduct and withhold a tax equal to the smallest of (i) one-third of 28 percent of the amount realized on the disposition, (ii) the "seller's maximum tax liability" (discussed below), or (iii) the fair market value of that portion of the sale proceeds which is within the withholder's control. The "seller's maximum tax liability" is the maximum amount which the Treasury determines that the seller could owe as his tax under the provision as a result of the disposition of a United States real property interest plus any unsatisfied prior withholding tax liabilities of foreign persons under the provision with respect to that interest. Thus, for example, if a U.S. person sells a U.S. real property interest to a foreign investor for \$1 million, if that foreign investor sells the property for \$1.5 million to a second foreign investor and no tax under this provision is paid, and if that second foreign investor in turn sells the property to a third foreign investor for \$2 million and again no tax is paid, the unsatisfied prior withholding liability on the subsequent sale of the property by the third foreign investor would be one-third of \$280,000 (assuming the gain of the first two foreign investors is long-term capital gain)—the sum of the unsatisfied withholding tax liabilities of the second and third foreign investors (which would be the amount of the maximum tax liabilities of the previous holders). Therefore, if the third investor sold the property for \$2.5 million, his "maximum tax liability" would be one-third of \$420,000—one-third of the sum of his \$280,000 unsatisfied prior withholding liability plus the \$140,000 tax due by reason of his disposition.

The limitation to the value of the proceeds in the withholder's control limits the amount of withholding in sales where part of the consideration is the assumption of a mortgage or where payments are to be made in installments. If the amount withheld exceeds the seller's liability for failure to withhold on a prior transaction and for gain

on the sale, the excess is refundable to the seller. The purchaser is indemnified against any claims by the seller if he withholds the lesser of one-third of 28 percent of the amount realized or the amount set forth in a "qualifying statement" (discussed below) from the IRS. If a purchaser fails to withhold when he had a duty to do so, he is relieved of liability to the extent that the tax is paid by the seller or some other person.

A person receiving a U.S. real property interest from a foreign person in an exchange is considered to be the purchaser of the interest for purposes of this provision and is required to withhold the appropriate amount of tax from the property transferred to the foreign person in the exchange. Thus, for example, in the case of a liquidation of an RPHO, the liquidating corporation is treated as the purchaser of stock exchanged by foreign shareholders for the liquidating distribution and is required to withhold from the liquidating distribution.

Where there are multiple sellers, the withholding rules apply to the portion of the proceeds which reflect the interests of sellers who are foreign persons. Where there are multiple purchasers, the withholding liability of each is limited, as described above, to the proceeds under his control.

Knowledge or notice requirement

The withholding requirement is not to apply to a purchaser of a United States real property interest unless, as of the time for settling the transaction, he knows that the seller is a foreign person or has received a notice from the seller or the seller's agent that the seller is a foreign person. However, if after the time for settling the transaction, the purchaser has any portion of the sale proceeds under his control and, immediately before the purchaser pays any of those proceeds to the seller, he knows or receives notice from the seller or the seller's agent that the seller is a foreign person, then the purchaser will be required to withhold with respect to the later payment.

The seller is required to notify the purchaser that the seller is a foreign person. The seller's agent (which can be the seller's nominee, broker, settlement attorney or any person holding any of the sale proceeds) is also required to notify the purchaser that the seller is a foreign person if, as of the time for settling the transaction, the agent has reason to believe that the seller may be a foreign person. The notice requirement for both the seller and his agents will be satisfied if at least one party gives the purchaser the required notice.

Other withholding agents

A domestic partnership, the trustee of a domestic trust, or the executor of a domestic estate will be required to deduct and withhold from distributions to foreign partners or beneficiaries to the extent that the distributions are attributable to the sale of a U.S. real property interest.

Failure to give notice

If a seller's agent is required to notify the purchaser of a U.S. real property interest that the seller is a foreign person and fails to give the notice, the agent is liable for the amount of the unpaid tax which the purchaser would have been required to withhold if the agent had given the purchaser the required notice. As in the case of

other withholders under this provision, the liability of the seller's agent is limited to the proceeds under his control. For this purpose, however, compensation received by the agent in connection with the transaction is treated as proceeds under his control. A seller's agent who fails to make reasonable inquiry is treated as required to give notice.

Exemptions from and reductions of withholding

A purchaser will not be required to withhold if: (i) the seller furnishes a "qualifying statement" (described below) to the person required to withhold, (ii) the property being sold is a single family residence which is to be used by the purchaser as his principal residence and the amount realized by the seller on the sale is \$150,000 or less, or (iii) the property being sold is stock of a corporation and the sales transaction takes place on an established securities market. For this purpose, "established securities market" would generally include those included for purposes of section 453(b)(3) and also any comparable foreign securities market. It would not include negotiated transactions. A "qualifying statement" is a statement by the Treasury that the seller either (i) has reached agreement with the Treasury on the payment of the tax imposed by section 897 and has satisfied or provided adequate security for unsatisfied prior tax liabilities under section 897, or, (ii) is exempt from tax imposed by section 897 and has satisfied or provided adequate security for unsatisfied prior tax liabilities under section 897. The Treasury may prescribe a reduced amount to be withheld if the Treasury upon request by the purchaser or the seller, determines that such reduced amount will not jeopardize the collection of the withholding tax or the tax under section 897.

Related legislation

The committee intends that the taxes imposed under similar provisions of H.R. 1319 and H.R. 1212 are to be paid in addition to the taxes imposed under this provision.

Reporting requirements

Requirement to file a return

If, at any time during a calendar year, (i) a corporation, partnership, or trust has United States real property interests which constitute more than 40 percent of the fair market value of its assets, (ii) 10 or fewer persons have a controlling interest (other than solely as a creditor) in the entity, and (iii) at least one foreign person has an interest (other than solely as a creditor) in the entity, the entity is required to file an information return for the year. The return is to set forth the following information: (i) the name and address of any person who held an interest (other than solely as a creditor) in the entity at any time during the calendar year, (ii) the composition of the assets of the entity at such time or times during the calendar year as the Treasury may prescribe by regulations, (iii) any information with respect to transfers during the calendar year of interests in the entity at any time during the calendar year, (iv) whether such entity is a United States RPHO at any time during the calendar year, and (v) any other information which the Treasury may prescribe by regulations.

In addition to the information return, the reporting entity is also required to furnish a written statement to every person who held an interest (other than solely as a creditor) in the entity during the calendar year setting forth the name and address of the entity making the return, whether the entity is a United States RPHO at any time during the calendar year and any other information that the Treasury may prescribe through regulations. The return will be furnished to the person having the interest no later than January 31 of the year following the year for which the return was made.

Failure to make a return or furnish a statement

A penalty for failure to file a tax return or to furnish a statement will be imposed in an amount equal to the greater of (i) \$25 for each day during which such failure continues but not to exceed \$25,000, or (ii) the amount of the tax imposed by section 897 which is not paid and which is attributable to transfers (other than those made in an established securities market) occurring during the calendar year for which the return or statement was required. However, if it is shown that the failure to file the return or to furnish the notice is due to reasonable cause and not to willful neglect, no penalty will be imposed.

Miscellaneous amendments

Source of income.—Income from the disposition of a United States real property interest will be United States source income.

Examination of taxpayer.—Section 7605(b) will not apply to an inspection of a taxpayer's books of account for purposes of sections 897 or 1444.

