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105TH CONGRESS
2D SESSION

H. R. 4700

To amend the Internal Revenue Code of 1986 to restructure and replace the income tax system of the United States to meet national priorities, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 5, 1998

Mr. ENGLISH of Pennsylvania introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1986 to restructure and replace the income tax system of the United States to meet national priorities, and for other purposes.

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

SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the ''Simplified USA Tax Act of 1998''.

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act a reference is made to the Code or to a section or provision of the

Code, the reference shall be considered to be made to the Internal Revenue Code of 1986 or to a section or provision thereof.

(c) TABLE OF CONTENTS.—

Sec. 1. Short title; amendment of 1986 Code; table of contents.

TITLE I—FINDINGS; NEED TO REPLACE THE INCOME TAX

Sec. 101. Replacing the income tax of the United States.

TITLE II—SIMPLIFIED USA TAX FOR INDIVIDUALS

Sec. 201. Simplified USA Tax for individuals.
Sec. 202. Reorganization of the Code.

TITLE III—SIMPLIFIED USA TAX FOR BUSINESSES

Sec. 301. Repeal of present corporate income tax; new tax paid by corporations and other businesses.
Sec. 302. Repeal of chapter 6.

TITLE IV—DEFERRED COMPENSATION PLANS

Sec. 401. Provisions saved.
Sec. 402. Clerical Amendments.
Sec. 403. Clerical Amendments.

TITLE V—REPEAL OF ESTATE AND GIFT TAXES

Sec. 501. Repeal of gratuitous transfer taxes.
Sec. 502. Effective Date.

TITLE VI—TECHNICAL AND ADMINISTRATIVE CHANGES; EFFECTIVE DATES

Sec. 601. USA Tax Code.
Sec. 602. Revisions to the Code.
Sec. 603. Application of subtitle F.
Sec. 604. Clerical amendment.

TITLE I—FINDINGS; NEED TO REPLACE THE INCOME TAX

SEC. 101. REPLACING THE INCOME TAX OF THE UNITED STATES.

(a) FINDINGS.—The Congress finds that—

(1) the current Tax Code is irreparably flawed and must be replaced;

(2) to enhance the liberty and protect the privacy of individuals, the Tax Code must be made simpler and nonintrusive, and it must be applied evenhandedly to all;

(3) to be fair and to provide for the prosperity of current and future generation, the Tax Code must give all individuals at all income levels an opportunity to save, invest and raise their standard of living and that of their children; and

(4) future economic growth requires a tax system that facilitates successful competition in the global marketplace.

(b) MAIN FEATURES OF SIMPLIFIED USA TAX SYSTEM.—

(1) REPLACEMENT OF OLD TAX SYSTEM.—Chapter 1 of subtitle A (related to income taxes) of the Code is repealed and replaced for years beginning after 1998.

(2) ESTATE AND GIFT TAX REPEALED.

(3) NEW TAX SYSTEM.—The Simplified USA Tax consists of—

(A) a simplified tax collected from individuals, that for years after 1998 replaces the in-

come tax imposed on individuals by section 1 of the Code, and

(B) a simplified tax collected from corporations and other businesses, that for years after 1998 replaces the income tax imposed on corporations by section 11 of the Code.

(3) SIMPLIFIED USA TAX ON GROSS PROFITS.—Corporations and other businesses pay tax on their annual gross profits from business conducted in the United States, except that—

(A) export revenues are excluded, and

(B) imports are taxed.

(4) SIMPLIFIED USA TAX ON INCOME.—Individuals pay tax on their annual income from wages, dividends, interest, and other financial income (including sales of property), except that—

(A) investment earnings on previously taxed income that is placed in a Roth IRA is exempt from further taxation,

(B) a portion of each family's income is exempt from tax, and

(C) deductions are allowed for—

(i) education costs,

(ii) religious, charitable, and other philanthropic donations,

(iii) home mortgage interest payments, and

(iv) contributions to qualified IRAs.

(5) CREDIT FOR FICA PAYROLL TAXES PAID.—The amount of tax due is reduced by the payroll tax that is—

(A) in the case of an employee, withheld from wages, or

(B) in the case of a corporation or other business, paid by the employer.

(c) CONCEPTS AND STRUCTURE OF NEW TAX SYSTEM.—

(1) GUIDING PRINCIPLES OF THE SIMPLIFIED USA TAX SYSTEM.—The Simplified USA Tax is based on the following principles:

(A) National wealth and well-being depend on the work, skill, and savings and investment of people.

(B) Businesses are people and their capital working together.

(C) Capital makes people more productive.

(D) Everyone benefits from a growing stock of national savings which in turn allows for a growing stock of physical and human capital.

(E) Under the Simplified USA Tax, the deferral of taxation on investments in human capital represents an investment by the Federal government in the nation's capital stock and the Federal government shares in the return on its investment in the form of higher economic output and revenues in the future.

(2) SINGLE TAX IN 2 PARTS.—The Simplified USA Tax is composed of a business tax and an individual tax which are 2 parts of a single tax system that subjects all income produced and received to taxation once and only once. The 2 parts are as follows:

(A) BUSINESS TAX AT THE SOURCE OF INCOME.—Tax is paid by corporations and other businesses which produce and sell goods and services that are—

(i) the source of nearly all the gross domestic product of the United States, and

(ii) the ultimate source of income received by individuals.

(B) INDIVIDUAL TAX ON INCOME RECEIVED.—Tax is paid by individuals when they receive wages and salaries as compensation for gross domestic product created by their work.

(3) SAVING AND INVESTMENT.—The Simplified USA Tax allows people to save and businesses to invest as follows:

(A) FAIR OPPORTUNITY FOR PEOPLE TO SAVE.—

(i) OPTIONAL ELIMINATION OF DOUBLE TAXATION.—When an individual earns income and is taxed on that income, the individual can save that income in a Roth IRA and not pay income taxes on the investment earnings.

(ii) DEDUCTIBLE AND EXCLUDABLE SAVINGS.—The Simplified USA Tax continues provisions of present law that allow—

(I) lower income individuals and certain other to make deductible contributions to individual retirement accounts, and

(II) encourage employer sponsored savings and retirement plans that defer taxation of income through use of 401(k) plans and other qualified retirement plans.

(B) FAIR OPPORTUNITY FOR BUSINESSES TO INVEST.—

(i) NO PREPAYMENT OF TAX.—When a business invests in plant and equipment—

(I) a deduction is allowed for the cost, and

(II) tax is deferred.

(ii) TAX ON EARNINGS AND RECOVERY OF COST.—When recovered out of business revenues, both the cost of the investment and the earnings on the investment are included in gross profit subject to tax.

(iii) EXPENSING.—The deduction for investment is the equivalent of allowing the cost of plant and equipment to be expensed instead of depreciated.

(4) FAIR OPPORTUNITY TO COMPETE IN THE GLOBAL MARKETPLACE.—The Simplified USA Tax serves the strategic interests of the United States in international markets as follows:

(A) BORDER ADJUSTABLE TAX.—

(i) AMERICAN-MADE EXPORTS.—Goods and services produced in the United

States can be sold into world markets free of tax.

(ii) FOREIGN-MADE IMPORTS.—Goods and services imported into the United States bear a fair and proportionate share of the tax burden in the United States.

(iii) LEVELING THE INTERNATIONAL PLAYING FIELD.—Border adjustments for exports and imports are consistent with international standards and practice.

(5) A SIMPLE AND UNDERSTANDABLE TAX—The Simplified USA Tax for individuals—

(A) is written in a simple, understandable form,

(B) contains only a few exemptions, deductions, and credits, and can be reported on a tax return only a small fraction the size of Form 1040.

(6) A NONINTRUSIVE, EVENHANDED TAX.—

(A) TAXPAYERS ARE IN CONTROL.—When the rules are few and clear, taxpayers can calculate their own tax correctly and file their own returns without fear of mistake or of getting caught up in an argument with the IRS.

(B) LIMITED ROLE FOR IRS.—When the rules are few and clear, the IRS does not have the broad interpretive power that puts taxpayers at risk of being treated unfairly and unevenly.

(C) RESTORING VOLUNTARY COMPLIANCE.—When the rules are few and clear, the IRS can concentrate on helping taxpayers voluntarily pay their correct share of tax revenues for public use and benefit under a tax system that is understood and respected.

(7) MAINTAINING TAX PROGRESSIVITY FOR INDIVIDUALS.—

(A) GRADUATED TAX.—Like the tax imposed by section 1 of the current Code, the Simplified USA Tax for individuals is a graduated tax.

(B) FAMILY LIVING ALLOWANCE.—The Simplified USA Tax recognizes that every family's budget includes necessities. The Simplified USA Tax provides a family living allowance that exempts from taxation the first dollars earned and spent to maintain a basic standard of living.

(8) BUSINESSES AND INDIVIDUAL SHARE THE TAX BURDEN.—

(A) BUSINESS PORTION OF TAX BURDEN.—Corporations and other businesses pay about the same portion of the total tax as under the current Code.

(B) INDIVIDUAL PORTION OF TAX BURDEN.—Individuals pay about the same portion of the total tax as under the current Code.

(9) EMPHASIZING PERSONAL INDEPENDENCE AND RESPONSIBILITY.—

(A) REINFORCING A CULTURE OF WORK AND THRIFT.—Instead of being solely a calculation of how much they must pay to the government, the Simplified USA Tax converts the income tax into an annual calculation of how much people produce and contribute to the economy.

(B) GREATER CONTROL AND RESPONSIBILITY.—Because people are not double taxed on their saving, they have—

(i) more control over their own income and taxes,

(ii) a greater ability to plan and provide for their own future, and

(iii) a fair opportunity to do so.

(10) MORE OPPORTUNITY FOR WAGE EARNERS AT LOWER INCOME LEVELS.—

(A) REFUNDABLE CREDIT FOR EMPLOYEE PAYROLL TAX.—The amount of the payroll tax paid or withheld under the Code from an employee's wages (and paid into the Social Security and Hospital Insurance Trust Funds) is—

(i) credited against the employee's income tax, and

(ii) refunded to the employee to the extent in excess of the employee's income tax.

(B) NO EFFECT ON TRUST FUND OR BENEFITS.—The income tax credit allowed for payroll taxes deposited in the Social Security Trust Fund does not—

(i) reduce the amount in such fund, or

(ii) reduce the payment of any person's benefits from the fund.

TITLE II—SIMPLIFIED USA TAX FOR INDIVIDUALS

SEC. 201. SIMPLIFIED USA TAX FOR INDIVIDUALS.

(a) IN GENERAL.—Chapter 1 of the Code is amended to read as follows:

"CHAPTER 1—SIMPLIFIED USA TAX FOR INDIVIDUALS

"Subchapter A. Basic rules.
"Subchapter B. Roth IRA and other savings provisions.
"Subchapter C. Basis, business transactions, and nonrecognition transactions.
"Subchapter D. Rules for exclusions from gross income.
"Subchapter E. Rules relating to deductions.
"Subchapter F. Special business activities.
"Subchapter G. Accounting methods.
"Subchapter H. Nonresident aliens.
"Subchapter I. Trusts and estates.
"Subchapter J. Definitions and rules of application.

"Subchapter A—Basic Rules

"Sec. 1. Simplified USA tax for individuals.
"Sec. 2. Persons liable for the Simplified USA for individuals.
"Sec. 3. Gross income.
"Sec. 4. Exclusions from gross income.
"Sec. 5. Alimony and child support deductions.
"Sec. 6. Personal and dependency deduction.
"Sec. 7. Family Living Allowance.
"Sec. 8. USA deductions.
"Sec. 9. Homeowner deduction.
"Sec. 10. Education deduction.
"Sec. 11. Philanthropic transfer deduction.
"Sec. 13. Limitation on deductions.
"Sec. 15. Tax rates.
"Sec. 16. Kiddie tax.
"Sec. 17. Rules for filing status and rate tables.
"Sec. 20. USA tax credits.
"Sec. 21. Payroll tax credit.
"Sec. 22. Taxes-paid tax credit.
"Sec. 23. Indexing for inflation.

"SEC. 1. SIMPLIFIED USA TAX FOR INDIVIDUALS.

"(a) IMPOSITION OF TAX.—An income tax is imposed on each individual described in section 2. The income tax shall equal the amount determined by applying the tax schedules in section 15 to the taxable income of the taxpayer for the taxable year and reducing the tax so determined by the USA tax credits for the taxable year.

"(b) TAXABLE INCOME.—'Taxable income' means adjusted gross income, reduced by—

"(1) the personal and dependency deduction,

"(2) the Family Living Allowance, and

"(3) the USA deductions, including—

"(A) the homeowner deduction,

"(B) the education deduction, and

"(C) the philanthropic transfer deduction.

"(c) ADJUSTED GROSS INCOME.—'Adjusted gross income' means gross income, reduced by—

"(1) the alimony and child support deductions, and

"(2) the qualified IRA deduction.

"(d) NAME.—The tax imposed by this chapter shall be known as the 'Simplified USA Tax for Individuals'.

"SEC. 2. PERSONS LIABLE FOR THE SIMPLIFIED USA TAX FOR INDIVIDUALS.

"(a) INDIVIDUALS ONLY.—The Simplified USA Tax for Individuals shall apply only to individuals.

"(b) CITIZENS AND RESIDENT ALIENS.—The Simplified USA Tax for Individuals shall apply to all citizens of the United States and to all resident aliens of the United States. Except as specifically provided in this chapter, the Simplified USA Tax for Individuals shall not apply to nonresident aliens.

"(c) NONRESIDENT ALIENS.—For rules applicable to the compensation income of nonresident aliens, see subchapter H (sections 131 and 132). For rules on the withholding of tax on nonresident aliens, see chapter 5 (sections 1441–1464).

"(d) TAXPAYER.—For purposes of this chapter, 'taxpayer' means an individual, or, in the case of a joint return, the husband and the wife.

"SEC. 3. GROSS INCOME.

"(a) GENERAL DEFINITION.—Except as otherwise provided in this chapter, 'gross income for the taxable year' means all income from whatever source derived by a taxpayer during the taxable year, including (but not limited to) the following items:

"(1) Compensation for services, including (but not limited to)—

"(A) salaries,

"(B) wages,

"(C) commissions,

"(D) tips, and

"(E) distributions from business entities (as defined in section 171).

"(2) Fringe benefits (except as specifically excluded by section 4(a)), including (but not limited to)—

"(A) the cost of health, disability, life or other similar insurance paid by an employer if the taxpayer is indirectly or directly the beneficiary of the policy or has the right to name the beneficiary of the policy,

"(B) employer-paid parking (unless the employee uses the automobile parked in the space regularly on employer business),

"(C) employer-paid educational benefits,

"(D) employer-paid housing (other than housing provided for the convenience of the employer),

"(E) employer-paid meals (other than meals provided for the convenience of the employer or reimbursement for the reasonable cost of meals incurred on overnight travel),

"(F) amounts contributed by an employer on behalf of an employee to a group legal services plan, and

"(G) dependent care assistance received from an employer.

"(3) Distributions from business entities (as defined in section 171) constituting—

"(A) compensation for use of capital, including interest, or

"(B) shares of profits (including dividends).

"(4) Interest not described in paragraph (3)(A).

"(5) Rents.

"(6) Royalties.

"(7) Alimony, child support, and separate maintenance payments.

"(8) Includible social security benefits.

"(9) Income from the discharge of indebtedness.

"(10) Gains on the sale or disposition of assets.

"(11) Amounts stolen or embezzled.

"(12) Distributions from retirement plans and annuities (other than USA Roth IRAs) to the extent not previously included as income, as determined in accordance with section 33.

"(13) Amounts received through health, accident or disability insurance to the extent that—

"(A) the cost of such insurance was paid by an employer and not included in the employee's taxable income and

"(B) such amounts exceed the actual medical expenses incurred and not paid or treated as paid with amounts otherwise excluded from income.

"(b) DEFINITIONS.—For purposes of subsection (a) and section 4—

"(1) EMPLOYER.—'Employer' includes—

"(A) in the case of a partner who provides services for a partnership, the partnership,

"(B) in the case of a proprietor, the proprietorship, and

"(C) in the case of an independent contractor, any business or individual that hires the independent contractor.

"(2) SOCIAL SECURITY BENEFITS.—

"(A) IN GENERAL.—'Social Security benefits' means any amount received by the taxpayer by reason of entitlement to—

"(i) a monthly benefit under title II of the Social Security Act, or

"(ii) a tier 1 railroad retirement benefit. The amount received by a taxpayer shall be determined as if the Social Security Act did not contain section 203(i) thereof.

"(B) TIER 1 RAILROAD RETIREMENT BENEFIT.—'Tier 1 railroad retirement benefit' means—

"(i) the amount of the annuity under the Railroad Retirement Act of 1974 equal to the amount of the benefit to which the taxpayer would have been entitled under the Social Security Act if all of the service after December 31, 1936, of the employee (on whose record the annuity is being paid) has been included in the term 'employment' as defined in the Social Security Act, and

"(ii) a monthly annuity amount under section 3(f)(3) of the Railroad Retirement Act of 1974.

"(C) WORKERS' COMPENSATION SUBSTITUTES.—If by reason of section 224 of the Social Security Act or section 3(a)(1) of the Railroad Retirement Act of 1974, any social security benefit is reduced because of the receipt of a benefit under a workers' compensation act, the term 'social security benefit' includes that portion of such benefit which equals such reduction.

"(D) EFFECT OF EARLY PAYMENT.—If social security benefits checks are delivered before the end of the calendar month for which they

are issued and are not deposited until the month for which they are issued, they will be treated as received in the month for which they are issued.

"(3) INCLUDIBLE SOCIAL SECURITY BENEFITS.—'Includible social security benefits' means the portion of social security benefits that would be included in gross income under section 86(a) of the Internal Revenue Code of 1986, except that for purposes of applying such section, the term 'modified adjusted gross income' means adjusted gross income (as defined in section 1(c)), determined without regard to the inclusion of any social security benefits.

"(c) PROPERTY RECEIVED FOR SERVICES.—

"(1) IN GENERAL.—If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

"(A) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to

a substantial risk of forfeiture, whichever occurs earlier, over

"(B) the amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

"(2) RULES AND REGULATIONS.—The Secretary shall prescribe rules and regulations similar to those applicable under section 83 of the Internal Revenue Code of 1986 for purposes of implementing this subsection.

"SEC. 4. EXCLUSIONS FROM GROSS INCOME.

"(a) GENERAL RULE.—Gross income does not include:

"(1) RETURNS OR BENEFITS FROM PREVIOUSLY TAXED INCOME.—

"(A) Social security benefits (as defined in section 3(b)(2)), other than includible social security benefits (as defined in section 3(b)(3)).

"(B) Amounts received under accident or health benefit plans (except as provided in section 3(a)(13)).

"(C) Value of services provided pursuant to a group legal service plan (but only if the cost of such services was paid by the employee or paid by the employer and included in the gross income of the employee).

"(D) Amounts received under an insurance contract for certain living expenses in the case of an individual whose principal residence is damaged or destroyed or who is denied access because of the threat of such occurrence.

"(E) Amounts treated as recovery of basis under any other provision of chapter 1.

"(2) COMPENSATION FOR SPECIAL KINDS OF SERVICE.—

"(A) In the case of a minister of the gospel—

"(i) the rental value of a home furnished to him, or

"(ii) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

"(B) Certain combat pay of members of the Armed Forces of the United States (as provided in section 92).

"(C) Certain reduced uniform services retirement pay (as defined in section 122 of the Internal Revenue Code of 1986).

"(D) Qualified military benefits (as defined in section 93).

"(E) Moving allowances for active military personnel (as defined in section 217(g) of the Internal Revenue Code of 1986).

"(F) Certain foster care payments (as defined in section 94).

"(3) GRATUITOUS, CHARITABLE, AND GOVERNMENTAL TRANSFERS.—

"(A) Gifts.

"(B) Inheritances.

"(C) Supplemental security income, aid to families with dependent children, food stamps, section 8 low-income rental assistance, benefits under the low-income home energy assistance program, and benefits under other similar Fed-

eral and State assistance programs for low-income individuals and families.

"(D) Benefits or assistance received from a charitable organization as the result of a disaster or by reason of financial need.

"(4) TAX-EXEMPT BOND INTEREST.—Interest on State and local bonds (as provided in section 91);

"(5) COMPENSATION FOR INJURY AND SICKNESS.—

"(A) Amounts received as compensation for personal injury or sickness (as provided in section 95).

"(B) Reimbursement and direct payments under Medicare and Medicaid.

"(6) BENEFITS PRIMARILY FOR THE CONVENIENCE OF THE EMPLOYER AND CERTAIN FRINGE BENEFITS.—

"(A) Meals or lodging furnished for the convenience of the employer (as provided in section 96).

"(B) Value of a parking space if employee uses the car parked in the space regularly on company business.

"(C) A fringe benefit that is a no-additional-cost service (as defined in section 97(b)),

subject to rules prohibiting discrimination in favor of the highly compensated.

"(D) A qualified employee discount (as defined in section 97(c)), subject to rules prohibiting discrimination in favor of the highly compensated.

"(E) Any property or services provided to an employee to the extent that if the employee were treated as a business and the business paid for those services, the employee could deduct the cost of such property or services under the business tax.

"(F) A de minimis fringe benefit (as defined in section 97(d)).

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

"(H) Any amount received directly or indirectly by an individual from an employer for moving expenses if—

"(i) the move is associated with a change in job locations for the same employer, and

"(ii) the expenses of such move would have been deductible under the rules under section 217 of the Internal Revenue Code of 1986 if paid directly by the employee.

"(I) Employer provided coverage under an accident or health plan.

"(7) REPAYABLE RECEIPTS.—The proceeds of borrowing or any other amounts legally received that the taxpayer is legally obligated to return (except that the imputed interest rules of section 7872 may apply if there is inadequate stated interest).

"(8) CERTAIN INCOME EARNED ABROAD.—Certain income and housing costs of citizens and residents of the United States living outside the United States in accordance with the rules under section 911 of the Internal Revenue Code of 1986.

"(9) DISCHARGE OF INDEBTEDNESS.—The amount of indebtedness discharged unless the discharge is for services, property, or other valuable right.

"(10) NONRECOGNITION TRANSACTIONS.—Amounts to which the nonrecognition transaction rules of section 77 apply.

"(11) PROCEEDS FROM SALE OF PRINCIPAL RESIDENCE.—Amounts excludable under section 76

(relating to certain proceeds from the sale of the taxpayer's principal residence).

"(12) TAXABLE RECEIPTS OF A BUSINESS ENTITY.—Amounts that are treated as taxable receipts of a business entity under the Simplified USA Tax for businesses and are not distributed to the individual taxpayer.

"(13) QUALIFIED RETIREMENT CONTRIBUTIONS.—Employer contributions to retirement plans that are exempt from taxation under chapter 3, including contributions pursuant to a cash or deferred payment plan described in section 401(k).

"(b) CROSS REFERENCES.—

"(1) ROTH IRAS.—For rules excluding from income earnings on, and distributions from, Roth IRAs, see sections 30 and 408A.

"(2) OTHER RETIREMENT PLANS.—For rules excluding or deferring from income earnings on other retirement plans, see chapter 3.

"SEC. 5. ALIMONY AND CHILD SUPPORT DEDUCTIONS.

"(a) GENERAL RULE.—A taxpayer shall be allowed an alimony and child support deductions for an amount equal to the alimony, child support, or separate maintenance payments paid during the taxpayer's taxable year.

"(b) DEFINITION OF ALIMONY, CHILD SUPPORT, AND SEPARATE MAINTENANCE PAYMENTS.—'Alimony, child support, and separate maintenance payments' means any alimony, child support, or separate maintenance payment which is includible in gross income of the recipient under section 3.

"SEC. 6. PERSONAL AND DEPENDENCY DEDUCTION.

"(a) AMOUNT OF EXEMPTION.—The personal and dependency deduction for an individual shall equal the number of exemptions multiplied by $2,700.

"(b) NUMBER OF EXEMPTIONS.—

"(1) TAXPAYER.—One exemption shall be allowed for the taxpayer unless the taxpayer files a joint return with a spouse, in which case 1 exemption shall be allowed for the husband and 1 for the wife.

"(2) ELIGIBLE DEPENDENT.—An exemption shall be allowed for each eligible dependent.

"(c) DEPENDENT.—

"(1) DEFINITION.—'Dependent' means any of the following individuals over half of whose support, for the calendar year was received from the taxpayer or is treated as received from the taxpayer:

"(A) A son or daughter of the taxpayer, or a descendant of either.

"(B) A stepson, stepdaughter, stepfather, or stepmother of the taxpayer.

"(C) A brother, sister, stepbrother, or stepsister of the taxpayer.

"(D) The father or mother of the taxpayer, or an ancestor of either.

"(E) A son or daughter of a brother or sister of the taxpayer.

"(F) A brother or sister of the mother or father of the taxpayer.

"(G) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer.

"(H) An individual (other than an individual who at any time during the taxable year was the spouse, determined without regard to section 7703, of a taxpayer) who, for the taxable year of the taxpayer, has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household.

"(2) RULES RELATING TO THE GENERAL DEFINITION.—The Secretary shall prescribe rules similar to the rules under section 152 of the Internal Revenue Code of 1986 that shall apply to the general definition of 'dependent', including definitional rules,

rules relating to multiple support agreements, and support tests in cases of children of divorced parents.

"(d) ELIGIBLE DEPENDENT.—

"(1) IN GENERAL.—'Eligible dependent' means a dependent—

"(A) whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than the exemption amount, or

"(B) who is a child of the taxpayer and who—

"(i) has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or

"(ii) is a student who has not attained the age of 24 at the close of such calendar year.

"(2) EXCLUSIONS.—A dependent who files a joint return with a spouse for the calendar year is not an eligible dependent.

"(3) RULES RELATING TO DEFINITIONS.—The Secretary shall prescribe rules similar to those included in or applicable under the Internal Revenue Code of 1986 relating to this subsection, including

rules defining 'child' and 'student' and rules relating to the income of handicapped dependents.

"(e) INFLATION ADJUSTMENT.—The dollar amount contained in subsection (a) shall be adjusted for inflation beginning with calendar year 1999 in accordance with the procedures of section 23.

"SEC. 7. FAMILY LIVING ALLOWANCE.

"(a) AMOUNT OF ALLOWANCE.—The Family Living Allowance for a taxpayer shall be determined in accordance with the following schedule:

"Form of Return:	Family Living Allowance:
Taxpayers filing joint return	$8,140.
Surviving spouse	$8,140.
Head of household	$5,940.
Individual who is not married or a head of household.	$4,840.
Married filing separate return	$4,070.

"(b) LIMITATION IN THE CASE OF CERTAIN DEPENDENTS.—In the case of an individual for whom another taxpayer can claim an exemption under section 6, the Family Living Allowance for such individual shall not exceed the greater of $700 or such individual's earned income (as defined in section 171(a)(6)).

"(c) ADJUSTMENTS FOR INFLATION.—The dollar amounts contained in subsections (a) and (b) shall be adjusted for inflation beginning with calendar year 1999 in accordance with the procedures of section 23.

"SEC. 8. USA DEDUCTIONS.

"In computing taxable income, an individual shall be entitled to the following deductions:

"(1) The homeowner deduction described in section 9.

"(2) The education deduction described in section 10.

"(3) The philanthropic transfer deduction described in section 11.

"SEC. 9. HOMEOWNER DEDUCTION.

"(a) IN GENERAL.—The homeowner deduction shall equal the amount of interest paid by the taxpayer during the taxable year on acquisition indebtedness with respect to any qualified residence of the taxpayer.

"(b) DEFINITIONS.—

"(1) ACQUISITION INDEBTEDNESS.—'Acquisition indebtedness' means any indebtedness that is secured by a qualified residence and that—

"(A) was incurred in acquiring, constructing, or substantially improving the qualified residence, or

"(B) was incurred to refinance any indebtedness that is described in subparagraph (A) or this subparagraph (B) but only to the extent that the refinancing does not exceed the amount refinanced.

The aggregate amount treated as acquisition indebtedness shall not exceed $1,000,000 ($500,000 in the case of a married individual filing separately).

"(2) QUALIFIED RESIDENCE.—'Qualified residence' means the principal residence of the taxpayer and 1 other residence of the taxpayer that is designated by the taxpayer and which—

"(A) is used by the taxpayer as a residence for more than 14 days during such year for which such unit is rented, and

"(B) is not rented for more than 14 days during such year.

"(c) COOPERATIVE HOUSING CORPORATION TENANT.—Any indebtedness secured by stock held by a taxpayer as a tenant-stockholder in a cooperative housing corporation shall be treated as secured by the house or apartment which the taxpayer is entitled to occupy as a tenant-stockholder. If such stock cannot be used to secure indebtedness, the indebtedness will be treated as so secured if the taxpayer establishes that such indebtedness was incurred to acquire stock.

"SEC. 10. EDUCATION DEDUCTION.

"(a) IN GENERAL.—The education deduction shall equal the sum of the qualified educational expenses for each eligible student.

"(b) QUALIFIED EDUCATION EXPENSES.—

"(1) IN GENERAL.—'Qualified education expenses' means with respect to an eligible student the lesser of—

"(A) $4,000, or

"(B) the qualified higher education expenses of the eligible student paid by the taxpayer during the taxable year.

"(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

"(A) IN GENERAL.—'Qualified higher education expenses' means tuition and fees required for the enrollment of an eligible student at an eligible education institution. Such term shall not include expenses with respect to any course or other education involving sports, games, or hobbies other than as part of a degree program.

"(B) ELIGIBLE EDUCATIONAL INSTITUTION.—'Eligible educational institution' means—

"(i) an institution which is described in section 481 of the Higher Education Act of 1965 (as in effect on May 15,

1998), and which is eligible to participate in a program under title IV of such Act.

"(ii) in the case of a student who has attained the age of 18 before the beginning of the taxable year, and not graduated from high school before the beginning of the taxable year, an accredited school providing remedial education.

"(3) ELIGIBLE STUDENT.—'Eligible student' means—

"(A) the taxpayer, but only if no other taxpayer treats the taxpayer as a dependent for which an exemption is allowed in computing the dependency deduction under section 6,

"(B) the taxpayer's spouse if a joint return is filed, and

"(C) any dependent of the taxpayer for whom the taxpayer is allowed an exemption in computing the dependency deduction under section 6.

"(c) LIMITATION.—The maximum education deduction in a taxable year is $12,000 ($6,000 in the case of married individuals filing separate returns).

"(d) INFLATION ADJUSTMENTS.—The dollar amounts contained in subsections (b)(1)(A) and (c) shall

be adjusted for inflation beginning with calendar year 1999 in accordance with section 23.

"SEC. 11. PHILANTHROPIC TRANSFER DEDUCTION.

"(a) IN GENERAL.—The philanthropic transfer deduction shall equal the amount of charitable contributions made by the taxpayer in the taxable year, subject to the limitations in subsection (b). A deduction shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

"(b) LIMITATION ON AMOUNT.—

"(1) GENERAL RULE.—A deduction for contributions to regular charities in any taxable year shall be allowed only to the extent that such contributions do not exceed 50 percent of the taxpayer's adjusted gross income. Other charitable contributions shall be allowed only to the extent that such contributions do not exceed the lesser of—

"(A) 30 percent of the taxpayer's adjusted gross income, or

"(B) the excess, if any, of 50 percent of the taxpayer's adjusted gross income over the amount of charitable contributions to regular charities.

"(2) CARRYOVER.—If the amount of charitable contributions made in a taxable year exceeds the

amount which can be deducted in such year, the excess shall be carried over for a period of up to 5 years in accordance with rules to be prescribed by the Secretary.

"(3) REGULAR CHARITY.—For purposes of this subsection, 'regular charity' means an organization described in section 101, that is not a private foundation (other than a private operating foundation) (as such terms are defined in section 102).

"(c) CHARITABLE CONTRIBUTION.—'Charitable contribution' means a contribution or gift to or for the use of a governmental or charitable recipient (as defined in section 101).

"(d) CONTRIBUTIONS OF PROPERTY.—

"(1) GENERAL RULE.—In the case of a charitable contribution of property, the amount of the contribution shall equal the lesser of the fair market value of the property or the taxpayer's basis in the property.

"(2) FAIR MARKET VALUE DEDUCTIONS IN CERTAIN CASES.—Notwithstanding paragraph (1), in the case of a charitable contribution (other than a contribution to a private foundation that is not a private operating foundation) of—

"(A) real property,

"(B) tangible property if the use by the donee is related to its purpose or function constituting the basis for its exemption from the business tax or in the case of a governmental unit, to any governmental unit, and

"(C) stocks, bonds, or other securities held for more than one year,

the amount of the charitable contribution shall equal the fair market value of the property.

"(3) CONTRIBUTIONS OF STOCK FOR WHICH MARKET QUOTATIONS ARE READILY AVAILABLE.—

"(A) IN GENERAL.—In the case of contributions of qualified appreciated stock, paragraph (2) shall apply without regard to whether the stock is contributed to a private foundation.

"(B) QUALIFIED APPRECIATED STOCK.—'Qualified appreciated stock' means any stock of a corporation for which (as of the date of the contribution) market quotations are readily available on an established securities market, except that in the case of a donor to a private foundation, the term does not include stock to the extent that the amount so contributed, when increased by prior contributions by the donor of stock in the same corporation, exceeds

10 percent in value of the outstanding stock of such corporation.

"(e) OTHER RULES.—The Secretary shall prescribe rules limiting the availability of the philanthropic transfer deduction in certain cases, including rules for—

"(1) contributions of property placed in trust,

"(2) contributions of partial interests in property,

"(3) contributions subject to liabilities that are assumed,

"(4) out-of-pocket expenditures on behalf of a charity to influence legislation,

"(5) substantiation of contributions in excess of $250,

"(6) contributions designated for lobbying activity,

"(7) amounts paid to maintain certain students as members of taxpayer's household,

"(8) qualified conservation contributions, and

"(9) deductions for travel expenses on behalf of a charity where there is a significant element of personal pleasure.

"SEC. 13. LIMITATION ON DEDUCTIONS.

"(a) IN GENERAL.—A taxpayer's deductions shall not reduce the taxpayer's taxable income below zero. Except

as provided in section 11(b) (relating to the limitation on the philanthropic transfer deduction), a taxpayer shall not be entitled to carry over any unused deductions.

"(b) DEDUCTIONS.—For purposes of this section, 'deductions' means—

"(1) the alimony and child support deductions,

"(2) the personal and dependency deduction,

"(3) the Family Living Allowance,

"(4) the USA deductions, and

"(5) the qualified IRA deduction.

"SEC. 15. TAX RATES.

"(a) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—The tax schedule for every married individual who files a joint return with a spouse and for every surviving spouse (as defined in section 17(a)) is—

"If taxable income is:	**The tax is:**
Not over $40,000	15% of taxable income.
Over $40,000, but not over $80,000.	$6,000, plus 25% of the excess over $40,000.
Over $80,000	$16,000, plus 30% of the excess over $80,000.

"(b) HEADS OF HOUSEHOLDS.—The tax schedule for every head of household (as defined in section 17(b)) is—

"If taxable income is:	**The tax is:**
Not over $35,000	15% of taxable income.
Over $35,000, but not over $70,000.	$5,250, plus 25% of the excess over $35,000.
Over $70,000	$14,000, plus 30% of the excess over $70,000.

"(c) UNMARRIED INDIVIDUALS.—The tax schedule for an unmarried individual who is not a head of a household or a surviving spouse is—

"If taxable income is:	**The tax is:**
Not over $24,000	15% of taxable income.
Over $24,000, but not over $48,000.	$3,600, plus 25% of the excess over $24,000.
Over $48,000	$9,600, plus 30% of the excess over $48,000.

"(d) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—The tax schedule for a married individual filing a separate return is—

"If taxable income is:	**The tax is:**
Not over $20,000	15% of taxable income.
Over $20,000, but not over $40,000.	$3,000, plus 25% of the excess over $20,000.
Over $40,000	$8,000, plus 30% of the excess over $40,000.

"(e) ADJUSTMENTS FOR INFLATION.—Beginning with calendar year 1999, the tax schedules in subsections (a) through (d) shall be adjusted so that inflation will not result in tax increases in accordance with the procedures under section 23.

"(f) DEFINITIONS.—See section 17 for rules on filing status.

"SEC. 16. KIDDIE TAX.

"(a) GENERAL RULE.—If a child has a living parent and net unearned income and the child has not attained the age of 14 before the close of the taxable year—

"(1) the net unearned income of the child shall be included in the taxable income of the eligible par-

ent for purposes of determining the parent's tax liability, or

"(2) the tax calculated under the tax rate schedules for the child as a separate taxpayer shall not be less than the sum of—

"(A) the tax which would have been determined under the rate schedule if the taxable income of the child were reduced by the net unearned income of the child, plus

"(B) such child's share of the allocable parental tax.

"(b) CHILD'S SHARE OF ALLOCABLE PARENTAL TAX.—

"(1) ALLOCABLE PARENTAL TAX.—'Allocable parental tax' means the excess of—

"(A) the tax that would have been determined under the rate schedules on the eligible parent's taxable income if such income included the net unearned income of all of the eligible parent's children to which this section applies, over

"(B) the tax actually determined under the rate schedules without regard to this section.

"(2) CHILD'S SHARE.—A child's share of the allocable parental tax is equal to the amount that

bears the same ratio to the total allocable parental tax as the child's net unearned income bears to the aggregate net unearned income of all children to whom this section applies for whom the eligible parent is the eligible parent.

''(c) ELIGIBLE PARENT.—'Eligible parent' means—

''(1) both parents of the child if the parents file a joint return,

''(2) the surviving parent of a child if the child has only 1 surviving parent,

''(3) the custodial parent if the child's parents are not married, or

''(4) the parent with the greater taxable income if the parents are married and filing separate returns.

''(d) NET UNEARNED INCOME.—'Net unearned income' means the excess, if any, of—

''(1) the adjusted gross income of the child, over

''(2) the sum of—

''(A) the earned income (as defined in section 171(a)(6)) of the child, and

''(B) an amount equal to the Family Living Allowance for a dependent child.

"SEC. 17. RULES FOR FILING STATUS AND RATE TABLES.

"(a) DEFINITION OF SURVIVING SPOUSE.—

"(1) IN GENERAL.—'Surviving spouse' means an individual—

"(A) whose spouse died during either of his 2 calendar years immediately preceding the calendar year, and

"(B) who maintains as his home a household which constitutes for the taxable year the principal place of abode (as a member of such household) of a dependent—

"(i) who (within the meaning of section 6) is a son, stepson, daughter, or stepdaughter of the taxpayer, and

"(ii) who the taxpayer is entitled to treat as an exemption for purposes of computing the personal dependency deduction for the taxable year under section 6.

For purposes of this paragraph, an individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

"(2) LIMITATIONS.—Notwithstanding paragraph (1), for purposes of section 15, an individual shall not be considered to be a surviving spouse—

"(A) if the individual has remarried at any time before the close of the taxable year, or

"(B) unless, for the individual's taxable year during which his spouse died, a joint return could have been made under the provisions of section 6013 (without regard to subsection (a)(3) thereof).

"(3) SPECIAL RULE WHERE DECEASED SPOUSE WAS IN MISSING STATUS.—If an individual was in a missing status (within the meaning of section 6013(f)(3)) as a result of service in a combat zone and if such individual remains in such status until the date referred to in subparagraph (A) or (B), then, for purposes of paragraph (1)(A), the date on which such individual died shall be treated as the earlier of the date determined under subparagraph (A) or the date determined under subparagraph (B):

"(A) the date on which the determination is made under section 556 of title 37 of the United States Code or under section 5566 of title 5 of such Code (whichever is applicable) that such individual died while in such missing status, or

"(B) the date which is 2 years after the date designated under section 92 (relating to

exemption for combat zones) as the date of termination of combatant activities in that zone.

"(b) DEFINITION OF HEAD OF HOUSEHOLD.—

"(1) IN GENERAL.—An individual shall be considered a head of a household if, and only if, such individual is not married at the close of his taxable year, is not a surviving spouse (as defined in subsection (a)), and either—

"(A) maintains as his home a household which constitutes for more than one-half of such taxable year the principal place of abode, as a member of such household, of—

"(i) a son, stepson, daughter, or stepdaughter of the taxpayer, or a descendant of a son or daughter of the taxpayer, but if such son, stepson, daughter, stepdaughter, or descendant is married at the close of the taxpayer's taxable year, only if the taxpayer is entitled to claim such person as an exemption for the taxable year for purposes of computing the dependency deduction under section 6 (or would be so entitled but for the release of a claim to such exemption by the custodial parent),

"(ii) any other person who is a dependent of the taxpayer, if the taxpayer is entitled to claim such person as an exemption in determining the personal dependency deduction for the taxable year, or

"(B) maintains a household which constitutes for such taxable year the principal place of abode of the father or mother of the taxpayer, if the taxpayer is entitled to a personal dependency deduction for the taxable year for such father or mother.

For purposes of this paragraph, an individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

"(2) DETERMINATION OF STATUS.—For purposes of this subsection—

"(A) a legally adopted child of a person shall be considered a child of such person by blood;

"(B) an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married;

"(C) a taxpayer shall be considered as not married at the close of his taxable year if at any time during the taxable year his spouse is a nonresident alien; and

"(D) a taxpayer shall be considered as married at the close of his taxable year if his spouse (other than a spouse described in subparagraph (C)) died during the taxable year.

"(3) LIMITATIONS.—Notwithstanding paragraph (1), for purposes of this chapter, a taxpayer shall not be considered to be a head of a household—

"(A) if at any time during the taxable year he is a nonresident alien; or

"(B) by reason of an individual who would not be a dependent for the taxable year but for—

"(i) subparagraph (H) of section 6(c)(1) or

"(ii) multiple support rules prescribed by the Secretary.