Effective date

The amendments made by the provision will generally apply to dispositions after December 31, 1979. However, for a 5-year period, gain will not be taxed to the extent required by treaty obligations of the United States. After that 5-year period for the renegotiation of conflicting treaty provisions (i.e., after December 31, 1984), the provision will prevail over any conflicting treaty provisions remaining in effect.

Revenue effect

It is estimated that this provision will increase budget receipts by \$25 million in fiscal year 1980, \$35 million in 1981, \$39 million in 1982, \$43 million in 1983 and \$47 million in fiscal year 1984.

B. Tax Incentives for Reforestation and Reforestation Trust Fund

(Title II of the bill and secs. 48, 63, 193, and 1245 of the Code)

Present law

Reforestation expenditures

Under present law, direct costs incurred in connection with reforestation of timberlands are treated as capital expenditures. (Treas. Regs. § 1.611-3(a)). Reforestation costs for this purpose are those for site preparation (including girdling, herbicide applications, baiting of rodents, and bush removal), seed or seedlings, plus labor and tool expenses incident to planting or seeding. Depreciation on tractors, trucks and other equipment used in these activities must also be capitalized as a reforestation cost.¹

These capitalized reforestation costs may not be depreciated but are recovered through a depletion deduction when the timber is harvested fifteen or more years later.

If a private owner of timberland receives funds from the Federal Government or State government under certain reforestation cost sharing programs, these funds are not included in income. In addition, the private owner of timberlands does not receive any depletion, depreciation or other deduction for his reforestation costs paid with these cost-sharing funds, and the owner's basis in the property does not reflect the amount of these payments.² These rules apply for grants made after September 30, 1979.

Where additional costs are incurred for clearing brush and unwanted trees after the planting or seeding of timberlands, these costs are currently deductible because they are in the nature of maintenance charges.³

Import duties on lumber and plywood

Under present law, revenues from import duties on lumber and plywood are deposited in the general funds of the U.S. Treasury and are not dedicated for any particular purpose.

Reasons for change

The committee considers an adequate domestic supply of timber to be important to economic stability and is concerned that recent in-

¹ Rev. Rul. 75-467, 1975-2 C. B. 93.

² These rules, found in sections 126 and 1255 of the Code, were enacted under section 543 of the Revenue Act of 1978 (P.L. 95-800).

³ Rev. Rul. 66-18, 1966-1 C. B. 59, indicates that such expenses are currently deductible. This ruling was modified by Rev. Rul. 71-228, 1971-1 C. B. 53, to indicate that costs of annual shearing of Christmas trees are also currently deductible. This latter ruling also follows the decision in *Daniel D. Kinley*, 51 T.C. 1002 (1969), *aff'd per curiam*, 70-2 USTC ¶ 9462 (2d Cir. 1970), acq. 1971-2 Cum. Bull. 3.) See also, *Ransburg v. United States*, 281 F. Supp 324 (S.D. Ind. 1967) (current deduction for weed, brush and insect control expenses conceded by United States; the court also allowed a current deduction of expenses for annual shearing of Christmas trees).

activity (particularly by owners of small acreages of timberland) in planting or seeding trees will have a significant adverse effect on the timber supply over the long-term. This inactivity is considered to be at least partially attributable to present tax rules, under which a private timber property owner is allowed no recovery of reforestation costs until 15–30 years later when the timber is harvested. In addition, there is concern that insufficient financial support has been provided for reforestation of public lands. The committee consequently believes that additional Federal incentives are necessary in order to prevent a long-term shortfall in the timber supply.

Explanation of provision

The bill provides several Federal initiatives to promote reforestation on both private and public timberlands. Reforestation of private lands is encouraged through providing seven-year amortization and the 10-percent regular investment credit for a limited amount of qualifying reforestation expenditures each year. In addition, a trust fund is established to fund reforestation activities in order to eliminate a replanting backlog in the National Forest System.

Tax incentives for reforestation

Seven-year amortization

Under the bill, a taxpayer may elect to amortize, over a seven-year period, up to \$10,000 of qualifying reforestation expenditures incurred during a taxable year in connection with qualified timber property. Amortization deductions claimed under this provision would be allowed as “above the line” deductions, that is, deductions in computing adjusted gross income, so that this limited amortization provision is equally available to small timberland owners regardless of whether they itemize deductions for income tax purposes.

A taxpayer may elect seven-year (84-month) amortization on up to \$10,000 of qualifying reforestation expenditures each year. The election is to be made annually on a property-by-property basis. However, the maximum amount of qualifying reforestation or reforestation expenditures paid or incurred during a taxable year which may be amortized is \$10,000 for all of the taxpayer’s timber properties, and there is no carryover of excess expenditures to subsequent years. If a taxpayer incurs more than \$10,000 in qualifying costs in connection with more than one qualified timber property during a taxable year and elects to amortize the costs attributable to these properties, the Secretary is delegated authority to prescribe regulations concerning the allocation of this amortizable basis among these timber properties.

A mandatory half-year convention is provided, under which it is required that the amortization period begins on the first day of the first month of the last half of the taxable year during which the reforestation costs were incurred. (For example, the amortization period begins on July 1 for a taxpayer who uses a calendar year for tax purposes, regardless of whether the reforestation expenditures were incurred in January or December of that year.) The maximum annual amortization deduction for qualifying expenditures incurred in any taxable year is \$1,428.57 ($\$10,000 \div 7$) and total deductions for any one year under this provision will reach \$10,000 only if a taxpayer incurs and elects to amortize the maximum \$10,000 of expenditures

each year over an 8-year period. (The full \$10,000 deduction would be reached in the eighth year.)

In order to be eligible for this elective amortization treatment, qualifying reforestation expenditures must be incurred in connection with a qualifying timber property. A qualifying timber property is defined as property held for purposes of the commercial production of timber in order to exclude, for example, shelter belts (for which current deductions are allowed under Code section 175) and ornamental trees.

Qualifying reforestation expenditures are direct costs incurred to plant or seed for forestation or reforestation purposes, including costs for site preparation, seed or seedlings, labor and tool costs (including depreciation on equipment used for this purpose), and site maintenance expenditures. Reforestation expenditures for this purpose exclude costs for which the taxpayer has been reimbursed under a governmental cost-sharing program, unless the amounts reimbursed have been included in the taxpayer's gross income. In addition, the definition of qualifying reforestation expenditures includes only those costs which must be capitalized and become part of the amortizable basis of the property and excludes costs which are currently deductible.

Rules are also provided concerning the general application of this amortization election. For example, it is provided that a life tenant is entitled to the benefit of this amortization provision on qualifying costs incurred by him and any remainder interest in the property is to be ignored for this purpose. Amortization deductions claimed under this provision will be subject to recapture as ordinary income (to the extent of gain) under Code section 1245 where there is a disposition of the timber property to which the amortizable basis (and the amortization deductions) are attributable within ten taxable years from the year in which the amortizable basis was created.

The annual limitation on the dollar amount of expenditures which can be amortized by a taxpayer is intended to insure that these provisions allow only a limited dollar benefit to any enterprise regardless of size. Consequently, where qualifying costs are incurred by a corporation which is a component member of a controlled group of corporations, the \$10,000 maximum limitation on costs eligible for amortization applies to the entire controlled group of corporations, and the Secretary is authorized to prescribe regulations concerning allocation of the limitation among members of the controlled group. In determining whether a group of corporations is a controlled group of corporations for purposes of this provision, the standard of control or ownership by the common parent corporation is "at least 50 percent." (This is the same standard as is provided under Code section 179, relating to additional first-year depreciation.)

In applying the \$10,000 limitation to partnerships, the dollar limitation is first applied at the partnership level, and then is applied to each partner. Thus, if an individual is a member of a partnership which owns qualified timber property and also owns qualified timber property directly, the maximum amount of amortizable basis acquired during any taxable year on which he can obtain amortization is \$10,000.⁴

⁴ The partnership rule is also the same as the rule applicable under Code section 179. As under section 179, this provision is inapplicable to trusts.

Investment tax credit

The bill also would allow the 10-percent regular investment tax credit on reforestation costs eligible for the amortization election, regardless of whether amortization treatment is elected for these costs. However, the same annual limitation applies so that the amount of qualifying costs eligible for the credit is limited to \$10,000 each taxable year, and there is no carryover excess qualifying costs to subsequent years.

The credit also would not be allowed on qualifying reforestation costs attributable to the capitalization of depreciation on property which already qualifies for the regular investment credit.⁵ For example, no investment credit would be allowed for reforestation costs attributable to depreciation on equipment which itself qualifies for the investment credit.

In applying these rules, the reduction in basis for depreciation sustained with respect to other property used in the reforestation process shall be applied prior to the application of the \$10,000 limitation on eligible costs. Thus, for example, if in a taxable year a taxpayer pays or incurs \$12,000 of qualifying reforestation costs with respect to properties for which an election is in effect and \$2,000 of such costs are attributable to depreciation of the taxpayer's equipment, such \$12,000 would first be reduced by the \$2,000 of depreciation, and the \$10,000 limitation would be applied following such reduction.

Reforestation trust fund

In addition, the bill would establish a reforestation trust fund, the proceeds of which would be used to supplement congressional appropriations for reforestation and timber stock improvement on publicly owned national forests. Funding for this trust fund would come from import duties on plywood and lumber, from which appropriations to the trust fund would be authorized in a maximum amount of \$30 million each year for a six-year period from October 1, 1979, through September 30, 1985.

Proceeds of the trust fund could be used by the Secretary of Agriculture, in amounts up to \$30 million per year, to meet obligations incurred in eliminating and preventing a backlog in reforestation of the National Forest System, including administrative costs of such programs. However, trust fund proceeds could be used only to the extent that these obligations exceed amounts appropriated from general funds for these purposes.

The Secretary of the Treasury would be authorized to invest trust fund proceeds, in excess of amounts needed for current withdrawals, in interest-bearing obligations of the United States or guaranteed by the United States. At the termination of the trust fund on September 30, 1985, unexpended amounts, including interest earned on invested proceeds, would be returned to the general fund of the Treasury.

⁵ This reflects the existing rule relating to qualified investment in new self-constructed property. Under this rule, the taxpayer is required to reduce the basis of self-constructed property by "any depreciation sustained with respect to any other property used in the construction, reconstruction, or erection" for purposes of the investment credit (Treas. Reg. § 1.46-3(c)(1)).

Effective date

The amortization election and investment credit for certain reforestation expenditures would apply to qualifying reforestation expenditures incurred after December 31, 1979. The trust fund provisions would apply for the period from October 1, 1979, through September 30, 1985.

Revenue effect

It is estimated that the amortization and investment credit provisions for certain reforestation expenses will reduce budget receipts by \$2 million in fiscal year 1980, \$4 million in fiscal year 1981, \$5 million in fiscal year 1982, \$7 million in fiscal year 1983, and \$8 million in fiscal year 1984.

C. Employee Stock Ownership Plans

(Title III of the Bill)

1. Cash distribution option and put option for stock bonus plans (sec. 301 of the bill and new sec. 401(a)(22) of the Code)

Present law

Under present law, tax-qualified stock bonus plans must generally distribute stock to participants entitled to a distribution. However, a stock bonus plan which is either a tax credit employee stock ownership plan or an employee stock ownership plan may distribute cash, subject to a participant's right to demand that benefits be distributed in the form of employer securities.

Reason for change

The committee believes that a tax-qualified stock bonus plan generally should be eligible for the same rules with respect to cash and stock distributions to participants which govern tax credit employee stock ownership plans and employee stock ownership plans.

Explanation of provision

The provision would permit a tax-qualified stock bonus plan to distribute cash to a participant entitled to a distribution, subject to the participant's right to demand that benefits be distributed in the form of employer stock. If a stock bonus plan provides for cash distributions and if stock which is distributed is not readily tradable on an established market, the participant would have to have the right to require the employer to repurchase the stock.

Effective date

The provision would be effective for plan years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision will not have any revenue effect.

2. Availability of additional investment credit percentage for tax credit employee stock ownership plans of public utilities (sec. 302 of the bill and sec. 46(f) of the Code)

Present law

Under present law, a corporation is allowed an additional investment tax credit of up to one and one-half percent if the corporation makes contributions in that amount to a tax credit employee stock ownership plan. However, the credit is not available to public utilities if the agencies which regulate them require flow-through of the regular investment tax credit to consumers.

Reason for change

The committee has determined that the one and one-half percent additional investment tax credit should be available to a public utility for a contribution to a tax credit employee stock ownership plan if the additional credit is not required to be flowed-through, regardless of whether the public utility is required to flow through to consumers the regular investment tax credit. Similarly, the committee believes that the regular credit should not be denied merely because the additional credit is required to be flowed through.

Explanation of provision

Under the provision, if an agency regulating a public utility requires flow-through of the regular investment tax credit by a public utility the utility may, nonetheless, be eligible for the additional one and one-half percent investment tax credit for certain contributions to a tax credit employee stock ownership plan, provided that the additional one and one-half percent investment tax credit is not required to be flowed through to consumers. The committee amendment would also provide that if a utility is required to flow through the additional investment tax credit but is not required to flow through the regular investment tax credit, the regular credit will not be denied.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision will not have any revenue effect.

3. Special limitation for tax credit employee stock ownership plans and employee stock ownership plans (sec. 303 of the bill and sec. 415(c)(6)(A) of the Code)

Present law

Under present law, the dollar limitation on annual additions with respect to a participant in a tax credit employee stock ownership plan or an employee stock ownership plan may be increased, provided certain requirements with respect to allocations of employer contributions are met. The amount of such increase is the lesser of (1) the usual dollar limitation on annual additions to a participant's account or (2) the amount of employer securities contributed to the plan.

Reason for change

The committee believes that a clarifying change to the rule of present law which allows an increase in the limitation on contributions with respect to a participant in a tax credit employee stock ownership plan or an employee stock ownership plan is needed to make it clear that cash used to purchase employer securities is included for purposes of determining the limitation on annual additions to a participant's account.

Explanation of provision

Under the provision, the increase in the dollar limitation on annual additions with respect to a participant in a tax credit employee stock

ownership plan or an employee stock ownership plan (provided certain requirements are met with respect to allocations under the plan) would be the lesser of (1) the usual dollar limitation on annual additions to a participant's account, or (2) the amount of employer securities (or cash used to acquire such securities) contributed to the plan).

Effective date

The provision would be effective for years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision will not have any revenue effect.

4. Valuation of employer securities in tax credit employee stock ownership plans (sec. 304 of the bill and sec. 48(n)(B)(i) of the Code)

Present law

Under present law, the value of employer securities listed on a national exchange which are contributed to a tax credit employee stock ownership plan is the average of closing prices for such securities for the 20 consecutive trading days immediately preceding the due date for filing the employer's tax return for the year (including extensions).

Reason for change

The provision of present law for valuing readily tradable employer securities contributed to a tax credit employee stock ownership plan causes employers to postpone contributions of employer securities to a tax credit employee stock ownership plan until the due date for filing the employer's tax return.