"(c) CERTAIN MARRIED INDIVIDUALS LIVING APART.—For purposes of this part, an individual shall be treated as not married at the close of the taxable year

if such individual is so treated under the provisions of section 7703(b).

"(d) NONRESIDENT ALIENS.—In the case of a nonresident alien individual, the taxes imposed by section 1 shall not apply.

"SEC. 20. USA TAX CREDITS.

"(a) IN GENERAL.—The USA tax credits are and shall be applied in the following order:

"(1) The foreign tax credit as prescribed by the Secretary under rules similar to the rules of subpart A of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1986, but only with respect to foreign taxes on amounts that are included in the gross income of the taxpayer.

"(2) The payroll tax credit under section 21.

"(3) The taxes-paid tax credit under section 22.

"(b) REFUNDABLE CREDITS.—If a taxpayer's USA tax credits (other than the foreign tax credit) for a taxable year exceed the taxpayer's tax liability for the taxable year (after application of the foreign tax credit but before application of the other USA tax credits), the taxpayer shall be entitled to a refund for such excess. The taxpayer may elect in lieu of a refund to apply such excess as a tax paid for the following taxable year.

"SEC. 21. PAYROLL TAX CREDIT.

"(a) IN GENERAL.—A taxpayer shall be allowed a payroll tax credit in an amount equal to the sum of—

"(1) the employee's share of the basic FICA tax,

"(2) the employee's share of the basic Tier 1 railroad retirement tax, and

"(3) one-half of the basic SECA tax payable with respect to the taxpayer's compensation or earnings during the taxable year.

"(b) DEFINITIONS.—

"(1) EMPLOYEE'S SHARE OF THE BASIC FICA TAX.—'Employee's share of the basic FICA tax' means the old-age, survivors and disability insurance tax imposed by section 3101(a) and the portion of the hospital insurance tax imposed by section 3101(b) that is attributable to the wage base on which the section 3101(a) tax is imposed.

"(2) EMPLOYEE'S SHARE OF THE BASIC TIER 1 RAILROAD RETIREMENT TAX.—Employee's share of the basic Tier 1 railroad retirement tax' means—

"(A) the portion of the tax imposed by section 3201 with respect to compensation below the applicable base (as defined in section 3231(e)(2)); and

"(B) the portion of the tax imposed by section 3211(a)(1) on railroad employee representatives attributable to the tax imposed by section 3101(a) and the portion of the hospital insurance tax imposed by section 3101(b) that is attributable to the wage base on which the section 3101(a) tax is imposed.

"(3) BASIC SECA TAX.—'Basic SECA tax' means the old-age, survivors and disability insurance tax imposed by section 1401(a) on self-employment income and the portion of the hospital insurance tax imposed by section 1401(b) on self-employment income that is attributable to the amount of self-employment income (as determined under section 1402(b)) on which the section 1401(a) tax is imposed.

"(c) NO CREDIT FOR REFUNDABLE TAX.—No credit shall be allowed with respect to any FICA tax or railroad retirement tax for which a taxpayer is entitled to a refund because of overpayment of tax on the applicable wage base.

"SEC. 22. TAXES-PAID TAX CREDIT.

"The taxes-paid tax credit shall equal the sum of—

"(1) WAGE WITHHOLDING.—The amount withheld as tax under chapter 24.

"(2) SPECIAL REFUNDS OF SOCIAL SECURITY TAX WHEN WAGES EARNED FROM MORE THAN 1 EMPLOYER.—The amount allowable under section 6413(c) as a special refund of taxes imposed on wages.

"(3) OVERPAYMENTS OF PRIOR-YEAR TAX.—Any overpayment of a prior tax obligation that the taxpayer or the Secretary applies to the tax for the taxable year.

"(4) ESTIMATED TAXES.—Any estimated taxes paid by the taxpayer with respect to the taxpayer's tax liability for the taxable year which are treated as payment on account of income tax for purposes of section 6315 (relating to estimated taxes).

"SEC. 23. INDEXING FOR INFLATION.

"(a) PUBLICATION OF TABLES AND NUMBERS.—Not later than December 15 of 1998, and each subsequent calendar year, the Secretary shall prescribe tables and dollar amounts which shall apply in the immediately following calendar year in lieu of the tables and dollar amounts that are required to be adjusted for inflation in accordance with this section.

"(b) METHOD OF ADJUSTMENT.—

"(1) IN GENERAL.—The dollar amounts which are required to be adjusted pursuant to this section

for a calendar year shall be the dollar amounts as stated in this chapter multiplied by the cost of living adjustment for such calendar year, rounded as provided in subsection (d).

"(2) TAX RATE TABLES.—In the case of a tax rate table, the dollar amounts to be adjusted in accordance with paragraph (1) are the minimum and maximum dollar amounts for each rate bracket for which a tax is imposed. The amounts setting forth the bottom tax for each bracket shall be adjusted to the extent necessary to reflect the adjustments in the rate brackets.

"(c) COST-OF-LIVING ADJUSTMENT.—

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

"(A) the CPI for the preceding calendar year, exceeds

"(B) the CPI for the calendar year 1997.

"(2) CPI FOR ANY CALENDAR YEAR.—For purposes of paragraph (1), the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on August 31 of such calendar year.

"(3) CONSUMER PRICE INDEX.—For purposes of paragraph (2), 'Consumer Price Index' means the last Consumer Price Index for all-urban consumers published by the Department of Labor. For purposes of the preceding sentence, the revision of the Consumer Price Index which is most consistent with the Consumer Price Index for calendar year 1998 shall be used.

"(d) ROUNDING.—

"(1) IN GENERAL.—If any increase determined under subsection (b) is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

"(2) MULTIPLES OF $25.—Paragraph (1) shall be applied by substituting '$25' for '$50' in the case of—

"(A) amounts for married individuals filing separately, and

"(B) any other dollar amount that is to be adjusted for inflation if that dollar amount is less than $1,000.

"Subchapter B—Roth IRA and Other Savings Provisions

"Sec. 30. Roth IRAs.
"Sec. 31. Deductible IRAs.
"Sec. 32. Effect of repeal of special savings provisions.

"SEC. 30. ROTH IRAS.

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

"(b) ROTH IRA.—'Roth IRA' means an individual retirement plan (as defined in section 7701(a)(37)) which is designated (in such manner as the Secretary may prescribe) at the time of establishment of the plan as a Roth IRA. Such designation shall be made in such manner as the Secretary may prescribe.

"(c) TREATMENT OF CONTRIBUTIONS.—

"(1) NO DEDUCTION ALLOWED.—No deduction shall be allowed for a contribution to a Roth IRA.

"(2) CONTRIBUTION LIMIT.—The aggregate amount of contributions for any taxable year to all Roth IRAs maintained for the benefit of an individual (or, in the case of individuals filing a joint return, either spouse) shall not exceed the taxpayer's adjusted gross income for the taxable year.

"(3) ROLLOVER FROM IRA.—

"(A) ROLLOVER CONTRIBUTIONS.—No rollover contribution may be made to a Roth IRA unless it is a qualified rollover contribution.

"(B) LIMITS.—A taxpayer shall not be allowed to make a qualified rollover contribution

to a Roth IRA from an individual retirement plan other than a Roth IRA during any taxable year if—

"(i) the taxpayer's adjusted gross income for such taxable year exceeds $100,000, or

"(ii) the taxpayer is a married individual filing a separate return.

"(C) MARITAL STATUS.—Section 31(g)(4) shall apply for purposes of this paragraph.

"(4) CONTRIBUTIONS PERMITTED AFTER AGE 70½.—Contributions to a Roth IRA may be made even after the individual for whom the account is maintained has attained age 70½.

"(5) MANDATORY DISTRIBUTION RULES NOT TO APPLY BEFORE DEATH.—Notwithstanding subsections (a)(6) and (b)(3) of section 408 (relating to required distributions), the following provisions shall not apply to any Roth IRA:

"(A) Section 401(a)(9)(A).

"(B) The incidental death benefit requirements of section 401(a).

"(6) TIME WHEN CONTRIBUTIONS MADE.—A taxpayer shall be deemed to have made a contribution to a Roth IRA during a year if the contribution

is made on account of such year and is made not later than April 15 of the following year.

"(d) EXCLUSION FROM INCOME.—For purposes of this chapter—

"(1) GENERAL RULES.—A distribution from a Roth IRA shall not be includible in gross income.

"(2) NONQUALIFIED DISTRIBUTION.—The automatic exclusion from gross income under paragraph (1) shall not apply to any distribution, other than a qualified special purpose distribution if—

"(A) it is made within the 5-taxable year period beginning with the 1st taxable year for which the individual made a contribution to a Roth IRA (or such individual's spouse made a contribution to a Roth IRA) established for such individual, or

"(B) in the case of a payment or distribution properly allocable (as determined in the manner prescribed by the Secretary) to a qualified rollover contribution from an individual retirement plan other than a Roth IRA (or income allocable thereto), it is made within the 5-taxable year period beginning with the taxable year in which the rollover contribution was made.

"(3) NONQUALIFIED DISTRIBUTIONS.—In applying section 33 to any distribution from a Roth IRA described in paragraph (2), such distribution shall be treated as made from contributions to the Roth IRA to the extent that such distribution, when added to all previous distributions from the Roth IRA, does not exceed the aggregate amount of contributions to the Roth IRA. Only distributions attributable to earnings on accounts (as opposed to distributions of contributions) shall be included in gross income.

"(4) ROLLOVERS FROM AN IRA OTHER THAN A ROTH IRA.—

"(A) IN GENERAL.—Notwithstanding section 408(d)(3), in the case of any distribution to which this paragraph applies there shall be included in gross income any amount which would be includible were it not part of a qualified rollover contribution.

"(B) DISTRIBUTIONS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to a distribution from an individual retirement plan (other than a Roth IRA) maintained for the benefit of an individual which is contributed to a Roth IRA maintained for the benefit of

such individual in a qualified rollover contribution.

"(C) CONVERSIONS.—The conversion of an individual retirement plan (other than a Roth IRA) to a Roth IRA shall be treated for purposes of this paragraph as a distribution to which this paragraph applies.

"(D) CONVERSION OF EXCESS CONTRIBUTIONS.—If, no later than the due date for filing the return of tax for any taxable year (without regard to extensions), an individual transfers, from an individual retirement plan (other than a Roth IRA), contributions for such taxable year (and any earnings allocable thereto) to a Roth IRA, no such amount shall be includible in gross income to the extent no deduction was allowed with respect to such amount.

"(E) ADDITIONAL REPORTING REQUIREMENTS.—Trustees of Roth IRAs, trustees of individual retirement plans, or both, whichever is appropriate, shall include such additional information in reports required under section 408(i) as the Secretary may require to ensure that amounts required to be included in gross income under subparagraph (A) are so included.

"(4) COORDINATION WITH INDIVIDUAL RETIREMENT ACCOUNTS.—Section 408(d)(2) shall be applied separately with respect to Roth IRAs and other individual retirement plans.

"(5) QUALIFIED SPECIAL PURPOSE DISTRIBUTION.—'Qualified special purpose distribution' means—

"(i) DISTRIBUTIONS UPON DEATH.—Distributions made to a beneficiary (or to the estate of the individual) on or after the death of the individual.

"(ii) DISTRIBUTIONS UPON DISABILITY.—Distributions attributable to the individual's being disabled.

"(iii) DISTRIBUTIONS TO PAY MEDICAL EXPENSES.—Distributions made to the individual for amounts paid during the year for medical care, but only to the extent that the amounts paid for medical care exceed 7.5% of the adjusted gross income of the taxpayer. (determined without regard to whether the employee itemizes deductions for such taxable year).

"(iv) QDROS.—Any distribution to an alternate payee pursuant to a qualified

domestic relations order (within the meaning of section 414(p)(1)).

"(v) DISTRIBUTIONS TO UNEMPLOYED INDIVIDUALS FOR HEALTH INSURANCE PREMIUMS.—Distributions to an individual—

"(I) if such individual has received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment compensation law by reason of such separation (or in the case of a self-employed individual, to the extent provided in regulations, if the individual would have received unemployment compensation but for the fact the individual was self-employed),

"(II) if such distributions are made during any taxable year during which such unemployment compensation is paid or the succeeding taxable year,

"(III) to the extent such distributions do not exceed the amount paid during the taxable year for insurance

for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (or for transportation primarily for and essential to such medical care) (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) or for any qualified long-term care insurance contract (as defined in section 7702B(b)) with respect to the individual and the individual's spouse and dependents, and

"(IV) such distributions are not made after the individual has been employed for at least 60 days after the separation from employment to which clause (I) applies.

"(v) DISTRIBUTIONS TO PAY HIGHER EDUCATION EXPENSES.—Distributions to the extent such distributions do not exceed the qualified higher education expenses (as defined in section 10(a)(2)) of—

"(I) the taxpayer,

"(II) the taxpayer's spouse, or

"(III) any child or grandchild of the taxpayer or the taxpayer's spouse.

"(vi) DISTRIBUTIONS FOR FIRST HOME PURCHASES.—Distributions which are qualified first-time homebuyer distributions (as defined in paragraph (6)).

"(6) QUALIFIED FIRST-TIME HOMEBUYER DISTRIBUTIONS.—

"(A) IN GENERAL.—'Qualified first-time homebuyer distribution' means any payment or distribution received by an individual to the extent such payment or distribution is used by the individual before the close of the 120th day after the day on which such payment or distribution is received to pay qualified acquisition costs with respect to a principal residence of a first-time homebuyer who is such individual, the spouse of such individual, or any child, grandchild, or ancestor of such individual or the individual's spouse.

"(B) LIFETIME DOLLAR LIMITATION.—The aggregate amount of payments or distributions received by an individual which may be

treated as qualified first-time homebuyer distributions for any taxable year shall not exceed the excess (if any) of—

"(i) $10,000, over

"(ii) the aggregate amounts treated as qualified first-time homebuyer distributions with respect to such individual for all prior taxable years.

"(C) QUALIFIED ACQUISITION COSTS.—'Qualified acquisition costs' means the costs of acquiring, constructing, or reconstructing a residence. Such term includes any usual or reasonable settlement, financing, or other closing costs.

"(D) FIRST-TIME HOMEBUYER; OTHER DEFINITIONS.—For purposes of this paragraph—

"(i) FIRST-TIME HOMEBUYER.—'First-time homebuyer' means any individual if such individual (and if married, such individual's spouse) had no present ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which this paragraph applies, and

"(ii) DATE OF ACQUISITION.—'Date of acquisition' means the date—

"(I) on which a binding contract to acquire the principal residence to which subparagraph (A) applies is entered into, or

"(II) on which construction or reconstruction of such a principal residence is commenced.

"(E) SPECIAL RULE WHERE DELAY IN ACQUISITION.—The Secretary shall prescribe rules under which a distribution will not be penalized if made in anticipation of being a qualified first-time homeowner distribution but construction delays or other unanticipated factors delay the closing.

"(e) QUALIFIED ROLLOVER CONTRIBUTION.—For purposes of this section, the term qualified rollover contribution means a rollover contribution to a Roth IRA from another such account, or from an individual retirement plan, but only if such rollover contribution meets the requirements of section 408(d)(3). For purposes of section 408(d)(3)(B), there shall be disregarded any qualified rollover contribution from an individual retirement plan (other than a Roth IRA) to a Roth IRA.

"(f) PERMITTED INVESTMENTS.—

"(1) INVESTMENT PERMITTED.—A Roth IRA shall not cease to be an individual retirement account pursuant to section 408(e)(2) solely because funds from such account are used to make a debt or equity investment in a controlled business entity.

"(2) LOANS TO A CONTROLLED BUSINESS ENTITY.—

"(A) EXCESS RETURN.—If funds in a Roth IRA are loaned to a controlled business entity, any return on such loans in excess of a fair return shall be treated as gross income of the beneficiary that is then deposited in the Roth IRA.

"(B) LOAN.—For purposes of this section, an amount shall be treated as loaned to a controlled business entity only if—

"(i) the amount is treated in the books and records of the business entity as a loan,

"(ii) the transaction is reflected in a written note or other evidence of indebtedness, and

"(iii) the business entity is required to pay interest at least once per year and at

the time such loan is made it is reasonable to expect that such interest will be paid on a timely basis.

"(C) FAIR RETURN.—For purposes of this subsection, a 'fair return' with respect to a loan is interest at a rate not in excess of 3 percentage points plus the minimum rate of interest that would have to be charged with respect to such loan to prevent it from being a below-market loan for purposes of section 7872 (determined as if section 7872 applied to such loan).

"(3) EQUITY INVESTMENT IN A CONTROLLED BUSINESS ENTITY.—If funds in a Roth IRA are contributed to the capital of, applied to acquire stock or other equity interest in, or otherwise transferred to, a controlled business entity in a transaction that is not considered a loan for purposes of this subsection, any return on such equity shall be treated as gross income of the beneficiary that is then deposited in the Roth IRA. The preceding sentence shall not apply to—

"(A) the proceeds of the sale of such equity interest to a third party, or

"(B) the proceeds received by the Roth IRA as the result of a complete redemption of

the beneficiary's interest in the business entity (including any interests held through a Roth IRA).

"(4) CONTROLLED BUSINESS ENTITY.—'Controlled business entity' means any business entity in which the beneficiary of the Roth IRA holds at least a 5 percent interest in the profits and losses (after taking into account the investment through the Roth IRA) and in which an investment would cause the Roth IRA to cease to be an individual retirement account by reason of section 408(e)(2) but for this subsection.

"(5) APPLICATION OF SECTION 4975.—Section 4975 shall not apply to a loan or equity investment by a Roth IRA in a controlled business entity.

"(6) TAX AND PENALTY AVOIDANCE.—The Secretary shall prescribe regulations that prohibit the provisions of this subsection to be used to circumvent the application of subsection (d)(2) (relating to taxable distributions). The regulations shall not prohibit bona fide investments in controlled business entities. The regulations shall address loans to and investments in a controlled business entity that are used to fund distributions or dividends from the

business entity to the account beneficiary or a member of the beneficiary's family.

"SEC. 31. DEDUCTIBLE IRAS.

"(a) ALLOWANCE OF DEDUCTION.—The 'qualified IRA deduction' shall be an amount equal to the qualified retirement contributions of the individual for the taxable year, except as limited by subsection (b).

"(b) MAXIMUM AMOUNT OF DEDUCTION.—

"(1) IN GENERAL.—The amount allowable as a deduction under subsection (a) to any individual for any taxable year shall not exceed the lesser of—

"(A) $2,000, or

"(B) an amount equal to the compensation includible in the individual's gross income for such taxable year.

"(2) SPECIAL RULE FOR EMPLOYER CONTRIBUTIONS UNDER SIMPLIFIED EMPLOYEE PENSIONS.—This section shall not apply with respect to an employer contribution to a simplified employee pension.

"(3) GRANDFATHERED PLANS.—Notwithstanding paragraph (1), the amount allowable as a deduction under subsection (a) with respect to any contributions on behalf of an employee to a plan described in section 501(c)(18) of the Internal Revenue Code of 1986 shall not exceed the lesser of—

"(A) $7,000, or

"(B) an amount equal to 25 percent of the compensation (as defined in section 415(c)(3)) includible in the individual's gross income for such taxable year.

"(4) SPECIAL RULE FOR SIMPLE RETIREMENT ACCOUNTS.—This section shall not apply with respect to any amount contributed to a simple retirement account established under section 408(p).

"(c) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS.—

"(1) IN GENERAL.—In the case of an individual to whom this paragraph applies for the taxable year, the limitation of paragraph (1) of subsection (b) shall be equal to the lesser of—

"(A) the dollar amount in effect under subsection (b)(1)(A) for the taxable year, or

"(B) the sum of—

"(i) the compensation includible in such individual's gross income for the taxable year, plus

"(ii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by—

"(I) the amount allowed as a deduction under subsection (a) to such spouse for such taxable year, and

"(II) the amount of any contribution on behalf of such spouse to a Roth IRA under section 30 for such taxable year.

"(2) INDIVIDUALS TO WHOM PARAGRAPH (1) APPLIES.—Paragraph (1) shall apply to any individual if—

"(A) such individual files a joint return for the taxable year, and

"(B) the amount of compensation (if any) includible in such individual's gross income for the taxable year is less than the compensation includible in the gross income of such individual's spouse for the taxable year.

"(d) OTHER LIMITATIONS AND RESTRICTIONS.—

"(1) BENEFICIARY MUST BE UNDER AGE 70½.—No deduction shall be allowed under this section with respect to any qualified retirement contribution for the benefit of an individual if such individual has attained age 70½ before the close of such individual's taxable year for which the contribution was made.

"(2) RECONTRIBUTED AMOUNTS.—No deduction shall be allowed under this section with respect to a rollover contribution described in section 402(c), 403(a)(4), 403(b)(8), or 408(d)(3).

"(3) AMOUNTS CONTRIBUTED UNDER ENDOWMENT CONTRACT.—In the case of an endowment contract described in section 408(b), no deduction shall be allowed under this section for that portion of the amounts paid under the contract for the taxable year which is properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

"(4) DENIAL OF DEDUCTION FOR AMOUNT CONTRIBUTED TO INHERITED ANNUITIES OR ACCOUNTS.—No deduction shall be allowed under this section with respect to any amount paid to an inherited individual retirement account or individual retirement annuity (within the meaning of section 408(d)(3)(C)(ii)).

"(e) QUALIFIED RETIREMENT CONTRIBUTION.—For purposes of this section, the term 'qualified retirement contribution' means—

"(1) any amount paid in cash for the taxable year by or on behalf of an individual to an individual retirement plan for such individual's benefit, and

"(2) any amount contributed on behalf of any individual to a plan described in section 501(c)(18) of the Internal Revenue Code of 1986.

"(f) OTHER DEFINITIONS AND SPECIAL RULES.—

"(1) COMPENSATION.—For purposes of this section, the term 'compensation' includes earned income (as defined in section 401(c)(2)). The term 'compensation' does not include any amount received as a pension or annuity and does not include any amount received as deferred compensation. The term 'compensation' shall include any alimony, child support and separate maintenance payments includible in the individual's gross income with respect to a divorce or separation instrument. For purposes of this paragraph, section 401(c)(2) shall be applied as if the term trade or business for purposes of section 1402 included service described in subsection (c)(6).

"(2) MARRIED INDIVIDUALS.—The maximum deduction under subsection (b) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(3) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a contribution to an

individual retirement plan during a year if the contribution is made on account of such year and is made not later than April 15 of the following year.

"(4) REPORTS.—The Secretary shall prescribe regulations which prescribe the time and the manner in which reports to the Secretary and plan participants shall be made by the plan administrator of a qualified employer or government plan receiving qualified voluntary employee contributions.

"(5) EMPLOYER PAYMENTS.—For purposes of this title, any amount paid by an employer to an individual retirement plan shall be treated as payment of compensation to the employee (other than a self-employed individual who is an employee within the meaning of section 401(c)(1)) includible in his gross income in the taxable year for which the amount was contributed, whether or not a deduction for such payment is allowable under this section to the employee.

"(6) EXCESS CONTRIBUTIONS TREATED AS CONTRIBUTION MADE DURING SUBSEQUENT YEAR FOR WHICH THERE IS AN UNUSED LIMITATION.—

"(A) IN GENERAL.—If for the taxable year the maximum amount allowable as a deduction under this section for contributions to an indi-

vidual retirement plan exceeds the amount contributed, then the taxpayer shall be treated as having made an additional contribution for the taxable year in an amount equal to the lesser of—

"(i) the amount of such excess, or

"(ii) the amount of the excess contributions for such taxable year (determined under section 4973(b)(2) without regard to subparagraph (C) thereof).

"(B) AMOUNT CONTRIBUTED.—For purposes of this paragraph, the amount contributed—

"(i) shall be determined without regard to this paragraph, and

"(ii) shall not include any rollover contribution.

"(C) SPECIAL RULE WHERE EXCESS DEDUCTION WAS ALLOWED FOR CLOSED YEAR.—Proper reduction shall be made in the amount allowable as a deduction by reason of this paragraph for any amount allowed as a deduction under this section for a prior taxable year for which the period for assessing deficiency has expired if the amount so allowed exceeds the

amount which should have been allowed for such prior taxable year.

"(7) ELECTION NOT TO DEDUCT CONTRIBUTIONS.—For election not to deduct contributions to individual retirement plans, see section 408(o)(2)(B)(ii).

"(g) LIMITATION ON DEDUCTION FOR ACTIVE PARTICIPANTS IN CERTAIN PENSION PLANS.—

"(1) IN GENERAL.—If (for any part of any plan year ending with or within a taxable year) an individual is an active participant, each of the dollar limitations contained in subsections (b)(1)(A) and (c)(1)(A) for such taxable year shall be reduced (but not below zero) by the amount determined under paragraph (2).

"(2) AMOUNT OF REDUCTION.—

"(A) IN GENERAL.—The amount determined under this paragraph with respect to any dollar limitation shall be the amount which bears the same ratio to such limitation as—

"(i) the excess of—

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

"(II) the applicable dollar amount, bears to

"(ii) $10,000 ($20,000 in the case of a joint return for a taxable year beginning after December 31, 2006).

"(B) NO REDUCTION BELOW $200 UNTIL COMPLETE PHASE-OUT.—No dollar limitation shall be reduced below $200 under paragraph (1) unless (without regard to this subparagraph) such limitation is reduced to zero.

"(C) ROUNDING.—Any amount determined under this paragraph which is not a multiple of $10 shall be rounded to the next lowest $10.

"(3) ADJUSTED GROSS INCOME; APPLICABLE DOLLAR AMOUNT.—For purposes of this subsection—

"(A) ADJUSTED GROSS INCOME.—Adjusted gross income of any taxpayer shall be determined without regard to the qualified IRA deduction.

"(B) APPLICABLE DOLLAR AMOUNT.—The term 'applicable dollar amount' means the following:

"(i) In the case of a taxpayer filing a joint return:

"For taxable years beginning in:	"The applicable dollar amount is:
1999	$51,000
2000	$52,000
2001	$53,000
2002	$54,000
2003	$60,000
2004	$65,000
2005	$70,000
2006	$75,000
2007 and thereafter	$80,000.

"(ii) In the case of any other taxpayer (other than a married individual filing a separate return):

For taxable years beginning in:	The applicable dollar amount is:
1999	$31,000
2000	$32,000
2001	$33,000
2002	$34,000
2003	$40,000
2004	$45,000
2005 and thereafter	$50,000.

"(iii) In the case of a married individual filing a separate return, zero.

"(4) SPECIAL RULE FOR MARRIED INDIVIDUALS FILING SEPARATELY AND LIVING APART.—A husband and wife who—

"(A) file separate returns for any taxable year, and

"(B) live apart at all times during such taxable year, shall not be treated as married individuals for purposes of this subsection.

"(5) ACTIVE PARTICIPANT.—For purposes of this subsection, the term 'active participant' means, with respect to any plan year, an individual—

"(A) who is an active participant in—

"(i) a plan described in section 401(a) which includes a trust exempt from tax,

"(ii) an annuity plan described in section 403(a),

"(iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing,

"(iv) an annuity contract described in section 403(b),

"(v) a simplified employee pension (within the meaning of section 408(k)), or

"(vi) any simple retirement account (within the meaning of section 408(p), or

"(B) who makes deductible contributions to a trust described in section 501(c)(18).

The determination of whether an individual is an active participant shall be made without regard to whether or not such individual's rights under a plan, trust, or contract are nonforfeitable. An eligible de-

ferred compensation plan (within the meaning of section 457(b) of the Internal Revenue Code of 1986) shall not be treated as a plan described in subparagraph (A)(iii).

"(6) CERTAIN INDIVIDUALS NOT TREATED AS ACTIVE PARTICIPANTS.—For purposes of this subsection, any individual described in any of the following subparagraphs shall not be treated as an active participant for any taxable year solely because of any participation so described:

"(A) MEMBERS OF RESERVE COMPONENTS.—Participation in a plan described in subparagraph (A)(iii) of paragraph (5) by reason of service as a member of a reserve component of the Armed Forces (as defined in section 10101 of title 10, unless such individual has served in excess of 90 days on active duty (other than active duty for training) during the year.

"(B) VOLUNTEER FIREFIGHTERS.—A volunteer firefighter—

"(i) who is a participant in a plan described in subparagraph (A)(iii) of paragraph (5) based on his activity as a volunteer firefighter, and

"(ii) whose accrued benefit as of the beginning of the taxable year is not more than an annual benefit of $1,800 (when expressed as a single life annuity commencing at age 65).

"(7) SPECIAL RULE FOR CERTAIN SPOUSES.—In the case of an individual who is an active participant at no time during any plan year ending with or within the taxable year but whose spouse is an active participant for any part of any such plan year—

"(A) the applicable dollar amount under paragraph (3)(B)(i) with respect to the taxpayer shall be $150,000, and

"(B) the amount applicable under paragraph (2)(A)(ii) shall be $10,000.

"(h) CROSS REFERENCE.—For failure to provide required reports, see section 6652(g).

"SEC. 32. EFFECT OF REPEAL OF SPECIAL SAVINGS PROVISIONS.

"(a) EDUCATION IRA'S.—

"(1) IN GENERAL.—An account that qualifies as an education IRA under the Internal Revenue Code of 1986 as in effect immediately before adoption of the Simplified USA Tax Act shall be treated

as a Roth IRA for purposes of this chapter (including rules allowing for tax-free rollover).

"(2) NO NEW CONTRIBUTIONS.—Neither paragraph (1) nor section 530 of the Internal Revenue Code of 1986 shall apply to an education IRA to which contributions are made after December 31, 1998.

"(3) SPECIAL RULE.—For purposes of applying section 30 to an account that was an educational IRA, the designated beneficiary of such account shall be treated as described in a subclause of clause (vi) of section 30(d)(5).

"(b) MEDICAL SAVINGS ACCOUNTS.—

"(1) EQUIVALENT OF DEDUCTIBLE IRA.—A medical savings account shall be treated as an individual retirement plan other than a Roth IRA for purposes of this chapter and chapter 3.

"(2) SPECIAL ROLLOVER RULES.—

"(A) NO INCOME LIMIT.—The income limits of section 30(c)(3)(B) shall not apply to the rollover of a medical savings account into a Roth IRA.

"(B) MEDICAL DISTRIBUTIONS.—For purposes of applying section 30 to the amount of any medical savings account rolled over to a

Roth IRA, subclause (iii) of section 30(d)(5) shall apply without regard to the limitation based on adjusted gross income.

"(3) MEDICAL SAVINGS ACCOUNT.—'Medical savings account' means an account established under section 220 of the Internal Revenue Code of 1986.

"(c) QUALIFIED STATE TUITION PROGRAMS.—

"(1) EDUCATION SAVINGS ACCOUNT PROGRAMS.—No account shall fail to qualify as a Roth IRA merely because in addition to the beneficiary of the account, there is a 'designated beneficiary' whose education expenses the beneficiary expects to pay or have paid with the proceeds of the account. The payment of such expenses with the proceeds of an account shall be treated as a distribution from the account.

"(2) PREPAID TUITION CERTIFICATES.—

"(A) CONTRIBUTION TO ACCOUNTS.—An individual may contribute prepaid tuition certificates to a Roth IRA before January 1, 2002, without recognizing gross income on the contribution of such certificates. For purposes of section 30, the amount contributed shall equal the cost of the certificates.

"(B) PURCHASE OF PREPAID TUITION CERTIFICATES.—A Roth IRA account may purchase prepaid tuition certificates without violating section 408.

"(C) PREPAID TUITION CERTIFICATES.—'Prepaid tuition certificates' means credits or certificates that entitle a designated beneficiary of such certificates to the waiver or payment of qualified higher education expenses of the designated beneficiary.

"(3) ROLLOVER OF ACCOUNTS.—An account to which section 529 of the Internal Revenue Code of 1986 (before adoption of the Simplified USA Tax Act) shall be treated as a Roth IRA for purposes of rules relating to qualified rollovers (except that in the case of any such rollover, any contributions made to the section 529 account after July 1, 1998, shall be treated as contributions to the Roth IRA in the year of the rollover for purposes of section 30(c)(2)).

"(4) TRANSITION.—

"(A) TRANSITION PERIOD.—Subsections (a) and (c) of section 529 of the Internal Revenue Code of 1986 shall apply until January 1, 2002.

"(B) TRANSITION.—The Secretary shall prescribe rules to facilitate use of the Roth IRA rules to exempt earnings on accounts and certificates previously exempted under section 529 of the Internal Revenue Code of 1986.

"(5) QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of this subsection, the definition 'qualified higher education expenses' in section 529(e)(3) of the Internal Revenue Code of 1986 shall apply.

"SEC. 33. ANNUITIES, CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS.

"(a) GENERAL RULE FOR ANNUITIES.—Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

"(b) EXCLUSION RATIO.—

"(1) IN GENERAL.—Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date).

"(2) EXCLUSION LIMITED TO INVESTMENT.—The portion of any amount received as an annuity which is excluded from gross income under paragraph (1) shall not exceed the unrecovered investment in the contract immediately before the receipt of such amount.

"(3) DEDUCTION WHERE ANNUITY PAYMENTS CEASE BEFORE ENTIRE INVESTMENT RECOVERED.—

"(A) IN GENERAL.—If—

"(i) after the annuity starting date, payments as an annuity under the contract cease by reason of the death of an annuitant, and

"(ii) as of the date of such cessation, there is unrecovered investment in the contract,

the amount of such unrecovered investment (in excess of any amount specified in subsection (e)(5) which was not included in gross income) shall be allowed as a deduction from adjusted gross income in determining taxable income of the annuitant for his last taxable year.

"(B) PAYMENTS TO OTHER PERSONS.—In the case of any contract which provides for payments meeting the requirements of subpara-

graphs (B) and (C) of subsection (c)(2), the deduction under subparagraph (A) shall be allowed to the person entitled to such payments for the taxable year in which such payments are received.

"(c) DEFINITIONS.—

"(1) INVESTMENT IN THE CONTRACT.—For purposes of subsection (b), the investment in the contract as of the annuity starting date is—

"(A) the aggregate amount of premiums or other consideration paid for the contract (including any amounts earned on the contract which were included in gross income and reinvested in the contract), minus

"(B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

"(2) OTHER TERMS USED IN SUBSECTION (b).—Calculations under subsections (a) and (b) shall be made in accordance with regulations prescribed by the Secretary, which regulations shall generally be consistent with the section 72 of the Internal Revenue Code of 1986.

"(d) SPECIAL RULES FOR QUALIFIED EMPLOYER RETIREMENT PLANS.—

"(1) SIMPLIFIED METHOD OF TAXING ANNUITY PAYMENTS.—

"(A) IN GENERAL.—In the case of any amount received as an annuity under a qualified employer retirement plan—

"(i) subsection (b) shall not apply, and

"(ii) the investment in the contract shall be recovered as provided in this paragraph.

"(B) METHOD OF RECOVERING INVESTMENT IN CONTRACT.—

"(i) IN GENERAL.—Gross income shall not include so much of any monthly annuity payment under a qualified employer retirement plan as does not exceed the amount obtained by dividing—

"(I) the investment in the contract (as of the annuity starting date), by

"(II) the number of anticipated payments determined under the table contained in clause (iii) (or, in the

case of a contract to which subsection (c)(3)(B) applies, the number of monthly annuity payments under such contract).

"(ii) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (2) and (3) of subsection (b) shall apply for purposes of this paragraph.

"(iii) NUMBER OF ANTICIPATED PAYMENTS.—If the annuity is payable over the life of a single individual, the number of anticipated payments shall be determined as follows:

If the age of the annuitant on the annuity starting date is:	The number:
Not more than 55	360
More than 55 but not more than 60.	310
More than 60 but not more than 65.	260
More than 65 but not more than 70.	210
More than 70	160

"(iv) NUMBER OF ANTICIPATED PAYMENTS WHERE MORE THAN ONE LIFE.—If the annuity is payable over the lives of more than 1 individual, the number of anticipated payments shall be determined as follows:

If the combined ages of the annuitants are:	The number:
Not more than 110	410
More than 110 but not more than 120.	360
More than 120 but not more than 130.	310
More than 130 but not more than 140.	260
More than 140	210

"(C) SPECIAL RULE WHERE LUMP SUM PAID IN CONNECTION WITH COMMENCEMENT OF ANNUITY PAYMENTS.—If, in connection with the commencement of annuity payments under any qualified employer retirement plan, the taxpayer receives a lump sum payment—

"(i) such payment shall be taxable under subsection (e) as if received before the annuity starting date, and

"(ii) the investment in the contract for purposes of this paragraph shall be determined as if such payment had been so received.

"(D) EXCEPTION.—This paragraph shall not apply in any case where the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity.

"(E) ADJUSTMENT WHERE ANNUITY PAYMENTS NOT ON A MONTHLY BASIS.—In any

case where the annuity payments are not made on a monthly basis, appropriate adjustments in the application of this paragraph shall be made to take into account the period on the basis of which such payments are made.

"(F) QUALIFIED EMPLOYER RETIREMENT PLAN.—For purposes of this paragraph, the term 'qualified employer retirement plan' means any plan or contract described in paragraph (1), (2), or (3) of section 4974(c).

"(2) TREATMENT OF EMPLOYEE CONTRIBUTIONS UNDER DEFINED CONTRIBUTION PLANS.—For purposes of this section, employee contributions (and any income allocable thereto) under a defined contribution plan may be treated as a separate contract.

"(e) AMOUNTS NOT RECEIVED AS ANNUITIES.—

"(1) APPLICATION OF SUBSECTION.—

"(A) IN GENERAL.—This subsection shall apply to any amount which—

"(i) is received under an annuity, endowment, or life insurance contract, and

"(ii) is not received as an annuity,

if no provision of this subtitle (other than this subsection) applies with respect to such amount.

"(B) DIVIDENDS.—For purposes of this section, any amount received which is in the nature of a dividend or similar distribution shall be treated as an amount not received as an annuity.

"(2) GENERAL RULE.—Any amount to which this subsection applies—

"(A) if received on or after the annuity starting date, shall be included in gross income, or

"(B) if received before the annuity starting date—

"(i) shall be included in gross income to the extent allocable to income on the contract, and

"(ii) shall not be included in gross income to the extent allocable to the investment in the contract.

"(3) ALLOCATION OF AMOUNTS TO INCOME AND INVESTMENT.—For purposes of paragraph (2)(B):

"(A) Any amount to which this subsection applies shall be treated as allocable to income on the contract to the extent that such amount does not exceed the excess (if any) of—

"(i) the cash value of the contract (determined without regard to any surrender charge) immediately before the amount is received, over

"(ii) the investment in the contract at such time.

"(B) Any amount to which this subsection applies shall be treated as allocable to investment in the contract to the extent that such amount is not allocated to income under subparagraph (A).

"(4) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (2)(B).—For purposes of paragraph (2)(B):

"(A) LOANS TREATED AS DISTRIBUTIONS.—If, during any taxable year, an individual—

"(i) receives (directly or indirectly) any amount as a loan under any contract to which this subsection applies, or

"(ii) assigns or pledges (or agrees to assign or pledge) any portion of the value of any such contract,

such amount or portion shall be treated as received under the contract as an amount not received as an annuity. The preceding sentence shall not apply for purposes of determining investment in the contract, except that the investment in the contract shall be increased by any amount included in gross income by reason of the amount treated as received under the preceding sentence.

"(B) TREATMENT OF TRANSFERS WITHOUT ADEQUATE CONSIDERATION.—

"(i) IN GENERAL.—If an individual who holds an annuity contract transfers it without full and adequate consideration, such individual shall be treated as receiving an amount equal to the excess of—

"(I) the cash surrender value of such contract at the time of transfer, over

"(II) the investment in such contract at such time,

under the contract as an amount not received as an annuity.

"(ii) EXCEPTION FOR CERTAIN TRANSFERS BETWEEN SPOUSES OR FORMER SPOUSES.—Clause (i) shall not apply to any transfer to which section 77(c) (relating to transfers of property between spouses or incident to divorce) applies.

"(iii) ADJUSTMENT TO INVESTMENT IN CONTRACT OF TRANSFEREE.—If under clause (i) an amount is included in the gross income of the transferor of an annuity contract, the investment in the contract of the transferee in such contract shall be increased by the amount so included.

"(5) RETENTION OF EXISTING RULES IN CERTAIN CASES.—Paragraph (5) of section 72(e) of the Internal Revenue Code of 1986 shall apply to contracts described in subparagraph (B) of such paragraph to the extent provided therein.

"(6) INVESTMENT IN THE CONTRACT.—For purposes of this subsection, the investment in the contract as of any date is—

"(A) the aggregate amount of premiums or other consideration paid for the contract before such date, minus

"(B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

"(7) APPLICATION OF PARAGRAPH (2)(B) TO QUALIFIED PLANS.—

"(A) IN GENERAL.—Notwithstanding any other provision of this subsection, in the case of any amount received before the annuity starting date from a trust or contract described in paragraph (5)(D), paragraph (2)(B) shall apply to such amounts.

"(B) ALLOCATION OF AMOUNT RECEIVED.—For purposes of paragraph (2)(B), the amount allocated to the investment in the contract shall be the portion of the amount described in subparagraph (A) which bears the same ratio to such amount as the investment in the contract bears to the account balance. The determination under the preceding sentence shall be made as of the time of the distribution

or at such other time as the Secretary may prescribe.

"(C) TREATMENT OF FORFEITABLE RIGHTS.—If an employee does not have a nonforfeitable right to any amount under any trust or contract to which subparagraph (A) applies, such amount shall not be treated as part of the account balance.

"(D) INVESTMENT IN THE CONTRACT BEFORE 1987.—In the case of a plan which on May 5, 1986, permitted withdrawal of any employee contributions before separation from service, subparagraph (A) shall apply only to the extent that amounts received before the annuity starting date (when increased by amounts previously received under the contract after December 31, 1986) exceed the investment in the contract as of December 31, 1986.

"(8) TREATMENT OF MODIFIED ENDOWMENT CONTRACTS.—

"(A) IN GENERAL.—Notwithstanding paragraph (5)(C), in the case of any modified endowment contract (as defined in section 7702A)—

"(i) paragraphs (2)(B) and (4)(A) shall apply, and

"(ii) in applying paragraph (4)(A), 'any person' shall be substituted for 'an individual'.

"(B) TREATMENT OF CERTAIN BURIAL CONTRACTS.—Notwithstanding subparagraph (A), paragraph (4)(A) shall not apply to any assignment (or pledge) of a modified endowment contract if such assignment (or pledge) is solely to cover the payment of expenses referred to in section 7702(e)(2)(C)(iii) and if the maximum death benefit under such contract does not exceed $25,000.

"(9) ANTI-ABUSE RULES.—

"(A) IN GENERAL.—For purposes of determining the amount includible in gross income under this subsection—

"(i) all modified endowment contracts issued by the same company to the same policyholder during any calendar year shall be treated as 1 modified endowment contract, and

"(ii) all annuity contracts issued by the same company to the same policyholder

during any calendar year shall be treated as 1 annuity contract.

The preceding sentence shall not apply to any contract described in paragraph (5)(D).

"(B) REGULATORY AUTHORITY.—The Secretary may by regulations prescribe such additional rules as may be necessary or appropriate to prevent avoidance of the purposes of this subsection through serial purchases of contracts or otherwise.

"(f) SPECIAL RULES FOR COMPUTING EMPLOYEES' CONTRIBUTIONS.—In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, and for purposes of subsection (e)(6), the aggregate premiums or other consideration paid, amounts contributed by the employer shall be included, but only to the extent that—

"(1) such amounts were includible in the gross income of the employee under this subtitle or prior income tax laws; or

"(2) if such amounts had been paid directly to the employee at the time they were contributed, they would not have been includible in the gross income of the employee under the law applicable at the time of such contribution.

"(g) RULES FOR TRANSFEREE WHERE TRANSFER WAS FOR VALUE.—Where any contract (or any interest therein) is transferred (by assignment or otherwise) for a valuable consideration, to the extent that the contract (or interest therein) does not, in the hands of the transferee, have a basis which is determined by reference to the basis in the hands of the transferor, then—

"(1) for purposes of this section, only the actual value of such consideration, plus the amount of the premiums and other consideration paid by the transferee after the transfer, shall be taken into account in computing the aggregate amount of the premiums or other consideration paid for the contract;

"(2) for purposes of subsection (c)(1)(B), there shall be taken into account only the aggregate amount received under the contract by the transferee before the annuity starting date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws; and

"(3) the annuity starting date is January 1, 1954, or the first day of the first period for which the transferee received an amount under the contract as an annuity, whichever is the later.

"(h) OPTION TO RECEIVE ANNUITY IN LIEU OF LUMP SUM.—If—

"(1) a contract provides for payment of a lump sum in full discharge of an obligation under the contract, subject to an option to receive an annuity in lieu of such lump sum;

"(2) the option is exercised within 60 days after the day on which such lump sum first became payable; and

"(3) part or all of such lump sum would (but for this subsection) be includible in gross income by reason of subsection (e)(1),

then, for purposes of this subtitle, no part of such lump sum shall be considered as includible in gross income at the time such lump sum first became payable.

"(i) INTEREST.—Notwithstanding any other provision of this section, if any amount is held under an agreement to pay interest thereon, the interest payments shall be included in gross income.

"(j) FACE-AMOUNT CERTIFICATES.—For purposes of this section, the term 'endowment contract' includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a–2), issued after December 31, 1954.

"(k) SPECIAL RULES APPLICABLE TO EMPLOYEE ANNUITIES AND DISTRIBUTIONS UNDER EMPLOYEE PLANS.—

"(1) COMPUTATION OF CONSIDERATION PAID BY THE EMPLOYEE.—In computing—

"(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of subsection (c)(1)(A) (relating to the investment in the contract), and

"(B) the aggregate premiums or other consideration paid for purposes of subsection (e)(6) (relating to certain amounts not received as an annuity),

any amount allowed as a deduction with respect to the contract under section 404 which was paid while the employee was an employee within the meaning of section 401(c)(1) shall be treated as consideration contributed by the employer, and there shall not be taken into account any portion of the premiums or other consideration for the contract paid while the employee was an owner-employee which is properly allocable (as determined under regulations prescribed by the Secretary) to the cost of life, accident, health, or other insurance.

"(2) LIFE INSURANCE CONTRACTS.—

"(A) This paragraph shall apply to any life insurance contract—

"(i) purchased as a part of a plan described in section 403(a), or

"(ii) purchased by a trust described in section 401(a) which is exempt from tax if the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant.

"(B) Any contribution to a plan described in subparagraph (A)(i) or a trust described in subparagraph (A)(ii) which is allowed as a deduction under section 404, and any income of a trust described in subparagraph (A)(ii), which is determined in accordance with regulations prescribed by the Secretary to have been applied to purchase the life insurance protection under a contract described in subparagraph (A), is includible in the gross income of the participant for the taxable year when so applied.

"(C) In the case of the death of an individual insured under a contract described in subparagraph (A), an amount equal to the cash surrender value of the contract immediately be-

fore the death of the insured shall be treated as a payment under such plan or a distribution by such trust, and the excess of the amount payable by reason of the death of the insured over such cash surrender value shall not be includible in gross income under this section and shall be treated as provided in section 101.

"(3) PENALTIES APPLICABLE TO CERTAIN AMOUNTS RECEIVED BY 5-PERCENT OWNERS.—

"(A) This paragraph applies to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by an individual who is, or has been, a 5-percent owner, or by a successor of such an individual, but only to the extent such amounts are determined, under regulations prescribed by the Secretary, to exceed the benefits provided for such individual under the plan formula.

"(B) If a person receives an amount to which this paragraph applies, his tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of

the amount so received which is includible in his gross income for such taxable year.

"(C) For purposes of this paragraph, the term '5-percent owner' means any individual who, at any time during the 5 plan years preceding the plan year ending in the taxable year in which the amount is received, is a 5-percent owner (as defined in section 416(i)(1)(B).

"(4) OWNER-EMPLOYEE DEFINED.—For purposes of this subsection, the term 'owner-employee' has the meaning assigned to it by section 401(c)(3) and includes an individual for whose benefit an individual retirement account or annuity described in section 408(a) or (b) is maintained. For purposes of the preceding sentence, the term 'owner-employee' shall include an employee within the meaning of section 401(c)(1).

"(5) MEANING OF DISABLED.—For purposes of this section, an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof

of the existence thereof in such form and manner as the Secretary may require.

"(6) DETERMINATION OF INVESTMENT IN THE CONTRACT IN THE CASE OF QUALIFIED DOMESTIC RELATIONS ORDERS.—Under regulations prescribed by the Secretary, in the case of a distribution or payment made to an alternate payee who is the spouse or former spouse of the participant pursuant to a qualified domestic relations order (as defined in section 414(p)), the investment in the contract as of the date prescribed in such regulations shall be allocated on a pro rata basis between the present value of such distribution or payment and the present value of all other benefits payable with respect to the participant to which such order relates.

"(l) ANNUITIES UNDER RETIRED SERVICEMAN'S FAMILY PROTECTION PLAN OR SURVIVOR BENEFIT PLAN.—Subsection (b) shall not apply in the case of amounts received after December 31, 1965, as an annuity under chapter 73 of title 10 of the United States Code, but all such amounts shall be excluded from gross income until there has been so excluded (under section 122(b)(1) of the Internal Revenue Code of 1986, section 93, or this section, including amounts excluded before January 1, 1966) an amount equal to the consideration for the con-

tract (as defined by section 122(b)(2) of the Internal Revenue Code of 1986). Thereafter all amounts so received shall be included in gross income.

"(m) SPECIAL RULES FOR DISTRIBUTIONS FROM QUALIFIED PLANS TO WHICH EMPLOYEE MADE DEDUCTIBLE CONTRIBUTIONS.—

"(1) TREATMENT OF CONTRIBUTIONS.—For purposes of this section and sections 402 and 403, notwithstanding section 414(h), any deductible employee contribution made to a qualified employer plan or government plan shall be treated as an amount contributed by the employer which is not includible in the gross income of the employee.

"(2) AMOUNTS CONSTRUCTIVELY RECEIVED.—

"(A) IN GENERAL.—For purposes of this subsection, rules similar to the rules provided by subsection (n) (other than the exception contained in paragraph (2) thereof) shall apply.

"(B) PURCHASE OF LIFE INSURANCE.—To the extent any amount of accumulated deductible employee contributions of an employee are applied to the purchase of life insurance contracts, such amount shall be treated as distributed to the employee in the year so applied.

"(3) SPECIAL RULE FOR TREATMENT OF ROLLOVER AMOUNTS.—For purposes of sections 402(c), 403(a)(4), and 408(d)(3), the Secretary shall prescribe regulations providing for such allocations of amounts attributable to accumulated deductible employee contributions, and for such other rules, as may be necessary to insure that such accumulated deductible employee contributions do not become eligible for additional tax benefits (or freed from limitations) through the use of rollovers.

"(4) ORDERING RULES.—Unless the plan specifies otherwise, any distribution from such plan shall not be treated as being made from the accumulated deductible employee contributions, until all other amounts to the credit of the employee have been distributed.

"(n) LOANS TREATED AS DISTRIBUTIONS.—For purposes of this section—

"(1) TREATMENT AS DISTRIBUTIONS.—

"(A) LOANS.—If during any taxable year a participant or beneficiary receives (directly or indirectly) any amount as a loan from a qualified employer plan, such amount shall be treated as having been received by such individual as a distribution under such plan.

"(B) ASSIGNMENTS OR PLEDGES.—If during any taxable year a participant or beneficiary assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a qualified employer plan, such portion shall be treated as having been received by such individual as a loan from such plan.

"(2) EXCEPTION FOR CERTAIN LOANS.—

"(A) GENERAL RULE.—Paragraph (1) shall not apply to any loan to the extent that such loan (when added to the outstanding balance of all other loans from such plan whether made on, before, or after August 13, 1982), does not exceed the lesser of—

"(i) $50,000, reduced by the excess (if any) of—

"(I) the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date on which such loan was made, over

"(II) the outstanding balance of loans from the plan on the date on which such loan was made, or

"(ii) the greater of (I) one-half of the present value of the nonforfeitable accrued benefit of the employee under the plan, or (II) $10,000.

for purposes of clause (ii), the present value of the nonforfeitable accrued benefit shall be determined without regard to any accumulated deductible employee contributions (as defined in subsection (m)(5)(B)).

"(B) REQUIREMENT THAT LOAN BE REPAYABLE WITHIN 5 YEARS.—

"(i) IN GENERAL.—Subparagraph (A) shall not apply to any loan unless such loan, by its terms, is required to be repaid within 5 years.

"(ii) EXCEPTION FOR HOME LOANS.—Clause (i) shall not apply to any loan used to acquire any dwelling unit which within a reasonable time is to be used (determined at the time the loan is made) as the principal residence of the participant.

"(C) REQUIREMENT OF LEVEL AMORTIZATION.—Except as provided in regulations, this paragraph shall not apply to any loan unless substantially level amortization of such loan

(with payments not less frequently than quarterly) is required over the term of the loan.

"(D) RELATED EMPLOYERS AND RELATED PLANS.—For purposes of this paragraph—

"(i) the rules of subsections (b), (c), and (m) of section 414 shall apply, and

"(ii) all plans of an employer (determined after the application of such subsections) shall be treated as 1 plan.

"(o) 10-PERCENT PENALTY FOR PREMATURE DISTRIBUTIONS FROM ANNUITY CONTRACTS.—

"(1) IMPOSITION OF PENALTY.—If any taxpayer receives any amount under an annuity contract, the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

"(2) SUBSECTION NOT TO APPLY TO CERTAIN DISTRIBUTIONS.—Paragraph (1) shall not apply to any distribution—

"(A) made on or after the date on which the taxpayer attains age 59½,

"(B) made on or after the death of the holder (or, where the holder is not an individual, the death of the primary annuitant),

"(C) attributable to the taxpayer's becoming disabled within the meaning of subsection (k)(5),

"(D) which is a part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and his designated beneficiary,

"(E) from a plan, contract, account, trust, or annuity described in section 72(e)(5)(D) of the Internal Revenue Code of 1986,

"(F) allocable to investment in the contract before August 14, 1982,

"(G) under a qualified funding asset,

"(H) to which subsection (r) applies (without regard to paragraph (2) thereof),

"(I) under an immediate annuity contract, or

"(J) which is purchased by an employer upon the termination of a plan described in section 401(a) or 403(a) and which is held by the

employer until such time as the employee separates from service.

"(3) CHANGE IN SUBSTANTIALLY EQUAL PAYMENTS.—If—

"(A) paragraph (1) does not apply to a distribution by reason of paragraph (2)(D), and

"(B) the series of payments under such paragraph are subsequently modified (other than by reason of death or disability)—

"(i) before the close of the 5-year period beginning on the date of the first payment and after the taxpayer attains age 59½, or

"(ii) before the taxpayer attains age 59½,

the taxpayer's tax for the 1st taxable year in which such modification occurs shall be increased by an amount, determined under regulations, equal to the tax which (but for paragraph (2)(D)) would have been imposed, plus interest for the deferral period (within the meaning of subsection (r)(4)(B)).

"(p) CERTAIN RAILROAD RETIREMENT BENEFITS TREATED AS RECEIVED UNDER EMPLOYER PLANS.—

"(1) IN GENERAL.—Notwithstanding any other provision of law, any benefit provided under the

Railroad Retirement Act of 1974 (other than a tier 1 railroad retirement benefit) shall be treated for purposes of this title as a benefit provided under an employer plan which meets the requirements of section 401(a).

"(2) TIER 2 TAXES TREATED AS CONTRIBUTIONS.—For purposes of paragraph (1)—

"(i) the tier 2 portion of the tax imposed by section 3201 (relating to tax on employees) shall be treated as an employee contribution,

"(ii) the tier 2 portion of the tax imposed by section 3211 (relating to tax on employee representatives) shall be treated as an employee contribution, and

"(iii) the tier 2 portion of the tax imposed by section 3221 (relating to tax on employers) shall be treated as an employer contribution.

"(B) TIER 2 PORTION.—For purposes of subparagraph (A)—

"(1) AFTER 1984.—With respect to compensation paid after 1984, the tier 2 portion shall be the taxes imposed by sections 3201(b), 3211(a)(2), and 3221(b).

"(2) BEFORE 1985.—With respect to compensation paid before 1985, see section 72(r) of Internal Revenue Code of 1986 for the definition of tier 2 portion.

"(C) CONTRIBUTIONS NOT ALLOCABLE TO SUPPLEMENTAL ANNUITY OR WINDFALL BENEFITS.—For purposes of paragraph (1), no amount treated as an employee contribution under this paragraph shall be allocated to—

"(i) any supplemental annuity paid under section 2(b) of the Railroad Retirement Act of 1974, or

"(ii) any benefit paid under section 3(h), 4(e), or 4(h) of such Act.

"(3) TIER 1 RAILROAD RETIREMENT BENEFIT.—For purposes of paragraph (1), the term 'tier 1 railroad retirement benefit' has the meaning given such term by section 3(b)(2)(B).

"(q) REQUIRED DISTRIBUTIONS WHERE HOLDER DIES BEFORE ENTIRE INTEREST IS DISTRIBUTED.—

"(1) IN GENERAL.—A contract shall not be treated as an annuity contract for purposes of this chapter unless it provides that—

"(A) if any holder of such contract dies on or after the annuity starting date and before

the entire interest in such contract has been distributed, the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used as of the date of his death, and

"(B) if any holder of such contract dies before the annuity starting date, the entire interest in such contract will be distributed within 5 years after the death of such holder.

"(2) EXCEPTION FOR CERTAIN AMOUNTS PAYABLE OVER LIFE OF BENEFICIARY.—IF—

"(A) any portion of the holder's interest is payable to (or for the benefit of) a designated beneficiary,

"(B) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

"(C) such distributions begin not later than 1 year after the date of the holder's death or such later date as the Secretary may by regulations prescribe,

then for purposes of paragraph (1), the portion referred to in subparagraph (A) shall be treated as

distributed on the day on which such distributions begin.

"(3) SPECIAL RULE WHERE SURVIVING SPOUSE BENEFICIARY.—If the designated beneficiary referred to in paragraph (2)(A) is the surviving spouse of the holder of the contract, paragraphs (1) and (2) shall be applied by treating such spouse as the holder of such contract.

"(4) DESIGNATED BENEFICIARY.—For purposes of this subsection, the term 'designated beneficiary' means any individual designated a beneficiary by the holder of the contract.

"(5) EXCEPTION FOR CERTAIN ANNUITY CONTRACTS.—This subsection shall not apply to any annuity contract—

"(A) which is provided—

"(i) under a plan described in section 401(a) which includes a trust exempt from tax under section 501, or

"(ii) under a plan described in section 403(a),

"(B) which is described in section 403(b),

"(C) which is an individual retirement annuity or provided under an individual retirement account or annuity, or

"(D) which is a qualified funding asset.

"(6) SPECIAL RULE WHERE HOLDER IS CORPORATION OR OTHER NON-INDIVIDUAL.—

"(A) IN GENERAL.—For purposes of this subsection, if the holder of the contract is not an individual, the primary annuitant shall be treated as the holder of the contract.

"(B) PRIMARY ANNUITANT.—For purposes of subparagraph (A), the term 'primary annuitant' means the individual, the events in the life of whom are of primary importance in affecting the timing or amount of the payout under the contract.

"(7) TREATMENT OF CHANGES IN PRIMARY ANNUITANT WHERE HOLDER OF CONTRACT IS NOT AN INDIVIDUAL.—For purposes of this subsection, in the case of a holder of an annuity contract which is not an individual, if there is a change in a primary annuitant (as defined in paragraph (6)(B)), such change shall be treated as the death of the holder.

"(r) 10-PERCENT ADDITIONAL TAX ON EARLY DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.—

"(1) IMPOSITION OF ADDITIONAL TAX.—If any taxpayer receives any amount from a qualified re-

tirement plan (as defined in section 4974(c)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

"(2) SUBSECTION NOT TO APPLY TO CERTAIN DISTRIBUTIONS.—Except as provided in paragraphs (3) and (4), paragraph (1) shall not apply to any of the following distributions:

"(A) IN GENERAL.—Distributions which are—

"(i) made on or after the date on which the employee attains age 59½,

"(ii) made to a beneficiary (or to the estate of the employee) on or after the death of the employee,

"(iii) attributable to the employee's being disabled within the meaning of subsection 72(m)(7) of the Internal Revenue Code of 1986,

"(iv) part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the employee or the

joint lives (or joint life expectancies) of such employee and his designated beneficiary,

"(v) made to an employee after separation from service after attainment of age 55,

"(vi) dividends paid with respect to stock of a corporation which are described in section 404(k), or

"(vii) made from a Roth IRA (other than a distribution described in section 30(d)(2)).

"(B) MEDICAL EXPENSES.—Distributions made to the employee (other than distributions described in subparagraph (A), (C), or (D)) to the extent such distributions do not exceed the amount allowable as a deduction under section 31 to the employee for amounts paid during the taxable year for medical care (determined without regard to whether the employee itemizes deductions for such taxable year).

"(C) PAYMENTS TO ALTERNATE PAYEES PURSUANT TO QUALIFIED DOMESTIC RELATIONS ORDERS.—Any distribution to an alternate payee pursuant to a qualified domestic re-

lations order (within the meaning of section 414(p)(1)).

"(D) DISTRIBUTIONS TO UNEMPLOYED INDIVIDUALS FOR HEALTH INSURANCE PREMIUMS.—

"(i) IN GENERAL.—Distributions from an individual retirement plan to an individual after separation from employment—

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

"(II) if such distributions are made during any taxable year during which such unemployment compensation is paid or the succeeding taxable year, and

"(III) to the extent such distributions do not exceed the amount paid during the taxable year for insurance described in section 213(d)(1)(D) of the Internal Revenue Code of 1986

with respect to the individual and the individual's spouse and dependents.

"(ii) DISTRIBUTIONS AFTER REEMPLOYMENT.—Clause (i) shall not apply to any distribution made after the individual has been employed for at least 60 days after the separation from employment to which clause (i) applies.

"(iii) SELF-EMPLOYED INDIVIDUALS.—To the extent provided in regulations, a self-employed individual shall be treated as meeting the requirements of clause (i)(I) if, under Federal or State law, the individual would have received unemployment compensation but for the fact the individual was self-employed.

"(E) DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR HIGHER EDUCATION EXPENSES.—Distributions to an individual from an individual retirement plan to the extent such distributions do not exceed the qualified higher education expenses (as defined in paragraph (7)) of the taxpayer for the taxable year. Distributions shall not be taken into account under the preceding sentence if such distribu-

tions are described in subparagraph (A), (C), or (D) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).

"(F) DISTRIBUTIONS FROM CERTAIN PLANS FOR FIRST HOME PURCHASES.—Distributions to an individual from an individual retirement plan which are qualified first-time homebuyer distributions (as defined in paragraph (8)). Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A), (C), (D), or (E) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).

"(3) LIMITATIONS.—

"(A) CERTAIN EXCEPTIONS NOT TO APPLY TO INDIVIDUAL RETIREMENT PLANS.—Subparagraphs (A)(v), and (C) of paragraph (2) shall not apply to distributions from an individual retirement plan.

"(B) PERIODIC PAYMENTS UNDER QUALIFIED PLANS MUST BEGIN AFTER SEPARATION.—Paragraph (2)(A)(iv) shall not apply to any amount paid from a trust described in sec-

tion 401(a) which is exempt from tax under section 501(a) or from a contract described in section 72(e)(5)(D)(ii) of the Internal Revenue Code of 1986 unless the series of payments begins after the employee separates from service.

"(4) CHANGE IN SUBSTANTIALLY EQUAL PAYMENTS.—

"(A) IN GENERAL.—If—

"(i) paragraph (1) does not apply to a distribution by reason of paragraph (2)(A)(iv), and

"(ii) the series of payments under such paragraph are subsequently modified (other than by reason of death or disability)—

"(I) before the close of the 5-year period beginning with the date of the first payment and after the employee attains age 59½, or

"(II) before the employee attains age 59½, the taxpayer's tax for the 1st taxable year in which such modification occurs shall be increased by an amount, determined under regulations, equal to the tax which (but for

paragraph (2)(A)(iv)) would have been imposed, plus interest for the deferral period.

"(B) DEFERRAL PERIOD.—For purposes of this paragraph, the term 'deferral period' means the period beginning with the taxable year in which (without regard to paragraph (2)(A)(iv)) the distribution would have been includible in gross income and ending with the taxable year in which the modification described in subparagraph (A) occurs.

"(5) EMPLOYEE.—For purposes of this subsection, the term 'employee' includes any participant, and in the case of an individual retirement plan, the individual for whose benefit such plan was established.

"(6) SPECIAL RULES FOR SIMPLE RETIREMENT ACCOUNTS.—In the case of any amount received from a simple retirement account (within the meaning of section 408(p) during the 2-year period beginning on the date such individual first participated in any qualified salary reduction arrangement maintained by the individual's employer under section 408(p)(2), paragraph (1) shall be applied by substituting '25 percent' for '10 percent'.

"(7) QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of paragraph (2)(E)—

"(A) IN GENERAL.—The term 'qualified higher education expenses' means qualified higher education expenses (as defined in section 10(b)(2)) for education furnished to—

"(i) the taxpayer,

"(ii) the taxpayer's spouse, or

"(iii) any child or grandchild of the taxpayer or the taxpayer's spouse, at an eligible educational institution (as defined in section 10(b)(2)(B)).

"(B) COORDINATION WITH OTHER PROVISIONS.—For purposes of this subsection, section 30 and section 32, qualified higher education expenses in any taxable year shall be treated as first paid with distributions under section 32, next with distributions to which section 30(d)(5)(v) (relating to early withdrawals from Roth IRAs to pay higher education expenses) applies, and finally from withdrawals to which this subsection applies.

"(8) QUALIFIED FIRST-TIME HOMEBUYER DISTRIBUTIONS.—For purposes of this subsection, the term 'qualified first-time homebuyer distribution'

has the meaning given to it in section 30(d)(6) and the limits contained in such section shall apply on a combined basis to this subsection and section 30. Qualified acquisition costs (as defined in section 30(d)(6)) taken into account for purposes of section 30(d)(5)(vi) shall not also be taken into account separately for purposes of this subsection. A taxpayer may elect to treat distributions from an account other than Roth IRAs to which this subsection applies as a qualified first-time homeowner distribution before determining whether a distribution from a Roth IRAs is a qualified first-time homeowner distribution.

"(r) 10-PERCENT ADDITIONAL TAX FOR TAXABLE DISTRIBUTIONS FROM MODIFIED ENDOWMENT CONTRACTS.—

"(1) IMPOSITION OF ADDITIONAL TAX.—If any taxpayer receives any amount under a modified endowment contract (as defined in section 7702A), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

"(2) SUBSECTION NOT TO APPLY TO CERTAIN DISTRIBUTIONS.—Paragraph (1) shall not apply to any distribution—

"(A) made on or after the date on which the taxpayer attains age 59½,

"(B) which is attributable to the taxpayer's becoming disabled (within the meaning of subsection (m)(7)), or

"(C) which is part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and his beneficiary.

"Subchapter C—Basis, Business Transactions and Nonrecognition Transactions

"Sec. 71. Gain or loss on the sale of an asset.
"Sec. 72. Basis.
"Sec. 73. Basis in business entities.
"Sec. 74. Gratuitous transfers.
"Sec. 75. Transactions involving business entities.
"Sec. 76. Rollover on residence sale.
"Sec. 77. Other nonrecognition transactions.
"Sec. 78. Wash sales and straddles.

"SEC. 71. GAIN OR LOSS ON THE SALE OF AN ASSET.

"(a) IN GENERAL.—Except as otherwise provided in this chapter, the amount of gross income to be recognized on the sale, exchange, or other disposition of property equals the excess of—

"(1) the amount realized from the disposition, over

"(2) the taxpayer's adjusted basis in the property.

"(b) AMOUNT REALIZED.—The amount realized from the disposition of property shall be sum of money received plus the fair market value of the property (other than money) received. See section 122(c) for the treatment of installment sales.

"(c) NONRECOGNITION TRANSACTION.—Subsection (a) shall not apply to nonrecognition transactions described in this chapter.

"(d) CONTRACTS MARKED TO MARKET.—

"(1) IN GENERAL.—Under regulations prescribed by the Secretary, a markable contract held by the taxpayer at the end of the year shall be treated as sold and reacquired for its fair market value on the last business day of the taxable year. The regulations shall adopt principles and definitions similar to those that applied under section 1256 of the Internal Revenue Code of 1986.

"(2) MARKABLE CONTRACT.—For purposes of this subsection, 'markable contract' means—

"(A) any regulated futures contract,

"(B) any foreign currency contract,

"(C) any nonequity option,

"(D) any dealer equity option

as such terms were defined for purposes of section 1256 of the Internal Revenue Code of 1986.

"SEC. 72. BASIS.

"(a) BASIS, SALE, OR EXCHANGE.—Except to the extent inconsistent with provisions of this chapter, adjusted basis and the existence of a sale or exchange shall be determined in accordance with principles applicable under the Internal Revenue Code of 1986.

"(b) DEFINITION OF BASIS.—For purposes of this chapter, 'basis' means the adjusted basis of property. The adjusted basis of property is generally its cost, as adjusted for actions or transactions that increase or decrease the basis of property. Except as provided in section 73 (relating to business entities and basis in business entities), the taxpayer's adjusted basis on January 1, 1999, in an asset acquired before that date, shall be its adjusted basis as of December 31, 1998, as determined under the Internal Revenue Code of 1986.

"SEC. 73. BASIS IN BUSINESS ENTITIES.

"(a) RULES FOR ALL BUSINESS ENTITIES.—

"(1) IN GENERAL.—A taxpayer's basis in an interest in a business entity shall equal—

"(A) the cost of acquiring the interest,

"(B) increased by the amount of cash and basis of any property contributed to the entity, and

"(C) decreased by the portion of any liquidating distributions from the entity that are treated as returns of capital in accordance with rules prescribed by the Secretary.

"(2) INITIAL BASIS.—Except as otherwise provided in this section, a taxpayer's basis on January 1, 1999, or any interest in a business entity held as of December 31, 1998, shall be the basis of such interest as of December 31, 1998, as determined under the Internal Revenue Code of 1986.

"(3) CROSS REFERENCES.—See section 75 for rules relating to the effect of certain business transactions on a taxpayer's basis.

"(4) SPECIAL RULE FOR CONTRIBUTION OF PERSONAL USE PROPERTY.—If a taxpayer contributes personal-use property (as defined in section 210(b)(3)(B)), the taxpayer's basis in the property shall not be increased by an amount in excess of the fair market value of the property contributed.

"(b) SPECIAL RULES FOR PARTNERSHIP INTERESTS.—

"(1) INITIAL BASIS IN OLD PARTNERSHIPS.—A partner's basis in a partnership interest as of January 1, 1999, equals—

"(A) the partner's basis in the partnership as of the end of the taxable year ending on December 31, 1998, minus

"(B) the amount of the partner's share of the indebtedness of the partnership taken into account in determining such basis.

"(2) NEGATIVE BASIS.—If the amount determined under paragraph (1) is negative, the taxpayer has a negative basis in the partnership and such negative basis shall increase the gain on the sale or disposition of the partnership interest (except to the extent such negative basis has been adjusted by reason of capital contributions).

"(3) ADJUSTMENT TO BASIS.—Except as otherwise provided in this section, a partner's basis in a partnership interest shall be determined in accordance with the general principles of this chapter applicable to an individual's basis in an interest in a business entity. A partner's basis in a partnership shall not be adjusted by reason of any—

"(A) distribution from the partnership (except to the extent such distribution is treated as

distribution of basis in accordance with the general principles of this chapter applicable to an individual's basis in an interest in a business entity),

"(B) income, earnings, or loss of the partnership, or

"(C) any change in the partner's share of the partnership's indebtedness.

"(4) SPECIAL RULE FOR TRANSITION DISTRIBUTIONS.—

"(A) EFFECT OF TRANSITION DISTRIBUTION.—A transition distribution from partnership to a partner shall—

"(i) reduce the partner's basis in the partnership, and

"(ii) not be included in gross income.

"(B) DEFINITION.—A 'transition distribution' is a distribution by a business entity to an individual made during the first three months of 1999 but only to the extent that such distribution, when added to all other distributions of the entity to the individual after March 31, 1998, does not exceed the amount of taxable income allocated by the entity to the individual

during the taxable year of the entity ending on December 31, 1998.

"(5) PARTNERSHIP.—For purposes of this section, 'partnership' includes a limited liability company that was taxable as a partnership under the Internal Revenue Code of 1986.

"(c) SPECIAL RULES FOR SHARES OF S CORPORATIONS.—Rules similar to those contained in subsection (b) shall apply with respect to the basis of stock of a corporation that was treated as an S corporation under the Internal Revenue Code of 1986.

"(d) SPECIAL RULES FOR PROPRIETORSHIPS.—

"(1) OLD PROPRIETORSHIP.—A proprietor's basis in any business activity conducted before January 1, 1999, which is treated as a business activity as of such date equals—

"(A) the proprietor's adjusted basis in the assets of such business entity as of the end of the taxable year ending on December 31, 1998, minus

"(B) the balance of any indebtedness the interest on which the proprietor had treated as business interest under section 163(h)(2)(A) of the Internal Revenue Code of 1986.

"(2) NEGATIVE BASIS.—If the amount determined under paragraph (1) is negative, the proprietor has a negative basis in the proprietorship and such negative basis shall increase the gain on the sale or disposition of the entity (except to the extent such negative basis has been adjusted by reason of capital contributions).

"(3) ADJUSTMENT TO BASIS.—Except as otherwise provided in this section, a proprietor's basis in a proprietorship shall be determined in accordance with the general principles of this chapter applicable to an individual's basis in an interest in a business entity.

"(4) PROPRIETORSHIP.—'Proprietorship' includes—

"(A) any family business that is not a partnership, and

"(B) any business activity conducted by a taxpayer other than as an employee if such activity constitutes a business entity.

"(e) ANTI-AVOIDANCE RULE.—

"(1) IN GENERAL.—If a pass-through entity's distributions to an individual in its taxable year or taxable years ending in 1998 exceeds 125 percent of the individual's distributive share of income for such

period, the amount of such excess distribution shall be treated as a cash distribution to the partner on January 1, 1999, and shall not reduce the partner's basis in his partnership interest.

"(2) PASS THROUGH ENTITY.—'Pass through entity' means a partnership, proprietorship, or S corporation.

"SEC. 74. GRATUITOUS TRANSFERS.

"(a) IN GENERAL.—If after December 31, 1998, a taxpayer receives any property by gift, inheritance, or other gratuitous transfer, the taxpayer's basis in the property shall be the lesser of—

"(1) the fair market value of the property at the time of transfer, or

"(2) the transferee's basis in the property at the time of transfer.

"(b) PROOF REQUIRED.—A taxpayer's basis in an asset received by gift, inheritance, or other gratuitous transfer shall be presumed to be zero unless the taxpayer can demonstrate to the satisfaction of the Secretary the basis claimed by the taxpayer.

"SEC. 75. DISTRIBUTIONS FROM BUSINESS ENTITIES.

"(a) IN GENERAL.—Except as otherwise provided in this section or in regulations issued by the Secretary in accordance with this section—

"(1) CASH DISTRIBUTIONS.—Distributions of cash by a business entity with respect to its equity ownership shall be treated as dividends and included in gross income.

"(2) DISTRIBUTIONS OF PROPERTY.—If a business entity distributes property (other than stock or other equity ownership described in paragraph (3) in connection with a merger, acquisition or reorganization), the fair market value of the property received shall be treated as a dividend and included in gross income.

"(3) DISTRIBUTIONS OF STOCK OR OTHER EQUITY OWNERSHIP.—If a taxpayer receives with respect to its ownership interest in a business entity stock or other ownership interests in such business entity (as reorganized) or in another business entity that is controlled by such business entity or is acquiring or merging with such business entity, no gain or loss shall be recognized on the distribution.

"(b) BASIS IN BUSINESS DIVISIONS.—In the case of a spin-off, split-off, or split-up of a business entity in which a taxpayer has basis, the taxpayer's basis in the original business entity shall be allocated among the new and surviving entities in accordance with the relative fair market values of the taxpayer's interests in those entities.

If interests in the entities are publicly traded, fair market values shall be based on public trading prices. In other cases, the Secretary shall accept any reasonable allocation made by the taxpayer if the taxpayer notifies the Secretary of the allocation in an attachment to its tax return for the taxable year of the transaction.

"(c) DISTRIBUTIONS CONSTITUTING RETURN OF BASIS.—

"(1) COMPLETE LIQUIDATIONS.—

"(A) IN GENERAL.—In the case of a distribution in complete liquidation of a business entity, a taxpayer shall be treated as receiving cash and assets of the entity in exchange for the taxpayer's equity in the business entity. In such case, the taxpayer shall recognize gain to the extent that the sum of the cash and fair market value of assets received exceeds the taxpayer's basis in its interest in the business entity or shall recognize loss to the extent that the basis exceeds the fair market value of cash and assets received.

"(B) DISTRIBUTION OF EQUITY INTERESTS.—In the case of a complete liquidation in which at least 90 percent of the value of assets and cash distributed to an equity holder is eq-

uity interests in other business entities controlled by the distributing entity—

"(i) subparagraph (A) shall not apply,

"(ii) paragraph (3) of subsection (a) shall apply,

"(iii) the cash and fair market value of assets other than equity interests in controlled entities shall be applied to reduce the taxpayer's basis in the distributing entity and gain will be recognized only to the extent that the cash and such fair market value exceeds the taxpayer's basis in the distributing entity, and

"(iv) the taxpayer's remaining basis shall be allocated among the distributed equity interests in controlled entities in accordance with the relative fair market values of such interests.

"(C) DISTRIBUTION OF BUSINESS PROPERTY.—Under regulations prescribed by the Secretary, rules similar to those that applied to partnerships under the Internal Revenue Code of 1986 shall apply in lieu of subparagraph (A) to distributions that include property used in a trade or business if such property is contributed

to a new business entity within 180 days of the distribution.

"(2) TRANSITION RULES.—See subsections (b) and (d) of section 73 for transition rules relating to partnerships and proprietorships.

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) CERTAIN RULES OF APPLICATION.—

"(A) PRINCIPLES APPLICABLE TO INTERNAL REVENUE CODE.—This section shall be applied without regard to—

"(i) continuity of business interest,

"(ii) continuity of ownership interest,

"(iii) requirements of section 355 of the Internal Revenue Code of 1986 for spin-offs, split-offs and split-ups,

"(iv) business purposes for a corporate reorganization or restructuring (except if the transaction is potentially abusive), and

"(v) except as provided in paragraph (3), rules treating dividends as returns of capital because of the absence of earnings and profits.

"(B) CONSTRUCTIVE RECEIPT.—If a taxpayer is given the choice of receiving cash or an

equity interest in a business entity, the taxpayer will be treated for purposes of this section as if he received the cash and purchased the equity interest.

"(C) DEBT VERSUS EQUITY.—The principles distinguishing debt and equity that applied prior to the adopt of the Simplified USA Tax generally shall apply for purposes of applying this section. An investment in a business entity shall not be considered debt unless—

"(i) it is reflected in the books and records of the business entity as debt, and

"(ii) there is written evidence of the investment that treats such investment as indebtedness.

"(2) CONTROL.—For purposes of this section, 'control' of a business entity means—

"(A) ownership of more than 50% of the voting power held by equity holders of such entity, or

"(B) ownership of rights to more than 50% of the periodic distributions that the business entity may make to its equity holders and 50% of the distributions if the business entity were liquidated.

"(3) REGULATIONS.—

"(A) SIGNIFICANT DOWNSIZING AND PARTIAL LIQUIDATIONS.—The Secretary is authorized to issue regulations under which distributions resulting from a significant downsizing of a business entity will be treated in part as return of equity holders' capital.

"(B) ASSUMPTION AND RELEASE OF LIABILITY.—The Secretary shall prescribe regulations addressing the consequences of a distributee's assumption of the liabilities of the distributor.

"SEC. 76. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

"(a) EXCLUSION.—Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

"(b) LIMITATIONS.—

"(1) IN GENERAL.—The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed $250,000.

"(2) $500,000 LIMITATION FOR CERTAIN JOINT RETURNS.—Paragraph (1) shall be applied by substituting '$500,000' for '$250,000' if—

"(A) a husband and wife make a joint return for the taxable year of the sale or exchange of the property,

"(B) either spouse meets the ownership requirements of subsection (a) with respect to such property,

"(C) both spouses meet the use requirements of subsection (a) with respect to such property, and

"(D) neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3).

"(3) APPLICATION TO ONLY 1 SALE OR EXCHANGE EVERY 2 YEARS.—

"(A) IN GENERAL.—Subsection (a) shall not apply to any sale or exchange by the taxpayer if, during the 2-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection (a) applied.

"(B) PRE-MAY 7, 1997, SALES NOT TAKEN INTO ACCOUNT.—Subparagraph (A) shall be

applied without regard to any sale or exchange before May 7, 1997.

"(c) EXCLUSION FOR TAXPAYERS FAILING TO MEET CERTAIN REQUIREMENTS.—

"(1) IN GENERAL.—In the case of a sale or exchange to which this subsection applies, the ownership and use requirements of subsection (a) shall not apply and subsection (b)(3) shall not apply; but the amount of gain excluded from gross income under subsection (a) with respect to such sale or exchange shall not exceed—

"(A) the amount which bears the same ratio to the amount which would be so excluded under this section if such requirements had been met, as

"(B) the shorter of—

"(i) the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence, or

"(ii) the period after the date of the most recent prior sale or exchange by the taxpayer to which subsection (a) applied

and before the date of such sale or exchange,

bears to 2 years.

"(2) SALES AND EXCHANGES TO WHICH SUBSECTION APPLIES.—This subsection shall apply to any sale or exchange if—

"(A) subsection (a) would not (but for this subsection) apply to such sale or exchange by reason of—

"(i) a failure to meet the ownership and use requirements of subsection (a), or

"(ii) subsection (b)(3), and

"(B) such sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

"(d) SPECIAL RULES.—

"(1) JOINT RETURNS.—If a husband and wife make a joint return for the taxable year of the sale or exchange of the property, subsections (a) and (c) shall apply if either spouse meets the ownership and use requirements of subsection (a) with respect to such property.

"(2) PROPERTY OF DECEASED SPOUSE.—For purposes of this section, in the case of an unmarried

individual whose spouse is deceased on the date of the sale or exchange of property, the period such unmarried individual owned and used such property shall include the period such deceased spouse owned and used such property before death.

"(3) PROPERTY OWNED BY SPOUSE OR FORMER SPOUSE.—For purposes of this section—

"(A) PROPERTY TRANSFERRED TO INDIVIDUAL FROM SPOUSE OR FORMER SPOUSE.—In the case of an individual holding property transferred to such individual by such individual's spouse or former spouse in a transaction incident to divorce, the period such individual owns such property shall include the period the transferor owned the property.