Explanation of provision

Under the bill, the value of employer securities listed on a national exchange contributed to a tax credit employee stock ownership plan would be the average of the closing prices of such securities for the 20 consecutive trading days immediately preceding the date of contribution to the plan.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision will not have any revenue effect.

5. Participation of subsidiary corporation in a tax credit employee stock ownership plan (sec. 305 of the bill and sec. 409A (1)(4) of the Code)

Present law

The present-law rules governing tax credit employee stock ownership plans permit a 50-percent owned first-tier subsidiary of a parent corporation, and 80-percent owned second and lower-tier subsidiaries, to contribute employer securities of the parent corporation to a tax credit employee stock ownership plan.

Reasons for change

If a first-tier subsidiary corporation owns 50 percent of a second-tier subsidiary and the first-tier subsidiary is 100-percent owned by the parent corporation, the committee has determined that sufficient control of the second-tier subsidiary by the parent corporation exists to permit the second-tier subsidiary to contribute employer securities of the parent to a tax credit employee stock ownership plan.

Explanation of provision

Under the provision, if a parent corporation owns 100 percent of a first-tier subsidiary and the first-tier subsidiary owns 50 percent of a second-tier subsidiary, the second-tier subsidiary is allowed to contribute employer securities of the parent corporation to its tax credit employee stock ownership plan. In addition, parent stock could be contributed by 80-percent owned lower-tier subsidiaries in this chain.

Effective date

The provision would be effective as if it had been included in section 141 of the Revenue Act of 1978.

Revenue effect

It is estimated that this provision will not have any revenue effect.

6. Retirement savings by tax credit employee stock ownership plan participants (sec. 306 of the bill and sec. 410(b)(1) of the Code)

Present law

Under present law, an employee who is an active participant in a tax-qualified plan during a year is not eligible to make deductible contributions to an IRA (individual retirement account, individual retirement annuity, or retirement bond). Therefore, if an employee is an active participant in a tax-qualified tax credit employee stock ownership plan during a year such employee is ineligible for an IRA. A plan can allow an employee to elect not to participate in a tax credit employee stock ownership plan in order to allow the employee to establish an IRA, however, the plan may then be unable to satisfy certain minimum requirements of the Code relating to employee eligibility for plan participation (sec. 410(b)(1)).

Reasons for change

If the only tax-qualified plan maintained by an employer is a tax credit employee stock ownership plan and if the value of employer securities allocated to employees' accounts under the tax credit employee stock ownership plan is relatively low, the committee believes that the minimum coverage requirements for tax-qualification of the tax credit employee stock ownership plan should be modified to permit employees to elect out of the plan, if the plan so provides, to establish IRA's.

Explanation of provision

Under the provision, the minimum coverage requirement for a tax credit employee stock ownership plan would be changed, if a tax credit employee stock ownership plan is the only tax-qualified plan main-

tained by an employer. If employees are permitted to elect out of the tax credit employee stock ownership plan for the purpose of establishing IRAs, the tax credit employee stock ownership plan would not fail to meet the minimum coverage requirements of the Code if the plan benefits at least 50 percent of all employees (excluding employees who have not satisfied the minimum age and service requirements or who are otherwise permitted to be excluded), and if the total allocations under the tax credit employee stock ownership plan are equal to no more than two percent of the compensation of participating employees.

Effective date

The provision would be effective for plan years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision will decrease budget receipts by less than \$5 million annually.

D. Transfers of Proven Oil or Gas Properties to a Controlled Corporation

(Sec. 401 of the bill and sec. 613A of the Code)

Present law

Under present law, oil and gas production generally is not entitled to percentage depletion. However, independent producers and royalty holders are permitted a percentage depletion deduction of 22 percent with respect to 1,200 barrels of oil (the "depletable quantity") per day. Starting in 1980, percentage depletion is allowed with respect to only 1,000 barrels of oil or gas; between the end of 1980, and the beginning of 1984, the rate of percentage depletion phases down from 22 percent to 15 percent.

Generally, present law requires the depletable quantity of oil and gas to be allocated among all the properties owned directly by the taxpayer, and among all the properties owned by certain other persons with specified relationships to the taxpayer. For this purpose, the following persons are treated as one taxpayer, and must be aggregated in applying the depletable quantity: component members of the same controlled group of corporations, businesses (including corporations, trusts, or estates) under common control, and members of the same family. Present law, however, does not require an allocation of the depletable quantity between a trust and a beneficiary of the trust, or between an individual and his or her controlled corporation. As a result, in these instances each taxpayer has a separate depletable quantity.

Under present law, production from a proven oil or gas property which has been transferred after December 31, 1974, generally is not eligible for percentage depletion. However, this rule generally does not apply to testamentary transfers, certain changes in trust interests, or to situations where the transferor and the transferee must allocate one depletable quantity following the transfer. If the allocation rule applies, this special exception to the general prohibition on the transfer of proven oil or gas properties applies to transfers covered by section 351, i.e., to transfers to a corporation which is controlled by the transferor(s) after the transfer. Since the depletable quantity is not allocable between an individual and his or her controlled corporation, this special exception is inapplicable to such transfers. As a result, percentage depletion is not available with respect to production from a proven oil or gas property which has been transferred after 1974 by an individual to his or her controlled corporation.

Reasons for change

The committee believes that the percentage depletion rules pertaining to transfers of proven properties by an individual to his or her controlled corporation are unnecessarily complex and restrictive. In addition, the committee believes that these rules may result in an un-

intended denial of percentage depletion in instances where taxpayers transfer proven properties, without thorough consideration of the income tax consequences, for various business or estate planning reasons. Nevertheless, the committee also recognizes the importance of restricting the possibility of increasing the number of barrels with respect to which a taxpayer may benefit from percentage depletion, and of preventing a proliferation of percentage depletion exemptions.

The committee believes that the various important business, estate planning, and tax policy considerations involved can be reconciled. Therefore, the committee believes that it is appropriate to amend the rules relating to transfers of proven oil and gas properties to controlled corporations.

Explanation of provision

Generally, the amendment provides that a shareholder or shareholders having control of a corporation (as described in subsection (c) of section 368) may elect to have each such controlling shareholder and the corporation be component members of a controlled group treated as one taxpayer. An electing shareholder who transfers proven oil or gas properties to a controlled corporation thus would have his depletable oil quantity allocated among all the properties owned directly by him and among the properties transferred to the controlled corporation.

The amendment provides that proven oil or gas properties may be transferred to a controlled corporation without loss of the otherwise allowable percentage depletion deduction, if the transfer qualifies under section 351 of the Code and the depletable quantity must be allocated between the transferor and the corporation after the transfer. This special rule would apply only if the transferors elect to have the depletable quantity allocated, and for only so long as it is required to be allocated, in accordance with the general provisions of Code section 613A, and only for so long as the transferors hold the interests i.e., the shares in the transferee corporation.

Under the committee amendment, the depletable quantity must be allocated and aggregated with regard to the generally applicable rules of section 613A, including those relating to situations in which production exceeds the depletable quantity.

The committee amendment also grants the Secretary broad authority to issue regulations to prevent the proliferation of the amount of oil or gas potentially eligible for percentage depletion.