"(B) PROPERTY USED BY FORMER SPOUSE PURSUANT TO DIVORCE DECREE, ETC.—Solely for purposes of this section, an individual shall be treated as using property as such individual's principal residence during any period of ownership while such individual's spouse or former spouse is granted use of the property under a divorce or separation instrument.

"(4) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—For purposes of this sec-

tion, if the taxpayer holds stock as a tenant-stockholder in a cooperative housing corporation—

"(A) the holding requirements of subsection (a) shall be applied to the holding of such stock, and

"(B) the use requirements of subsection (a) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

"(5) INVOLUNTARY CONVERSIONS.—For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

"(6) DETERMINATION OF USE DURING PERIODS OF OUT-OF-RESIDENCE CARE.—In the case of a taxpayer who—

"(A) becomes physically or mentally incapable of self-care, and

"(B) owns property and uses such property as the taxpayer's principal residence during the 5-year period described in subsection (a) for periods aggregating at least 1 year,

then the taxpayer shall be treated as using such property as the taxpayer's principal residence during any time during such 5-year period in which the tax-

payer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

"(7) SALES OF REMAINDER INTERESTS.—For purposes of this section—

"(A) IN GENERAL.—At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of such interest being a remainder interest in such residence, but this section shall not apply to any other interest in such residence which is sold or exchanged separately.

"(B) EXCEPTION FOR SALES TO RELATED PARTIES.—Subparagraph (A) shall not apply to any sale to, or exchange with, a related party (as defined in section 171).

"(e) DENIAL OF EXCLUSION FOR EXPATRIATES.—This section shall not apply to any sale or exchange by an individual if rules relating to expatriation to avoid tax apply to such individual.

"(f) ELECTION TO HAVE SECTION NOT APPLY.—This section shall not apply to any sale or exchange with

respect to which the taxpayer elects not to have this section apply.

"(g) RESIDENCES ACQUIRED IN ROLLOVERS UNDER SECTION 1034.—For purposes of this section, in the case of property the acquisition of which by the taxpayer resulted under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997) in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used such property as the taxpayer's principal residence, there shall be included the aggregate periods for which such other residence (and each prior residence taken into account in determining the holding period of such property) had been so owned and used.

"SEC. 77. OTHER NONRECOGNITION TRANSACTIONS.

"(a) INVOLUNTARY CONVERSIONS.—Under regulations prescribed by the Secretary, the involuntary conversion of property held by an individual shall not result in gross income to the individual to the extent that the individual receives property in exchange for the involuntarily converted property. To the extent that income is not recognized under this subsection, the taxpayer's basis in the converted property shall carry over to the new property.

"(b) CERTAIN REACQUISITIONS OF REAL PROPERTY.—Under regulations prescribed by the Secretary, gross income shall not be recognized in the case of certain reacquisitions of real property. The regulations shall adopt principles similar to those under section 1038 of the Internal Revenue Code of 1986.

"(c) TRANSFERS OF PROPERTY BETWEEN SPOUSES OR INCIDENT TO DIVORCE.—

"(1) GENERAL RULE.—Gross income shall not be recognized on the transfer of property from an individual to (or in trust for the benefit of)—

"(A) a spouse, or

"(B) a former spouse, but only if the transfer is incident to divorce.

"(2) TRANSFER TREATED AS A GIFT.—Any transfer described in paragraph (1) shall be treated as a gift.

"(d) CERTAIN EXCHANGES OF INSURANCE POLICIES.—Under regulations prescribed by the Secretary, gross income shall not be recognized on the exchange of insurance policies or another life insurance policy or an annuity contract or the exchange of annuity contracts. The regulations shall adopt principles similar to those under section 1035 of the Internal Revenue Code of 1986.

"(e) CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS.—When so provided by regulations promulgated by the Secretary in connection with the issue of obligations of the United States, no gain or loss shall be recognized on the surrender to the United States of obligations of the United States issued under chapter 31 of title 31 in exchange solely for other obligations issued under such chapter.

"SEC. 78. WASH SALES AND STRADDLES.

"(a) LOSSES FROM WASH SALES OF STOCK OR SECURITIES.—Under regulations prescribed by the Secretary, no loss shall be recognized on the wash sale of stock or securities. The regulations shall adopt principles similar to those under section 1091 of the Internal Revenue Code of 1986.

"(b) STRADDLES.—Under regulations prescribed by the Secretary, the loss that can be taken into account from 1 or more straddle positions shall be limited. The regulations shall adopt principles similar to those under section 1038 of the Internal Revenue Code of 1986.

"SEC. 79. LIMITATION ON LOSSES FROM CAPITAL TRANSACTIONS.

"(a) NO LOSS ON PERSONAL USE PROPERTY.—No loss shall be recognized on the sale or exchange of personal use property (as defined in section 210(b)(3)(B)).

"(b) LIMITATION ON NET CAPITAL LOSS.—

"(1) IN GENERAL.—Losses from sales or exchanges of capital assets in a taxable year shall be allowed only to the extent of the gains from such sales or exchanges, plus $3,000 ($1,500 in the case of a married individual filing a separate return).

"(2) CAPITAL LOSS CARRYOVERS.—Under regulations prescribed by the Secretary, any loss not allowed by reason of paragraph (1) shall be carried over to the following taxable year and treated as a capital loss incurred in such year. There shall be no limit on the number of years that a capital loss can be carried forward.

"(3) CAPITAL ASSETS.—Under regulations prescribed by the Secretary, the principles of the Internal Revenue Code of 1986 (including, without limitation, sections 1234 (relating to options), 1234A (relating to gains or losses from certain terminations), 1253 (relating to franchises and trademarks) and 1258 (gain from certain financial transactions) shall apply for purposes of determining what is a capital asset and whether an event is to be treated as a sale or exchange of capital assets, except to the extent inconsistent with principles of this chapter.

"(4) RECAPTURE.—If a taxpayer claimed depreciation, amortization or other cost recovery deductions under the Internal Revenue Code of 1986 with respect to property which is subsequently sold or exchanged in a transactions that is not treated as transaction of a business entity, the amount of gain on the exchange of such property which is treated as gain from the sale or exchange of a capital asset shall be reduced (but not below zero) by the amount of such deductions claimed with respect to the property.

"Subchapter D—Rules for Exclusions from Gross Income

"Sec. 91. Interest on tax-exempt bonds.
"Sec. 92. Combat pay.
"Sec. 93. Qualified military benefits.
"Sec. 94. Qualified foster care payments.
"Sec. 95. Compensation for injury and sickness.
"Sec. 96. Meals or lodging for convenience of employer.
"Sec. 97. Certain fringe benefits.

"SEC. 91. INTEREST ON TAX-EXEMPT BONDS.

"(a) EXCLUSION.—Except as provided in subsection (b), gross income does not include interest on any State or local bond.

"(b) EXCEPTIONS.—Subsection (a) shall not apply to—

"(1) PRIVATE ACTIVITY BOND WHICH IS NOT A QUALIFIED BOND—Any private activity bond which

is not a qualified bond (within the meaning of paragraph (3) of subsection (c)).

"(2) ARBITRAGE BOND.—Any arbitrage bond.

"(3) BOND NOT IN REGISTERED FORM, ETC.—Any bond unless such bond meets the applicable requirements set forth in regulations.

"(c) DEFINITIONS—For purposes of this section—

"(1) STATE OR LOCAL BOND.—'State or local bond' means an obligation of a State or political subdivision thereof.

"(2) STATE.—'State' includes the District of Columbia and any possession of the United States.

"(3) QUALIFIED BOND.—'QUALIFIED BOND' MEANS ANY PRIVATE ACTIVITY BOND IF—

"(A) IN GENERAL.—Such bond is—

"(i) an exempt facility bond,

"(ii) a qualified mortgage bond,

"(iii) a qualified veterans' mortgage bond,

"(iv) a qualified small issue bond,

"(v) a qualified student loan bond,

"(vi) a qualified 253(c)(3) bond.

"(B) VOLUME CAP.—Such bond is issued as part of an issue which meets the applicable

volume cap requirements set forth in regulations.

"(C) OTHER REQUIREMENTS.—Such bond meets the applicable requirements set forth in regulations.

"(d) REGULATIONS.—

"(1) STATUTORY REGULATIONS.—The Secretary shall publish as regulations governing the application of this section the text of part IV of subchapter B of chapter 1 of the Internal Revenue Code of 1986 (sections 141 through 149) with only such changes as are required to conform cross references.

"(2) OTHER REGULATIONS.—The Secretary shall have the authority to promulgate such other regulations as he deems necessary or proper to implement this section, except that no such regulations shall conflict with the regulations mandated by paragraph (1) except as provided in this subtitle.

"SEC. 92. COMBAT PAY.

"(a) ENLISTED PERSONNEL.—Gross income does not include compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which such member—

"(1) served in a combat zone, or

"(2) was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone; but this paragraph shall not apply for any month beginning more than 2 years after the date of the termination of combatant activities in such zone.

"(b) COMMISSIONED OFFICERS.—Gross income does not include so much of the compensation as does not exceed $500 received for active service as a commissioned officer in the Armed Forces of the United States for any month during any part of which such officer—

"(1) served in a combat zone, or

"(2) was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone; but this paragraph shall not apply for any month beginning more than 2 years after the date of the termination of combatant activities in such zone.

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

"(1) 'Commissioned officer' does not include a commissioned warrant officer.

"(2) 'Combat zone' means any area which the President of the United States by Executive Order designates, for purposes of this section or corresponding provisions of prior income tax laws, an

area in which Armed Forces of the United States are or have (after June 24, 1950) engaged in combat.

''(3) Service is performed in a combat zone only if performed on or after the date designated by the President by Executive Order as the date of the commencing of combatant activities in such zone, and on or before the date designated by the President by Executive Order as the date of the termination of combatant activities in such zone; except that June 25, 1950, shall be considered the date of the commencing of combatant activities in the combat zone designated in Executive Order 10195.

''(4) The term 'compensation' does not include pensions and retirement pay.

"SEC. 93. QUALIFIED MILITARY BENEFIT.

''(a) IN GENERAL.—'Qualified military benefit' means any allowance or in-kind benefit (other than personal use of a vehicle) which—

''(1) is received by any member or former member of the uniformed service of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services, and

"(2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date (other than a provision of this title).

"(b) NO OTHER BENEFIT TO BE EXCLUDABLE AS PROVIDED BY THIS TITLE.—Notwithstanding any other provision of law, no benefit shall be treated as a qualified military benefit unless such benefit—

"(1) is a benefit described in subsection (a), or

"(2) is excludable from gross income under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act.

"(c) LIMITATIONS ON MODIFICATIONS.—

"(1) IN GENERAL.—Except as provided in paragraph (2), no modification or adjustment of any qualified military benefit after September 9, 1986, shall be taken into account.

"(2) EXCEPTION FOR CERTAIN ADJUSTMENTS TO CASH BENEFITS.—Paragraph (1) shall not apply to any adjustment to any qualified military benefit payable in cash which—

"(A) is pursuant to a provision of law or regulation (as in effect on September 9, 1986), and

"(B) is determined by reference to any fluctuation in cost, price, currency, or other similar index.

"SEC. 94. QUALIFIED FOSTER CARE PAYMENTS.

"(a) QUALIFIED FOSTER CARE PAYMENT DEFINED.—

"(1) IN GENERAL.—'Qualified foster care payment' means any amount—

"(A) which is paid by a state or political subdivision thereof or by a placement agency which is described in section 253(c)(3) and exempt from tax under section 253(a), and

"(B) which is—

"(i) paid to the foster care provider for caring for a qualified foster individual in the foster care provider's home, or

"(ii) a difficulty of care payment.

"(2) QUALIFIED FOSTER INDIVIDUAL.—'Qualified foster individual' means any individual who is living in a foster family home in which such individual was placed by—

"(A) an agency of a State or a political subdivision thereof, or

"(B) in the case of an individual who has not attained age 19, an organization which is li-

censed by a State (or political subdivision thereof) as a placement agency and which is described in section 253(c)(3) and exempt from tax under section 253(a).

"(3) LIMITATION BASED ON NUMBER OF INDIVIDUALS OVER THE AGE OF 18.—In the case of any foster home in which there is a qualified foster care individual who has attained age 19, foster care payments (other than difficulty of care payments) for any period to which such payments relate shall not be excludable from gross income under subsection (a) to the extent such payments are made for more than 5 such qualified foster individuals.

"(b) DIFFICULTY OF CARE PAYMENTS.—For purposes of this section—

"(1) DIFFICULTY OF CARE PAYMENTS.—'Difficulty of care payments' means payments to individuals which are not described in subsection (a)(1)(B)(i), and which—

"(A) are compensation for providing the additional care of a qualified foster individual which is—

"(i) required by reason of a physical, mental, or emotional handicap of such individual with respect to which the State

has determined that there is a need for additional compensation, and

"(ii) provided in the home of the foster care provider, and

"(B) are designated by the payor as compensation described in subparagraph (A).

"(2) LIMITATION BASED ON NUMBER OF INDIVIDUALS.—In the case of any foster home, difficulty of care payments for any period to which such payments relate shall not be excludable from gross income under subsection (a) to the extent such payments are made for more than—

"(A) 10 qualified foster individuals who have not attained age 19, and

"(B) 5 qualified foster individuals not described in subparagraph (A).

"SEC. 95. COMPENSATION FOR INJURIES OR SICKNESS.

"(a) IN GENERAL.—Gross income does not include—

"(1) amounts received under workers' compensation acts as compensation for personal injuries or sickness;

"(2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness;

"(3) amounts received through accident or health insurance for medical care;

"(4) amounts received through accident or health insurance for personal injuries or sickness (other than for medical care), but only to the extent such amounts (A) are not attributable to contributions by the employer which were not includible in the gross income of the employee, and are (B) not are paid by the employer;

"(5) amounts received as pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 808 of the Foreign Service Act of 1980; and

"(6) amounts received by an individual as disability income attributable to injuries incurred as a direct result of a violent attack which the Secretary of State determines to be a terrorist attack and which occurred while such individual was an employee of the United States engaged in the performance of his official duties outside the United States.

Paragraph (2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness.

"(b) TERMINATION OF APPLICATION OF SUBSECTION (a)(4) IN CERTAIN CASES.—

"(1) IN GENERAL.—Subsection (a)(4) shall not apply in the case of an individual who is not described in paragraph (2).

"(2) INDIVIDUALS TO WHOM SUBSECTION (a)(4) CONTINUES TO APPLY.—An individual is described in this paragraph if—

"(A) on or before September 24, 1975, he was entitled to receive any amount described in subsection (a)(4),

"(B) on September 24, 1975, he was a member of any organization (or reserve component thereof) referred to in subsection (a)(4) or under a binding written commitment to become such a member,

"(C) he receives an amount described in subsection (a)(4) by reason of a combat-related injury, or

"(D) on application therefore, he would be entitled to receive disability compensation from the Veterans' Administration.

"(3) SPECIAL RULES FOR COMBAT-RELATED INJURIES.—For purposes of this subsection, the term 'combat-related injury' means personal injury or sickness—

"(A) which is incurred—

"(i) as a direct result of armed conflict,

"(ii) while engaged in extrahazardous service, or

"(iii) under conditions simulating war; or

"(B) which is caused by an instrumentality of war.

In the case of an individual who is not described in subparagraph (A) or (B) of paragraph (2), except as provided in paragraph (4), the only amounts taken into account under subsection (a)(4) shall be the amounts which he receives by reason of a combat-related injury.

"(4) AMOUNT EXCLUDED TO BE NOT LESS THAN VETERANS' DISABILITY COMPENSATION.—In the case of any individual described in paragraph (2), the amounts excludable under subsection (a)(4) for any period with respect to any individual shall not be less than the maximum amount which such

individual, on application therefor, would be entitled to receive as disability compensation from the Veterans' Administration.

"SEC. 96. MEALS OR LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER.

"(a) MEALS AND LODGING FURNISHED TO EMPLOYEE, HIS SPOUSE, AND HIS DEPENDENTS, PURSUANT TO EMPLOYMENT.—There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him, his spouse, or any of his dependents by or on behalf of his employer for the convenience of the employer, but only if—

"(1) in the case of meals, the meals are furnished on the business premises of the employer, or

"(2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

"(b) SPECIAL RULES.—For the purposes of subsection (a)—

"(1) PROVISIONS OF EMPLOYMENT CONTRACT OR STATE STATUTE NOT TO BE DETERMINATIVE.—In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State stat-

ute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation.

"(2) CERTAIN FACTORS NOT TAKEN INTO ACCOUNT WITH RESPECT TO MEALS.—In determining whether meals are furnished for the convenience of the employer, the fact that a charge is made for such meals, and the fact that the employee may accept or decline such meals, shall not be taken into account.

"(3) CERTAIN FIXED CHARGES FOR MEALS.—

"(A) IN GENERAL.—If—

"(i) an employee is required to pay on a periodic basis a fixed charge for his meals, and

"(ii) such meals are furnished by the employer for the convenience of the employer,

there shall be excluded from the employee's gross income an amount equal to such fixed charge.

"(B) APPLICATION OF SUBPARAGRAPH (A).—Subparagraph (A) shall apply—

"(i) whether the employee pays the fixed charge out of his stated compensation or out of his own funds, and

"(ii) only if the employee is required to make the payment whether he accepts or declines the meals.

"(c) EMPLOYEES LIVING IN CERTAIN CAMPS.—

"(1) IN GENERAL.—In the case of an individual who is furnished lodging in a camp located in a foreign country by or on behalf of his employer, such camp shall be considered to be part of the business premises of the employer.

"(2) CAMP.—For purposes of this section, a camp constitutes lodging which is—

"(A) provided by or on behalf of the employer for the convenience of the employer because the place at which such individual renders services is in a remote area where satisfactory housing is not available on the open market,

"(B) located, as near as practicable, in the vicinity of the place at which such individual renders services, and

"(C) furnished in a common area (or enclave) which is not available to the public and

which normally accommodates 10 or more employees.

"(d) LODGING FURNISHED BY CERTAIN EDUCATIONAL INSTITUTIONS TO EMPLOYEES.—

"(1) IN GENERAL.—In the case of an employee of an educational institution, gross income shall not include the value of qualified campus lodging furnished to such employee during the taxable year.

"(2) EXCEPTION IN CASES OF INADEQUATE RENT.—Paragraph (1) shall not apply to the extent of the excess of—

"(A) the lesser of—

"(i) 5 percent of the appraised value of the qualified campus lodging, or

"(ii) the average of the rentals paid by individuals (other than employees or students of the educational institution) during such calendar year for lodging provided by the educational institution which is comparable to the qualified campus lodging provided to the employee, over

"(B) the rent paid by the employee for the qualified campus lodging during such calendar year.

The appraised value under subparagraph (A)(i) shall be determined as of the close of the calendar year in which the taxable year begins, or, in the case of a rental period not greater than 1 year, at any time during the calendar year in which such period begins.

"(3) QUALIFIED CAMPUS LODGING.—For purposes of this subsection, the term 'qualified campus lodging' means lodging to which subsection (a) does not apply and which is—

"(A) located on, or in the proximity of, a campus of the educational institution, and

"(B) furnished to the employee, his spouse, and any of his dependents by or on behalf of such institution for use as a residence.

"(4) EDUCATIONAL INSTITUTION.—For purposes of this paragraph, the term 'educational institution' means an eligible educational institution as defined in section 10(b)(2)(B).

"SEC. 97. CERTAIN FRINGE BENEFITS.

"(a) PURPOSE.—This section includes definitions and rules applicable to the exclusion from gross income for certain fringe benefits.

"(b) NO-ADDITIONAL-COST SERVICE DEFINED.—'No-additional-cost service' means any service provided by an employer to an employee for use by such employee if—

"(1) such service is offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services, and

"(2) the employer incurs no substantial additional cost (including forgone revenue) in providing such service to the employee (determined without regard to any amount paid by the employee for such service).

"(c) QUALIFIED EMPLOYEE DISCOUNT DEFINED.—

"(1) QUALIFIED EMPLOYEE DISCOUNT.—The term 'qualified employee discount' means any employee discount with respect to qualified property or services to the extent such discount does not exceed—

"(A) in the case of property, the gross profit percentage of the price at which the property is being offered by the employer to customers, or

"(B) in the case of services, 20 percent of the price at which the services are being offered by the employer to customers.

"(2) GROSS PROFIT PERCENTAGE.—

"(A) IN GENERAL.—'Gross profit percentage' means the percent which—

"(i) the excess of the aggregate sales price of property sold by the employer to customers over the aggregate cost of such property to the employer, is of

"(ii) the aggregate sales price of such property.

"(B) DETERMINATION OF GROSS PROFIT PERCENTAGE.—Gross profit percentage shall be determined on the basis of—

"(i) all property offered to customers in the ordinary course of the line of business of the employer in which the employee is performing services (or a reasonable classification of property selected by the employer), and

"(ii) the employer's experience during a representative period.

"(3) EMPLOYEE DISCOUNT DEFINED.—'Employee discount' means the amount by which—

"(A) the price at which the property or services are provided by the employer to an employee for use by such employee, is less than

"(B) the price at which such property or services are being offered by the employer to customers.

"(4) QUALIFIED PROPERTY OR SERVICES.—'Qualified property or services' means any property (other than real property and other than personal property of a kind held for investment) or services which are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services.

"(c) DE MINIMIS FRINGE DEFINED.—

"(1) IN GENERAL.—'De minimis fringe' means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

"(2) TREATMENT OF CERTAIN EATING FACILITIES.—The operation by an employer of any eating facility for employees shall be treated as a de minimis fringe if—

"(A) such facility is located on or near the business premises of the employer, and

"(B) revenue derived from such facility normally equals or exceeds the direct operating costs of such facility.

The preceding sentence shall apply with respect to any highly compensated employee only if access to the facility is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees.

"(3) ON-PREMISES GYMS AND OTHER ATHLETIC FACILITIES.—

"(A) IN GENERAL.—De minimis fringe benefits include the provision of on-premises athletic facility by an employer to its employees.

"(B) ON-PREMISES ATHLETIC FACILITY.—For purposes of this paragraph, 'on-premises athletic facility' means any gym or other athletic facility—

"(i) which is located on the premises of the employer,

"(ii) which is operated by the employer, and

"(iii) substantially all the use of which is by employees of the employer, their spouses, and their dependent children.

"(d) CERTAIN EDUCATIONAL TRAINING BENEFITS.—Amounts paid or expenses incurred by the employer for education or training provided to the employee shall be excluded from gross income under section 4 if (and only if) such amounts or expenses are ordinary and necessary business expenses and are not for an advanced degree or to qualify an employee for a new line of work.

"(e) REGULATIONS.—The Secretary shall prescribe regulations under this section, including regulations that continue certain rules contained in section 132 to the Internal Revenue Code of 1986 related to the fringe benefits described in this section.

"Subchapter E—Rules Relating to Deductions

"Sec. 101. Charitable, etc. organizations.
"Sec. 102. Private foundations.

"SEC. 101. CHARITABLE, ETC. ORGANIZATIONS.

"(a) PURPOSE.—This section provides definitions for purposes of determining the philanthropic transfer deduction and for other purposes of this chapter and chapter 2.

"(b) REGULAR CHARITY.—

"(1) IN GENERAL.—

"(A) REGULAR CHARITY.—'Regular charity' means—

"(i) a church or a convention or association of churches,

"(ii) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on,

"(iii) an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research, if the organization is a hospital, or if the organization is a medical research organization directly engaged in the continuous active conduct of medical research in conjunction with a hospital,

"(iv) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for

its exemption under section 253(a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public, and which is organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university which is an organization referred to in clause (ii) of this subparagraph and which is an agency or instrumentality of a State or political subdivision thereof, or which is owned or operated by a State or political subdivision thereof or by an agency or instrumentality of one or more States or political subdivisions,

''(v) a governmental unit referred to in subsection (c)(1),

''(vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption

under section 253(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public,

"(vii) a private foundation described in subparagraph (C), or

"(viii) an organization described in section 102(a) (2) or (3).

"(B) SPECIAL RULE FOR MEDICAL RESEARCH ORGANIZATIONS.—For purposes of determining whether a contribution is to a regular charity, a medical research organization shall not be treated as described in clause (iii) of paragraph (2) unless during the calendar year in which the contribution is made such organization is committed to spend such contributions for such research before January 1 of the fifth calendar year which begins after the date such contribution is made,

"(C) CERTAIN PRIVATE FOUNDATIONS.—The private foundations referred to in subparagraph (A)(vii) and subsection (e)(1)(B) are—

"(i) a private operating foundation (as defined in section 4942(j)(3)),

"(ii) any other private foundation (as defined in section 102(a)) which, not later than the 15th day of the third month after the close of the foundation's taxable year in which contributions are received, makes qualifying distributions (as defined in section 4942(g), without regard to paragraph (3) thereof), which are treated, after the application of section 4942(g)(3), as distributions out of corpus (in accordance with section 4942(h)) in an amount equal to 100 percent of such contributions, and with respect to which the taxpayer obtains adequate records or other sufficient evidence from the foundation showing that the foundation made such qualifying distributions, and

"(iii) a private foundation all of the contributions to which are pooled in a common fund and which would be described in section 102(a)(3) but for the right of any substantial contributor (hereafter in this clause called 'donor') or his spouse to designate annually the recipients, from among organizations described in paragraph (1) of

section 102(a), of the income attributable to the donor's contribution to the fund and to direct (by deed or by will) the payment, to an organization described in such paragraph (1), of the corpus in the common fund attributable to the donor's contribution; but this clause shall apply only if all of the income of the common fund is required to be (and is) distributed to one or more organizations described in such paragraph (1) not later than the 15th day of the third month after the close of the taxable year in which the income is realized by the fund and only if all of the corpus attributable to any donor's contribution to the fund is required to be (and is) distributed to one or more of such organizations not later than one year after his death or after the death of his surviving spouse if she has the right to designate the recipients of such corpus.

"(2) REFERENCES.—Any reference in other law or in legal documents to an organization described in a clause of section 170(b)(1)(A) of the Internal Revenue Code of 1986 shall constitute a reference to

an organization described in the same clause of section 101(b)(1)(A).

"(c) CHARITY.—For purposes of determining the deductibility of a philanthropic transfer, 'charitable contribution' means a contribution or gift for the use of—

"(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

"(2) A corporation, trust, or community chest, fund, or foundation—

"(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

"(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes (but only if no part of its activities involve the provision of athletic facilities or equipment) or for the prevention of cruelty to children or animals,

"(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual, and

"(D) which qualifies for exemption from the business tax under section 253(c) and is not disqualified for tax exemption by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

"(3) [intentionally deleted]

"(4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

"(5) A cemetery company owned and operated exclusively for the benefit of its members, or any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if such company or corporation

is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

"(d) RULES FOR SUBSECTION (c).—

"(1) LIMITATIONS.—A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of subsection (c)(2)(B) only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B).

"(2) REFERENCES.—Any reference in other law or in legal documents to an organization described in a paragraph of section 170(c) of the Internal Revenue Code of 1986 shall constitute a reference to an organization described in the same paragraph number of section 101(c) if an organization is described in such paragraph.

"(e) QUALIFIED CONSERVATION CONTRIBUTION.—

"(1) IN GENERAL.—'Qualified conservation contribution' means a contribution—

"(A) of a qualified real property interest,

"(B) to a qualified organization,

"(C) exclusively for conservation purposes.

"(2) QUALIFIED REAL PROPERTY INTEREST.—'Qualified real property interest' means any of the following interests in real property:

"(A) the entire interest of the donor other than a qualified mineral interest,

"(B) a remainder interest, and

"(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

"(3) QUALIFIED ORGANIZATION.—For purposes of paragraph (1), the term 'qualified organization' means an organization which—

"(A) is described in clause (v) or (vi) of subsection (b)(1)(A), or

"(B) is described in section 253(c)(3) and—

"(i) meets the requirements of section 102(a)(2), or

"(ii) meets the requirements of section 102(a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

"(4) CONSERVATION PURPOSE DEFINED.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'conservation purpose' means—

"(i) the preservation of land areas for outdoor recreation by, or the education of, the general public,

"(ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,

"(iii) the preservation of open space (including farmland and forest land) where such preservation is—

"(I) for the scenic enjoyment of the general public, or

"(II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit, or

"(iv) the preservation of an historically important land area or a certified historic structure.

"(B) CERTIFIED HISTORIC STRUCTURE.—For purposes of subparagraph (A)(iv), the term 'certified historic structure' means any building, structure, or land area which—

"(i) is listed in the National Register, or

"(ii) is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this chapter for the taxable year in which the transfer is made.

"(5) EXCLUSIVELY FOR CONSERVATION PURPOSES.—For purposes of this subsection—

"(A) CONSERVATION PURPOSE MUST BE PROTECTED.—A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

"(B) NO SURFACE MINING PERMITTED.—

"(i) IN GENERAL.—Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph (A) shall not be treated as

met if at any time there may be extraction or removal of minerals by any surface mining method.

"(ii) SPECIAL RULE.—With respect to any contribution of property in which the ownership of the surface estate and mineral interests were separated before June 13, 1976, and remain so separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

"(6) QUALIFIED MINERAL INTEREST.—For purposes of this subsection, the term 'qualified mineral interest' means—

"(A) subsurface oil, gas, or other minerals, and

"(B) the right to access to such minerals.

"(f) DENIAL OF DEDUCTION FOR CERTAIN TRAVEL EXPENSES.—No deduction shall be allowed under section 211 for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

"(g) TREATMENT OF CERTAIN AMOUNTS PAID TO OR FOR THE BENEFIT OF INSTITUTIONS OF HIGHER EDUCATION.—For purposes of section 11, if as the result of a contribution to or for the benefit of an educational organization—

"(1) which is described in subsection (b)(1)(A)(ii), and

"(2) which is an institution of higher education (as defined in section 3304(f))

the taxpayer receives (directly or indirectly) as a result of paying such amount the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution, 80 percent of such contribution shall be treated as a charitable contribution (but only if such amount would be allowable as a deduction but for the fact that the taxpayer received the right to purchase tickets). If any portion of a payment is for the purchase of such tickets, such portion and the remaining portion (if any) of such payment shall be treated as separate amounts for purposes of this subsection.

"Subchapter F—Special Business Activities

"Sec. 111. Rules of rental of real estate.

"SEC. 111. RULES FOR RENTAL OF REAL ESTATE.

"(a) IN GENERAL.—Except as provided in subsection (b)—

"(1) the activity of rental of real estate is a business activity to which the Simplified USA Tax for businesses under chapter 2 applies,

"(2) a taxpayer shall not be entitled to any deductions under this chapter with respect to rental property, and

"(3) a taxpayer shall recognize gross income only with respect to distributions from the rental activity.

"(b) INSUBSTANTIAL RENTAL ACTIVITY.—

"(1) NOT RENTAL PROPERTY.—If an individual or individuals own property, such individual or individuals and their families use the property on more than 14 days during the taxable year for nonbusiness purposes, the property is rented for no more than 14 days during the taxable year, and the total rental received by the individuals with respect to such property does not exceed $10,000, the property shall not be considered rental property or used in the activity of rental of real estate during the taxable year for purposes of subsection (a) and the Simplified USA Tax for businesses under chapter 2.

"(2) RENTS FROM NONRENTAL PROPERTY.—Any rent from property described in paragraph (1)

shall be included in gross income for purposes of the Simplified USA Income Tax.

"(c) USE FOR A NONBUSINESS PURPOSE.—For purposes of this section, 'use for a nonbusiness purpose' means use other than—

"(1) use for which fair rent is paid,

"(2) use in connection with the preparation of the property for rental, or

"(3) use that serves a clear business purpose. Use during any part of a day shall constitute use for that day.

"Subchapter G—Accounting Methods and Periods

"Sec. 121. Taxable year.
"Sec. 122. Cash method of accounting; installment sales.

"SEC. 121. TAXABLE YEAR.

"(a) IN GENERAL.—The taxable year for all individuals subject to tax under this chapter shall be the calendar year except as provided in subsection (b).

"(b) SHORT TAXABLE YEARS.—

"(1) BIRTH.—An individual's taxable year in year of his birth shall begin on the date of his birth.

"(2) DEATH.—An individual's taxable year in the year of his death shall end on the date of his death.

"SEC. 122. CASH METHOD OF ACCOUNTING; INSTALLMENT SALES.

"(a) IN GENERAL.—All individuals shall determine their income and deductions using the cash receipts and disbursement method.

"(b) OID RULES.—

"(1) IN GENERAL.—Original issue discount shall not be included in gross income until received.

"(2) PREVIOUSLY RECOGNIZED OID.—Original issue discount included in income under the Internal Revenue Code of 1986 shall increase the adjusted basis of the instrument to which the original issue discount related and shall not again be included in income when received.

"(c) INSTALLMENT SALES.—

"(1) IN GENERAL.—Taxpayers shall take into account income from installment sales when received.

"(2) REGULATIONS.—The Secretary shall promulgate regulations implementing paragraph (1). Such regulations shall generally follow the principles of sections 453, 453A and 453B of the Internal Revenue Code of 1986, except to the extent such principles are inconsistent with other provisions of this chapter.

"(d) CONSTRUCTIVE RECEIPT.—Income shall be treated as received when constructively received.

"(e) EFFECT OF CHANGE OF ACCOUNTING METHOD.—Rules similar to those under section 226 shall apply to ensure that a taxpayer does not deduct the same expense twice or include the same item in income twice.

"Subchapter H—Nonresident Aliens

"Sec. 131. Tax on nonresident alien individuals.
"Sec. 132. Tax treatment of certain community income of nonresident aliens.

"SEC. 131. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

"(a) NONBUSINESS INCOME.—

"(1) INCOME OTHER THAN CERTAIN GAINS.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as—

"(A) interest (other than portfolio interest (as defined in subsection (b)(2)), deposit interest (as defined in subsection (b)(3)) and original issue discount, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual periodical gains, profits and income,

"(B) gains from the disposal of timber, coal, or iron ore with a retained economic interest,

"(C) in the case of the sale of an original discount obligation or payment on an original issue discount obligation, the interest accrued while the individual was a nonresident alien, and

"(D) includible social security benefits (as defined in section 3(b)(2)).

"(2) CAPITAL GAINS OF CERTAIN ALIENS.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed a tax of 30 percent of the amount by which the gains, derived from sources within the United States, from the sale or exchange at any time during such year exceeds his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets.

"(3) TAX DOES NOT APPLY TO BUSINESS INCOME.—The taxes imposed by this section shall not apply to the income of any business entity, except to

the extent such income is distributed as compensation, dividends, or interest.

"(b) SPECIAL RULES AND DEFINITIONS.—

"(1) CERTAIN ANNUITIES.—The taxes imposed by subsection (a) shall not apply to any amount received as an annuity under a qualified annuity plan described in section 403(a)(1), or from a qualified trust described in section 401(a) and exempt under section 253(a) if—

"(A) all of the personal services by reason of which the annuity is payable were either—

"(i) personal services performed outside the United States by an individual who, at the time of performance of such personal services, was a nonresident alien, or

"(ii) personal services by a nonresident alien temporarily present in the United States for a period or periods not exceeding 90 days during a taxable year, whose compensation for such services did not exceed $3,000, and who performed such services for—

"(I) a nonresident alien individual, foreign partnership, or foreign

corporation, not engaged in a trade or business within the United States, or

"(II) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation, and

"(B) at the time the first amount is paid as annuity under the annuity plan or by the trust, 90 percent or more of the employees for whom contributions or benefits are provided under such plan are citizens or residents of the United States.

"(2) PORTFOLIO INTEREST.—

"(A) IN GENERAL.—'Portfolio interest' means—

"(i) interest on obligations in registered form if the United States person who would otherwise be required to withhold tax on such interest under section 1441(a) receives a statement that the beneficial owner of the obligation is not a United States person, and

"(ii) interest on obligations in nonregistered form if appropriate precautions are taken to ensure that such obligations will be sold only to persons who are not United States persons and such interest is paid outside the United States.

"(B) EXCEPTIONS.—Under rules to be prescribed by the Secretary, portfolio interest does not include—

"(i) interest received by a 10-percent equity owner, or

"(ii) contingent interest.

"(3) DEPOSIT INTEREST.—'Deposit interest' means interest on deposits which are—

"(A) deposits with persons carrying on a banking business (including savings and loans), and

"(B) amounts held by an insurance company under an agreement to pay interest thereon.

"(4) OTHER EXCEPTIONS.—The taxes imposed by subsection (a) shall not apply to—

"(A) a percentage of any dividend paid by a business entity, 80 percent of whose gross receipts are not taken into account under chapter

1 because they are from outside the United
2 States, equal to the percentage of gross receipts
3 not so taken into account,
4 "(B) gambling winnings (except to the ex-
5 tent that the Secretary determines by regula-
6 tion that the collection of the tax is administra-
7 tively feasible),
8 "(C) compensation paid by a foreign em-
9 ployer to a nonresident alien individual for the
10 period he is temporarily present in the United
11 States as a nonimmigrant under subparagraph
12 (F) or (J) of section 101(a)(15) of the Immi-
13 gration and Nationality Act, as amended,
14 "(D) interest from a series E or series H
15 savings bond if the individual acquired the bond
16 while a resident of the Ryuku Islands or the
17 Trust Territory of the Pacific Islands, or
18 "(E) amounts earned or payable to any
19 person who is a bona fide resident of Puerto
20 Rico, Guam, American Samoa, or the Northern
21 Mariana Islands (and, therefore, is subject to
22 the tax imposed by subchapter A).
23 "(c) EXPATRIATION TO AVOID TAX.—
24 "(1) IN GENERAL.—A nonresident alien individ-
25 ual who at any time within the 10-year period imme-

diately preceding the close of the taxable year lost United States citizenship shall be taxable in the manner described in paragraph (2) unless none of the principal purposes of losing citizenship was avoidance of tax under subchapter A or subtitle B.

"(2) ALTERNATIVE TAX.—A nonresident alien individual described in paragraph (1) shall be subject to tax on the items taxable under subsection (a) as determined without regard to exceptions listed or based on definitions contained in subsection (b) using the rate schedule for single individuals under section 215. If the taxes determined under subsection (a) are greater than the tax determined under this subsection, the greater tax shall apply.

"SEC. 132. TAX TREATMENT OF CERTAIN COMMUNITY INCOME OF NONRESIDENT ALIENS.

"(a) GENERAL RULE.—In the case of a married couple one or both of whom are nonresident alien individuals and who have community income for the taxable year, such community income shall be treated as follows:

"(1) Compensation income shall be treated as income of the spouse who rendered the services,

"(2) Partnership distributions shall be treated as the related distributive shares of partnership income would be treated under section 1402(a)(5),

"(3) Community income which is derived from the separate property of a spouse shall be treated as income of that spouse, and

"(4) All other such community income shall be treated as provided in the applicable community property law.

"(b) EXCEPTION WHERE ELECTION UNDER SECTION 6013(g) IS IN EFFECT.—Subsection (a) shall not apply if an election under subsection (g) or (h) of section 6013 (relating to election to treat nonresident alien individuals as residents of the United States) is in effect.

"SEC. 133. RELATIONSHIP WITH TREATIES.

"(a) STATEMENT OF POLICY.—It is the intention of the USA Tax Code to promote a worldwide tax system in which each nation taxes—

"(1) under an individual tax, only the income of individuals who are residents or citizens of that nation, and

"(2) under a business tax only the business activity in such nation.

"(b) EFFECT OF TREATIES.—No tax shall be imposed under section 131(a) on income that is exempt from tax by reason of a treaty between the nation of which the nonresident alien is a citizen or resident and the United States. If any such treaty requires that a lower rate of

tax be imposed on some or all of the items of income subject to tax under section 331(a), such lower rate shall apply to such items in the case of persons to whom such treaty applies.

"(c) EFFECT OF UNILATERAL ACTION BY FOREIGN NATION.—No tax shall be imposed under section 331(a) on nonresident aliens who are citizens or residents of another nation if—

"(1) such nation exempts from its income and withholding taxes nonresident alien individuals who are residents or citizens of the United States,

"(2) such nation has entered into a tax information sharing agreement with the United States, and

"(3) the Secretary certifies that the preceding two requirements have been satisfied.

"Subchapter I—Trusts and Estates

"Sec. 140. Prepayment of tax by trusts and estates.
"Sec. 141. Application of tax.
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"Sec. 163. Income of an estate or trust in case of divorce, etc.
"Sec. 164. Recognition of gain on certain transfers to certain foreign persons and estates.
"Sec. 165. Treatment of funeral trusts.
"Sec. 166. Income in respect of a decedent.

"SEC. 140. PREPAYMENT OF TAX BY TRUSTS AND ESTATES.

"(a) PREPAYMENT OF TAX.—A trust or estate shall prepay the Simplified USA Tax for individuals in accordance with the provisions of this subchapter.

"(b) IMPOSITION OF TAX.—There is hereby imposed a tax on the taxable income of trusts and estates (as determined in accordance with this subchapter) a tax determined as follows:

"If taxable income is:	**The tax is:**
Not over $1,600	15% of taxable income.
Over $1,600, but not over $3,800	$240, plus 25% of the excess over $1,600.
Over $3,800	$790, plus 30% of the excess over $3,800.

"(c) INFLATION ADJUSTMENT.—The schedule in subsection (b) shall be adjusted for inflation in accordance with section 23.

"(d) BUSINESS ACTIVITIES.—

"(1) TAX ON BUSINESS ACTIVITY DETERMINED AT BUSINESS LEVEL.—If a trust engages in business activity (as defined in section 206(b)), it shall be

considered a business entity with respect to such activities for purposes of the business tax under chapter 2. The business entity shall be considered an asset of the trust.

"(2) BUSINESS ENTITY AS SOLE BENEFICIARY.—If the only beneficiaries of a trust are business entities, no tax shall be imposed on such trust under this subchapter.

"SEC. 141. APPLICATION OF TAX.

"(a) IN GENERAL.—The tax imposed by section 140 shall apply to the taxable income of estates or of any kind of property held in trust, including—

"(1) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

"(2) income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

"(3) income received by estates of deceased persons during the period of administration or settlement of the estate; and

"(4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

"(b) COMPUTATION AND PAYMENT.—The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this subchapter. The tax shall be computed on such taxable income and shall be paid by the fiduciary. For purposes of this subsection, a foreign trust or foreign estate shall be treated as a nonresident alien individual who is not present in the United States at any time.

"(c) EXCLUSION OF INCLUDIBLE GAIN FROM TAXABLE INCOME.—The taxable income of a trust does not include the amount of any includible gain as defined in section 144(b) reduced by any deductions properly allocable thereto.

"SEC. 142. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.

"(a) USA DEDUCTION AND FAMILY LIVING ALLOWANCE.—

"(1) NO DEDUCTION OR ALLOWANCE.—A trust or estate shall not be allowed any USA Deductions or a Family Living Allowance.

"(2) SPECIAL DEDUCTION.—For purposes of determining taxable income, trusts and estates shall

be entitled to the following deductions from gross income—

"(A) ESTATE.—An estate shall be allowed a deduction of $600.

"(B) DISTRIBUTING TRUST.—A trust which, under its governing instrument, is required to distribute all of its income currently shall be allowed a deduction of $300.

"(C) OTHER TRUSTS.—Trusts not described in subparagraph (B) shall be allowed a deduction of $100.

"(b) DEDUCTION FOR AMOUNTS PAID OR PERMANENTLY SET ASIDE FOR A CHARITABLE PURPOSE.—

"(1) GENERAL RULE.—In the case of an estate or trust, there shall be allowed as a deduction in computing its taxable income (in lieu of the philanthropic transfer deduction) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 101(c) (determined without regard to section 101(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may

elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary prescribes by regulations.

"(2) POOLED INCOME FUNDS.—In the case of a pooled income fund (as defined in paragraph (3)), there shall also be allowed as a deduction in computing its taxable income any amount of the gross income attributable to gain from the sale of a capital asset held for more than 1 year, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 101(c).

"(3) DEFINITION OF POOLED INCOME FUND.—For purposes of paragraph (2), a pooled income fund is a trust—

"(A) to which each donor transfers property, contributing an irrevocable remainder interest in such property to or for the use of an organization described in section 101(b)(1)(A) (other than in clauses (vii) or (viii)), and retaining an income interest for the life of one or more beneficiaries (living at the time of such transfer),

"(B) in which the property transferred by each donor is commingled with property transferred by other donors who have made or make similar transfers,

"(C) which cannot have investments in securities which are exempt from taxes imposed by this subtitle,

"(D) which includes only amounts received from transfers which meet the requirements of this paragraph,

"(E) which is maintained by the organization to which the remainder interest is contributed and of which no donor or beneficiary of an income interest is a trustee, and

"(F) from which each beneficiary of an income interest receives income, for each year for which he is entitled to receive the income interest referred to in subparagraph (A), determined by the rate of return earned by the trust for such year.

For purposes of determining the amount of any charitable contribution allowable by reason of a transfer of property to a pooled fund, the value of the income interest shall be determined on the basis of the highest rate of return earned by the fund for

any of the 3 taxable years immediately preceding the taxable year of the fund in which the transfer is made. In the case of funds in existence less than 3 taxable years preceding the taxable year of the fund in which a transfer is made the rate of return shall be deemed to be 6 percent per annum, except that the Secretary may prescribe a different rate of return.

''(c) UNUSED LOSS CARRYOVERS.—If on the termination of an estate or trust, the estate or trust has a loss carryover then such carryover shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary, to the beneficiaries succeeding to the property of the estate or trust.

''(d) CERTAIN DISTRIBUTIONS BY CEMETERY PERPETUAL CARE FUNDS.—In the case of a cemetery perpetual care fund which—

''(1) was created pursuant to local law by a taxable cemetery corporation for the care and maintenance of cemetery property, and

''(2) is treated for the taxable year as a trust for purposes of this subchapter,

any amount distributed by such fund for the care and maintenance of gravesites which have been purchased from the cemetery corporation before the beginning of the

taxable year of the trust and with respect to which there is an obligation to furnish care and maintenance shall be considered to be a distribution solely for purposes of sections 144 and 146, but only to the extent that the aggregate amount so distributed during the taxable year does not exceed $5 multiplied by the aggregate number of such gravesites.

"SEC. 143. DEFINITIONS AND RULES APPLICABLE TO SUBCHAPTER I.

For purposes of this subchapter—

"(a) DISTRIBUTABLE NET INCOME.—'Distributable net income' means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

"(1) No deduction shall be taken under sections 144 and 146 (relating to additional deductions).

"(2) No deduction shall be taken under section 142(a)(2) (relating to deduction for personal exemptions).

"(3) Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified

in section 142(b). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year.

''(4) For purposes only of rules under section ____, there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.

''(5) There shall be included any tax-exempt interest.

''(6) In the case of a foreign trust—

''(A) There shall be included the amounts of gross income from sources without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265(a)(1) (relating to disallowance of certain deductions).

"(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

"(C) Paragraph (3) shall not apply to a foreign trust. In the case of such a trust, there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges.

If the estate or trust is allowed a deduction under section 142(b), the amount of the modifications specified in paragraphs (5) and (6) shall be reduced to the extent that the amount of income which is paid, permanently set aside, or to be used for the purposes specified in section 142(b) is deemed to consist of items specified in those paragraphs. For this purpose, such amount shall (in the absence of specific provisions in the governing instrument) be deemed to consist of the same proportion of each class of items of income of the estate or trust as the total of each class bears to the total of all classes.

"(b) INCOME.—'Income', when not preceded by the words 'taxable', 'distributable net', 'undistributed net', or 'gross', means the amount of income of the estate or trust

for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

''(c) BENEFICIARY.—'Beneficiary' includes heir, legatee, devisee.

''(d) TREATMENT OF PROPERTY DISTRIBUTED IN KIND.—

''(1) BASIS OF BENEFICIARY.—The basis of any property received by a beneficiary in a distribution from an estate or trust shall be—

''(A) the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for

''(B) any gain or loss recognized to the estate or trust on the distribution.

''(2) AMOUNT OF DISTRIBUTION.—In the case of any distribution of property (other than cash), the amount taken into account under sections 146(a)(2) and 147(a)(2) shall be the lesser of—

"(A) the basis of such property in the hands of the beneficiary (as determined under paragraph (1)), or

"(B) the fair market value of such property.

"(3) ELECTION TO RECOGNIZE GAIN.—

"(A) IN GENERAL.—In the case of any distribution of property (other than cash) to which an election under this paragraph applies—

"(i) paragraph (2) shall not apply,

"(ii) gain or loss shall be recognized by the estate or trust in the same manner as if such property had been sold to the distributee at its fair market value, and

"(iii) the amount taken into account under sections 146(a)(2) and 147(a)(2) shall be the fair market value of such property.

"(B) ELECTION.—Any election under this paragraph shall apply to all distributions made by the estate or trust during a taxable year and shall be made on the return of such estate or trust for such taxable year.

Any such election, once made, may be revoked only with the consent of the Secretary.

"(4) EXCEPTION FOR DISTRIBUTIONS DESCRIBED IN SECTION 148(a).—This subsection shall not apply to any distribution described in section 148(a).

"(f) TREATMENT OF MULTIPLE TRUSTS.—For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if—

"(1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and

"(2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter.

For purposes of the preceding sentence, a husband and wife shall be treated as 1 person.

"(g) CERTAIN PAYMENTS OF ESTIMATED TAX TREATED AS PAID BY BENEFICIARY.—Under rules prescribed by the Secretary, a trustee may elect to treat any portion of a payment of estimated tax made by such trust for any taxable year of the trust as a payment made by a beneficiary of such trust. This rule shall also apply in the case of a taxable year reasonably expected to be the last taxable year of an estate.

"(h) FOREIGN TRUSTS AND FOREIGN INCOME.—The Secretary shall prescribe special rules for foreign trusts

and foreign income of trusts. Those rules should generally be consistent with the rules under subchapter J of chapter 1 of the Internal Revenue Code of 1986, except that they shall take into account the principles of the Simplified USA Tax.

"(i) CERTAIN REVOCABLE TRUSTS TREATED AS PART OF ESTATE.

"(1) IN GENERAL.—If both the executor (if any) of an estate and the trustee of a qualified revocable trust elect the treatment provided in this section, such trust shall be treated and taxed as part of such estate (and not as a separate trust) for all taxable years of the estate ending after the date of the decedent's death and before the applicable date.

"(2) QUALIFIED REVOCABLE TRUST.—For purposes of this subsection, 'qualified revocable trust' means any trust (or portion thereof) which was treated under section 158 as owned by the decedent of the estate referred to in paragraph (1) by reason of a power in the grantor (determined without regard to section 154(e).

"(3) APPLICABLE DATE.—For purposes of this subsection, 'applicable date' means—

"(A) if no return of tax imposed by chapter 11 is required to be filed, the date which is

2 years after the date of the decedent's death, and

"(B) if such a return is required to be filed, the date which is 6 months after the date of the final determination of the liability for tax imposed by chapter 11.

"(4) ELECTION.—The election under this subsection shall be made not later than the time prescribed for filing the return of tax imposed by this chapter for the first taxable year of the estate (determined with regard to extensions) and, once made, shall be irrevocable.

"SEC. 144. DEDUCTION FOR TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

"(a) DEDUCTION.—In the case of any trust the terms of which—

"(1) provide that all of its income is required to be distributed currently, and

"(2) do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in section 142(b) (relating to deduction for charitable, etc., purposes),

there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed cur-

rently. This section shall not apply in any taxable year in which the trust distributes amounts other than amounts of income described in paragraph (1).

"(b) LIMITATION ON DEDUCTION.—If the amount of income required to be distributed currently exceeds the distributable net income of the trust for the taxable year, the deduction shall be limited to the amount of the distributable net income. For this purpose, the computation of distributable net income shall not include items of income which are not included in the gross income of the trust and the deductions allocable thereto.

"SEC. 145. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

"(a) INCLUSION.—Subject to subsection (b), the amount of income for the taxable year required to be distributed currently by a trust described in section 144 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. If such amount exceeds the distributable net income, there shall be included in the gross income of each beneficiary an amount which bears the same ratio to distributable net income as the amount of income required to be distributed to such beneficiary bears to the

amount of income required to be distributed to all beneficiaries.

"(b) CHARACTER OF AMOUNTS.—The amounts specified in subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income of the trust as the total of each class bears to the total distributable net income of the trust, unless the terms of the trust specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary.

"SEC. 146. DEDUCTION FOR ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

"(a) DEDUCTION.—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust described in section 144), the sum of—

"(1) any amount of income for such taxable year required to be distributed currently (including

any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

"(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

"(b) CHARACTER OF AMOUNTS DISTRIBUTED.—The amount determined under subsection (a) shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income of the estate or trust as the total of each class bears to the total distributable net income of the estate or trust in the absence of the allocation of different classes of income under the specific terms of the governing instrument. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 142(b)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary.

"(c) LIMITATION ON DEDUCTION.—No deduction shall be allowed under subsection (a) in respect of any por-

tion of the amount allowed as a deduction under that subsection (without regard to this subsection) which is treated under subsection (b) as consisting of any item of distributable net income which is not included in the gross income of the estate or trust.

"SEC. 147. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

''(a) INCLUSION.—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 146(a) is paid, credited, or required to be distributed (by an estate or trust described in section 146), the sum of the following amounts:

''(1) AMOUNTS REQUIRED TO BE DISTRIBUTED CURRENTLY.—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (computed without the deduction allowed by section 142(b), relating to deduction for charitable, etc., purposes) of the estate or trust, then, in lieu of the amount provided in the preceding sen-

tence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. For purposes of this section, the phrase 'the amount of income for the taxable year required to be distributed currently' includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such taxable year.

''(2) OTHER AMOUNTS DISTRIBUTED.—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. If the sum of—

''(A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and

''(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries

exceeds the distributable net income of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which

bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

"(b) CHARACTER OF AMOUNTS.—The amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income of the estate or trust unless the terms of the governing instrument specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 142(b)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary. In the application of this subsection to the amount determined under paragraph (1) of subsection (a), distributable net income shall be computed without regard

to any portion of the deduction under section 142(b) which is not attributable to income of the taxable year.

"SEC. 148. SPECIAL RULES APPLICABLE TO SECTIONS 146 AND 147.

"(a) EXCLUSIONS.—There shall not be included as amounts falling within section 146(a) or 147(a)—

"(1) GIFTS, BEQUESTS, ETC.—Any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments. For this purpose an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money.

"(2) CHARITABLE, ETC., DISTRIBUTIONS.—Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 142(b) (computed without regard to sections 508(d), 162, and 4948(c)(4)).

"(3) DENIAL OF DOUBLE DEDUCTION.—Any amount paid, credited, or distributed in the taxable year, if section 144 or section 146 applied to such amount for a preceding taxable year of an estate or

trust because credited or required to be distributed in such preceding taxable year.

"(b) DISTRIBUTIONS IN FIRST SIXTY-FIVE DAYS OF TAXABLE YEAR.—

"(1) GENERAL RULE.—If within the first 65 days of any taxable year of an estate or a trust, an amount is properly paid or credited, such amount shall be considered paid or credited on the last day of the preceding taxable year.

"(2) LIMITATION.—Paragraph (1) shall apply with respect to any taxable year of an estate or a trust only if the executor of such estate or the fiduciary of such trust (as the case may be) elects, in such manner and at such time as the Secretary prescribes by regulations, to have paragraph (1) apply for such taxable year.

"(c) SEPARATE SHARES TREATED AS SEPARATE ESTATES OR TRUSTS.—For the sole purpose of determining the amount of distributable net income in the application of sections 146 and 147, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. Rules similar to the rules of the preceding provisions of this subsection shall apply to treat substantially separate and independent

shares of different beneficiaries in an estate having more than 1 beneficiary as separate estates. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts or estates, including the application of sections 150 through 152, shall be determined in accordance with regulations prescribed by the Secretary.

"SEC. 149. CHARITABLE REMAINDER TRUSTS.

"(a) GENERAL RULE.—Notwithstanding any other provision of this subchapter, the provisions of this section shall, in accordance with regulations prescribed by the Secretary, apply in the case of a charitable remainder annuity trust and a charitable remainder unitrust.

"(b) CHARACTER OF DISTRIBUTIONS.—Amounts distributed by a charitable remainder annuity trust or by a charitable remainder unitrust shall be considered as having the following characteristics in the hands of a beneficiary to whom is paid the annuity described in subsection (d)(1)(A) or the payment described in subsection (d)(2)(A):

"(1) First, as amounts of income (other than gains, and amounts treated as gains, from the sale or other disposition of capital assets) includible in gross income to the extent of such income of the

trust for the year and such undistributed income of the trust for prior years;

"(2) Second, as a capital gain to the extent of the capital gain of the trust for the year and the undistributed capital gain of the trust for prior years;

"(3) Third, as other income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years; and

"(4) Fourth, as a distribution of trust corpus.

For purposes of this section, the trust shall determine the amount of its undistributed capital gain on a cumulative net basis.

"(c) EXEMPTION FROM INCOME TAXES.—A charitable remainder annuity trust and a charitable remainder unitrust shall, for any taxable year, not be subject to any tax imposed by this chapter. Any such trust shall be liable for tax on its unrelated business taxable income (within the meaning of section 255).

"(d) DEFINITIONS.—

"(1) CHARITABLE REMAINDER ANNUITY TRUST.—For purposes of this section, a charitable remainder annuity trust is a trust—

"(A) from which a sum certain (which is not less than 5 percent nor more than 50 percent of the initial net fair market value of all

property placed in trust) is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 101(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

''(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 101(c),

''(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 101(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in

section 4975(e)(7) in a qualified gratuitous transfer (as defined by subsection (g)).

"(D) the value (determined under section 7520 of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust.

"(2) CHARITABLE REMAINDER UNITRUST.—For purposes of this section, a charitable remainder unitrust is a trust—

"(A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 101(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

"(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or

for the use of any person other than an organization described in section 101(c),

"(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 101(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7) in a qualified gratuitous transfer (as defined by subsection (g)).

"(D) with respect to each contribution of property to the trust, the value (determined under section 7520 of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

"(3) EXCEPTION.—Notwithstanding the provisions of paragraphs (2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year—

"(A) the amount of the trust income, if such amount is less than the amount required to be distributed under paragraph (2)(A), and

"(B) any amount of the trust income which is in excess of the amount required to be distributed under paragraph (2)(A), to the extent that (by reason of subparagraph (A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

"(4) SEVERANCE OF CERTAIN ADDITIONAL CONTRIBUTIONS.—If—

"(A) any contribution is made to a trust which before the contribution is a charitable remainder unitrust, and

"(B) such contribution would (but for this paragraph) result in such trust ceasing to be a charitable unitrust by reason of paragraph (2)(D), such contribution shall be treated as a transfer to a separate trust under regulations prescribed by the Secretary.

"(e) VALUATION FOR PURPOSES OF CHARITABLE CONTRIBUTION.—For purposes of determining the amount of any charitable contribution, the remainder interest of a charitable remainder annuity trust or charitable

remainder unitrust shall be computed on the basis that an amount equal to 5 percent of the net fair market value of its assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year.

"(f) CERTAIN CONTINGENCIES PERMITTED.—

"(1) GENERAL RULE.—If a trust would, but for a qualified contingency, meet the requirements of paragraph (1)(A) or (2)(A) of subsection (d), such trust shall be treated as meeting such requirements.

"(2) VALUE DETERMINED WITHOUT REGARD TO QUALIFIED CONTINGENCY.—For purposes of determining the amount of any charitable contribution (or the actuarial value of any interest), a qualified contingency shall not be taken into account.

"(3) QUALIFIED CONTINGENCY.—For purposes of this subsection, the term 'qualified contingency' means any provision of a trust which provides that, upon the happening of a contingency, the payments described in paragraph (1)(A) or (2)(A) of subsection (d) (as the case may be) will terminate not later than such payments would otherwise terminate under the trust.

"(g) QUALIFIED GRATUITOUS TRANSFER OF QUALIFIED EMPLOYER SECURITIES.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified gratuitous transfer' means a transfer of qualified employer securities to an employee stock ownership plan (as defined in section 4975(e)(7) but only to the extent that—

"(A) the securities transferred previously passed from a decedent dying before January 1, 1999, to a trust described in paragraph (1) or (2) of subsection (d),

"(B) no deduction under section 404 is allowable with respect to such transfer,

"(C) such plan contains the provisions required by paragraph (3),

"(D) such plan treats such securities as being attributable to employer contributions but without regard to the limitations otherwise applicable to such contributions under section 404, and

"(E) the employer whose employees are covered by the plan described in this paragraph files with the Secretary a verified written statement consenting to the application of sections 4978 and 4979A with respect to such employer.

"(2) EXCEPTION.—The term 'qualified gratuitous transfer' shall not include a transfer of quali-

fied employer securities to an employee stock ownership plan unless—

"(A) such plan was in existence on August 1, 1996,

"(B) at the time of the transfer, the decedent and members of the decedent's family (within the meaning of section 171(a)(6)(D)) own (directly or through constructive ownership rules) no more than 10 percent of the value of the stock of the corporation referred to in paragraph (4), and

"(C) immediately after the transfer, such plan owns (after the application of section 318(a)(4) at least 60 percent of the value of the outstanding stock of the corporation.

"(3) PLAN REQUIREMENTS.—A plan contains the provisions required by this paragraph if such plan provides that—

"(A) the qualified employer securities so transferred are allocated to plan participants in a manner consistent with section 401(a)(4),

"(B) plan participants are entitled to direct the plan as to the manner in which such securities which are entitled to vote and are al-

located to the account of such participant are to be voted,

"(C) an independent trustee votes the securities so transferred which are not allocated to plan participants,

"(D) each participant who is entitled to a distribution from the plan has the rights described in subparagraphs (A) and (B) of section 409(h)(1),

"(E) such securities are held in a suspense account under the plan to be allocated each year, up to the limitations under section 415(c), after first allocating all other annual additions for the limitation year, up to the limitations under sections 415 (c) and (e), and

"(F) on termination of the plan, all securities so transferred which are not allocated to plan participants as of such termination are to be transferred to, or for the use of, an organization described in section 101(c). For purposes of the preceding sentence, the term 'independent trustee' means any trustee who is not a member of the family (within the meaning of section 171(a)(6)(D)) of the decedent or a 5-percent shareholder. A plan shall not fail to be

treated as meeting the requirements of section 401(a) by reason of meeting the requirements of this subsection.

"(4) QUALIFIED EMPLOYER SECURITIES.—For purposes of this section, the term 'qualified employer securities' means employer securities (as defined in section 409(l)) which are issued by a domestic corporation—

"(A) which has no outstanding stock which is readily tradable on an established securities market, and

"(B) which has only 1 class of stock.

"(5) TREATMENT OF SECURITIES ALLOCATED BY EMPLOYEE STOCK OWNERSHIP PLAN TO PERSONS RELATED TO DECEDENT OR 5-PERCENT SHAREHOLDERS.—

"(A) IN GENERAL.—If any portion of the assets of the plan attributable to securities acquired by the plan in a qualified gratuitous transfer are allocated to the account of—

"(i) any person who is related to the decedent (within the meaning of section 171(a)(5) or a member of the decedent's family (within the meaning of section 171(a)(6)(D), or

"(ii) any person who, at the time of such allocation or at any time during the 1-year period ending on the date of the acquisition of qualified employer securities by the plan, is a 5-percent shareholder of the employer maintaining the plan, the plan shall be treated as having distributed (at the time of such allocation) to such person or shareholder the amount so allocated.

"(B) 5-PERCENT SHAREHOLDER.—For purposes of subparagraph (A), the term '5-percent shareholder' means any person who owns (directly or through the application of constructive ownership rules) more than 5 percent of the outstanding stock of the corporation which issued such qualified employer securities or of any corporation which is a member of the same controlled group of corporations (within the meaning of section 409(l)(4)) as such corporation.

"(C) CROSS REFERENCE.—For excise tax on allocations described in subparagraph (A), see section 4979A.

"(6) TAX ON FAILURE TO TRANSFER UNALLOCATED SECURITIES TO CHARITY ON TERMI-

NATION OF PLAN.—If the requirements of paragraph (3)(F) are not met with respect to any securities, there is hereby imposed a tax on the employer maintaining the plan in an amount equal to the sum of—

"(A) the amount of the increase in the tax which would be imposed by chapter 11 if such securities were not transferred as described in paragraph (1), and

"(B) interest on such amount at the underpayment rate under section 6621 (and compounded daily) from the due date for filing the return of the tax imposed by chapter 11.

"SEC. 150. DEFINITIONS APPLICABLE TO EXCESS DISTRIBUTION RULES.

"(a) UNDISTRIBUTED NET INCOME.—For purposes of sections 150 through 152, the term 'undistributed net income' for any taxable year means the amount by which the distributable net income of the trust for such taxable year exceeds the sum of—

"(1) the amounts for such taxable year specified in paragraphs (1) and (2) of section 146(a), and

"(2) the amount of taxes imposed on the trust attributable to such distributable net income.

"(b) ACCUMULATION DISTRIBUTION.—For purposes of sections 150 through 152, except as provided in subsection (c), the term 'accumulation distribution' means, for any taxable year of the trust, the amount by which—

"(1) the amounts specified in paragraph (2) of section 146(a) for such taxable year, exceed

"(2) distributable net income for such year reduced (but not below zero) by the amounts specified in paragraph (1) of section 146(a).

For purposes of section 152 (other than subsection (c) thereof, relating to multiple trusts), the amounts specified in paragraph (2) of section 146(a) shall not include amounts properly paid, credited, or required to be distributed to a beneficiary from a trust (other than a foreign trust) as income accumulated before the birth of such beneficiary or before such beneficiary attains the age of 21. If the amounts properly paid, credited, or required to be distributed by the trust for the taxable year do not exceed the income of the trust for such year, there shall be no accumulation distribution for such year.

"(c) EXCEPTION FOR ACCUMULATION DISTRIBUTIONS FROM CERTAIN DOMESTIC TRUSTS.—For purposes of sections 150 through 152—

"(1) IN GENERAL.—In the case of a qualified trust, any distribution in any taxable year beginning

after the date of the enactment of this subsection shall be computed without regard to any undistributed net income.

"(2) QUALIFIED TRUST.—For purposes of this subsection, the term 'qualified trust' means any trust other than—

"(A) a foreign trust (or, except as provided in regulations, a domestic trust which at any time was a foreign trust), or

"(B) a trust created before March 1, 1984, unless it is established that the trust would not be aggregated with other trusts under section 143(f) if such section applied to such trust.

"(d) TAXES IMPOSED ON THE TRUST.—For purposes of sections 150 through 152—

"(1) IN GENERAL.—The term 'taxes imposed on the trust' means the amount of the taxes which are imposed for any taxable year of the trust under this chapter (without regard to sections 150 through 152) and which, under regulations prescribed by the Secretary, are properly allocable to the undistributed portions of distributable net income and gains in excess of losses from sales or exchanges of capital assets. The amount determined in the preceding sentence shall be reduced by any amount of such taxes

deemed distributed under section 151(b) and (c) to any beneficiary.

"(2) FOREIGN TRUSTS.—In the case of any foreign trust, the term 'taxes imposed on the trust' includes the amount, reduced as provided in the last sentence of paragraph (1), of any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on such foreign trust which, as determined under paragraph (1), are so properly allocable. Under rules or regulations prescribed by the Secretary, in the case of any foreign trust of which the settlor or another person would be treated as owner of any portion of the trust but for section 154(f), the term 'taxes imposed on the trust' includes the allocable amount of any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on the settlor or such other person in respect of trust income.

"SEC. 151. ACCUMULATION DISTRIBUTION ALLOCATED TO PRECEDING YEARS.

"(a) AMOUNT ALLOCATED.—In the case of a trust which is subject to sections 146 through 149, the amount of the accumulation distribution of such trust for a taxable year shall be deemed to be an amount within the meaning

of paragraph (2) of section 146(a) distributed on the last day of each of the preceding taxable years, commencing with the earliest of such years, to the extent that such amount exceeds the total of any undistributed net income for all earlier preceding taxable years. The amount deemed to be distributed in any such preceding taxable year under the preceding sentence shall not exceed the undistributed net income for such preceding taxable year. For purposes of this subsection, undistributed net income for each of such preceding taxable years shall be computed without regard to such accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

''(b) TOTAL TAXES DEEMED DISTRIBUTED.—If any portion of an accumulation distribution for any taxable year is deemed under subsection (a) to be an amount within the meaning of paragraph (2) of section 146(a) distributed on the last day of any preceding taxable year, and such portion of such distribution is not less than the undistributed net income for such preceding taxable year, the trust shall be deemed to have distributed on the last day of such preceding taxable year an additional amount within the meaning of paragraph (2) of section 146(a). Such additional amount shall be equal to the taxes imposed on the trust for such preceding taxable year attributable to

the undistributed net income. For purposes of this subsection, the undistributed net income and the taxes imposed on the trust for such preceding taxable year attributable to such undistributed net income shall be computed without regard to such accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

"(c) PRO RATA PORTION OF TAXES DEEMED DISTRIBUTED.—If any portion of an accumulation distribution for any taxable year is deemed under subsection (a) to be an amount within the meaning of paragraph (2) of section 146(a) distributed on the last day of any preceding taxable year and such portion of the accumulation distribution is less than the undistributed net income for such preceding taxable year, the trust shall be deemed to have distributed on the last day of such preceding taxable year an additional amount within the meaning of paragraph (2) of section 146(a). Such additional amount shall be equal to the taxes imposed on the trust for such taxable year attributable to the undistributed net income multiplied by the ratio of the portion of the accumulation distribution to the undistributed net income of the trust for such year. For purposes of this subsection, the undistributed net income and the taxes imposed on the trust for such preceding taxable year attributable to such undistributed net in-

come shall be computed without regard to the accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

"(d) RULE WHEN INFORMATION IS NOT AVAILABLE.—If adequate records are not available to determine the proper application of this subchapter to an amount distributed by a trust, such amount shall be deemed to be an accumulation distribution consisting of undistributed net income earned during the earliest preceding taxable year of the trust in which it can be established that the trust was in existence.

"(e) DENIAL OF REFUND TO TRUSTS AND BENEFICIARIES.—No refund or credit shall be allowed to a trust or a beneficiary of such trust for any preceding taxable year by reason of a distribution deemed to have been made by such trust in such year under this section.

"SEC. 152. TREATMENT OF AMOUNTS DEEMED DISTRIBUTED BY TRUST IN PRECEDING YEARS.

"(a) GENERAL RULE.—The total of the amounts which are treated under section 151 as having been distributed by a trust in a preceding taxable year shall be included in the income of a beneficiary of the trust when paid, credited, or required to be distributed to the extent that such total would have been included in the income of such beneficiary under section 147(a)(2) (and, with re-

spect to any tax-exempt interest to which section 103 applies, under section 147(b)) if such total had been paid to such beneficiary on the last day of such preceding taxable year. The tax imposed by this subtitle on a beneficiary for a taxable year in which any such amount is included in his income shall be determined only as provided in this section and shall consist of the sum of—

"(1) a partial tax computed on the taxable income reduced by an amount equal to the total of such amounts, at the rate and in the manner as if this section had not been enacted,

"(2) a partial tax determined as provided in subsection (b) of this section, and

"(3) in the case of a foreign trust, the interest charge determined as provided in section 152.

"(b) TAX ON DISTRIBUTION.—

"(1) IN GENERAL.—The partial tax imposed by subsection (a)(2) shall be determined.

"(A) by determining the number of preceding taxable years of the trust on the last day of which an amount is deemed under section 151(a) to have been distributed,

"(B) by taking from the 5 taxable years immediately preceding the year of the accumulation distribution the 1 taxable year for which

the beneficiary's taxable income was the highest and the 1 taxable year for which his taxable income was the lowest,

"(C) by adding to the beneficiary's taxable income for each of the 3 taxable years remaining after the application of subparagraph (B) an amount determined by dividing the amount deemed distributed under section 151 and required to be included in income under subsection (a) by the number of preceding taxable years determined under subparagraph (A), and

"(D) by determining the average increase in tax for the 3 taxable years referred to in subparagraph (C) resulting from the application of such subparagraph.

The partial tax imposed by subsection (a)(2) shall be the excess (if any) of the average increase in tax determined under subparagraph (D), multiplied by the number of preceding taxable years determined under subparagraph (A), over the amount of taxes (other than the amount of taxes described in section 150(d)(2)) deemed distributed to the beneficiary under sections 151 (b) and (c).

"(2) TREATMENT OF LOSS YEARS.—For purposes of paragraph (1), the taxable income of the

beneficiary for any taxable year shall be deemed to be not less than zero.

"(3) CERTAIN PRECEDING TAXABLE YEARS NOT TAKEN INTO ACCOUNT.—For purposes of paragraph (1), if the amount of the undistributed net income deemed distributed in any preceding taxable year of the trust is less than 25 percent of the amount of the accumulation distribution divided by the number of preceding taxable years to which the accumulation distribution is allocated under section 151(a), the number of preceding taxable years of the trust with respect to which an amount is deemed distributed to a beneficiary under section 151(a) shall be determined without regard to such year.

"(4) EFFECT OF OTHER ACCUMULATION DISTRIBUTIONS.—In computing the partial tax under paragraph (1) for any beneficiary, the income of such beneficiary for each of his prior taxable years shall include amounts previously deemed distributed to such beneficiary in such year under section 151 as a result of prior accumulation distributions (whether from the same or another trust).

"(5) MULTIPLE DISTRIBUTIONS IN THE SAME TAXABLE YEAR.—In the case of accumulation distributions made from more than one trust which are

includible in the income of a beneficiary in the same taxable year, the distributions shall be deemed to have been made consecutively in whichever order the beneficiary shall determine. Generation-skipping transfer bears to the total accumulation distribution.

''(c) SPECIAL RULE FOR MULTIPLE TRUSTS.—

''(1) IN GENERAL.—If, in the same prior taxable year of the beneficiary in which any part of the accumulation distribution from a trust (hereinafter in this paragraph referred to as ''third trust'') is deemed under section 151(a) to have been distributed to such beneficiary, some part of prior distributions by each of 2 or more other trusts is deemed under section 151(a) to have been distributed to such beneficiary, then subsections (b) and (c) of section 151 shall not apply with respect to such part of the accumulation distribution from such third trust.

''(2) ACCUMULATION DISTRIBUTIONS FROM TRUST NOT TAKEN INTO ACCOUNT UNLESS THEY EQUAL OR EXCEED $1,000.—For purposes of paragraph (1), an accumulation distribution from a trust to a beneficiary shall be taken into account only if such distribution, when added to any prior accumulation distributions from such trust which are

deemed under section 151(a) to have been distributed to such beneficiary for the same prior taxable year of the beneficiary, equals or exceeds $1,000.

"SEC. 153. TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS.

''Where it is specified in sections 153 through 161 that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to sections 140 through 152. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.

"SEC. 154. DEFINITIONS AND RULES.

"(a) ADVERSE PARTY.—For purposes of sections 153 through 160, 'adverse party' means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.

"(b) NONADVERSE PARTY.—For purposes of sections 153 through 160, 'nonadverse party' means any person who is not an adverse party.

"(c) RELATED OR SUBORDINATE PARTY.—For purposes of sections 153 through 161, 'related or subordinate party' means any nonadverse party who is—

"(1) the grantor's spouse if living with the grantor;

"(2) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

For purposes of subsection (f) and sections 156 and 157, a related or subordinate party shall be presumed to be

subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence.

"(d) RULE WHERE POWER IS SUBJECT TO CONDITION PRECEDENT.—A person shall be considered to have a power described in sections 153 through 161 even though the exercise of the power is subject to a precedent giving of notice or takes effect only on the expiration of a certain period after the exercise of the power.

"(e) GRANTOR TREATED AS HOLDING ANY POWER OR INTEREST OF GRANTOR'S SPOUSE.—

"(1) IN GENERAL.—For purposes of sections 153 through 160, a grantor shall be treated as holding any power or interest held by—

"(A) any individual who was the spouse of the grantor at the time of the creation of such power or interest, or

"(B) any individual who became the spouse of the grantor after the creation of such power or interest, but only with respect to periods after such individual became the spouse of the grantor.

"(2) MARITAL STATUS.—For purposes of paragraph (1)(A), an individual legally separated from

his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

"(f) RULES NOT TO RESULT IN FOREIGN OWNERSHIP.—

"(1) IN GENERAL.—Notwithstanding any other provision in sections 153 through 160, sections 153 through 160 shall apply only to the extent such application results in an amount (if any) being currently taken into account (directly or through 1 or more entities) under this chapter in computing the income of a citizen or resident of the United States or a domestic corporation.

"(2) EXCEPTIONS.—

"(A) CERTAIN REVOCABLE AND IRREVOCABLE TRUSTS.—Paragraph (1) shall not apply to any portion of a trust if—

"(i) the power to revest absolutely in the grantor title to the trust property to which such portion is attributable is exercisable solely by the grantor without the approval or consent of any other person or with the consent of a related or subordinate party who is subservient to the grantor, or

"(ii) the only amounts distributable from such portion (whether income or corpus) during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor.

"(B) COMPENSATORY TRUSTS.—Except as provided in regulations, paragraph (1) shall not apply to any portion of a trust distributions from which are taxable as compensation for services rendered.

"(3) SPECIAL RULES.—Except as otherwise provided in regulations prescribed by the Secretary, a controlled foreign corporation shall be treated as a domestic corporation for purposes of paragraph (1).

"(4) RECHARACTERIZATION OF PURPORTED GIFTS.—In the case of any transfer directly or indirectly from a partnership or foreign corporation which the transferee treats as a gift or bequest, the Secretary may recharacterize such transfer in such circumstances as the Secretary determines to be appropriate to prevent the avoidance of the purposes of this subsection.

"(5) SPECIAL RULE WHERE GRANTOR IS FOREIGN PERSON.—If—

"(A) but for this subsection, a foreign person would be treated as the owner of any portion of a trust, and

"(B) such trust has a beneficiary who is a United States person,

such beneficiary shall be treated as the grantor of such portion to the extent such beneficiary has made (directly or indirectly) transfers of property (other than in a sale for full and adequate consideration) to such foreign person.

"(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations providing that paragraph (1) shall not apply in appropriate cases.

"SEC. 155. REVERSIONARY INTERESTS.

"(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

"(b) REVERSIONARY INTEREST TAKING EFFECT AT DEATH OF MINOR LINEAL DESCENDANT BENEFICIARY.—In the case of any beneficiary who—

"(1) is a lineal descendant of the grantor, and

"(2) holds all of the present interests in any portion of a trust,

the grantor shall not be treated under subsection (a) as the owner of such portion solely by reason of a reversionary interest in such portion which takes effect upon the death of such beneficiary before such beneficiary attains age 21.

"(c) SPECIAL RULE FOR DETERMINING VALUE OF REVERSIONARY INTEREST.—For purposes of subsection (a), the value of the grantor's reversionary interest shall be determined by assuming the maximum exercise of discretion in favor of the grantor.

"(d) POSTPONEMENT OF DATE SPECIFIED FOR REACQUISITION.—Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest shall be treated as a new transfer in trust commencing with the date on which the postponement is effective and terminating with the date prescribed by the postponement. However, income for any period shall not be included in the income of the grantor by reason of the preceding sentence if such income would not be so includible in the absence of such postponement.

"SEC. 156. POWER TO CONTROL BENEFICIAL ENJOYMENT.

"(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

"(b) EXCEPTIONS FOR CERTAIN POWERS.—Subsection (a) shall not apply to the following powers regardless of by whom held:

"(1) POWER TO APPLY INCOME TO SUPPORT OF A DEPENDENT.—A power described in section 159(b) to the extent that the grantor would not be subject to tax under that section.

"(2) POWER AFFECTING BENEFICIAL ENJOYMENT ONLY AFTER OCCURRENCE OF EVENT.—A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under section 155 if the power were a reversionary interest; but the grantor may be treated as the owner after the occurrence of the event unless the power is relinquished.

"(3) POWER EXERCISABLE ONLY BY WILL.—A power exercisable only by will, other than a power in

the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

"(4) POWER TO ALLOCATE AMONG CHARITABLE BENEFICIARIES.—A power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 101(c) (relating to definition of charitable contributions) or to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined in section 149(g)(1)).

"(5) POWER TO DISTRIBUTE CORPUS.—A power to distribute corpus either—

"(A) to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite standard which is set forth in the trust instrument; or

"(B) to or for any current income beneficiary, provided that the distribution of corpus

must be chargeable against the proportionate share of corpus held in trust for the payment of income to the beneficiary as if the corpus constituted a separate trust.

A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

"(6) POWER TO WITHHOLD INCOME TEMPORARILY.—A power to distribute or apply income to or for any current income beneficiary or to accumulate the income for him, provided that any accumulated income must ultimately be payable—

"(A) to the beneficiary from whom distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate, or

"(B) on termination of the trust, or in conjunction with a distribution of corpus which is augmented by such accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument.

Accumulated income shall be considered so payable although it is provided that if any beneficiary does not survive a date of distribution which could reasonably have been expected to occur within the beneficiary's lifetime, the share of the deceased beneficiary is to be paid to his appointees or to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children.

"(7) POWER TO WITHHOLD INCOME DURING DISABILITY OF A BENEFICIARY.—A power exercisable only during—

"(A) the existence of a legal disability of any current income beneficiary, or

"(B) the period during which any income beneficiary shall be under the age of 21 years, to distribute or apply income to or for such beneficiary or to accumulate and add the income to corpus. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

"(8) POWER TO ALLOCATE BETWEEN CORPUS AND INCOME.—A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language.

"(c) EXCEPTION FOR CERTAIN POWERS OF INDEPENDENT TRUSTEES.—Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor—

"(1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or

"(2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children. For periods during which an individual is the spouse of the grantor (within the meaning of section 154(e)(2)), any reference in this subsection to the grantor shall be treated as including a reference to such individual.

"(d) POWER TO ALLOCATE INCOME IF LIMITED BY A STANDARD.—Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions of paragraph (6) or (7) of subsection (b) are satisfied, if such power is limited by a reasonably definite external standard which is

set forth in the trust instrument. A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children.

"SEC. 157. ADMINISTRATIVE POWERS.

''The grantor shall be treated as the owner of any portion of a trust in respect of which—

''(1) POWER TO DEAL FOR LESS THAN ADEQUATE AND FULL CONSIDERATION.—A power exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party enables the grantor or any person to purchase, exchange, or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate consideration in money or money's worth.

''(2) POWER TO BORROW WITHOUT ADEQUATE INTEREST OR SECURITY.—A power exercisable by the grantor or a nonadverse party, or both, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security except where a trustee (other than the grantor) is authorized under a general lending

power to make loans to any person without regard to interest or security.