The provisions of the committee amendment would apply with respect to post-1979 oil or gas production from properties transferred after 1974. However, the requirements of section 351 must have been satisfied at the time of the transfer and the transferors must elect to be subject to the section 613A allocation and aggregation rules. In addition, neither the properties nor the transferors ownership interests may have been transferred after 1974 and before the effective date of the committee amendment if the transfer was one within the meaning of section 613A(c)(9) (but without regard to the allocation requirement of section 613A(c)(9)(B)(ii)). Therefore, the amendment would not apply to production from a property which had been transferred after 1974 if the transfer would not have been allowable under the committee amendment had it been effective at the time of transfer.

The election generally would be required by the earlier of (i) the first return due by any electing shareholder for the year in which the transfer occurs or (ii) the return of the corporation for the year in which the transfer occurs.

Effective date

The provision would apply to production of oil and gas after December 31, 1979, from property transferred after December 31, 1974.

Revenue effect

It is estimated that this provision will reduce budget receipts by less than \$5 million in fiscal year 1980 and by less than \$10 million per year thereafter.

E. Extension of Time to Amend Governing Instruments of Charitable Split-Interest Trusts

(Sec. 402 of the bill and secs. 170, 2055, and 2522 of the Code)

Present law

The Tax Reform Act of 1969 imposed new requirements that must be met in order for a charitable deduction to be allowed for income, gift, and estate tax purposes for the transfer of a split interest to charity (i.e., part charitable and part noncharitable). In the case of a remainder interest in trust, the interest passing to charity must be in either a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund. In the case of an "income" interest passing to charity (i.e., a charitable lead trust), the "income" interest must be either a guaranteed annuity or a fixed percentage of the fair market value of the trust (determined annually). These rules generally apply, for estate and gift tax purposes, in the case of decedents dying, or transfers made, after December 31, 1969, and for income tax purposes to contributions and transfers in trust after July 31, 1969. However, certain exceptions were provided in the case of wills executed, or property transferred in trust, on or before October 9, 1969. In general, these exceptions did not apply the new rules to these wills and revocable trusts until October 9, 1972 (unless the will was modified in the meantime), to allow a reasonable period of time to take the new rules into account.

In 1970, the Internal Revenue Service issued proposed regulations with respect to the new requirements for a charitable remainder annuity trust or unitrust (under sec. 664 of the Code). These regulations provided additional transitional rules allowing trusts created after July 31, 1969 (which did not come within the statutory exceptions) to qualify for an income, estate, or gift tax deduction if the governing instrument was amended prior to January 1, 1971. Subsequently, the date by which the governing instrument had to be amended was further extended by the Internal Revenue Service. On August 22, 1972, the Internal Revenue Service issued final regulations which further extended the date to December 31, 1972. On September 5, 1972, the Internal Revenue Service published Rev. Rul. 72-395, 1972-2 C.B. 340, which provided sample provisions for inclusion in the governing instrument of a charitable remainder trust that could be used to satisfy the requirements under section 664.

In 1974, Congress extended the date by which the governing instrument of a trust created after July 31, 1969, and before September 21, 1974, or pursuant to a will executed before September 21, 1974, could be amended (P.L. 93-483). Under that Act, if the governing instrument was amended to conform by December 31, 1975, to meet the requirements of a charitable remainder annuity trust or unitrust or pooled income fund, an estate tax deduction was allowed for the charitable remainder interest which passed in trust from the decedent even though the executed before December 31, 1977.

The Tax Reform Act of 1976 extended to December 31, 1977, the date by which the governing instrument of a charitable remainder trust created after July 31, 1969 and before December 31, 1969, must be amended in order to qualify as a charitable remainder annuity or unitrust or pooled income fund for purposes of the estate tax deduction. The Act also extended the date in the case of a trust created after July 31, 1969, pursuant to a will executed before December 31, 1977.

In the Revenue Act of 1978, Congress extended the amendment procedure to instruments establishing charitable lead trusts, and charitable remainder trusts in the case of income and gift taxes, which were created before December 31, 1977 (or created pursuant to a will executed before such date) which were amended (or judicial proceedings to amend were commenced) by December 31, 1978. As part of that provision, the Act extended until December 31, 1978, the time to amend (or to commence judicial proceedings to amend) instruments establishing charitable remainder trusts which were created before December 31, 1977 (or created pursuant to a will executed before such date) in order to conform such instruments to the requirements of the Tax Reform Act of 1969 for a charitable deduction to be allowed for estate tax purposes.

Reasons for change

Despite the additional period provided by the Revenue Act of 1978, it has come to the attention of the committee that there are several wills and trust instruments becoming effective which provide charitable remainders or lead interests which still do not meet the requirements of the Tax Reform Act of 1969. The committee believes it is appropriate to provide an additional 2-year extension to permit wills and trust instruments establishing charitable remainder and lead interests to be amended to comply with the requirements of the 1969 Act. While the committee believes it appropriate to allow reformation of trusts to which the requirements of the Tax Reform Act of 1969 apply for an additional 2 years, it does not believe that the period of limitations should be waived for this purpose.

Explanation of provision

The provision extends for 2 years (i.e., until December 31, 1980) the time to amend (or commence judicial proceedings to amend) instruments of both charitable lead trusts and charitable remainder trusts which were created before December 31, 1977 (or which were created pursuant to a will executed before such date) in order to conform such instruments to the requirements of the Tax Reform Act of 1969 for a charitable deduction to be allowed for income, gift, or estate tax purposes.

Effective date

The provision is effective, for estate and gift tax purposes, for decedents dying and transfers after December 31, 1969, and, for income tax purposes, for contributions and transfers in trust after July 31, 1969.

Revenue effect

It is estimated that this provision will decrease budget receipts by \$5 million in fiscal year 1980, by \$5 million in fiscal year 1981, and will not have any revenue effect thereafter.

F. Change of Time for Paying Excise Tax on Fishing Equipment

(Sec. 403 of the bill and sec. 4161(a) of the Code)

Present law

Under present law (Code sec. 4161(a)), there is imposed upon the sale of fishing rods, creels, reels, and artificial lures, baits, and flies (including parts or accessories of such articles sold on or in connection therewith, or with the sale thereof) by the manufacturer, producer, or importer a tax equivalent to 10 percent of the price for which so sold.

Treasury Department regulations prescribing the time for making deposits of manufacturers excise taxes are found in Treas. Reg. sec. 48.6302(c)-1. If an individual is liable in any month for more than \$100 of taxes reportable on Form 720 (Quarterly Excise Return) and he is not required to make semimonthly deposits, the individual must deposit the amount on or before the last day of the next month at an authorized depository or at the Federal Reserve Bank serving the area in which the individual is located. If any individual had more than \$2,000 in excise tax liability for any month of a preceding calendar quarter, he must deposit such taxes for the following quarter (regardless of amount) on a semimonthly basis. The taxes must be deposited by the ninth day following the semimonthly period for which they are reported. In addition, if the semimonthly period is in either of the first two months of the quarter, any underpayment of excise taxes for a month must be deposited by the ninth day of the second month following such month. Underpayments in the third month of the quarter must be deposited by the end of the following month.

No special rules are provided to defer payment of the excise tax with respect to sales of taxable articles on credit except in the case of certain installment sales.

Reasons for change

Retail sale of sport fishing equipment is seasonal in nature. However, manufacturers of such equipment produce throughout the year in order to make efficient use of capital and labor. To avoid inventory storage costs otherwise resulting from year-round production, manufacturers encourage wholesalers and retailers to make early purchases of fishing equipment stock by offering extended credit terms. The manufacturers excise tax on fishing equipment is payable relatively soon after the fishing equipment is sold by the manufacturer, regardless of the fact that the deferred credit terms may result in sale proceeds not being collected for several months.