"(3) BORROWING OF THE TRUST FUNDS.—The grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year. The preceding sentence shall not apply to a loan which provides for adequate interest and adequate security, if such loan is made by a trustee other than the grantor and other than a related or subordinate trustee subservient to the grantor. For periods during which an individual is the spouse of the grantor (within the meaning of section 154(e)(2)), any reference in this paragraph to the grantor shall be treated as including a reference to such individual.

"(4) GENERAL POWERS OF ADMINISTRATION.—A power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of this paragraph, the term 'power of administration' means any one or more of the following powers: (A) a power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are

significant from the viewpoint of voting control; (B) a power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; or (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.

"SEC. 158. POWER TO REVOKE.

''(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a non-adverse party, or both.

''(b) POWER AFFECTING BENEFICIAL ENJOYMENT ONLY AFTER OCCURRENCE OF EVENT.—Subsection (a) shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under section 155 if the power were a reversionary interest. But the

grantor may be treated as the owner after the occurrence of such event unless the power is relinquished.

"SEC. 159. INCOME FOR BENEFIT OF GRANTOR.

"(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 156, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be—

"(1) distributed to the grantor or the grantor's spouse;

"(2) held or accumulated for future distribution to the grantor or the grantor's spouse; or

"(3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse (except policies of insurance irrevocably payable for a purpose specified in section 101(c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that the grantor would not be treated as the owner under section 153 if the power were a reversionary interest; but the grantor may be treated as the owner

after the occurrence of the event unless the power is relinquished.

"(b) OBLIGATIONS OF SUPPORT.—Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse) whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 146(a) and shall be taxed to the grantor under section 147.

"SEC. 160. PERSON OTHER THAN GRANTOR TREATED AS SUBSTANTIAL OWNER.

"(a) GENERAL RULE.—A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

"(1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or

"(2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 153 to 159, inclusive, subject a grantor of a trust to treatment as the owner thereof.

"(b) EXCEPTION WHERE GRANTOR IS TAXABLE.—Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 161 applies) is otherwise treated as the owner under sections 153 through 159 or section 161.

"(c) OBLIGATIONS OF SUPPORT.—Subsection (a) shall not apply to a power which enables such person, in the capacity of trustee or cotrustee, merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income of the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 146(a) and shall be taxed to the holder of the power under section 147.

"(d) EFFECT OF RENUNCIATION OR DISCLAIMER.—Subsection (a) shall not apply with respect to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence.

"SEC. 161. FOREIGN TRUSTS HAVING ONE OR MORE UNITED STATES BENEFICIARIES.

"(a) TRANSFEROR TREATED AS OWNER.—

"(1) IN GENERAL.—A United States person who directly or indirectly transfers property to a foreign trust (other than a trust described in section 6048(a)(3)(B)(ii)) shall be treated as the owner for his taxable year of the portion of such trust attributable to such property if for such year there is a United States beneficiary of any portion of such trust.

"(2) EXCEPTIONS.—Paragraph (1) shall not apply—

"(A) TRANSFERS BY REASON OF DEATH.—To any transfer by reason of the death of the transferor.

"(B) TRANSFERS AT FAIR MARKET VALUE.—To any transfer of property to a trust in exchange for consideration of at least the fair market value of the transferred property. For

purposes of the preceding sentence, consideration other than cash shall be taken into account at its fair market value.

"(3) CERTAIN OBLIGATIONS NOT TAKEN INTO ACCOUNT UNDER FAIR MARKET VALUE EXCEPTION.—

"(A) IN GENERAL.—In determining whether paragraph (2)(B) applies to any transfer by a person described in clause (ii) or (iii) of subparagraph (C), there shall not be taken into account—

"(i) except as provided in regulations, any obligation of a person described in subparagraph (C), and

"(ii) to the extent provided in regulations, any obligation which is guaranteed by a person described in subparagraph (C).

"(B) TREATMENT OF PRINCIPAL PAYMENTS ON OBLIGATION.—Principal payments by the trust on any obligation referred to in subparagraph (A) shall be taken into account on and after the date of the payment in determining the portion of the trust attributable to the property transferred.

"(C) PERSONS DESCRIBED.—The persons described in this subparagraph are—

"(i) the trust,

"(ii) any grantor, owner, or beneficiary of the trust, and

"(iii) any person who is related (within the meaning of section 143(i)(2)(B) to any grantor, owner, or beneficiary of the trust.

"(4) SPECIAL RULES APPLICABLE TO FOREIGN GRANTOR WHO LATER BECOMES A UNITED STATES PERSON.—

"(A) IN GENERAL.—If a nonresident alien individual has a residency starting date within 5 years after directly or indirectly transferring property to a foreign trust, this section and section 6048 shall be applied as if such individual transferred to such trust on the residency starting date an amount equal to the portion of such trust attributable to the property transferred by such individual to such trust in such transfer.

"(B) TREATMENT OF UNDISTRIBUTED INCOME.—For purposes of this section, undistributed net income for periods before such individual's residency starting date shall be taken into

account in determining the portion of the trust which is attributable to property transferred by such individual to such trust but shall not otherwise be taken into account.

"(C) RESIDENCY STARTING DATE.—For purposes of this paragraph, an individual's residency starting date is the residency starting date determined under section 7701(b)(2)(A).

"(5) OUTBOUND TRUST MIGRATIONS.—If—

"(A) an individual who is a citizen or resident of the United States transferred property to a trust which was not a foreign trust, and

"(B) such trust becomes a foreign trust while such individual is alive, then this section and section 6048 shall be applied as if such individual transferred to such trust on the date such trust becomes a foreign trust an amount equal to the portion of such trust attributable to the property previously transferred by such individual to such trust. A rule similar to the rule of paragraph (4)(B) shall apply for purposes of this paragraph.

"(b) TRUSTS ACQUIRING UNITED STATES BENEFICIARIES.—If—

"(1) subsection (a) applies to a trust for the transferor's taxable year, and

"(2) subsection (a) would have applied to the trust for his immediately preceding taxable year but for the fact that for such preceding taxable year there was no United States beneficiary for any portion of the trust,

then, for purposes of this chapter, the transferor shall be treated as having income for the taxable year (in addition to his other income for such year) equal to the undistributed net income (at the close of such immediately preceding taxable year) attributable to the portion of the trust referred to in subsection (a).

"(c) TRUSTS TREATED AS HAVING A UNITED STATES BENEFICIARY.—

"(1) IN GENERAL.—For purposes of this section, a trust shall be treated as having a United States beneficiary for the taxable year unless—

"(A) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a United States person, and

"(B) if the trust were terminated at any time during the taxable year, no part of the in-

come or corpus of such trust could be paid to or for the benefit of a United States person.

"(2) ATTRIBUTION OF OWNERSHIP.—For purposes of paragraph (1), an amount shall be treated as paid or accumulated to or for the benefit of a United States person if such amount is paid to or accumulated for a foreign corporation, foreign partnership, or foreign trust or estate, and—

"(A) in the case of a foreign corporation, such corporation is a controlled foreign corporation,

"(B) in the case of a foreign partnership, a United States person is a partner of such partnership, or

"(C) in the case of a foreign trust or estate, such trust or estate has a United States beneficiary (within the meaning of paragraph (1)).

"(3) CERTAIN UNITED STATES BENEFICIARIES DISREGARDED.—A beneficiary shall not be treated as a United States person in applying this section with respect to any transfer of property to foreign trust if such beneficiary first became a United States person more than 5 years after the date of such transfer.

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

"SEC. 162. LIMITATION ON CHARITABLE DEDUCTION.

"In computing the deduction allowable under section 142(c) to a trust, no amount otherwise allowable under section 142(c) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to unrelated business income for such year.

"SEC. 163. INCOME OF AN ESTATE OR TRUST IN CASE OF DIVORCE, ETC.

"(a) INCLUSION IN GROSS INCOME OF WIFE.—There shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance (or who is separated from her husband under a written separation agreement) the amount of the income of any trust which such wife is entitled to receive and which, except for this section, would be includible in the gross income of her husband, and such amount shall not, despite any other provision of this subtitle, be includible in the gross income of such husband. This subsection shall not apply to that part of any such income of the trust which the terms of the decree, written separation agreement, or trust instrument fix, in terms of an amount of money or a portion of such income, as

a sum which is payable for the support of minor children of such husband. In case such income is less than the amount specified in the decree, agreement, or instrument, for the purpose of applying the preceding sentence, such income, to the extent of such sum payable for such support, shall be considered a payment for such support.

''(b) WIFE CONSIDERED A BENEFICIARY.—For purposes of computing the taxable income of the estate or trust and the taxable income of a wife to whom subsection (a) applies, such wife shall be considered as the beneficiary.

''(c) CROSS REFERENCE.—For definitions of 'husband' and 'wife', as used in this section, see section 7701(a)(17).

"SEC. 164. RECOGNITION OF GAIN ON CERTAIN TRANSFERS TO CERTAIN FOREIGN TRUSTS AND ESTATES.

''(a) IN GENERAL.—Except as provided in regulations, in the case of any transfer of property by a United States person to a foreign estate or trust, for purposes of this subtitle, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of—

''(1) the fair market value of the property so transferred, over

"(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

"(b) EXCEPTION.—Subsection (a) shall not apply to a transfer to a trust by a United States person to the extent that any person is treated as the owner of such trust under section 153.

"(c) TREATMENT OF TRUSTS WHICH BECOME FOREIGN TRUSTS.—If a trust which is not a foreign trust becomes a foreign trust, such trust shall be treated for purposes of this section as having transferred, immediately before becoming a foreign trust, all of its assets to a foreign trust.

"SEC. 165. TREATMENT OF FUNERAL TRUSTS.

"(a) IN GENERAL.—In the case of a qualified funeral trust, sections 144 through 161 shall not apply, and no deduction shall be allowed by section 142(b).

"(b) QUALIFIED FUNERAL TRUST.—'Qualified funeral trust' means any trust (other than a foreign trust) if—

"(1) the trust arises as a result of a contract with a person engaged in the trade or business of providing funeral or burial services or property necessary to provide such services,

"(2) the sole purpose of the trust is to hold, invest, and reinvest funds in the trust and to use such funds solely to make payments for such services or property for the benefit of the beneficiaries of the trust,

"(3) the only beneficiaries of such trust are individuals with respect to whom such services or property are to be provided at their death under contracts described in paragraph (1),

"(4) the only contributions to the trust are contributions by or for the benefit of such beneficiaries,

"(5) the trustee elects the application of this subsection, and

"(6) the trust would (but for the election described in paragraph (5)) be treated as owned under sections 153 through 161 by the purchasers of the contracts described in paragraph (1).

"(c) DOLLAR LIMITATION ON CONTRIBUTIONS.—

"(1) IN GENERAL.—Any trust which accepts aggregate contributions by or for the benefit of an individual in excess of $7,000 shall not be a qualified funeral trust.

"(2) RELATED TRUSTS.—For purposes of paragraph (1), all trusts having trustees which are relat-

ed persons shall be treated as 1 trust. For purposes of the preceding sentence, persons are related if—

"(A) the relationship between such persons is described in section 171(a)(5), or

"(B) the Secretary determines that treating such persons as related is necessary to prevent avoidance of the purposes of this section.

"(3) INFLATION ADJUSTMENT.—In the case of any contract referred to in subsection (b)(1) which is entered into during any calendar year after 1998, the dollar amount referred to in paragraph (1) shall be adjusted for inflation in accordance with section 23.

"(d) APPLICATION OF RATE SCHEDULE.—Section 140(b) shall be applied to each qualified funeral trust by treating each beneficiary's interest in each such trust as a separate trust.

"(e) TREATMENT OF AMOUNTS REFUNDED TO PURCHASER ON CANCELLATION.—No gain or loss shall be recognized to a purchaser of a contract described in subsection (b)(1) by reason of any payment from such trust to such purchaser by reason of cancellation of such contract. If any payment referred to in the preceding sentence consists of property other than money, the basis of such property in the hands of such purchaser shall be the same

as the trust's basis in such property immediately before the payment.

"(f) SIMPLIFIED REPORTING.—The Secretary may prescribe rules for simplified reporting of all trusts having a single trustee.

"SEC. 166. INCOME IN RESPECT OF A DECEDENT.

"(a) INCLUSION IN GROSS INCOME.—

"(1) GENERAL USE.—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of a taxable period in which falls the date of his death, or a prior period, shall be included in gross income, for the taxable year when received, of—

"(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate,

"(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent,

"(C) the person who acquires from the decedent the right to receive the amount by bequest, devise or inheritance, if the amount is re-

ceived after a distribution by the decedent's estate of such right.

"(2) DEFINITION.—The Secretary shall prescribe regulations on the treatment of income from sales of rights to receive income and installment sales.

"(b) The amount of any homeowner deduction or foreign tax credit in respect of a decedent which is not properly allowable to the decedent with respect to the taxable period in which falls the date of his death, or a prior period, shall be allowed in accordance with regulations that reflect the principles of section 691(b) of the Internal Revenue Code of 1986.

"Subchapter J—Definitions and Rules of Application

"Sec. 171. Definitions.
"Sec. 172. Rules of application.

"SEC. 171. DEFINITIONS.

"(a) IN GENERAL.—When used in this chapter, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

"(1) BUSINESS ENTITY.—The definition of 'business entity' in section 206 (relating to the business tax) shall apply.

"(2) BUSINESS TAX.—'Business tax' and 'Simplified USA Tax for businesses' mean the tax im-

posed by section 201 and, to the extent required by the context, the provisions of chapter 2.

"(3) INTERNAL REVENUE CODE OF 1986.—'Internal Revenue Code of 1986' means the Internal Revenue Code of 1986 as in effect immediately before the enactment of the Simplified USA Tax Act of 1998.

"(4) UNITED STATES.—'United States' means the States and the District of Columbia.

"(5) RELATED PARTY.—'Related party' means—

"(A) Members of a family, as defined in paragraph (6)(D);

"(B) An individual and a business entity more than 50 percent in value of which is owned, directly or indirectly, by or for such individual (applying rules of constructive ownership);

"(C) Two business entities that are eligible to file a consolidated return under chapter 2;

"(D) A grantor and a fiduciary of any trust;

"(E) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;

"(F) A fiduciary of a trust and a beneficiary of such trust;

"(G) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

"(H) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;

"(I) A person and an organization to which section 251 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;

"(J) Two business entities if the same persons own more than 50 percent of the value of each (applying rules of constructive ownership), with value measured by—

"(i) the value of the outstanding stock in the case of a corporation,

"(ii) the capital interest or the profits interest, whichever is greater, in the case

of a partnership or limited liability company;

"(K) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

"(6) CONSTRUCTIVE OWNERSHIP.—For purposes of determining, in applying paragraph (5), the ownership of a business entity—

"(A) Stock or other equity interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

"(B) An individual shall be considered as owning the stock or other equity interest owned, directly or indirectly, by or for his family;

"(C) An individual owning (otherwise than by the application of subparagraph (B)) any stock in a corporation or other equity interest in another form of business entity shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

"(D) The family of an individual shall include only his brothers and sisters (whether by

the whole or half blood), spouse, ancestors, and lineal descendants; and

"(E) Stock or other equity interest constructively owned by a person by reason of the application of subparagraph (A) shall, for the purpose of applying subparagraph (A), (B), or (C), be treated as actually owned by such person, but stock or other equity interest constructively owned by an individual by reason of the application of subparagraph (B) or (C) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock or equity interest.

"(6) EARNED INCOME.—

"(A) IN GENERAL.—'Earned income' means—

"(i) wages, salaries, tips, and other employee compensation, plus

"(ii) the amount of the taxpayer's net earnings from self-employment for the taxable year (within the meaning of section 1402(a)).

"(B) SPECIAL RULES.—For purposes of subparagraph (A)—

"(i) the earned income of an individual shall be computed without regard to any community property laws,

"(ii) no amount received as a pension or annuity shall be taken into account,

"(iii) no income of nonresident alien individuals not connected with United States business shall be taken into account, and

"(iv) no amount received for services provided by an individual while the individual is an inmate at a penal institution shall be taken into account.

"(b) TERMS DEFINED IN CHAPTER 1.—If a term that is used but not defined in this chapter or in section 7701 is defined in chapter 2, the definition in chapter 2 shall apply except if manifestly incompatible with the intent of the provision in which the term is used.

"SEC. 172. RULES OF APPLICATION.

"(a) DEFINITIONS.—Any definition included in this chapter shall apply for all purposes of this chapter unless—

"(1) such definition is limited to the purposes of a particular chapter, section, or subsection, or

"(2) the definition clearly would not be applicable in a particular context.

"(b) INTERPRETATIONS CONSISTENT WITH INTERNAL REVENUE CODE OF 1986.—Terms not defined in this chapter or elsewhere in this title, but defined in the Internal Revenue Code of 1986, shall be interpreted in a manner consistent with the Internal Revenue Code of 1986, except to the extent such interpretation would be inconsistent with the principles and purposes of this chapter."

(c) EXEMPTION FROM PROHIBITED TRANSACTION TAX.—Section 4975(g) of the Code is amended by—

(1) striking "or" at the end of paragraph (2),

(2) deleting the period at the end of paragraph (3) and inserting "; or",

(3) and inserting the following new paragraph (4):

"(4) to a Roth IRA in the case of a loan to or equity investment in a controlled business entity as permitted by section 30(f))."

TITLE III—SIMPLIFIED USA TAX FOR BUSINESSES

SEC. 301. REPEAL OF CORPORATE INCOME TAX; NEW TAX PAID BY CORPORATIONS AND OTHER BUSINESSES.

(a) IN GENERAL.—Chapter 2 of the Internal Revenue Code is renumbered chapter 3 and following new chapter is inserted after chapter 1:

"CHAPTER 2—SIMPLIFIED USA TAX FOR BUSINESSES

"Subchapter A. Imposition of tax.
"Subchapter B. Basic rules for business tax.
"Subchapter C. Capital contributions, mergers, acquisitions, and distributions.
"Subchapter D. Accounting methods.
"Subchapter E. Land and rental property.
"Subchapter F. Insurance and financial products.
"Subchapter G. Financial intermediation and financial institutions.
"Subchapter H. Tax-exempt organizations.
"Subchapter I. Cooperatives.
"Subchapter J. Sourcing rules.
"Subchapter K. Business conducted in a possession.
"Subchapter L. Payroll tax credit.
"Subchapter M. Import tax.
"Subchapter N. Transition rules.
"Subchapter O. Rules for administration, consolidated returns.
"Subchapter P. Definitions and rules of applications.

"Subchapter A—Imposition of Tax

"Sec. 201. Tax imposed.

"SEC. 201. TAX IMPOSED.

"(a) TAXABLE BUSINESS ACTIVITY.—A tax is imposed on the sale of goods and services in the United States by a business entity. The amount of the tax equals the amount by which—

"(1) the business tax exceeds,

"(2) the payroll tax credit.

"(b) BUSINESS TAX IMPOSED.—

"(1) IN GENERAL.—The 'business tax' imposed on a business entity that sells or leases property or sells services in the United States equals the sum of—

"(A) 8 percent of the portion of the gross profits of the business entity for the taxable year that does not exceed $150,000, and

"(B) 12 percent of such portion of the gross profits of the business entity for the taxable year that exceeds $150,000.

"(2) LIMITATION ON APPLICATION OF BENEFITS OF GRADUATED RATE SCHEDULE.—The Secretary shall prescribe rules under which the gross profits of business entities under common control are aggregated for purposes of applying the benefit of the lower rate described in subparagraph (A) of paragraph (1). Such rules shall be similar to rules applicable under sections 1551 and 1561 of the Internal Revenue Code of 1986.

"(c) PAYROLL TAX CREDIT.—The 'payroll tax credit' is a credit for the social security, railroad retirement and hospital insurance taxes paid by an employer, as deter-

mined in accordance with subchapter L (sections 281 through 283).

"(d) IMPORT TAX.—For rules relating to the import tax imposed by this chapter, see subchapter M (sections 286 through 288).

"Subchapter B—Basic Rules for Business Tax

"Sec. 202. Gross profits.
"Sec. 203. Taxable receipts.
"Sec. 204. Deductible amounts.
"Sec. 205. Cost of business purchases.
"Sec. 206. Business entity and business activity.
"Sec. 207. Loss carryover deduction.

"SEC. 202. GROSS PROFITS.

" 'Gross profits' means for a taxable year of a business entity the amount by which—

"(1) the taxable receipts of the business entity for the taxable year exceed,

"(2) the deductible amounts for the business entity for the taxable year.

"SEC. 203. TAXABLE RECEIPTS.

"(a) IN GENERAL.—'Taxable receipts' means all receipts from the sale of property, use of property, and performance of services in the United States.

"(b) GAMES OF CHANCE.—Amounts received for playing games of chance by business entities engaging in the activity of providing such games shall be treated as receipts from the sale of property or services.

"(c) IN-KIND RECEIPTS.—The taxable receipts attributable to the receipt of property, use of property or services in whole or partial exchange for property, use of property or services equal the fair market value of the services or property received.

"(d) TAXES.—Taxable receipts do not include any excise tax, sales tax, custom duty, or other separately stated levy imposed by a Federal, State, or local government received by a business entity in connection with the sale of property or services or the use of property.

"(e) FINANCIAL RECEIPTS.—

"(1) IN GENERAL.—Excepts as provided in subchapter G (relating to financial intermediation and financial institutions), taxable receipts do not include financial receipts.

"(2) FINANCIAL RECEIPTS.—'Financial receipts' include—

"(A) interest,

"(B) dividends and other distributions by a business entity,

"(C) proceeds from the sale of stock, other ownership interests in business entities, or other financial instruments (as defined in section 242(b)(3)),

"(D) proceeds from life insurance policies,

"(E) proceeds from annuities,

"(F) proceeds from currency hedging or exchanges, and

"(G) proceeds from other financial transactions.

"(f) CROSS REFERENCES.—

"(1) FINANCIAL INTERMEDIATION.—See subchapters F and G for rules relating to financial intermediation.

"(2) EXPORTS, SALES IN THE UNITED STATES.—See subchapter J for the exclusion from gross receipts for export sales and for rules on sales of property and services in the United States.

"(3) LAND.—See subchapter E for rules relating to certain sales of land.

"(4) INSURANCE PROCEEDS.—See section 237 for rules on the inclusion of certain insurance proceeds in taxable receipts.

"SEC. 204. DEDUCTIBLE AMOUNTS.

"(a) IN GENERAL.—'Deductible amounts' for a business entity in a taxable year include—

"(1) the cost of business purchases in the taxable year (as determined under section 205),

"(2) such entity's loss carryover deduction (as determined under section 207) , and

"(3) the transition basis deduction (as determined under section 290).

"(b) FINANCIAL INTERMEDIATION.—See subchapters F and G for special rules for business entities engaging in financial intermediation.

"SEC. 205. COST OF BUSINESS PURCHASES.

"(a) BUSINESS PURCHASES.—

"(1) IN GENERAL.—'Business purchases' means the acquisition of—

"(A) property,

"(B) the use of property, or

"(C) services

in the United States for use in a business activity.

"(2) EXAMPLES.—Business purchases include (without limitation) the—

"(A) purchase or rental of real property,

"(B) purchase or rental of capital equipment,

"(C) purchase of supplies and inventory,

"(D) purchase of services from independent contractors,

"(E) purchase of financial intermediation services (as determined in accordance with section 236),

"(F) purchase of a business loss policy (as determined in accordance with section 237), and

"(G) imports for use in a business activity.

"(3) EXCLUSIONS.—Business purchases do not include—

"(A) payments for use of money or capital, such as interest or dividends (except to the extent that a portion so paid is a fee for financial intermediation services),

"(B) premiums for life insurance,

"(C) the acquisition of savings assets or other financial instruments (as defined in section 242(b)(3)).

"(D) property acquired outside the United States (but such property shall be taken into account as an import if imported),

"(E) services performed outside the United States (unless treated as imported into the United States),

"(F) compensation expenses for an individual (other than amounts paid to an individual in his capacity as a business entity), or

"(G) taxes (except as provided in subsection (b)(2) relating to product taxes).

"(4) COMPENSATION EXPENSES.—'Compensation expenses' means—

"(A) wages, salaries or other cash payable for services,

"(B) any taxes imposed on the recipient that are withheld by the business entity,

"(C) the cost of property purchased to provide employees with compensation (other than property incidental to the provision of fringe benefits that are excluded from income under the individual tax),

"(D) the cost of fringe benefits which are includible in an employee's, partner's, or proprietor's income under the Simplified USA Income Tax (or are excluded solely because they constitute employee savings), including (without limitation)—

"(i) contributions to retirement and severance benefit plans,

"(ii) premiums for the cost of life, health, accident, disability and other insurance policies for which the service provider, members of his family, or persons designated by him or members of his family are the beneficiaries,

"(iii) rental of parking spaces or parking fees (unless the parking space is used for a vehicle that is regularly used in a business activity);

"(iv) employer paid educational benefits;

"(v) employer paid housing (other than housing provided for the convenience of the employer); and

"(vi) employer paid meals (other than meals provided for the convenience of the employer).

"(b) COST OF BUSINESS PURCHASES.—

"(1) IN GENERAL.—The 'cost of a business purchase' is the amount paid or to be paid for the business purchase.

"(2) TAXES.—

"(A) IN GENERAL.—The 'cost of business purchases' includes any product taxes paid with respect to the property or services purchased.

"(B) PRODUCT TAX.—'Product tax' means any excise tax, sales or use tax, custom duty, or other separately stated levy imposed by a Federal, State, or local government on the production, severance or consumption of property or

on the provision of services, whether or not separately stated, and including any such taxes that are technically imposed on the seller of property or services.

"(C) TAXES NOT PRODUCT TAXES.—Product taxes do not include—

"(i) the import tax,

"(ii) state and local property taxes,

"(iii) franchise or income taxes,

"(iv) payroll taxes and self-employment taxes, or

"(v) the business tax.

"(3) IMPORTS.—In the case of an import by a business entity, the cost of the import is the import price for purposes of the import tax. The import tax is not part of the cost of the import.

"(c) PROPERTY AND SERVICES ACQUIRED FOR PROPERTY.—If a business entity receives property or services from a business entity in whole or partial exchange for property or services, the property or services acquired shall be treated as if they were purchased for an amount equal to the fair market value of the services or property received. For purposes of this section, property includes stock and other equity interests in business other than stock or an equity interest in the business entity acquiring

the property or services. See section 210(b) for rules on property or services received in exchange for an equity interest in the recipient.

"(d) GAMBLING PAYMENTS.—In the case of a business involving gambling, lotteries, or other games of chance, business purchases include amounts paid to winners.

"(e) SAVINGS ASSETS.—'Savings assets' means stocks, bonds, securities, certificates of deposits, investments in partnerships and limited liability companies, shares of mutual funds, life insurance policies, annuities, and other similar savings or investment assets.

"(f) CROSS REFERENCES.

"(1) FINANCIAL INTERMEDIATION AND INSURANCE.—For rules relating to fees for financial intermediation services and insurance, see subchapter F.

"(2) LAND.—For special rules relating to the acquisition of land, see subchapter E.

"(3) RENTAL REAL ESTATE.—For special rules relating to the rental of real estate previously occupied by an owner of the real estate, see section 232.

"(4) OUTSIDE THE UNITED STATES.—For special rules relating to services performed outside the United States but used inside the United States and international services, see subchapter J.

"SEC. 206. BUSINESS ENTITY AND BUSINESS ACTIVITY.

"(a) BUSINESS ENTITY.—For purposes of the business tax, 'business entity' means any corporation, unincorporated association, partnership, limited liability company, proprietorship, independent contractor, individual, or any other person engaging in business activity in the United States. An individual shall be considered a business entity only with respect to the individual's business activities.

"(b) BUSINESS ACTIVITY.—'Business activity' means the sale of property or services, the leasing of property, the development of property or services for subsequent sale or use in producing property or services for subsequent sale. 'Business activity' does not include casual or occasional sales of property used by an individual (other than in a business activity), such as the sale by an individual of a vehicle used by the individual.

"(c) EXCEPTION FOR CERTAIN EMPLOYEES.—

"(1) IN GENERAL.—'Business activity' does not include—

"(A) the performance of services by an employee for an employer that is a business entity with respect to the activity in which the employee is engaged, or

"(B) the performance of regular domestic household services (including babysitting, housecleaning, and lawn cutting) by an em-

ployee of an employer that is an individual or family.

"(2) EMPLOYEE DEFINED.—For purposes of this subsection, 'employee' includes an individual partner who provides services to a partnership or an individual member who provides services to a limited liability company, or a proprietor with respect to compensation for services from his proprietorship.

"SEC. 207. LOSS CARRYOVER DEDUCTION.—

"(a) DEDUCTION.—The 'loss carryover deduction' for a taxable year is the lesser of—

"(1) the business entity's gross profits for the taxable year (determined without the loss carryover deduction), or

"(2) the amount of the loss carryover to the taxable year.

"(b) LOSS CARRYOVER.—

"(1) GENERAL RULE.—A loss for any taxable year shall be a loss carryover to each of the 215 taxable years following the taxable year of the loss.

"(2) LOSS CARRYOVERS TO A TAXABLE YEAR.—The loss carryover to a taxable year is the sum of the loss carryovers from all prior taxable years beginning on or after January 1, 1999, that can be carried over to the taxable year.

"(3) REDUCTION OF LOSS CARRYOVERS AS A RESULT OF THE DEDUCTION.—A business entity's loss carryovers shall be reduced each year by the amount of the loss carryover deduction for the year. Loss carryovers shall be reduced in the order that they arose.

"(c) LOSS FOR TAXABLE YEAR.—A business entity's loss (if any) for the taxable year equals the excess (if any) of—

"(1) the sum of—

"(A) the cost of business purchases for the taxable year, and

"(B) the transition basis adjustment for the taxable year, over

"(2) taxable receipts for the taxable year.

"(d) SPECIAL RULES.—

"(1) CONSOLIDATED RETURNS.—In the case of a consolidated return, the loss for a taxable year shall be determined on a consolidated group basis. In the case of a deconsolidation, the loss carryovers from the consolidated group shall be allocated in accordance with rules to be prescribed by the Secretary.

"(2) LOSS CARRYOVERS OF ACQUIRED BUSINESS ENTITY.—

"(A) IN GENERAL.—If a business entity acquires another business entity in a transaction that is considered the acquisition of a business entity and the two entities file a consolidated return or if two business entities merge, the loss carryovers will survive and can be applied against the taxable receipts attributable to the business activities carried on (or in the case of a merger formerly carried on) by either entity.

"(B) ASSET ACQUISITION.—If a business entity acquires all or substantially all of the assets of another entity in a transaction that is considered an asset acquisition rather than the acquisition of a business entity, the acquirer will be treated as if it acquired the loss carryovers of the selling entity. For purposes of this rule, the assets of a business entity include ownership interests in other business entities.

"(C) SUBSTANTIALLY ALL.—For purposes of this paragraph 'substantially all' means more than 80 percent of the fair market value of a business entity's net assets. Under rules prescribed by the Secretary, the parties to a transaction may elect to treat acquisitions in excess

of 70 percent of the fair market value of a business entity's net assets as acquisitions of 'substantially all' of a business entity's net assets.

"Subchapter C—Capital Contributions, Mergers, Acquisitions, and Distributions

"Sec. 210. Contributions to a business entity.
"Sec. 211. Distributions of property.
"Sec. 212. Asset acquisitions.
"Sec. 213. Mergers and stock acquisitions.
"Sec. 214. Spin-offs, split-off, etc.
"Sec. 215. Allocation of certain tax attributes.

"SEC. 210. CONTRIBUTIONS TO A BUSINESS ENTITY.

"(a) BY BUSINESS ENTITY.—

"(1) CASH.—If a business entity contributes cash to a business entity of which it is or becomes a partial or full owner, the amount contributed is not a deductible amount to the contributor or a taxable receipt to the recipient.

"(2) PROPERTY OR SERVICES.—If a business entity contributes property or services to a business entity of which it is or becomes a partial or full owner, the transaction will not result in taxable receipts to the contributor or a deduction for a business purchase for the recipient and will not constitute a sale resulting in taxable receipts to the contributor.

"(b) BY INDIVIDUAL.—

"(1) CASH.—If an individual contributes cash to a business entity, the cash received is not a taxable receipt.

"(2) NEW PROPERTY.—If an individual contributes to a business entity property that the individual purchased for the business entity but which was not used by any person after its purchase, the property shall be considered purchased by such business entity from the person from which the individual purchased the property.

"(3) PERSONAL USE PROPERTY.—

"(A) IN GENERAL.—If an individual contributes personal use property to a business entity in which the individual has an ownership interest or for which the individual receives an ownership interest, the business entity shall not be permitted to deduct the value of the property received as a business expense. The business entity will have a tax basis in the contributed property equal to the contributor's basis.

"(B) PERSONAL USE PROPERTY.—'Personal use property' means any property used by an individual at any time other than in a business activity.

"(4) SERVICES.—If an individual contributes services to a business entity in which the individual has an ownership interest or receives an ownership interest, the business entity shall not be permitted to deduct the value of the services received (or the value of the equity interest provided to the services provider).

"SEC. 211. DISTRIBUTIONS OF PROPERTY.

"(a) DISTRIBUTIONS OTHER THAN TO CONTROLLING BUSINESS.—If a business entity distributes all or a portion of its assets to its owners (other than a controlling business entity), the business entity will be treated as if it sold the assets to its owners at fair market value. The fair market value will be determined by the distributing corporation and those determinations, unless unreasonable, will be binding on the recipients.

"(b) DISTRIBUTIONS TO A CONTROLLING BUSINESS.—If a business entity distributes all or a portion of its assets to a controlling business, the controlling business will assume the distributing entity's tax attributes with respect to the assets and neither entity will have taxable receipts or a deduction as a result of the transaction.

"(c) DISTRIBUTION OF PERSONAL USE PROPERTY.—If personal use property is distributed to the individual who contributed the personal use property to a busi-

ness entity, the fair market value of the property for purposes of paragraph (a) shall equal the basis of the property plus any enhancement in value of the property attributable to business purchases with respect to the property.

"(d) CONTROLLING BUSINESS ENTITY.—A business entity is a 'controlling business entity' with respect to another business entity if it owns directly or indirectly more than 50 percent of the profits or capital interest in the other business entity.

"(e) APPLICATION OF THIS SECTION.—This section applies to both liquidating and nonliquidating distributions. Property shall be treated as distributed if the property is used for a nonbusiness purpose (as defined in section 232) for more than an insubstantial period of time during a taxable year. See section 232 for rules relating to certain rental property.

"SEC. 212. ASSET ACQUISITIONS.

"(a) IN GENERAL.—If a business entity transfers some or all of its assets, the consideration received for such assets shall be allocated among the assets transferred in the same manner as was required by section 1060 of the Internal Revenue Code of 1986. If the transferee and transferor agree in writing on the allocation of any consideration, or as to the fair market value of any of the assets, such agreement shall be binding on both the transferor

and transferee unless the Secretary determines that such allocation (or fair market value) is not appropriate.

"(b) TAX CONSEQUENCES.—The tax consequences of an asset acquisition shall be determined in accordance with the rules of this chapter and shall be dependent upon allocations made under subsection (a). In general, consideration allocable to savings assets, such as stock in another business entity, would not be included in taxable receipts of the transferor and would not be a business purchase of the purchaser, but consideration allocable to the sale of tangible property and intangible property (other than savings assets) will constitute taxable receipts of the seller and a business purchase of the purchaser.

"(c) ELECTION TO TREAT ASSET ACQUISITION AS A STOCK ACQUISITION.—In the case of the sale of substantially all of the assets of a business entity or substantially all of the assets of a line of business or a separately standing business of a business entity, the transferee and transferor can jointly elect to treat the acquisition as if it were an acquisition of the stock of a business entity holding the assets so transferred. In such case, the rules of section 213 shall apply.

"(d) AUTHORITY TO REQUIRE ALLOCATION AGREEMENT AND NOTICE TO THE SECRETARY.—If the Secretary determines that certain types of asset acquisitions

have significant possibilities of tax avoidance, the Secretary may require—

"(1) parties to such types of acquisitions to enter into agreements allocating consideration,

"(2) parties to acquisitions involving certain kinds of assets to enter into agreements allocating part of the consideration to those assets, or

"(3) parties to certain acquisitions to report information to the Secretary.

"(e) ASSET ACQUISITION RULES DO NOT APPLY IF CONSIDERATION INCLUDES EQUITY IN PURCHASER.—

"(1) IN GENERAL.—If a business entity issues its own equity or equity in a subsidiary or other controlled entity as part of the consideration for the transfer of assets to it, the transaction shall not be treated as an asset acquisition and the rules of section 13 shall apply.

"(2) EQUITY.—For purposes of this subsection, equity means—

"(A) stock, in the case of a corporation,

"(B) partnership or similar interest, in the case of a partnership or limited liability company, and

"(C) an ownership interest or interest in profits in the case of any other business entity.

"SEC. 213. MERGERS AND STOCK ACQUISITIONS.

''(a) MERGERS.—A merger of one business entity into another or two businesses entities into a third business entity or any other similar transaction shall have no direct consequences under the business tax. The surviving entity shall assume the tax attributes of the merged corporations, including any loss carryovers and credit carryovers.

''(b) STOCK ACQUISITION.—The acquisition of all or substantially all of the ownership interest in one business entity either for cash or in exchange for ownership in the acquiring entity or an entity controlled by the acquired entity shall have no direct consequences under the business tax.

"SEC. 214. SPIN-OFFS, SPLIT-OFFS, ETC.

''A spin-off, split-off or split-up of a business entity shall have no direct tax consequences under the business tax.

"SEC. 215. ALLOCATION OF CERTAIN TAX ATTRIBUTES.

''The Secretary shall prescribe rules for allocation of loss carryovers and payroll tax credit carryovers in cases of substantial shifts of assets from one business entity to another business entity. Under such rules, a portion of a business entity's carryovers may be deemed transferred when assets are transferred.

"Subchapter D—Accounting Method Rules

"Sec. 220. General accounting rules.
"Sec. 221. Use of the cash method of accounting.
"Sec. 222. Taxable year.
"Sec. 223. Long-term contracts.
"Sec. 224. Post-sale price adjustments and refunds.
"Sec. 225. Bad debts.
"Sec. 226. Transition rules.

"SEC. 220. GENERAL ACCOUNTING RULES.

"(a) IN GENERAL.—Except as provided in section 221, a business entity shall use an accrual method of accounting for purposes of determining the timing of recognition of taxable receipts and deduction of business purchases. All business purchases shall be deducted when incurred (in the case of a business entity using the accrual method of accounting) or when paid (in case of a business entity using the cash method of accounting) without regard to whether the business purchases are for or relate to—

"(1) inventory,

"(2) assets with a useful life of more than one year, or

"(3) property that will be used to produce other property.

"(b) ECONOMIC PERFORMANCE.—For purposes of determining whether an amount has been incurred, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

"(c) CONSISTENT ACCOUNTING METHODS.—Except as otherwise expressly provided in this chapter, a business entity shall secure the consent of the Secretary before changing the method of accounting by which it determines gross profits. This provision shall not apply to changes required by the adoption of the business tax.

"SEC. 221. USE OF THE CASH METHOD OF ACCOUNTING.

"(a) IN GENERAL.—A business entity that was permitted to use and used the cash method of accounting under the Internal Revenue Code of 1986 shall be permitted to continue to use the cash method of accounting.

"(b) NEW BUSINESS ENTITIES.—A new business entity shall be permitted to use the cash method of accounting if permitted to under regulations prescribed by the Secretary.

"(c) CHANGE OR EXPANSION OF BUSINESS.—Subsection (a) shall cease to apply to a business entity that changes or expands its business such that under regulations prescribed by the Secretary it is no longer eligible to use the cash method of accounting.

"(d) REGULATIONS.—

"(1) USE OF CASH METHOD.—The Secretary shall prescribe regulations defining which business entities may use the cash method of accounting. In general, those regulations shall be consistent with

the rules under sections 447 and 448 of the Internal Revenue Code of 1986, except that all corporations shall be treated as C corporations were treated under those sections. The regulations shall not require a business entity described in subsection (a) to convert to the accrual method prior to January 1, 2000.

"(2) CHANGE IN ACCOUNTING METHOD.—The Secretary shall prescribe regulations to prevent double counting of taxable receipts and deductible expenses in the case of a change in accounting method.

"SEC. 222. TAXABLE YEAR.

"(a) COMPUTATION OF GROSS PROFITS.—Gross profits shall be computed on the basis of a business entity's taxable year.

"(b) TAXABLE YEAR.—'Taxable year' means—

"(1) the taxpayer's annual accounting period, if it is a calendar year or a fiscal year;

"(2) the calendar year, if subsection (g) applies; or

"(3) the period for which the return is made if the return is made for a period of less than 12 months.

"(c) ANNUAL ACCOUNTING PERIOD.—'Annual accounting period' means the annual period on the basis of which the business entity regularly keeps its books.

"(d) CALENDAR YEAR.—'Calendar year' means a period of 12 months ending on December 31.

"(e) FISCAL YEAR.—'Fiscal year' means a period of 12 months ending on the last day of any month other than December. In the case of any business entity that has made the election provided by subsection (f), the term means the annual period (varying from 52 to 53 weeks) so elected.

"(f) ELECTION OF 52–53 WEEK YEAR.—

"(1) GENERAL RULE.—A business entity which, in keeping its books, regularly computes its income or profits on a basis of an annual period which varies from 52 to 53 weeks and ends always on the same day of the week and ends always—

"(A) on whatever date such same day of the week last occurs in a calendar month, or

"(B) on whatever date such same day of the week falls which is nearest to the last day of a calendar month,

may elect to compute its gross profits on the basis of such annual period.