The committee is informed that this payment problem is unique to the fishing equipment industry, and has concluded that some extension of time for payment is appropriate in these circumstances to the extent it can be provided without incurring any fiscal year revenue loss.

Explanation of provision

The bill would provide that the manufacturers excise tax imposed on the sale of fishing equipment is payable according to the following schedule:

For articles sold during the quarter ending:

Payment of the tax is due by:

December 31-----	March 31-----
March 31-----	June 30-----
June 30-----	September 24-----
September 30-----	According to Treasury Regulations

In the case of sales of fishing equipment made during the first two quarters of the Federal fiscal year, the bill extends the due date for payment for up to 5 months and 1 week beyond that applicable under present law. In the case of sales made during the third such quarter (ending June 30), the extension is not as long (until September 24), in order to insure that all payments for sales made through June 30 are included in Federal Government receipts for the fiscal year, which ends on September 30.

In the case of sales made during the fourth such quarter, the bill does not require any change from the payment schedule presently in effect under Treasury regulations (sec. 48.6302(c)-1). However, the bill does not preclude the Secretary of the Treasury from changing such regulations, to the extent the Secretary from time to time may deem appropriate, with respect to the due date for payment of excise taxes incurred on sales of fishing equipment made during the quarter ending September 30.

(This provision is the same as sec. 7 of H.R. 5505 as passed the House.)

Effective date

The provision would apply to excise taxes payable on fishing equipment sold on or after the first day of the first calendar quarter beginning after the date of enactment of the bill.

Revenue effect

It is estimated that this provision will not have any fiscal year revenue effect.

G. Election of Estate Tax Alternate Valuation

(Sec. 404 of the bill and sec. 2032 of the Code)

Present law

Under present law, the executor of a decedent's estate may value the property in the gross estate as of the date of the decedent's death or the "alternate valuation date," generally 6 months after the date of the decedent's death (Code sec. 2032). Alternate valuation provides estate tax relief when property in a decedent's estate declines in value shortly after the decedent's death. Alternate valuation must be elected by the executor on an estate tax return filed within 9 months of the date of death or any period of extension granted by the Internal Revenue Service (Code sec. 2032(c)).

Under Code section 6081, the Internal Revenue Service may grant an extension of time to file an estate tax return. Except in the case of taxpayers who are abroad, the Internal Revenue Service has no discretionary authority to grant an extension exceeding 6 months.

Reasons for change

The effect of the present rule requiring the election of the alternate valuation date to be made on a timely filed estate tax return is to impose a penalty on failure to timely file the estate tax return. However, there are already penalties provided under present law for failure to timely file. The committee believes that it is inappropriate to impose an additional penalty where the estate tax return is not timely filed, since the amount of the penalty has no relationship to the amount of tax properly due. Moreover, the effect of the present law may deny relief in the types of cases for which the alternative valuation date rule was intended. Consequently, the committee believes that the executor should be able to elect the alternative valuation date until the first untimely estate tax return is filed. However, the committee believes that an election filed on an untimely estate tax return should be irrevocable.

Explanation of provision

The bill would permit the election of alternate valuation on a timely filed estate tax return or the first late return filed. In the case of a timely filed return, an executor would not be permitted to change the election after the due date for the return has passed. In the case of a late return, the election could not be changed after the first return has been filed.

Effective date

The provision would apply to estates of decedents dying after December 31, 1977.

The bill would provide a transitional rule applicable to estates of decedents dying before January 1, 1978. The transitional rule would

permit an effective election of alternate valuation to be made within 90 days after the enactment of the bill, if an election of alternate valuation had been indicated in the first estate tax return filed. If an election is made under the transitional rule, an assessment of a deficiency in tax may be made within 90 days of the election although such assessment is otherwise barred. (The transitional rule would benefit the estate of the late Sylvia Buring of Tennessee.)

Revenue effect

It is estimated that this provision will decrease budget receipts by \$1 million in fiscal year 1980 and will not have any revenue effect thereafter.

H. Certain Distributions From Money Purchase Pension Plans

(Sec. 405 of the bill and sec. 402(a)(6) of the Code)

Present law

An employee who receives a lump sum distribution from a tax-qualified pension, profit-sharing, or stock bonus plan may defer tax on the distribution by rolling over the proceeds (net of any employee contributions) within 60 days of receipt (1) to an IRA (an individual retirement account, annuity, or bond), (2) to another qualified pension, etc., plan. The rollover rule also applies to the spouse of an employee who receives a lump sum distribution on account of the employee's death. A lump sum distribution from a qualified plan is eligible for favorable income tax treatment (e.g., 10-year income-averaging) if no portion of the distribution is rolled over.

A distribution may be rolled over if it is a distribution of the balance to the credit of an employee under a qualified pension, etc., plan, made within one taxable year of the recipient. Generally, the distribution must have been made on account of death, separation from service, or the attainment of age 59½. If an employer maintains more than one qualified plan of the same type, the plans are aggregated for the purpose of determining whether the balance to the credit of an employee has been distributed. Under the aggregation rules, all pension plans (defined benefit and money purchase) maintained by the employer are treated as a single plan, all profit-sharing plans maintained by the employer are treated as a single plan, and all stock bonus plans maintained by the employer are treated as a single plan.

Reasons for change

The committee believes that the lump sum distribution rollover rules are too restrictive.

Explanation of provision

The bill would allow an employee who receives a total distribution (which otherwise meets the requirements for a tax-free rollover) from a qualified money purchase pension plan to roll over the distribution to an IRA or to another qualified plan where the employer also maintains a defined benefit pension plan covering the employee and a total distribution is not made from the defined benefit plan in the same taxable year. The provision would also apply to the spouse of an employee if the spouse receives such a total distribution on account of the employee's death.

If the recipient rolls over a total distribution from a money purchase pension plan and, in a subsequent taxable year, receives a total distribution from a qualified defined benefit pension plan maintained by the employer, the later plan distribution could be rolled over tax-free (if it otherwise qualifies for tax-free rollover treatment) but

would not otherwise be eligible for the favorable income tax treatment accorded lump sum distributions.

Effective date

Generally, this provision would apply to payments made in taxable years beginning after December 31, 1978. In the case of such payments made after December 31, 1978, and before January 1, 1981, the period for making a rollover would not expire before December 31, 1980.

Revenue effect

It is estimated that this provision will decrease budget receipts by less than \$5 million annually.

I. Extension of Cash and Deferred Plan Rules to Salary Reduction Arrangements Under Money Purchase Pension Plans

(Sec. 406 of the bill and sec. 401(k) of the Code)

Present law

The Employee Retirement Income Security Act of 1974 (ERISA) permitted the Treasury to deny favorable tax treatment to cash and deferred arrangements under profit-sharing, stock bonus, or money purchase pension plans with salary reduction arrangements, if the plans were not in existence on June 27, 1974. ERISA preserved the tax treatment of plans in existence on that date, pending study by the Congress of the appropriate treatment of these plans. The protection for plans in existence on June 27, 1974, was originally provided for contributions made before January 1, 1977. This protection has since been extended until January 1, 1980.

The Revenue Act of 1978 provided rules for new and old profit-sharing and stock bonus plans with cash or deferred arrangements. The new rules apply for plan years beginning after December 31, 1979. For years beginning before January 1, 1980, the tax treatment under a plan in existence on June 27, 1974, is determined under prior law. No rules were provided for salary reduction arrangements under money purchase pension plans by the 1978 Act.

Reasons for change

Many tax-exempt organizations have money purchase pension plans with a salary reduction feature. Because such organizations are generally precluded from adopting profit-sharing plans or stock bonus plans, they would like to continue in existence these money purchase pension plans. Profit-sharing plans and stock bonus plans, which are generally available to, and adopted by, taxable employers, permit a cash or deferred option which is similar to a salary reduction arrangement.

Explanation of provision

Under the bill, a money purchase pension plan in existence on June 27, 1974, which provided for a salary reduction arrangement on that date would be permitted to continue the arrangement after December 31, 1979. However, under the bill, these plans may not increase the level of either employer or employee contributions under a salary reduction arrangement (e.g., as a percentage of total compensation or a fixed dollar amount) above the level in effect under that arrangement on June 27, 1974. In addition, for plan years beginning on or after January 1, 1980, these money purchase pension plans must satisfy the standards applicable to cash or deferred profit-sharing and stock bonus plans relating to (1) employee participation and (2) discrimination in favor of employees who are officers, shareholders, or highly compensated. The provisions of the bill apply to businesses as well as tax-exempt organizations.

Effective date

The provision would apply for plan years beginning after December 31, 1979. However, the portion of the amendment relating to the tax treatment of contributions would apply for contributions made after December 31, 1979. A transition rule is provided for contributions made after December 31, 1979, and before the beginning of the first plan year beginning after that date.

Revenue effect

It is estimated that this provision will decrease budget receipts by less than \$1 million annually.

J. Elimination of Withholding Tax on Pensions Paid to Certain Nonresident Aliens

(Sec. 407 of the bill and sec. 871 of the Code)

Present law

Under present law, a nonresident alien is not subject to U.S. tax on compensation for services performed outside the United States (or certain *de minimis* services performed in the United States for a foreign employer). He is, however, generally subject to a tax of 30 percent on his investment income (interest, dividends, etc.) from U.S. sources.

If a nonresident alien receives a pension in the form of an annuity from a qualified trust or under a qualified annuity plan, and the pension is attributable to services performed outside the United States, he generally would not be subject to U.S. tax on the portion of the annuity which is attributable to his contributions or to his employer's contributions under the plan. However, he would generally be subject to the 30-percent withholding tax on the portion of the annuity attributable to investment income earned on the contributions while they were invested, unless a statutory or treaty exemption applies. Currently, there is a statutory exemption from tax on a pension paid to a nonresident alien for services performed outside the United States (or *de minimis* services within the United States for a foreign employer) if, at the time the annuity payments begin, 90 percent or more of the employees for whom contributions or benefits are provided by the plan are citizens or residents of the United States. (Sec. 871(f).) Also, a number of U.S. tax treaties provide reciprocally that pensions and annuities received by a resident of one country from sources in the other are taxable only by the country of residence.

Reasons for change

The committee believes that a pension paid to a nonresident alien should be exempt from withholding where his country of residence has unilaterally by its internal law enacted a provision granting the same relief to U.S. citizens and residents. Also, the committee believes that employers should be encouraged to provide pensions for their employees in certain developing countries.

Explanation of provision

The provision would expand the statutory exemption from tax for pension annuities by making it available to an individual if (a) the country of residence of the individual grants a substantially equivalent exclusion to citizens and residents of the United States (who are not also citizens of the recipient's country of residence) or (b) the recipient's country of residence is a "beneficiary developing country" under section 502 of the Trade Act of 1974.¹

Footnotes at end of article.

Effective date

The provision would apply to amounts received after July 1, 1979.

Revenue effect

It is estimated that this provision will decrease budget receipts by less than \$1 million in fiscal year 1980, and by less than \$5 million annually thereafter.

¹ The following countries and territories are designated beneficiary developing countries for purposes of the Generalized System of Preferences, provided for in Title V of the Trade Act of 1974, 19 U.S.C. § 2461 *et seq.* (as designated in Executive Order No. 11888, November 24, 1975, as amended*):

Independent countries

Afghanistan, Angola, Argentina, Bahamas, Bahrain, Bangladesh, Barbados, Bhutan, Bolivia, Botswana, Brazil, Burma, Burundi, Cameroon, Cape Verde, Central African Empire, Chad, Chile, Colombia, Comoros, Congo, Costa Rica, Cyprus, Dahomey, Djibouti, Dominican Republic, Egypt, El Salvador, Equatorial Guinea, Ethiopia, Fiji, Gambia, Ghana, Grenada, Guatemala, Guinea, Guinea Bissau, Guyana, Haiti, Honduras, India, Israel, Ivory Coast, Jamaica, Jordan, Kenya, Korea, Republic of, Laos, Lebanon, Lesotho, Liberia, Malagasy Republic, Malawi, Malaysia, Maldives, Mali, Malta, Mauritania, Mauritius, Mexico, Morocco, Mozambique, Nauru, Nepal, Nicaragua, Niger, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Romania, Rwanda, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Singapore, Somalia, Sri Lanka, Sudan, Surinam, Swaziland, Syria, Taiwan, Tanzania, Thailand, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Upper Volta, Uruguay, Western Samoa, Yemen Arab Republic, Yugoslavia, Zaire, and Zambia.

Non-independent countries and territories

Antigua, Belize, Bermuda, British Indian Ocean Territory, British Solomon Islands, Brunei, Cayman Islands, Christmas Island (Australia), Cocos (Keeling) Islands, Cook Islands, Dominica, Falkland Islands (Islas Malvinas), French Polynesia, Gibraltar, Gilbert and Ellice Islands, Heard Island and McDonald Islands, Hong Kong, Macao, Montserrat, Netherlands Antilles, New Caledonia, New Hebrides Condominium, Niue, Norfolk Island, Pitcairn Islands, Saint Christopher-Nevis-Anguilla, Saint Helena, Saint Lucia, Saint Vincent, Tokelau Islands, Trust Territory of the Pacific Islands, Turks and Caicos Islands, Virgin Islands, British, Wallis and Futuna Islands, and Western Sahara.

*Executive Order No. 11888, Nov. 24, 1975, 40 F.R. 55276, as amended by Ex. Ord. No. 11906, Feb. 26, 1976, 41 F.R. 8758; Ex. Ord. No. 11934, Aug. 30, 1976, 41 F.R. 37084; Ex. Ord. No. 11960, Jan. 19, 1977, 42 F.R. 4317; Ex. Ord. No. 11974, Feb. 25, 1977, 42 F.R. 11230A; Ex. Ord. No. 12032, Dec. 27, 1977, 42 F.R. 64851; Ex. Ord. No. 12041, Feb. 25, 1978, 43 F.R. 8099; Proc. No. 4561, Apr. 7, 1978, 43 F.R. 15127; Ex. Ord. No. 12104, Dec. 15, 1978, 43 F.R. 59053; Ex. Ord. No. 12124, Feb. 28, 1979, 44 F.R. 11729.

K. Voting Rights Pass Through Requirement for Defined Contribution Plans

(Sec. 408 of the Bill and Sec. 401(a)(22) of the Code)

Present law

Under present law, a tax-qualified defined contribution plan is required to pass through voting rights on employer securities to plan participants with respect to major corporate issues under certain circumstances. The vote pass-through applies if (1) the employer which established the plan does not have a class of publicly traded stock, (2) the plan acquired employer securities after December 31, 1979, and (3) after the acquisition more than 10 percent of the plan's total assets are invested in employer securities.

Reason for change

The committee is concerned that if this requirement is retained in the law it will inhibit the contribution of closely held employer securities to defined contribution plans, such as stock bonus plans and profit-sharing plans.