"(2) REGULATIONS.—The Secretary shall prescribe such regulations as he deems necessary for the application of this subsection, including regulations relating to the application of effective dates to taxpayers using a 52–53 week year.

"(g) CALENDAR YEAR REQUIRED.—

"(1) NO ACCOUNTING PERIOD.—A business entity's taxable year shall be the calendar year if the business entity does not have an annual accounting period or has an annual accounting period that does not qualify as a fiscal year.

"(2) NEW BUSINESS ENTITY.—The taxable year of a business entity that begins business activity after December 31, 1998, shall be the calendar year (or a 52–53 week fiscal year ending in December) unless the business entity can demonstrate a business reason for selecting an accounting period other than the calendar year.

"(h) TRANSITION RULE FOR BUSINESS ENTITIES WITH A FISCAL YEAR.—

"(1) IN GENERAL.—A business entity with a taxable year that is not the calendar year shall have a short taxable year ending on December 31, 1998, and a subsequent taxable year beginning on January 1, 1999, and ending on the day immediately preced-

ing the beginning of the business entity's next fiscal year.

"(2) BUSINESS ENTITIES WITH 52–53 WEEK YEAR ENDING IN DECEMBER.—

"(A) IN GENERAL.—If a business entity has a 52–53 week taxable year (under the Internal Revenue Code of 1986) that ends in December 1998, it may elect to begin its first taxable year for the business tax on the first day immediately following the last day of such taxable year.

"(B) NO ELECTION.—If a business entity that has a 52–53 week taxable year that ends in December 1998, does not make the election under subparagraph (A) or is prohibited from making such election by subparagraph (C), the business entity's taxable year under the Internal Revenue Code of 1986 that would end in December 1998 shall end on December 31, 1998.

"(C) ANTI-ABUSE RULE.—Subparagraph (A) shall not apply to any taxpayer that enters into business transactions in 1998 following the scheduled end of its fiscal year with business entities that are not subject to the business tax

at the time of such transactions if such transactions deviate from the normal course of business in order to achieve some tax benefit.

"SEC. 223. LONG-TERM CONTRACTS.

"(a) IN GENERAL.—In the case of a long-term contract—

"(1) CONTRACTOR EXPENSES.—The contractor shall be entitled to deduct its business purchases when paid or incurred.

"(2) CONTRACTOR RECEIPTS.—The contractor shall recognize taxable receipts—

"(A) in the case of a project in which the acquirer has no ownership interest in the project until delivery—

"(i) upon delivery of the project, in the case of an accrual basis contractor, or

"(ii) upon the later of delivery of the project or the receipt of payment, in the case of cash-basis contractor.

"(B) in the case of a project in which the acquirer obtains an ownership interest as the project is constructed—

"(i) when the contractor has the right to payments, in the case of an accrual basis contractor, or

"(ii) upon the later of when the contractor receives the cash or has the right to payments, in the case of a cash basis contractor.

"(3) ACQUIRER EXPENSES.—The acquirer that is a business entity shall be entitled to deduct its costs of the business purchase—

"(A) in the case of a cash-basis acquirer, at such time as a cash basis contractor would be required to treat the amounts paid as taxable receipts, or

"(B) in the case of an accrual-basis acquirer, at such time as an accrual basis contractor would be required to treat the amounts paid or due as taxable receipts.

"(b) RIGHT TO PAYMENTS.—

"(1) IN GENERAL.—A contractor shall be treated as having a right to payments with respect to a project at any time to the extent that the contractor would not be required to return payments received (or would be entitled to collect payments not yet received) if the project were terminated at such time by the contractor.

"(2) CONTRACTUAL PROVISIONS.—If a long-term contract includes a procedure for paying the

contractor as work is completed (for example, by reason of a draw down from a trust account), the contractual provisions shall generally govern when a contractor has a right to payment.

"(3) PERCENTAGE COMPLETION METHOD OF ACCOUNTING.—If a long-term contract does not include a mechanism for paying the contractor as work is completed, the percentage-of-completion method of accounting shall be used to determine the timing of taxable receipts of the contractor and business purchases of the acquirer.

"(c) LONG-TERM CONTRACT.—

"(1) IN GENERAL.—'Long-term contract' means—

"(A) any contract that covers service or production through parts of two different calendar years if the contract includes a formal deposit and draw-down mechanism, and

"(B) any contract for the manufacture, building, installation, or construction of property if such contract is not completed within the taxable year of the contractor in which such contract is entered into.

"(2) EXCEPTION.—A contract for the manufacture of property shall not be treated as a long-term

contract unless such contract involves the manufacture of—

"(A) any unique item of a type which is not normally included in the finished goods inventory of the taxpayer, or

"(B) any item which normally requires more than 12 calendar months to complete.

"(d) CONSISTENCY.—The Secretary may require business entities to file statements containing such information with respect to long-term contracts as the Secretary may prescribe to ensure consistency in reporting.

"(e) FOREIGN CONTRACTS.—This section shall not be construed to permit a deduction for a business purchase for the cost of property produced outside the United States pursuant to a long-term contract at any time prior to the import of such property into the United States.

"SEC. 224. POST-SALE PRICE ADJUSTMENTS AND REFUNDS.

"(a) RECEIPT OF PRICE ADJUSTMENT.—In the case of a post-sale price adjustment attributable to a business purchase which was taken into account in computing gross profits for a prior taxable year, the amount of such adjustment shall be treated as a reduction or increase, as the case may be, in the cost of business purchases for the taxable year in which the adjustment is made or incurred.

"(b) ISSUANCE OF PRICE ADJUSTMENT.—In the case of a post-sale price adjustment attributable to a sale the receipts from which were taken into account in determining taxable receipts for a prior taxable year, the amount of such adjustment shall be treated as a reduction or increase, as the case may be, in taxable receipts for the taxable year in which the adjustment is made or incurred.

"(c) POST-SALE PRICE ADJUSTMENT.—'Post-sale price adjustment' means a refund, rebate, or other price allowance attributable to a sale of property or services or an upward adjustment in price that was not previously taken into account under the business entity's method of accounting.

"SEC. 225. BAD DEBTS.

"(a) SELLER.—If an amount owed to an accrual basis business entity for property or services sold—

"(1) was taken into account as a taxable receipt in a prior taxable year, and

"(2) becomes wholly or partially uncollectible during the taxable year, then the seller shall treat the amount as a reduction in taxable receipts for the taxable year in which it becomes wholly or partially uncollectible.

"(b) NOTICE REQUIREMENT.—No reduction shall be allowed under subsection (a) unless the seller notifies the

purchaser of the amount which the seller has treated as wholly or partially uncollectible.

"(c) SUBSEQUENT COLLECTION.—If an amount which was treated as uncollectible under subsection (a) is subsequently collected, it shall be treated as a taxable receipt when collected.

"(d) PURCHASER.—If a purchaser receives notice under subsection (b) from a seller and the purchaser has treated the amount labeled uncollectible as a business purchase in a prior taxable year, then the purchaser shall treat such amount as a reduction in the cost of business purchases in the taxable year to which the notice relates. If the purchaser subsequently repays such amount, the repayment shall constitute the cost of a business purchase.

"SEC. 226. TRANSITION RULES.

"(a) NO DOUBLE DEDUCTIONS.—A business entity shall not be entitled to treat as a 'cost of business purchase' any amount that the business entity deducted in computing taxable income under the income tax in effect prior the effective date of the business tax.

"(b) NO DOUBLE INCLUSION.—A business entity shall not be required to include in taxable receipts any receipt that the business entity took into account in computing taxable income under the income tax in effect prior to the effect date of the business tax.

"(c) NO LOSS OF DEDUCTION.—An expense which—

"(1) a business entity would have been able to deduct as a cost of a business purchase in an accounting period before the effective date of the business tax if the business tax had been in effect in such period, and

"(2) the business entity would have been able to deduct as an expense in computing taxable income in a period after the business tax is effective if the income tax had continued in effect,

shall be treated as a cost of a business purchase incurred or paid at the time that it would have been paid or incurred under the income tax if the income tax had continued in effect. This subsection shall not apply to any amount which is to be taken into account under subchapter N (relating to amortization of transition basis, inventory costs, and safe harbor leases), any amounts which would have been deducted under the income tax through loss carryover deductions, or any deductions deferred by the uniform capitalization rules under section 263A of the Internal Revenue Code of 1986.

"(d) ALL TAXABLE RECEIPTS TAXED.—A receipt which—

"(1) a business entity would have been required to treat as a taxable receipt in an accounting period

before the effective date of the business tax if the business tax had been in effect in such period, and

"(2) the business entity would have been required to include in gross income in a period after the business tax is effective if the income tax had continued in effect

shall be treated as a taxable receipt at the time that it would have been included in income if the income tax had continued in effect.

"Subchapter E—Land and rental property

"Sec. 230. No deduction for land purchased for nonbusiness use.
"Sec. 231. Taxable receipts for land held for nonbusiness use.
"Sec. 232. Certain rental property.

"SEC. 230. NO DEDUCTION FOR LAND PURCHASED FOR NONBUSINESS USE.

"(a) IN GENERAL.—The acquisition of unimproved land shall not constitute a business purchase if the unimproved land is not acquired to be used in a business activity or if the land is acquired for—

"(1) speculation,

"(2) development (including subdivision), or

"(3) temporary leasing or other use not commensurate with the value of the land,

"(4) indefinite future use in a business activity, or

"(5) use in compensating employees.

"(b) FUTURE USE IN BUSINESS ACTIVITY.—Unimproved land will not be considered held for 'indefinite future use in a business activity' if promptly upon acquisition, the purchaser or the lessee begins construction of improvements on the land (other than improvements, such as paving or sewage lines, intended for indefinite future development) that will be used in a business activity. Such improvement must be commensurate with the value of the land.

"(c) UNIMPROVED LAND.—'Unimproved land' means—

"(1) land with no buildings on it,

"(2) land with improvements if the value of the improvements is relatively small in comparison to the value of the land and it is anticipated that the improvements will be demolished and not used,

"(3) land in excess of the amount reasonably needed for the buildings located on it.

"(d) CONVERSION TO BUSINESS USE.—If the acquisition of land is not treated as a business purchase by reason of subsection (a) and the land is subsequently used in a manner for which it could have been treated as a business purchase, the cost of the land will be treated as a business purchase when the improvements on the land

are placed in service (or in the case of construction for sale, substantially completed and advertised for sale).

"SEC. 231. TAXABLE RECEIPTS FROM SALE OF LAND HELD FOR NONBUSINESS USE.

"(a) TAX BASIS.—A business entity shall have a tax basis in land equal to the cost of the land if such cost is not deductible by reason of section 230(a) and the land has not been converted to business use for purposes of section 230(d).

"(b) TAXABLE RECEIPTS OF A LAND SALE.—The taxable receipts from the sale of land (or portion thereof) in which a business entity has a tax basis by reason of subsection (a) shall be the amount by which the proceeds exceed the basis of such land (or portion thereof).

"SEC. 232. CERTAIN RENTAL PROPERTY.

"(a) IN GENERAL.—Except as provided in subsection (b), the activity of rental of real estate is a business activity to which the business tax applies.

"(b) NOT RENTAL PROPERTY.—Subsection (a) shall not apply to property described in section 111(b)(1) (relating to property owned by individuals and used for at least 14 days for a nonbusiness purpose and rented for no more than 14 days during the taxable year).

"(c) RENTAL PROPERTY BECOMES NONRENTAL PROPERTY.—If property which is considered rental prop-

erty for purposes of subsection (a) in one taxable year ceases to be rental property (by reason of subsection (b)) in the following taxable year, the property (and any associated debt) shall be treated as distributed by the business entity to its owners. Section 211(a) shall apply to such distribution.

"Subchapter F—Insurance and Financial Products

"Sec. 235. General rules.
"Sec. 236. Fees for financial intermediation services.
"Sec. 237. Deductible insurance premiums.
"Sec. 238. Nondeductible insurance premiums.
"Sec. 239. Certain implicit fees for financial intermediate services.

"SEC. 235. GENERAL RULES.

"(a) TAXABLE RECEIPTS.—Except in the case of a financial intermediation business, taxable receipts do not include financial receipts (as defined in section 203(e)(2)).

"(b) BUSINESS PURCHASES.—Except in the case of a financial intermediation business, business purchases do not include the cost of financial instruments (as defined in section 242(b)(3)) or payments for use of money or capital, other than fees for financial intermediation services.

"SEC. 236. FEES FOR FINANCIAL INTERMEDIATION SERVICES.

"(a) BUSINESS PURCHASE.—Business purchases include explicit fees and implicit fees for financial intermediation services (except to the extent that such fees are for services treated as performed outside the United States

and not imported into the United States or for services treated as exported.).

"(b) FINANCIAL INTERMEDIATION SERVICES.—The definition of 'financial intermediation service' in section 241 applies for purposes of this section.

"(c) EXPLICIT FEES.—

"(1) IN GENERAL.—'Explicit fees for financial intermediation services' means separately stated fees for services provided by a business entity in the financial intermediation business. Explicit fees do not include fees for use of money or capital.

"(2) EXAMPLES.—Explicit fees for financial intermediation services include (without limitation)—

"(A) separately listed maintenance and service charges of providers of financial intermediation services,

"(B) loan documentation fees,

"(C) brokerage fees,

"(D) loan origination fees,

"(E) underwriting fees,

"(F) trustees' fees, and

"(G) fees for credit checks.

"(3) EXCLUSIONS.—Explicit fees for financial intermediation services do not include prepaid inter-

est and other fees for use of money or capital even if such fees are separately stated or are labeled as service fees.

"(d) IMPLICIT FEES.—

"(1) IMPLICIT FEES ATTRIBUTABLE TO BORROWING.—

"(A) IN GENERAL.—Implicit fees attributable to borrowing from banks and other financial institutions shall include the portion of interest payments that the Secretary designates as constituting service fees.

"(B) TIMING.—Implicit fees determined under this paragraph shall not be deductible in any taxable year prior to the taxable year in which the interest is paid. If the amount of the interest to which implicit fees relate was deducted as original issue discount under the Internal Revenue Code of 1986, the implicit fees with respect to such interest shall not constitute a deductible business purchase.

"(C) DESIGNATION BY SECRETARY.—

"(i) ESTIMATE OF DIFFERENTIAL.—The Secretary shall estimate for each calendar year the difference between the cost of funds for banks and the rates of interest

(including discount points) charged to the most credit-worthy depositors of banks. The determinations shall be made separately for—

"(I) loans with terms of not more than 3 years,

"(II) loans with terms of over 3 but not over 9 years, and

"(III) loans with terms of over 9 years.

"(ii) DESIGNATION OF IMPLICIT FEES.—The Secretary shall designate the differences determined under clause (i) as the portion of interest expense on loans from banks and other financial institutions that constitutes an implicit fee for term loans originated during the following calendar year for the respective periods listed in subclauses (I) through (III) of clause (i). The difference determined for loans described in subclause (I) of clause (i) shall apply to determine the implicit fee portion of interest on demand loans outstanding during the following calendar year.

"(iii) HISTORICAL DETERMINATION.—The Secretary shall make an historical determination in accordance with the principles of this subparagraph to designate the portion of interest on term loans made before January 1, 1998, that will constitute implicit fees.

"(2) IMPLICIT FEES FOR OTHER FINANCIAL INTERMEDIATION ACTIVITY.—Implicit fees for financial intermediation services include the portion of the fees or other charges paid to a provider of financial intermediation services (other than lending) as such provider designates in accordance with section 39.

"SEC. 237. DEDUCTIBLE INSURANCE PREMIUMS.

"(a) IN GENERAL.—The cost of insurance premiums on business loss policies that insure risks in the United States constitute costs of business purchases. Proceeds from such policies constitute taxable receipts.

"(b) BUSINESS LOSS POLICY.—A 'business loss policy' is an insurance policy—

"(1) owned by a business entity,

"(2) the beneficiary of which is the business entity or another business entity doing business with the owner of the policy,

"(3) that has no inside buildup or other savings component,

"(4) that covers losses on a loss incurred or claims made basis during the term of the policy,

"(5) that has a term of not more than 2 years,

"(6) that is not a direct or indirect form of compensation, and

"(7) that covers direct losses of the business, such as—

"(A) damage to or theft of property used in business activity,

"(B) tort claims against the business,

"(C) loss of use of business premises or services,

"(D) malpractice, or

"(E) alleged or actual breach of fiduciary obligations.

"SEC. 238. NONDEDUCTIBLE INSURANCE PREMIUMS.

"(a) NONDEDUCTIBILITY.—The cost of insurance policies that are not business loss policies are not deductible costs of business purchases.

"(b) PROCEEDS OF NONDEDUCTIBLE POLICIES.—Insurance proceeds from policies described in subsection (a) do not constitute taxable receipts.

"(c) APPLICATION OF THIS SECTION TO CERTAIN INSURANCE.—This section shall apply to life insurance policies.

"SEC. 239. CERTAIN IMPLICIT FEES FOR FINANCIAL INTERMEDIATION SERVICES.

"(a) DEDUCTIBILITY OF FEES.—If a financial intermediation business (as defined in section 241(b)) elects to determine implicit fees for financial intermediation services pursuant to this section and notify its business customers of their share of the implicit fees in accordance with this section, a business entity which receives such notice may treat the amount reported in the notice as an implicit fee for financial intermediation services in the calendar year to which such notice relates.

"(b) ALLOCATION AND REPORTING.—

"(1) IN GENERAL.—A financial intermediation business may—

"(A) allocate fees received for services for which no separately stated fees (or implicit fees for borrowing determined under section 236(d)(1)) are charged among recipients of such services on a reasonable and consistent basis, and

"(B) report to each recipient not later than February 15th of each year the amount so

allocated to it with respect to the immediately preceding calendar year.

"(2) MAXIMUM FEES ALLOCATED.—The maximum amount that may be allocated by a financial intermediation business for a calendar is the excess of—

"(A) the gross profits of the financial intermediation business for the calendar year (as reasonably estimated by the financial intermediation business), over

"(B) the explicit fees for financial intermediation services received by the financial intermediation business.

"(3) REASONABLE ALLOCATION.—An allocation will not be considered reasonable unless it takes into account and allocates fees to—

"(A) both services provided to business entities and services provided to individuals (other than in a business capacity), and

"(B) both persons who receive money from the financial intermediation business and persons who pay money to the financial intermediation business (even though amounts allocated to the former do not constitute implicit fees).

"(4) REGULATIONS.—The Secretary shall prescribe regulations relating to the allocations under this subsection, including regulations addressing—

"(A) rules for timing of deductions of implicit fees paid by fiscal year recipients,

"(B) subsequent year adjustments if a financial intermediation business allocates too much in a calendar year,

"(C) rules for advance approval from the Secretary for allocation procedures, and

"(D) safe-harbor alternatives to the allocation procedures described in this subsection.

"(c) NOT APPLICABLE TO LENDING SERVICES.—This section shall not apply to lending services.

"Subchapter G—Financial Intermediation and Financial Institutions

"Sec. 241. Activities constituting a financial intermediation business.
"Sec. 242. General rule for taxation.
"Sec. 243. Special rule for banks.
"Sec. 244. Insurance companies.
"Sec. 245. Financial pass-through entities.
"Sec. 246. Financial intermediation by other businesses.

"SEC. 241. ACTIVITIES CONSTITUTING A FINANCIAL INTERMEDIATION BUSINESS.

"(a) FINANCIAL INTERMEDIATION BUSINESS.—The providing of financial intermediation services shall be considered a business activity. The gross profit of a business entity providing financial intermediation services shall be

determined by taking into account the rules of this subchapter.

"(b) SEPARATE BUSINESS ACTIVITY.—The provision of financial intermediation services for unrelated persons shall be considered a separate business activity and a business shall be considered a separate entity with respect to such activity. An entity engaging in such business is referred to in this chapter as a 'financial intermediation business'.

"(c) FINANCIAL INTERMEDIATION BY A BUSINESS.—Section 246 shall apply to a business that provides financial intermediation services for itself and related parties but generally does not provide such services for unrelated parties.

"(d) DEFINITIONS.—

"(1) FINANCIAL INTERMEDIATION SERVICES.—'Financial intermediation services' include—

"(A) lending services,

"(B) insurance services,

"(C) market-making and dealer services, and

"(D) any other service provided as business activity in which a person acts as an intermediary in—

"(i) the transfer of property, services, or financial assets, liabilities, risks or instruments (or income or expense derived therefrom) between two or more persons, or

"(ii) the pooling of economic risk among other persons

and derives all or a portion of such person's gross receipts from streams of income or expense, discounts, or other financial flows associated with the matter with respect to which such person is acting as an intermediary.

"(2) LENDING SERVICES.—'Lending services' means the regular making of loans and providing credit to, or taking deposits from customers, but does not include an installment or delayed payment arrangement provided by a seller of property or services under which additional charges or fees are imposed by the seller for the late payment.

"(3) MARKET-MAKING OR DEALER SERVICES.—'Market-making or dealer services' means services provided by a person who—

"(A) regularly purchases financial instruments from or sells financial instruments to

customers in the ordinary course of a trade or business,

"(B) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in financial instruments with customers in the ordinary course of a trade or business.

"SEC. 242. GENERAL RULE FOR TAXATION.

"(a) IN GENERAL.—In the case of a financial intermediation business, gross profits shall be computed by—

"(1) substituting financial receipts for taxable receipts, and

"(2) including financial expenses as business purchases.

"(b) DEFINITIONS.—

"(1) FINANCIAL RECEIPTS.—'Financial receipts' means all receipts other than amounts received as contributions to capital.

"(2) FINANCIAL EXPENSES.—'Financial expenses' include—

"(A) payments for principal and interest that is properly allocable to the provision of financial intermediation services,

"(B) the cost of and payments under financial instruments (other than financial instruments in the person subject to the tax im-

posed under this chapter and any person related to such person),

"(C) claims and cash surrender values paid in connection with insurance or reinsurance services, and

"(D) amounts paid for reinsurance.

"(3) FINANCIAL INSTRUMENT.—'Financial instrument' means any—

"(A) share of stock in a corporation,

"(B) equity ownership in any widely held or publicly traded partnership, trust, or other business entity,

"(C) note, bond, debenture, or other evidence of indebtedness,

"(D) interest rate, currency, or equity notional principal contract,

"(E) evidence or interest in, or a derivative financial instrument in, any financial instrument described in subparagraph (A), (B), (C), or (D), or any currency, including any option, forward contract, short position, and any similar financial instrument in such a financial instrument or currency, and

"(F) a position which—

"(i) is not a financial instrument described in subparagraph (A), (B), (C), (D) or (E),

"(ii) is a hedge with respect to such a financial instrument, and

"(iii) is clearly identified in the dealer's records as being described in this subparagraph before the close of the day on which it was acquired or entered into.

"(c) INTERNATIONAL MATTERS.—For purposes of this section in the case of a financial intermediation business with activity in and outside the United States—

"(1) INCLUSION REGARDLESS OF SOURCE.—

"(A) Financial receipts shall be determined without regard to whether they are received for property or service provided in or outside the United States, except that financial receipts do not include amounts that—

"(i) are not taxable receipts (as determined without regard to this section), but

"(ii) would have been taxable receipts (as determined without regard to this section) if they had been received for services or property in the United States.

"(B) Financial expenses shall be determined without regard to whether they are received for property or services acquired in or outside the United States.

"(2) ALLOCATION.—Under regulations prescribed by the Secretary, gross profits (as determined without regard to this paragraph) shall be reduced by the amount of financial intermediation gross profit attributable to financial intermediation activity provided outside the United States.

"(3) GROSS PROFIT ATTRIBUTABLE TO FINANCIAL INTERMEDIATION ACTIVITY.—'Gross profits attributable to financial intermediation activity' means the excess of—

"(A) gross profits as determined under this section (but without regard to paragraph (2)), over

"(B) gross profits as determined without regard to this subchapter.

"SEC. 243. SPECIAL RULES FOR BANKS.

"(a) IN GENERAL.—In the case of a bank, gross profits shall be determined in accordance with section 242, except that—

"(1) FINANCIAL RECEIPTS.—Financial receipts shall include only—

"(A) taxable receipts (as determined without regard to this subchapter),

"(B) interest on loans made or acquired by the bank,

"(C) gain on the sale of loans,

"(D) discount points received, and

"(E) any explicit fees for financial or fiduciary services not included in subparagraphs (A) through (E).

"(2) FINANCIAL EXPENSES.—Financial expenses shall include only—

"(A) interest paid to depositors and on other funds borrowed by the bank, and

"(B) reasonable additions to reserves for bad debts.

"(3) FORECLOSURE PROPERTY.—Gross profits shall properly take into account proceeds from the operation or sale of foreclosure property.

"(b) BANK.—

"(1) IN GENERAL.—'Bank' means a bank or trust company incorporated and doing business under the laws of the United States, the District of Columbia, or any State, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fidu-

ciary powers similar to those exercised by national banks under the authority of the Comptroller of the Currency, and which is subject by law to supervision and examination by State or Federal authority having supervision over banking institutions or credit unions. Such term includes domestic building and loan associations and credit unions.

''(2) OTHER ACTIVITIES.—If a bank is engaged in significant amounts of activities other than those described in paragraph (1), the bank shall be considered as a separate business entity with respect to such other activity.

"SEC. 244. INSURANCE COMPANIES.

''(a) IN GENERAL.—In the case of companies providing insurance services, gross profits shall be determined in accordance with section 242, except—

''(1) subsection (c) of section 242 (relating to international operations) shall not apply, and

''(2) the rules of subchapter J (sourcing rules) shall apply to determine financial receipts and financial expenses.

''(b) RESULT INCONSISTENT WITH STATUTORY INTENT.—If an insurance company determines that the application of subsection (a) produces results inconsistent with the territorial approach of the business tax, it may

apply to the Secretary for permission to apply section 242(c) in lieu of subsection (a).

"SEC. 245. FINANCIAL PASS-THROUGH ENTITIES.

"(a) IN GENERAL.—In the case of a financial pass-thru entity, gross profits shall be determined in accordance with section 242, except—

"(1) financial receipts shall include contributions to capital,

"(2) financial expenses shall include—

"(A) distributions to persons holding interests in the pass-thru entity,

"(B) investments in related entities (including wholly owned entities) engaging in real estate investment.

"(b) PASS-THRU ENTITY.—

"(1) IN GENERAL.—'Pass-thru entity' means a business entity that is intended to serve as a conduit. The Secretary shall prescribe regulations defining pass-thru entity. Such term shall include—

"(A) entities that would qualify as regulated investment companies under the Internal Revenue Code of 1986,

"(B) entities that would qualify as real estate investment trusts under the Internal Revenue Code of 1986,

"(C) entities that would qualify as REMICs under the Internal Revenue Code of 1986, and

"(D) partnerships whose purposes are to invest the funds of the partners in financial instruments, distribute or reinvest the income from such investments, and distribute or reinvest the proceeds from the sale of such instruments.

"(2) ENGAGEMENT IN BUSINESS ACTIVITY.—An entity will not qualify as a pass-thru entity if it engages in more than an insubstantial amount of rental or other business activity (other than investing in and selling financial instruments). The preceding sentence will not apply if the business entity treats the business activity as engaged in by a separate business entity (separately subject to tax under this chapter).

"SEC. 246. FINANCIAL INTERMEDIATION BY OTHER BUSINESSES.

"(a) IN GENERAL.—If a business entity that is not regularly in the business of providing financial intermediation services to unrelated parties engages in significant financial intermediation activity, its gross profits shall be increased by its gross profits from financial intermediation

activity (determined as if such activity were activity of a pass-thru entity that paid all costs of such financial intermediation activity including—

"(1) compensation for persons engaging in such activity,

"(2) equipment involved in such activity, and

"(3) office space for persons involved in such activity).

"(b) PROXY.—A business entity to which subsection (a) applies will be treated as satisfying the requirements of that subsection if it increases its gross receipts by the portion of employee compensation properly allocable to the provision of financial intermediation services.

"(c) SIGNIFICANT FINANCIAL INTERMEDIATION.—A business will be considered as engaging in substantial financial intermediation if—

"(1) more than 5 percent of the compensation paid by the business to its employees is for employees whose primary activity is the management of the business's investments in financial instruments, or

"(2) at all times during the taxable year and the immediately preceding full taxable year, more than 10 percent of its assets are financial instruments other than—

"(A) equity interests in business entities in which it holds more than 50 percent in value of the outstanding equity,

"(B) equity interests in joint ventures in which the company is actively participating,

"(C) purchase money loans to its customers, and

"(D) business loans and equity investments that serve a direct business purpose.

"Subchapter H—Tax-Exempt Organizations

"Sec. 251. Exemption for governmental entities.
"Sec. 252. Taxable activity of governmental entities.
"Sec. 253. Tax-exempt organizations.
"Sec. 254. Special rules for (c)(3) organizations.
"Sec. 255. Tax on unrelated business activity.
"Sec. 256. Unrelated business activity.

"SEC. 251. EXEMPTION FOR GOVERNMENTAL ENTITIES.

"(a) STATES.—Except as provided in section 252, a state, political subdivision thereof and the District of Columbia shall be exempt from taxation under this chapter on any gross profits derived from the exercise of any essential governmental function.

"(b) POSSESSIONS.—The government of any possession of the United States shall be exempt from taxation under this chapter on any gross profits earned by the possession.

"SEC. 252. TAXABLE ACTIVITY OF GOVERNMENTAL ENTITIES.

"(a) CERTAIN ACTIVITIES TAXABLE.—A governmental entity shall be considered a business and subject to tax on any business activity of a type frequently provided by business entities subject to tax under this chapter.

"(b) CERTAIN ACTIVITIES TREATED AS ESSENTIAL GOVERNMENT FUNCTIONS.—Subsection (a) shall not apply to the following activities, which shall be treated as essential government functions:

"(1) Provision of mass transportation services.

"(2) Provision of public utility services.

"SEC. 253. TAX-EXEMPT ORGANIZATIONS.

"(a) EXEMPTION FROM TAXATION.—An organization described in subsection (c) or (d) shall be exempt from taxation under this chapter.

"(b) TAX ON UNRELATED BUSINESS ACTIVITY.—An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in sections 255 and 256, but shall be considered a tax-exempt organization for purposes of any law that refers to tax-exempt organizations.

"(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

"(1) INSTRUMENTALITY OF THE UNITED STATES.—Any corporation organized under Act of Congress which is an instrumentality of the United States but only if such corporation—

"(A) is exempt from Federal income taxes—

"(i) under such Act as amended and supplemented before July 18, 1984, or

"(ii) under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act, or

"(B) is described in subsection (h).

"(2) TITLE HOLDING COMPANIES.—Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section. Rules similar to the rules of subparagraph (G) of paragraph (25) shall apply for purposes of this paragraph.

"(3) CHARITABLE, EDUCATIONAL AND RELIGIOUS ORGANIZATIONS.—Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, sci-

entific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (g)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

''(4) SOCIAL WELFARE ORGANIZATIONS, ETC.—

''(A) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

"(B) Subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual

"(5) LABOR AND AGRICULTURAL ORGANIZATIONS.—Labor, agricultural, or horticultural organizations.

"(6) TRADE ASSOCIATIONS.—Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players) not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

"(7) SOCIAL CLUBS.—Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

"(8) CERTAIN FRATERNAL SOCIETIES.—Fraternal beneficiary societies, orders, or associations—

"(A) operating under the lodge system or for the exclusive benefit of the members of a

fraternity itself operating under the lodge system, and

"(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

"(9) VEBA'S.—Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

"(10) OTHER FRATERNAL ORGANIZATIONS.—Domestic fraternal societies, orders, or associations, operating under the lodge system—

"(A) the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and

"(B) which do not provide for the payment of life, sick, accident, or other benefits.

"(11) LOCAL TEACHERS' RETIREMENT FUNDS.—Teachers' retirement fund associations of a purely local character, if—

"(A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

"(B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

"(12) CERTAIN COOPERATIVES.—

"(A) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

"(B) In the case of a mutual or cooperative telephone company, subparagraph (A) shall be applied without taking into account any income received or accrued—

"(i) from a nonmember telephone company for the performance of communication services which involve members of the mutual or cooperative telephone company,

"(ii) from qualified pole rentals,

"(iii) from the sale of display listings in a directory furnished to the members of the mutual or cooperative telephone company, or

"(iv) from the prepayment of a loan under section 306A, 306B, or 311 of the Rural Electrification Act of 1936 (as in effect on January 1, 1987).

"(C) In the case of a mutual or cooperative electric company, subparagraph (A) shall be applied without taking into account any income received or accrued—

"(i) from qualified pole rentals, or

"(ii) from the prepayment of a loan under section 306A, 306B, or 311 of the Rural Electrification Act of 1936 (as in effect on January 1, 1987).

"(D) For purposes of this paragraph, the term 'qualified pole rental' means any rental of a pole (or other structure used to support wires) if such pole (or other structure)—

"(i) is used by the telephone or electric company to support one or more wires which are used by such company in provid-

ing telephone or electric services to its members, and

"(ii) is used pursuant to the rental to support one or more wires (in addition to the wires described in clause (i)) for use in connection with the transmission by wire of electricity or of telephone or other communications.

For purposes of the preceding sentence, the term 'rental' includes any sale of the right to use the pole (or other structure).

"(13) NONPROFIT CEMETERIES.—Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

"(14) GRANDFATHERED MUTUAL FINANCIAL INSTITUTIONS.—

"(A) Credit unions without capital stock organized and operated for mutual purposes

and without profit, but only if organized before July 1, 1998.

"(B) Certain corporations or associations organized before September 1, 1957, and described in subparagraphs (B) or (C) of section 501(c)(14) of the Internal Revenue Code of 1986.

"(15) GRANDFATHERED SMALL INSURANCE COMPANIES.—Insurance companies organized before July 1, 1998, and described in section 501(c)(15) of the Internal Revenue Code of 1986.

"(16) CROP FINANCING ASSOCIATIONS.—Corporations organized by an association subject to part IV of this subchapter or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or per-

mitted to participate, directly or indirectly, in the profits of the corporation, on dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

"(17) SUPPLEMENTAL EMPLOYMENT BENEFIT TRUST.—

"(A) A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits, if—

"(i) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities, with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits,

"(ii) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the

Secretary not to be discriminatory in favor of employees who are highly compensated employees (within the meaning of section 414(q)), and

"(iii) such benefits do not discriminate in favor of employees who are highly compensated employees (within the meaning of section 414(q). A plan shall not be considered discriminatory within the meaning of this clause merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

"(B) Rules similar to those contained in subparagraphs (B) through (E) of section 501(c)(7) of the Internal Revenue Code of 1986 shall apply to subparagraph (A).

"(18) GRANDFATHERED TRUSTS.—A trust or trusts created before June 25, 1959, and described in section 501(c)(18) of the Internal Revenue Code of 1986.

"(19) CERTAIN VETERANS' ORGANIZATIONS.—A post or organization of past or present members of the Armed Forces of the United States, or an

auxiliary unit or society of, or a trust or foundation for, any such post or organization—

"(A) organized in the United States or any of its possessions,

"(B) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets, and

"(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

"(20) LEGAL SERVICE PLAN TRUSTS.—An organization or trust created or organized in the United States, the exclusive function of which is to form part of a qualified group legal services plan or plans.

"(21) BLACK LUNG ACT TRUSTS.—A trust or trusts established in writing, created or organized in the United States, and contributed to by any person (except an insurance company) if—

"(A) the purpose of such trust or trusts is exclusively—

"(i) to satisfy, in whole or in part, the liability of such person for, or with respect to, claims for compensation for disability or death due to pneumoconiosis under Black Lung Acts,

"(ii) to pay premiums for insurance exclusively covering such liability,

"(iii) to pay administrative and other incidental expenses of such trust in connection with the operation of the trust and the processing of claims against such person under Black Lung Acts, and

"(iv) to pay accident or health benefits for retired miners and their spouses and dependents (including administrative and other incidental expenses of such trust in connection therewith) or premiums for insurance exclusively covering such benefits; and

"(B) such trusts meets requirements similar to those contained in section 501(c)(21) of the Internal Revenue Code of 1986.

"(22) MULTIEMPLOYER ERISA TRUST.—A trust created or organized in the United States and established in writing by the plan sponsors of multiemployer plans if—

"(A) the purpose of such trust is exclusively—

"(i) to pay any amount described in section 4223(c) or (h) of the Employee Retirement Income Security Act of 1974, and

"(ii) to pay reasonable and necessary administrative expenses in connection with the establishment and operation of the trust and the processing of claims against the trust,

"(B) no part of the assets of the trust may be used for, or diverted to, any purpose other than—

"(i) the purposes described in subparagraph (A), or

"(ii) prudent investment in securities, obligations, or time or demand deposits,

"(C) such trust meets the requirements of paragraphs (2), (3), and (4) of section 4223(b), 4223(h), or, if applicable, section 4223(c) of the

Employee Retirement Income Security Act of 1974, and

"(D) the trust instrument provides that, on dissolution of the trust, assets of the trust may not be paid other than to plans which have participated in the plan or, in the case of a trust established under section 4223(h) of such Act, to plans with respect to which employers have participated in the fund.

"(23) GRANDFATHERED VETERANS' INSURANCE ORGANIZATION.—Any association organized before 1880 more than 75 percent of the members of which are present or past members of the Armed Forces and a principal purpose of which is to provide insurance and other benefits to veterans or their dependents.

"(24) ERISA TRUST.—A trust described in section 4049 of the Employee Retirement Income Security Act of 1974 (as in effect on the date of the enactment of the Single-Employer Pension Plan Amendments Act of 1986).

"(25) REAL TITLE HOLDING CORPORATION OR TRUST.—

"(A) Any corporation or trust which—

"(i) has no more than 35 shareholders or beneficiaries,

"(ii) has only 1 class of stock or beneficial interest, and

"(iii) is organized for the exclusive purposes of—

"(I) acquiring real property and holding title to, and collecting income from, such property, and

"(II) remitting the entire amount of income from such property (less expenses) to 1 or more organizations described in subparagraph (C) which are shareholders of such corporation or beneficiaries of such trust.

"For purposes of clause (iii), the term 'real property' shall not include any interest as a tenant in common (or similar interest) and shall not include any indirect interest.

"(B) A corporation or trust shall be described in subparagraph (A) without regard to whether the corporation or trust is organized by 1 or more organizations described in subparagraph (C).

"(C) An organization is described in this subparagraph if such organization is—

"(i) a qualified pension, profit sharing, or stock bonus plan that meets the requirements of section 401(a),

"(ii) a governmental plan (within the meaning of section 414(d)),

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

"(iv) any organization described in paragraph (3).

"(D) A corporation or trust shall in no event be treated as described in subparagraph (A) unless such corporation or trust permits its shareholders or beneficiaries—

"(i) to dismiss the corporation's or trust's investment adviser, following reasonable notice, upon a vote of the shareholders or beneficiaries holding a majority of interest in the corporation or trust, and

"(ii) to terminate their interest in the corporation or trust by either, or both, of

the following alternatives, as determined by the corporation or trust:

"(I) by selling or exchanging their stock in the corporation or interest in the trust (subject to any Federal or State securities law) to any organization described in subparagraph (C) so long as the sale or exchange does not increase the number of shareholders or beneficiaries in such corporation or trust above 35, or

"(II) by having their stock or interest redeemed by the corporation or trust after the shareholder or beneficiary has provided 90 days notice to such corporation or trust.

"(E)(i) For purposes of this paragraph—

"(I) a corporation which is a qualified subsidiary shall not be treated as a separate corporation, and

"(II) all assets, liabilities, and items of income, deduction, and credit of a qualified subsidiary shall be treated as assets, liabilities, and such items (as the case may

be) of the corporation or trust described in subparagraph (A).

"(ii) For purposes of this subparagraph, the term 'qualified subsidiary' means any corporation if, at all times during the period such corporation was in existence, 100 percent of the stock of such corporation is held by the corporation or trust described in subparagraph (A).

"(iii) For purposes of this subtitle, if any corporation which was a qualified subsidiary ceases to meet the requirements of clause (ii), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the corporation or trust described in subparagraph (A) in exchange for its stock.

"(F) For purposes of subparagraph (A), the term 'real property' includes any personal property which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property for the taxable year does not exceed 15 percent of the total rent for the taxable year attributable

to both the real and personal property leased under, or in connection with, such lease.

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

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

"(26) STATE ESTABLISHED MEDICAL CARE INSURER.—Any membership organization if—

"(A) such organization is established by a State exclusively to provide coverage for medical care on a not-for-profit basis to individuals described in subparagraph (B) through—

"(i) insurance issued by the organization, or

"(ii) a health maintenance organization under an arrangement with the organization,

"(B) the only individuals receiving such coverage through the organization are individuals—

"(i) who are residents of such State, and

"(ii) who, by reason of the existence or history of a medical condition—

"(I) are unable to acquire medical care coverage for such condition through insurance or from a health maintenance organization, or

"(II) are able to acquire such coverage only at a rate which is substantially in excess of the rate for such coverage through the membership organization,

"(C) the composition of the membership in such organization is specified by such State, and

"(D) no part of the net earnings of the organization inures to the benefit of any private shareholder or individual. A spouse and any

qualifying child) of an individual described in subparagraph (B) (without regard to this sentence) shall be treated as described in subparagraph (B).

"(27) GRANDFATHERED WORKERS COMPENSATION ORGANIZATION.—Any membership organization established before June 1, 1996, by a State exclusively to reimburse its members for losses arising under workmen's compensation acts, and described in section 501(c)(27) of the Internal Revenue Code of 1986.

"(d) RELIGIOUS AND APOSTOLIC ORGANIZATIONS.—The following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if such activity is treated as unrelated business activity.