Explanation of provision

The provision would repeal the present law rule under which a tax-qualified defined contribution plan, established by an employer whose stock is not publicly traded, which acquires employer securities after December 31, 1979, and thereafter holds more than 10 percent of its assets in employer securities, is required to pass through to plan participants voting rights on major corporate issues with respect to employer securities held by the plan. The provision does not change the special vote pass-through rules for employee stock ownership plans and tax credit employee stock ownership plans.

Effective date

The provision would be effective for securities acquired after December 31, 1979.

Revenue effect

It is estimated that this provision will not have any revenue effect.

L. Cafeteria Plans Permitted to Provide Deferred Compensation Under Rules Applicable to Cash or Deferred Profit-Sharing and Stock Bonus Plans

(Sec. 409 of the bill and secs. 125 and 401(k) of the Code)

Present law

A cafeteria plan is an employee benefit plan under which a participant may choose between taxable benefits and one or more nontaxable fringe benefits. Under present law, cafeteria plans are not permitted to provide deferred compensation.

Reasons for change

Both cafeteria plans and cash or deferred profit-sharing plans allow employees to choose between current compensation and other benefits. The committee believes that present law is too restrictive because it does not permit employees to choose among currently taxable compensation, deferred compensation, and fringe benefits under a single plan.

Explanation of provision

Under the bill, benefits under a cafeteria plan could include amounts which an employee covered by a profit-sharing or stock bonus plan with a qualified cash or deferred arrangement, can elect to have the employer pay as a contribution to a trust under a profit-sharing or stock bonus plan. The committee intends that amounts contributed by the employer, pursuant to the employee's election, will be treated as nontaxable benefits for purposes of the "cafeteria" plan rules.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision will decrease budget receipts by less than \$5 million annually.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL AS AMENDED

Budget Effect

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made about the effect on the budget of this bill, H.R. 1212, as amended. The committee estimates that the amendments contained in the bill will increase budget receipts by \$4 million in fiscal year 1980; \$8 million in fiscal year 1981; \$16 million in fiscal year 1982; \$18 million in 1983; and \$21 million in fiscal year 1984. (For revenue estimates for the specific provisions of the bill, see table 1.)

These figures include \$0.5 million for each item that has been estimated at "less than \$1 million", \$3 million for each item that has been estimated at "less than \$5 million", and \$5 million for each item that has been estimated at "less than \$10 million". These amounts represent midpoints between zero and the upper end of the respective ranges and are used for budgetary purposes to take into account the revenue effects of those provisions for which only range estimates are available.

The Treasury Department agrees with this statement.

New Budget Authority and Tax Expenditures

In accordance with section 308 of the Budget Act, after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority or new tax expenditures but would involve a net decrease in existing tax expenditures of \$4 million for fiscal year 1980, \$8 million in fiscal year 1981, \$16 million in fiscal year 1982, \$18 million in fiscal year 1983, and \$21 million in fiscal year 1984.

Consultation with Congressional Budget Office on Budget Estimates

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

Vote of the Committee

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 1212, as amended, was ordered favorably reported by voice vote.

**Table 1.—Estimated Revenue Effect of H.R. 1212, As Reported By the Finance Committee,
Fiscal Years 1980–1984**

(Millions of dollars)

Provision	Fiscal year receipts				
	1980	1981	1982	1983	1984
1. Tax on gain on sale of U.S. real property by foreign investors.....	+25	+35	+39	+43	+47
2. Reforestation tax incentives.....	-2	-4	-5	-7	-8
3. Employee stock ownership plans:					
(a) Cash distribution option and put option for stock bonus plan.....					
(b) Availability of additional investment credit percentage for tax credit employee stock ownership plans for public utilities.....					
(c) Special limitation for employee stock ownership plans.....	(1)	(1)	(1)	(1)	(1)
(d) Valuation of employer securities in tax credit employee stock ownership plans.....					
(e) Participation of subsidiary corporation in a tax credit employee stock ownership plan.....					
(f) Retirement savings by tax credit employee stock ownership plan.....	(2)	(2)	(2)	(2)	(2)
4. Transfers of proven oil and gas properties to a controlled corporation.....	(2)	(3)	(3)	(3)	(3)
5. Extension of time to amend charitable split-interest.....	-5	-5			
6. Change of time for paying excise tax on fishing equipment.....					
7. Election of estate tax alternate valuation.....	-1				
8. Tax-free rollover treatment for certain distributions from money purchase pension plans.....	(2)	(2)	(2)	(2)	(2)
9. Extension of cash and deferred plan rules to money purchase pension plans.....	(1)	(1)	(1)	(1)	(1)
10. Elimination of withholding tax on pensions paid to certain nonresident aliens.....	(1)	(2)	(2)	(2)	(2)
11. Deletion of limited voting rights pass through requirement for defined contribution plans.....					
12. Cafeteria plans and deferred compensation plans.....	(2)	(2)	(2)	(2)	(2)
Total ⁴	+4	+8	+16	+18	+21

¹ Reduction of less than \$1 million.
² Reduction of less than \$5 million.
³ Reduction of less than \$10 million.
⁴ The totals were calculated including \$0.5 million for each item that has been estimated at "less than \$1 million", \$3 million for each item that has been estimated at "less than \$5

million", and \$5 million for each item that has been estimated at "less than \$10 million". These amounts represent midpoints between zero and the upper end of the respective ranges and are used for budgetary purposes to take into account the revenue effects of those provisions for which only range estimates are available.

IV. REGULATORY IMPACT OF THE BILL

In compliance with paragraph 5 of Rule XXIX of the Standing Rules of the Senate, the following statement is made regarding the provisions of this bill, H.R. 1212, as reported by the committee.

Individuals and businesses regulated and economic impact of regulation.—The bill does not regulate any individuals or businesses, but amends certain provisions of the tax law. One provision (title I of the bill) would impose a tax on a portion of the gain on the sale of U.S. real property by foreign investors. Under this provision, certain reporting requirements would be established to identify when taxable transactions had occurred. The tax would be collected through withholding requirements and related tax enforcement provisions.

Title II of the bill contains various other amendments of the tax laws, including provisions relating to (1) tax incentives for reforestation expenses, (2) transfers of proven oil and gas properties to a controlled corporation, (3) extension of time to amend governing instruments of charitable split-interest trusts, (4) change of time for paying excise tax on fishing equipment, (5) election of estate tax alternate valuation, (6) distributions from money purchase pension plans, (7) extension of cash and deferred plan rules to salary reduction arrangements under money purchase pension plans, (8) elimination of withholding tax on pensions paid to certain nonresident aliens, (9) voting rights pass through for defined contribution plans, (10) employer stock ownership plans, and (11) cafeteria plans and deferred compensation rules.

Impact on personal privacy.—The provisions under title I (relating to tax gain on sale of U.S. real property by foreign investors) will involve some possible impact on the privacy of those involved in reporting and withholding with respect to the imposition and collection of the tax. The other provisions of the bill will have minimal impact on personal privacy.

Determination of paperwork involved.—The provisions under title I of the bill (relating to tax on gain on sale of U.S. real property by foreign investors) will involve some additional paperwork with respect to the reporting, withholding, and other related tax enforcement provisions with respect to the imposition and collection of the tax. The provision eliminating the withholding tax on pensions paid to certain nonresident aliens will reduce the amount of paperwork and reporting by the payors of such pension payments. The other provisions of the bill will have minimal impact on paperwork.

**V. CHANGES IN EXISTING LAW MADE BY THE BILL,
AS REPORTED**

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, H.R. 1212, as reported by the committee).

(50)