"(e) COOPERATIVE HOSPITAL SERVICE ORGANIZATIONS.—For purposes of this chapter, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

"(1) such organization is organized and operated solely—

"(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing (including the purchasing of insurance on a group basis), warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

"(B) to perform such services solely for two or more hospitals each of which is—

"(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

"(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an

organization described in subsection (c)(3), or

"(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

"(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

"(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons. "For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 101(b)(1)(A)(iii).

"(f) COOPERATIVE SERVICE ORGANIZATIONS OF OPERATING EDUCATIONAL ORGANIZATIONS.—For purposes of this chapter, if an organization is—

"(1) organized and operated solely to hold, commingle, and collectively invest and reinvest (in-

cluding arranging for and supervising the performance by independent contractors of investment services related thereto) in stocks and securities, the moneys contributed thereto by each of the members of such organization, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members,

"(2) organized and controlled by one or more such members, and

"(3) comprised solely of members that are organizations described in clause (ii) or (iv) of section 101(b)(1)(A)—

"(A) which are exempt from taxation under subsection (a), or

"(B) the gross profits of which are excluded from taxation under section 251(a),

then such organization shall be treated as an organization organized and operated exclusively for charitable purposes.

"(g) EXPENDITURES BY PUBLIC CHARITIES TO INFLUENCE LEGISLATION.—

"(1) GENERAL RULE.—In the case of an organization to which this subsection applies, exemption from taxation under subsection (a) shall be denied because a substantial part of the activities of such organization consists of carrying on propaganda, or

otherwise attempting, to influence legislation, but only if such organization normally—

"(A) makes lobbying expenditures in excess of the lobbying ceiling amount for such organization for each taxable year, or

"(B) makes grass roots expenditures in excess of the grass roots ceiling amount for such organization for each taxable year.

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

"(A) LOBBYING EXPENDITURES.—'Lobbying expenditures' means expenditures for the purpose of influencing legislation (as defined in section 4911(d)).

"(B) LOBBYING CEILING AMOUNT.—The lobbying ceiling amount for any organization for any taxable year is 150 percent of the lobbying nontaxable amount for such organization for such taxable year, determined under section 4911.

"(C) GRASS ROOTS EXPENDITURES.—'Grass roots expenditures' means expenditures for the purpose of influencing legislation (as defined in section 4911(d) without regard to paragraph (1)(B) thereof).

"(D) GRASS ROOTS CEILING AMOUNT.—The grass roots ceiling amount for any organization for any taxable year is 150 percent of the grass roots nontaxable amount for such organization for such taxable year, determined under section 4911.

"(3) ORGANIZATIONS TO WHICH THIS SUBSECTION APPLIES.—This subsection shall apply to any organization which has elected (in such manner and at such time as the Secretary may prescribe) to have the provisions of this subsection apply to such organization and which, for the taxable year which includes the date the election is made, is described in subsection (c)(3) and is not described in paragraph (4) and is not a private foundation.

"(4) DISQUALIFIED ORGANIZATIONS.—This subsection does not apply to—

"(A) a church,

"(B) an integrated auxiliary of a church or of a convention or association of churches, or

"(C) a member of an affiliated group of organizations (within the meaning of section 4911(f)(2)) if one or more members of such group is described in subparagraph (A) or (B).

"(5) YEARS FOR WHICH ELECTION IS EFFECTIVE.—An election by an organization under this subsection shall be effective for all taxable years of such organization which—

"(A) end after the date the election is made, and

"(B) begin before the date the election is revoked by such organization (under regulations prescribed by the Secretary).

"(6) NO EFFECT ON CERTAIN ORGANIZATIONS.—With respect to any organization for a taxable year for which—

"(A) such organization is described in paragraph (5), or

"(B) an election under this subsection is not in effect for such organization, nothing in this subsection or in section 4911 shall be construed to affect the interpretation of the phrase, 'no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation,' under subsection (c)(3).

"(h) GOVERNMENT CORPORATIONS EXEMPT UNDER SUBSECTION (c)(1).—For purposes of subsection (c)(1),

the following organizations are described in this subsection:

"(1) The Central Liquidity Facility established under title III of the Federal Credit Union Act (12 U.S.C. 1795 et seq.).

"(2) The Resolution Trust Corporation established under section 21A of the Federal Home Loan Bank Act.

"(3) The Resolution Funding Corporation established under section 21B of the Federal Home Loan Bank Act.

"(i) CERTAIN EDUCATIONAL ORGANIZATIONS.—An organization shall not be eligible for exemption as an educational organization under subsection (c)(3) if a substantial amount of its activities and funds are devoted to—

"(1) conducting seminars and other similar programs,

"(2) conducting research to educate Congress or the general public about public policy issues,

"(3) producing books and pamphlets, or

"(4) a combination of the foregoing.

"SEC. 254. SPECIAL RULES FOR (c)(3) ORGANIZATIONS.

"(a) NEW ORGANIZATIONS MUST NOTIFY SECRETARY.—Except as provided in subsection (c), an organi-

zation shall not be treated as an organization described in section 253(c)(3)—

"(1) unless that it has given notice to the Secretary, in such manner as the Secretary may prescribe, that it is applying for recognition of such status, or

"(2) for any period before giving of such notice, if such notice is given after the time prescribed by the Secretary by regulations for giving notice under this subsection.

"(b) PRESUMPTION THAT ORGANIZATIONS ARE PRIVATE FOUNDATIONS.—Except as provided in subsection (c), any organization described in section 253(c)(3) and which does not notify the Secretary, at such time and in such manner as the Secretary may by regulations prescribe, that it is not a private foundation (as defined in section 102) shall be presumed to be a private foundation.

"(c) EXCEPTIONS.—Subsections (a) and (b) shall not apply to—

"(1) organizations organized before October 10, 1969;

"(2) organizations which obtained recognition of tax-exempt status under section 501(c)(3) of the Internal Revenue Code of 1986 (in the case of subsection (a) only);

"(3) organizations which were determined not to be private foundations under the Internal Revenue Code of 1986;

"(4) churches, their integrated auxiliaries, and conventions and associations of churches;

"(5) any organization that is not a private foundation and the gross receipts of which in each taxable year are not more than $25,000, or

"(6) such other classes of organizations which the Secretary may exempt.

"SEC. 255. TAX ON UNRELATED BUSINESS ACTIVITY.

"(a) IN GENERAL.—Each organization described in subsection (b) shall be subject to the Simplified USA Tax for businesses under section 201 on its gross profits from its unrelated business activity.

"(b) ORGANIZATIONS SUBJECT TO TAX.—This section shall apply to—

"(1) organizations exempt from the business tax under section 253(a), other than instrumentalities of the United States described in section 253(c)(1).

"(2) colleges and universities which are instrumentalities of any government and corporations owned by one or more such colleges or universities.

"SEC. 256. UNRELATED BUSINESS ACTIVITY.

"(a) IN GENERAL.—'Unrelated business activity' means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 253, except that such term does not include any trade or business—

"(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

"(2) which is carried on, in the case of an organization described in section 253(c)(3) or in the case of a college or university described in section 255(b), by the organization primarily for the convenience of its members, students, patients, officers, or employees, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

"(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

"(b) ADVERTISING, ETC., ACTIVITIES.—For purposes of this section, 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

"(c) TRADE OR BUSINESS.—

"(1) CERTAIN BUSINESS ACTIVITIES.—An activity shall not be considered a 'trade or business' solely because the activity is a business activity (such as certain passive rental activity) that would be subject to the business tax if conducted by a business entity other than a tax-exempt organization.

"(2) REGULATIONS.—The Secretary shall prescribe regulations defining a 'trade or business.'

Such regulations shall be consistent with the provisions under sections 511 through 513 of the Internal Revenue Code of 1986, except to the extent such provisions are inconsistent with other principles of the business tax. The regulations shall include exclusions from the definition of 'trade or business' similar to those contained in section 513 of the Internal Revenue Code for—

"(A) certain bingo games,

"(B) certain hospital services, and

"(C) certain public entertainment activity at fairs and expositions by an organization which regularly conducts, as one of its substantial exempt purposes, an agricultural or educational fair or exhibition.

"(3) TRADE SHOWS.—The conduct of trade shows and conventions shall not be excluded from the definition of trade or business.

"Subchapter I—Cooperatives

Sec. 260. Patronage dividends of cooperatives.

"SEC. 260. PATRONAGE DIVIDENDS OF COOPERATIVES.

"(a) PATRONAGE DIVIDENDS PAID BY SUPPLY COOPERATIVES.—A qualified patronage dividend paid by a supply cooperative to a patron shall be treated as if it is a refund of a portion of the amounts paid by the patron

for goods, services, or use of capital. In general, if the supply cooperative included the amount received from the patron in taxable receipts, the dividend shall reduce taxable receipts in the year incurred. If the recipient of the dividend is a business entity which deducted the cost of business purchases to which the dividend related, the recipient will reduce its cost of business purchases by the amount of the dividend in the year the dividend is paid or incurred.

"(b) PATRONAGE DIVIDENDS PAID BY MARKETING COOPERATIVES.—A qualified patronage dividend paid to a patron by a marketing cooperative shall be treated as an upward price adjustment in the amount received by the patron for its goods marketed by the cooperative. In general, the cooperative will increase its cost of business purchases by the amount of the qualified patronage dividend and the recipient will increase its taxable receipts by the amount of the qualified patronage dividend.

"(c) DIVIDEND TREATMENT.—Only the portion of a patronage dividend that is not a qualified patronage dividend shall be treated as a dividend under this chapter and chapter 2.

"(d) DEFINITIONS.—

"(1) QUALIFIED PATRONAGE DIVIDEND.—A 'qualified patronage dividend' is that part of a pa-

tronage dividend that is attributable to the patron's allocable share of patronage earnings of a marketing cooperative or a supply cooperative.

"(2) SUPPLY COOPERATIVE.—A 'supply cooperative' is a cooperative that sells goods or service to patrons and provided patronage dividends with respect to the quantity of purchases of the patrons.

"(3) MARKETING COOPERATIVE.—A 'marketing cooperative' is a cooperative that sells goods produced by its members and provides patronage dividends to the members based on the quantities of goods sold or provided for sale.

"(e) SPECIAL RULES.—

"(1) NOTICES OF ALLOCATION AND PER-UNIT RETAIN CERTIFICATES.—Except as provided in paragraph (2), a notice of allocation, per-unit retain certificate, or other similar document shall not be treated as a patronage dividend until it is redeemed in cash or property.

"(2) OPPORTUNITY TO RECEIVE CASH.—If a patron is given an opportunity to receive a patronage dividend in cash, but instead chooses to accept a per-unit retain certificate or a qualified notice of allocation, the patron will be treated as receiving

cash and simultaneously contributing to the capital of the cooperative.

"(3) APPLICATION LIMITED TO QUALIFIED COOPERATIVES.—Under rules to be prescribed by the Secretary, this section shall apply only to cooperatives to which one of the following provisions of the Internal Revenue Code of 1986 would have applied:

"(A) Section 501(c)(12) (relating to cooperative telephone companies and similar organizations).

"(B) Section 501(c)(14) (relating to certain cooperative banks).

"(C) Section 521 (relating to farm cooperatives).

"(D) Section 1381 (relating to cooperatives generally).

"(4) REGULATIONS.—The Secretary shall prescribe regulations for the application of this section. The regulations shall generally be consistent with subchapter T of chapter 1 of the Internal Revenue Code of 1986 except to the extent that such rules are inconsistent with provisions of this chapter.

"Subchapter J—Sourcing Rules

"Sec. 265. Exports of property or services.
"Sec. 266. Imports of property or services.
"Sec. 267. Import or export of services.
"Sec. 268. International transportation services.

"Sec. 269. International communications.
"Sec. 270. Insurance.

"SEC. 265. EXPORTS OF PROPERTY OR SERVICES.

"(a) GENERAL RULE.—Taxable receipts do not include amounts received by the exporter thereof for property or services exported from the United States for use or consumption outside the United States.

"(b) EXPORT THROUGH NONBUSINESS ENTITY.—For purposes of subsection (a), if property or services are sold to a governmental entity or a tax-exempt organization for export and are exported other than in an activity of such entity which is subject to the business tax, then the seller of such property or services is deemed to be the exporter thereof.

"(c) EXPORT OF SERVICES.—See section 267 for rules for determining whether services are exported or imported.

"SEC. 266. IMPORTS OF PROPERTY OR SERVICES.

"(a) IN GENERAL.—The import of property or services for consumption in the United States shall constitute a business purchase if such property or service is to be used in a business activity in the United States. Property being held for sale or retail by a business entity that is in the business of selling goods shall be considered held for 'use in a business activity'.

"(b) AMOUNT OF BUSINESS PURCHASE.—

"(1) IN GENERAL.—The cost of business purchases with respect to the import of property or services for use or consumption in the United States is the customs value, price or other amount used for purposes of determining the import tax under section 286 or section 287.

"(2) IMPORT TAX.—The cost of business purchases does not include any import tax paid. No deduction shall be allowed with respect to property or service imported by a business entity unless the import tax is paid with respect to such import.

"SEC. 267. IMPORT OR EXPORT OF SERVICES.

"(a) IN GENERAL.—Except as otherwise provided in this subchapter or in rules prescribed under subchapter G (relating to financial intermediation business), services shall not be treated as imported or exported from the location in which they are performed.

"(b) IMPORT OF SERVICES.—A business entity shall be treated as importing a service if—

"(1) the entire benefit of the service will be realized in the United States, and

"(2) the benefit will be realized in connection with the United States business activities of the business entity.

"(c) EXPORT OF SERVICES.—A business will be treating as exporting a service if—

"(1) the entire benefit of the service will be realized outside of the United States, and

"(2) the benefit will be realized solely in connection with the activities of the purchaser occurring outside the United States.

"(d) SERVICES ACQUIRED FROM SERVICE PROVIDER THAT PROVIDES SERVICES IN AND OUTSIDE THE UNITED STATES.—

"(1) IN GENERAL.—If a business entity acquires services from a service provider that provides services both in and outside the United States and the service provider shows on the invoice where the services are provided—

"(A) the business entity shall treat the services as provided where stated on the invoice, and

"(B) the service provider shall treat as taxable receipts any services listed as provided in the United States.

"(2) NO INVOICE.—If a business entity acquires services from a service provider that provides services both in and outside the United States and the

service provider does not show on an invoice where such services are provided—

"(A) the business entity shall treat the services as if provided in the location to which payment is sent, and

"(B) the service provider shall treat as taxable receipts any payments received in the United States.

"(e) SPECIAL RULES PREVAIL.—See sections 268 and 269 for special rule relating to transportation and communication services.

"SEC. 268. INTERNATIONAL TRANSPORTATION SERVICES.

"(a) TRANSPORTATION OF PROPERTY.—

"(1) TAXABLE RECEIPTS.—

"(A) EXPORTS.—Taxable receipts do not include receipts from the transportation of property exported from the United States.

"(B) IMPORTS.—Taxable receipts include receipts from transportation of property imported into the United States only if such costs are not taken into account in determining the import tax.

"(C) PRESUMPTIONS.—The Secretary shall prescribe regulations describing situations in which a transporter of property must presume

that no import tax has been paid on the cost of its services.

"(2) BUSINESS PURCHASES.—

"(A) EXPORTS.—Business purchases do not include amounts paid or incurred for the cost of transportation of property exported from the United States.

"(B) IMPORTS.—Amounts paid or incurred for transportation of goods imported into the United States, shall constitute a cost of business purchase only to the extent that they are taken into account in determining the customs value for purposes of section 286(a) (relating to the import tax).

"(b) TRANSPORTATION OF PASSENGERS.—

"(1) TAXABLE RECEIPTS.—Taxable receipts—

"(A) include receipts from the transportation of passengers from the United States to a destination outside the United States, but

"(B) do not include receipts from the transportation of passengers from outside the United States to a destination in the United States.

"(2) BUSINESS PURCHASES.—Business purchases—

"(A) include amounts paid or incurred in a business activity for the transportation of passengers from the United States to a destination outside the United States, but

"(B) do not include amounts paid or incurred for transportation of passengers from outside the United States to a destination in the United States.

"(3) SIMPLIFYING RULES.—The Secretary may provide rules that simplify this subsection, including rules under which—

"(A) half of receipts attributable to transportation to or from the United States are treated as taxable receipts,

"(B) half of the cost for business trips to and from the United States are treated as business purchases, and

"(C) all transportation expenses of a business entity that has no regular business outside the United States are treated as business purchases.

"SEC. 269. INTERNATIONAL COMMUNICATIONS.

"(a) IN GENERAL.—For purposes of section 266, communications services shall be treated as provided at

the point of origin of the communications and shall not be treated as imported or exported.

"(b) COMMUNICATIONS SERVICES.—Communications services include—

"(1) telephone communications services,

"(2) courier services (except in the case of transportation of property that is imported or exported),

"(3) satellite transmission services,

"(4) telegraph services,

"(5) facsimile transmission services, and

"(6) other similar services.

"SEC. 270. INSURANCE.

"(a) IN GENERAL.—Insurance services will be treated as provided at the location of the insurance company providing the services. Except as the Secretary may prescribe by regulations, insurance companies will be treated as providing services at the location to which insurance payments are made.

"(b) INSURED RISKS IN THE UNITED STATES.—If insurance services are provided outside the United States and the insured risk is located in the United States—

"(1) the insurance service shall be treated as imported,

"(2) the insurance premiums shall be subject to the import tax, and

"(3) payments of insurance benefits shall not be treated as imported.

"(c) INSURED RISK OUTSIDE THE UNITED STATES.—If insurance services are provided inside the United States and the insured risk is located outside the United States—

"(1) insurance services shall be treated as exported,

"(2) payments of insurance benefits shall be treated as payments for services outside the United States, and shall not be deducted as business purchases.

"(d) INSURANCE SERVICES.—Insurance services means the provision of insurance and services related to insurance other than insurance that is treated as a savings asset.

"SEC. 271. BANKING SERVICES.

"The Secretary shall prescribe regulations on the location of banking services and the extent to which such services are to be treated as imported or exported.

"Subchapter K—Business Conducted in a Possession

"Sec. 276. Treatment of possessions.

"SEC. 276. TREATMENT OF POSSESSIONS.

"(a) IN GENERAL.—For purposes of the business tax imposed by this chapter, the U.S. possessions shall not be treated as part of the United States.

"(b) EFFECT ON PAYROLL TAX CREDIT.—A business entity may not claim a payroll tax credit with respect to any payroll taxes paid with respect to income of residents of the U.S. possessions.

"(c) POSSESSION.—For purposes of this subchapter, 'U.S. possession' or 'possession' means a possession of the United States and includes the Commonwealth of Puerto Rico and the Virgin Islands.

"Subchapter L—Payroll Tax Credit

"Sec. 281. Amount of credit.
"Sec. 282. Current-year payroll tax credit.
"Sec. 283. Credit carryover.

"SEC. 281. AMOUNT OF CREDIT.

"(a) AMOUNT OF CREDIT.—The payroll tax credit for a business entity for a taxable year is the lesser of—

"(1) the sum of—

"(A) the current-year payroll tax credit, and

"(B) the credit carryovers to the taxable year, or

"(2) the business entity's business tax for the taxable year (determined without regard to the payroll tax credit).

"(b) CONSOLIDATED RETURNS.—In the case of business entities filing consolidated returns, the amount of the credit shall be determined using the combined payroll tax credits and credit carryovers of the business entities and the combined business tax of the business entities.

"SEC. 282. CURRENT-YEAR PAYROLL TAX CREDIT.

"(a) IN GENERAL.—The 'current-year payroll tax credit' is an amount equal to the sum of—

"(1) the employer's share of the FICA tax imposed on wages of its employees during the taxable year,

"(2) the employer's share of the tier 1 railroad retirement tax for its employees during the taxable year,

"(3) one-half of the allocable portion of the SECA tax imposed on individuals (other than independent contractors and other business entities) who provide services to the business entity.

"(b) DEFINITIONS.—

"(1) EMPLOYER'S SHARE OF THE FICA TAX.—'Employer's share of the FICA tax' means the old-age, survivors, disability and hospital insurance taxes imposed by section 3111.

"(2) EMPLOYER'S SHARE OF THE TIER 1 RAILROAD RETIREMENT TAX.—"Employer's share of the tier 1 railroad retirement tax' means—

"(A) the tier 1 railroad retirement tax imposed by section 3221(a), and

"(B) the portion of the tax imposed by section 3211(a)(1) on employee representatives attributable to the tax imposed by section 3111.

"(3) ONE-HALF OF THE ALLOCABLE PORTION OF THE SECA TAX.—

"(A) SECA TAX.—'SECA tax' means the self-employment tax imposed by section 1401.

"(B) PARTNERSHIPS.—Until such time as the SECA tax and the Federal Insurance Contributions Acts are amended to treat partners of partnerships as employees, if a partner designates a partnership as a principal source of employment income for the taxable year, one-half of the partnership's allocable portion of the SECA tax of such partner equals the FICA tax that the employer would have been required to pay under section 3111 with respect to such partner if the partner's self-employment income as reported by the partnership were wages subject to the FICA tax. A partner and partner-

ship can agree to treat no portion of a partner's SECA tax as allocable to the partnership.

"(C) PROPRIETORSHIP.—In the case of an individual who is a proprietor or sole owner and provider of service to a business entity, the individual shall allocate the portion of one-half of his SECA tax not allocated pursuant to subparagraph (B) to his business entities in accordance with rules prescribed by the Secretary.

"(c) SPECIAL RULE.—Under rules prescribed by the Secretary, an individual subject to the self-employment tax shall pay half of the self-employment tax on an amount of self employment income not less than the amount of the individual's self-employment income taken into account by partnerships under subparagraph (B) of subsection (b)(3).

"SEC. 283. CREDIT CARRYOVER.

"(a) CARRYOVER.—A current-year credit that is not applied in the taxable year in which earned shall constitute a credit carryover until applied but for no more than 15 taxable years.

"(b) Order of Use.—For purposes of determining which credits are applied under section 281, if the total credit allowable in a taxable year is less than the sum of the current-year payroll credit and the carryover credits,

the current-year payroll credit shall be considered applied first and then credit carryovers shall be considered applied in the order earned.

"Subchapter M—Import Tax

"Sec. 286. Imposition of tax on property.
"Sec. 287. Imposition of tax on import of services.
"Sec. 288. General rules for the import tax.

"Sec. 286. Imposition of tax on property.

"(a) GENERAL RULE.—There is hereby imposed a tax equal to 11 percent of the customs value of all property entered into the United States for consumption, use or warehousing.

"(b) LIABILITY FOR TAX.—The tax imposed on the import of property by subsection (a) shall be paid by the person entering the property into the United States for consumption, use or warehousing. Such tax shall be due and payable at the time of import.

"(c) IMPORTS OF PREVIOUSLY EXPORTED PROPERTY.—In the case of any article that is classified under a heading or subheading of subchapter I or II of chapter 98 of the Tariff Schedules of the United States, the tax under this section shall be imposed only on that portion of the customs value of such article that is dutiable under such heading or subheading.

"(d) IMPORTS FOR PERSONAL CONSUMPTION.—The import tax imposed by this section shall not apply to any article entered into the United States duty free under sub-

chapters I through VII of chapter 98 of the Tariff Schedules of the United States.

"SEC. 287. IMPOSITION OF TAX ON IMPORT OF SERVICES.

"(a) GENERAL RULE.—There is hereby imposed a tax equal to 11 percent of the cost of all services treated as imported into the United States during the taxable year of the service recipient.

"(b) LIABILITY FOR THE TAX.—The tax on the import of services imposed by subsection (a) shall be paid by the person who receives the imported services. The tax shall be payable as if it were an addition to the business tax imposed by section 201.

"(c) IMPORTED SERVICES.—For purposes of this section, services shall be treated as imported if they are treated as imported under section 267 (general rules on import of services) or section 270 (related to insurance).

"(d) SPECIAL RULE FOR INSURANCE.—The seller of insurance that is treated as imported under section 270 shall be liable for the collection of the tax imposed by subsection (a) on the insurance and for paying such tax to the Secretary. The first sentence of subsection (b) (relating to the person liable for the tax) shall apply to insurance only to the extent that the seller of the insurance services does not collect such tax.

"SEC. 288. GENERAL RULES FOR THE IMPORT TAX.

"(a) IMPORT TAX.—'Import tax' means the tax imposed by section 286 on the import of property and the tax imposed by section 287 on the import of services.

"(b) NO PAYROLL TAX CREDIT.—The payroll tax credit shall not be allowed against the import tax.

"Subchapter N—Transition Rules

"Sec. 290. Amortization of transition basis.
"Sec. 291. Sales of transition basis property.
"Sec. 292. Safe harbor leases.
"Sec. 293. Carryovers.
"Sec. 294. Section 481 adjustments.

"SEC. 290. AMORTIZATION OF TRANSITION BASIS.

"(a) TRANSITION BASIS DEDUCTION.—The 'transition basis deduction' for a taxable year is the sum of the amortization allowance determined under this section for the taxable year.

"(b) AMORTIZATION RULES.—The amortization allowance for each category of amortizable basis shall be determined by amortizing the amortizable basis of such category ratably over the amortization period for the category beginning January 1, 1999.

"(c) AMORTIZATION PERIOD.—The amortization periods shall be determined in accordance with the following table:

In the case of:	The amortization period is:
Category I basis	15 years
Category II basis	30 years
Category III basis	40 years
Unrecovered inventory costs	5 years

"(d) CATEGORIES.—

"(1) CATEGORY I BASIS.—'Category I basis' is the sum of the unrecovered bases as of January 1, 1999, of all depreciable property placed in service prior to January 1, 1999, and the unamortized portion of amortizable costs incurred before January 1, 1999, if—

"(A) cost recovery or amortization began before January 1, 1999, and

"(B) the remaining recovery period or amortization period as of January 1, 1999, is less than 15 years.

"(2) CATEGORY II BASIS.—'Category II basis' is the sum of the unrecovered bases as of January 1, 1999, of all depreciable property placed in service prior to January 1, 1999, and the unamortized portion of amortizable costs incurred before January 1, 1999, if—

"(A) cost recovery or amortization began before January 1, 1999, and

"(B) the remaining recovery period or amortization period as of January 1, 1999, is than 15 years or more.

"(3) CATEGORY III BASIS.—'Category III basis' is the sum of the adjusted basis of each asset satisfying the following requirements:

"(A) The asset was placed in service prior to January 1, 1999,

"(B) The asset was used in a business activity in 1999,

"(C) The cost of the asset was capitalized and not depreciable or otherwise recoverable under the Internal Revenue Code of 1986, and

"(D) The cost of the asset would have constituted deductible expenses under the business tax if such cost had been incurred after 1998.

"(4) UNRECOVERED INVENTORY COSTS.—'Unrecovered inventory costs' means the cost of goods sold (as determined under the Internal Revenue Code of 1986) if a business entity sold all of its inventory (including inventory being produced) on the effective date of the business tax.

"(e) RULES OF APPLICATION.—

"(1) REMAINING RECOVERY PERIOD.—

"(A) TIME OF MEASURE.—The remaining recovery period shall be determined as of December 31, 1998, and shall include each taxable year ending after such date in which a deduc-

tion would have been allowed under the Internal Revenue Code of 1986.

"(B) ACCOUNTING METHOD.—The remaining recovery period shall be determined using the cost recovery method and rules applicable for determining taxable income under the Internal Revenue Code of 1986.

"(2) DEPLETABLE ASSETS.—Under rules prescribed by the Secretary, this section shall apply to the remaining cost basis of depletable property and to other property for which a cost recovery method other than one based on time is used.

"SEC. 291. SALES OF TRANSITION BASIS PROPERTY.

"(a) IN GENERAL.—Except as provided in subsection (b), for purposes of determining the tax consequences of a sale, retirement, casualty or conversion to personal use of an asset whose basis or cost is taken into account under section 90, the amount to be amortized shall be treated as fully deducted upon the adoption of the business tax.

"(b) SUBSTANTIAL SALES.—

"(1) IN GENERAL.—In the case of a substantial sale of assets to which the amortization rules of section 90 apply, the purchaser and seller may jointly elect to have the purchaser assume the amortization

deductions attributable to such assets, in which case—

"(A) the seller's taxable receipts from such sale shall be reduced by the amount of unamortized basis or cost assumed by the purchaser,

"(B) the purchaser may treat as a cost of a business purchase only the portion of the purchase price in excess of the amount of unamortized basis or cost assumed,

"(C) the unamortized basis or cost assumed shall continue to be amortized in the manner amortized by the seller.

"(2) SUBSTANTIAL SALE.—A sale of assets by a business entity to another business entity is a substantial sale if—

"(A) more than 20 percent (in fair market value or in original cost) of the assets of the seller are sold,

"(B) the total consideration for the sale exceeds $1 million or 20 percent of the taxable receipts of the seller for the taxable year preceding the year of the sale, or

"(C) the sale satisfies other criteria established by the Secretary to prevent distortions in gross profits resulting from asset sales.

"SEC. 292. SAFE HARBOR LEASES.

"(a) IN GENERAL.—In the case of a safe harbor lease, rental payments deemed to occur under the lease and interest payments deemed to be made under the leases shall constitute costs of business purchases, and rental income and interest income deemed to be earned under the lease shall constitute taxable receipts. The transition basis deduction rules shall apply to the lessor's adjusted basis in assets subject to a safe harbor lease.

"(b) SAFE HARBOR LEASE.—'Safe harbor lease' means a sale and leaseback transaction entered into pursuant to section 168(f)(8) of the Internal Revenue Code, as added by the Economic Recovery Tax Act of 1981, when such provision was in effect but only if such transaction would not be treated as a sale and leaseback for tax purposes but for that provision.

"SEC. 293. CARRYOVERS.

"(a) NO LOSS CARRYOVERS.—No deduction shall be allowed under the business tax for net operating loss carryovers, capital loss carryovers, or any other loss carryovers from the income tax under the Internal Revenue Code of 1986.

"(b) NO CREDIT CARRYOVERS.—No credits shall be allowed under the business tax for business credit carryovers, minimum tax credit carryovers, or any other credit carryovers from the income tax under the Internal Revenue Code of 1986.

"SEC. 294. SECTION 481 ADJUSTMENTS.

"(a) POSITIVE NET SECTION 481 ADJUSTMENT AMOUNT.—If, as of January 1, 1999, a business entity has a positive net section 481 adjustment amount, the amount shall be applied to reduce the transition basis in accounts (for purposes of section 290) in the following order:

"(1) First, to reduce the category I basis (but not below zero),

"(2) Second, to reduce the category II basis (but not below zero),

"(3) Third, to reduce the unrecovered inventory costs.

"(b) NEGATIVE NET SECTION 481 ADJUSTMENT AMOUNT.—If, as of January 1, 1999, a business entity has a negative net section 481 adjustment amount, the amount shall be applied to increase category I basis for purposes of section 290.

"(c) SECTION 481 ADJUSTMENT.—A business entity's net section 481 adjustment is determined by subtracting—

"(1) the sum of all additional deductions to which a business entity would be entitled by reason of section 481 of the Internal Revenue Code of 1986 for periods beginning on or after the effective date of the business tax with respect to changes in accounting methods made before such effective date, from

"(2) the sum of all additional income which a business entity would recognize by reason of section 481 of the Internal Revenue Code of 1986 for periods beginning on or after the effective date of the business tax with respect to changes in accounting methods made before such effective date,

in each case assuming that the income tax under the Internal Revenue Code of 1986 remained in effect.

"Subchapter O—Rules for Administration, Consolidated Returns

"Sec. 301. Returns, due dates, etc.
"Sec. 302. Consolidated returns.

"SEC. 301. RETURNS, DUE DATES, ETC.

"(a) IN GENERAL.—Until subtitle F is amended to reflect the adoption of this chapter, the rules of subtitle

F relating to C corporations shall apply to business entities with respect to—

"(1) returns and records;

"(2) time and place for paying tax;

"(3) assessment of taxes;

"(4) collections and liens;

"(5) abatements, credits, and refunds;

"(6) interest on underpayments and overpayments;

"(7) additions to tax and penalties;

"(8) closing agreements and compromises;

"(9) crimes;

"(10) judicial proceedings;

"(11) discovery of liability and enforcement; and

"(12) estimated taxes.

"(b) INDIVIDUALS ENGAGING IN BUSINESS ACTIVITIES.—Under rules prescribed by the Secretary, individuals engaging in business activities on their own or with their spouses shall be permitted to file their business tax returns with their individual tax returns and shall be subject to estimated tax rules for individual income tax returns.

"SEC. 302. CONSOLIDATED RETURNS.

"(a) IN GENERAL.—Business entities may file consolidated returns of business tax if they would have been permitted to file consolidated returns under section 1501 of the Internal Revenue Code and such section were applied by treating each business entity as a corporation and its owners or partners as shareholders.

"(b) FINANCIAL INSTITUTIONS.—Financial intermediation businesses may be included in consolidated returns, but each financial intermediation business must compute its gross profits separately.

"(c) INTERCOMPANY TRANSACTIONS.—In computing the gross profits of a consolidated group, intercompany transactions can be taken into account, or at the election of the filer, be disregarded (except in the case of transactions with financial intermediation businesses).

"Subchapter P—Definitions and Rules of Application

"Sec. 310. Definitions.
"Sec. 311. Rules of application.

"SEC. 310. DEFINITIONS.

"(a) IN GENERAL.—When used in this chapter, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

"(1) USA INCOME TAX.—'USA Income Tax' and 'Simplified USA Tax' for individuals mean the tax imposed by chapter 1.

"(2) INTERNAL REVENUE CODE OF 1986.—'Internal Revenue Code of 1986' means the Internal Revenue Code of 1986 as in effect immediately before the enactment of the Simplified USA Tax.

"(3) UNITED STATES.—'United States' means the States and the District of Columbia.

"(b) TERMS DEFINED IN CHAPTER 2.—If a term that is used but not defined in this chapter or in section 7701 is defined in chapter 1, the definition in chapter 1 shall apply except if manifestly incompatible with the intent of the provision in which the term is used.

"SEC. 311. RULES OF APPLICATION.

"(a) DEFINITIONS.—Any definition included in this chapter shall apply for all purposes of this chapter unless—

"(1) such definition is limited to the purposes of a particular chapter, section, or subsection, or

"(2) the definition clearly would not be applicable in a particular context.

"(b) INTERPRETATIONS CONSIST WITH INTERNAL REVENUE CODE OF 1986.—Terms not defined in this chapter or elsewhere in this title, but defined in the Inter-

nal Revenue Code of 1986, shall be interpreted in a manner consistent with the Internal Revenue Code of 1986, except to the extent such interpretation would be inconsistent with the principles and purposes of this chapter.''

(b) The amendments made by this section shall be effective on January 1, 1999, except to the extent otherwise specifically provided in the text of such amendments.

SEC. 302. REPEAL OF CHAPTER 6.

Chapter 6 of the Code (relating to consolidated returns) is repealed as of January 1, 1999.

TITLE IV—DEFERRED COMPENSATION PLANS

SEC. 401. PROVISIONS SAVED.

(a) IN GENERAL.—Excepts as otherwise provided in this title, the sections contained in subchapter D of chapter 1 of the Code (relating to deferred compensation, etc.) are hereby saved as chapter 3.

(b) LIMITATIONS ON CHAPTER 3.—The following new section is inserted before section 401 of the Code (as saved by subsection (a)):

''SEC. 400. EFFECT OF CHAPTER 3.

''(a) IN GENERAL.—The provisions of chapter 3 (sections 401 through 420) are included in this subtitle for purposes of cross-reference and for purposes of determining whether plans are exempt from the business tax and

whether contributions to plans are deductible or excludable from gross income under chapter 1.

"(b) EFFECT ON BUSINESS TAX DEDUCTIONS.—Notwithstanding any provision to the contrary in this chapter, no provision of this chapter shall cause any amount to be treated as a cost of business purchase or to otherwise be deducted from gross receipts for purposes of computing the Simplified USA for Tax Businesses under chapter 2.

"(c) NO CREDITS.—Notwithstanding any provision to the contrary in this chapter, no provision of this chapter shall result in a tax credit against any tax imposed by chapter 1 or chapter 2.

"(d) EFFECT OF FAILURE TO COMPLY WITH PROVISIONS.—A failure to comply with applicable provisions in this chapter could cause a plan to lose its exemption from the business tax and, thereby subject certain business activities of the plan to the business tax and/or result in the constructive distribution of plan assets to plan participants."

(c) SECTION 408A SUSPERSEDED BY SECTION 30.—Section 408A is repealed.

SEC. 402. CLERICAL AMENDMENTS.

(a) TABLE OF SECTIONS.—The table of sections for subpart A of part 1 of chapter 3 of the USA Tax Code

(formerly subchapter D of chapter 1 of the Code) is amended by inserting at the beginning of the table:

"CHAPTER 3—DEFERRED COMPENSATION, ETC."

(b) RENUMBERING OF CHAPTERS.—

(1) RENUMBER CHAPTERS.—Chapters 2 and 3 of the Code are renumbered 4 and 5 respectively. Such renumbering shall be reflected in all tables and headings in the Code.

(2) CROSS REFERENCES.—Any cross reference to chapter 2 or 3 of the Code contained in any provision of the Code that is not amended by this Act or in any other statute shall be treated as a reference to such chapter as renumbered by paragraph 1.

TITLE V—REPEAL OF ESTATE AND GIFT TAXES

SEC. 501. REPEAL OF GRATUITOUS TRANSFER TAXES.

Subtitle B of the Code (relating to estate and gift taxes) is repealed.

SEC 502. EFFECTIVE DATE.

Section 501 shall apply to—

(1) gifts made after December 31, 1998;

(2) the estates of decedents dying after December 31, 1998, and

(3) generating skipping transfers (within the meaning of subchapter B of chapter 13 as in effect before its repeal by this Act) occurring after December 31, 1998.

TITLE VI—TECHNICAL AND ADMINISTRATIVE CHANGES: EFFECTIVE DATES

SEC. 601. USA TAX CODE.

(a) REDESIGNATION OF THE CODE.—The Internal Revenue Title enacted August 16, 1954, and as heretofore and hereby amended may be cited as the ''USA Tax Code''. The USA Tax Code, as hereinafter amended, may be cited as the ''USA Tax Code, as amended''.

(b) REFERENCES IN LAWS, ETC.—Except where inappropriate, any reference in any law, Executive order, or other document—

(1) to the Internal Revenue Code of 1954 or the Internal Revenue Code of 1986 shall include a reference to the USA Tax Code or the USA Tax Code, as amended,

(2) to the USA Tax Code or the USA Tax Code, as amended, shall include a reference, with respect to periods before January 1, 1999, to the Internal Revenue Code of 1954 or the Internal Revenue Code of 1986.

SEC. 602. REVISIONS TO THE CODE.

Not later than January 1, 2000, the Secretary shall submit to Congress proposed changes in the USA Tax Code that—

(1) eliminate cross-references to the Internal Revenue Code of 1986 (except with respect to transition issues) and insert provisions similar to the cross-referenced sections of the Internal Revenue Code of 1986,

(2) revise subtitles C through J of the USA Tax Code to fully reflect the amendments to subtitle A of the Code made by this Act and the repeal of subtitle B,

(3) include statutory definitions or rules in cases where the Secretary concludes that the definitions or rules cannot or should not be addressed by regulation,

(4) revise chapter 4 of the USA Tax Code (as renumbered by section 402 of this Act) (relating to the self-employment tax) to conform to changes made by this Act, and

(5) revise chapter 5 of the USA Tax Code (as renumbered by section 402 of this Act) (relating to withholding on nonresident aliens and foreign corporations) to reflect changes made in this Act.

SEC. 603. APPLICATION OF SUBTITLE F.

Until such time as subtitle F of the Code is amended to reflect the amendments made by this Act, the provisions of subtitle F shall be treated as generally applying to the Simplified USA Tax—

(1) without regard to specific cross references,

(2) without regard to provisions relating to partnerships, and

(3) as if the business tax under chapter 2 were the corporate income tax and all business entities were corporations (except for purposes of collection, in which case the owners of noncorporate entities shall be obligated for taxes owned by the entities to the same extent as they would if the entity owed the tax prior to the amendment of the Code).

SEC. 604. CLERICAL AMENDMENT.

The portion of the table at the beginning of the Code listing subtitles and chapters of subtitle A is amended to read as follows:

"Subtitle A. Simplified USA Tax.
"Subtitle B. [deleted].
"Subtitle C. Employment taxes.
"Subtitle D. Miscellaneous excise taxes.
"Subtitle E. Alcohol, tobacco and certain other excise taxes.
"Subtitle F. Procedure and administration.
"Subtitle G. The Joint Committee on Taxation.
"Subtitle H. Financing of presidential election campaigns.
"Subtitle I. Trust Fund Code.
"Subtitle K. Group health plan requirements.

"Subtitle A—Simplified USA Tax

"Chapter 1. Simplified USA Tax for individuals.
"Chapter 2. Simplified USA Tax for businesses.

"Chapter 3. Deferred compensation plans.
"Chapter 4. Tax on self-employment income.
"Chapter 5. Withholding of tax on nonresident aliens and foreign corporations."

SEC. 605. EFFECTIVE DATES.

(a) IN GENERAL.—Except as otherwise provided in this Act, the amendments made by this Act shall be effective on January 1, 1999, with respect to tax years beginning or such date.

(b) SPECIAL RULES FOR BUSINESSES WITH 52–53 WEEK YEAR.—If a business uses a 52–53 week taxable year the amendments made by this Act shall apply to the business with respect to its tax year beginning in the last week in December except with respect to any transactions occurring during 1998 that were structured to take advantage of the application of this Act to such business at a time when this Act did not apply to other businesses or to individuals.

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