106TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
106–238

FINANCIAL FREEDOM ACT OF 1999

REPORT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

TO ACCOMPANY

H.R. 2488

A BILL TO PROVIDE FOR RECONCILIATION PURSUANT TO SECTIONS 105 AND 211 OF THE CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 2000

together with

DISSENTING VIEWS

JULY 16, 1999.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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FINANCIAL FREEDOM ACT OF 1999

JULY 16, 1999.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ARCHER, from the Committee on Ways and Means, submitted the following

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 2488]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 2488) to amend the Internal Revenue Code of 1986 to reduce individual income tax rates, to provide marriage penalty relief, to reduce taxes on savings and investments, to provide estate and gift tax relief, to provide incentives for education savings and health care, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Financial Freedom Act of 1999".

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

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

(d) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Subtitle B—Marriage Penalty Tax Relief

TITLE I—BROAD-BASED TAX RELIEF

Subtitle A—10-Percent Reduction in Individual Income Tax Rates

SEC. 101. 10-PERCENT REDUCTION IN INDIVIDUAL INCOME TAX RATES.

(a) REGULAR INCOME TAX RATES.—

(1) IN GENERAL.—Subsection (f) of section 1 is amended by adding at the end the following new paragraph:

"(8) RATE REDUCTIONS.—In prescribing the tables under paragraph (1) which apply with respect to taxable years beginning in a calendar year after 2000, each rate in such tables (without regard to this paragraph) shall be reduced by the number of percentage points (rounded to the next lowest tenth) equal to the applicable percentage (determined in accordance with the following table) of such rate:

“For taxable years beginning in calendar year—	The applicable percentage is—
2001 through 2004	2.5
2005 through 2007	5.0
2008	7.5
2009 and thereafter	10.0.”

(2) TECHNICAL AMENDMENTS.—

(A) Subparagraph (B) of section 1(f)(2) is amended by inserting “except as provided in paragraph (8),” before “by not changing”.

(B) Subparagraph (C) of section 1(f)(2) is amended by inserting “and the reductions under paragraph (8) in the rates of tax” before the period.

(C) The heading for subsection (f) of section 1 is amended by inserting “RATE REDUCTIONS;” before “ADJUSTMENTS”.

(D) Section 1(g)(7)(B)(ii)(II) is amended by striking “15 percent” and inserting “the percentage applicable to the lowest income bracket in subsection (c)”.

(E) Subparagraphs (A)(ii)(I) and (B)(i) of section 1(h)(1) are each amended by striking “28 percent” and inserting “25.2 percent”.

(F) Section 531 is amended by striking “39.6 percent of the accumulated taxable income” and inserting “the product of the accumulated taxable income and the percentage applicable to the highest income bracket in section 1(c)”.

(G) Section 541 is amended by striking “39.6 percent of the undistributed personal holding company income” and inserting “the product of the undistributed personal holding company income and the percentage applicable to the highest income bracket in section 1(c)”.

(H) Section 3402(p)(1)(B) is amended by striking “specified is 7, 15, 28, or 31 percent” and all that follows and inserting “specified is—

“(i) 7 percent,

“(ii) a percentage applicable to 1 of the 3 lowest income brackets in section 1(c), or

“(iii) such other percentage as is permitted under regulations prescribed by the Secretary.”

(I) Section 3402(p)(2) is amended by striking “15 percent of such payment” and inserting “the product of such payment and the percentage applicable to the lowest income bracket in section 1(c)”.

(J) Section 3402(q)(1) is amended by striking “28 percent of such payment” and inserting “the product of such payment and the percentage applicable to the next to the lowest income bracket in section 1(c)”.

(K) Section 3402(r)(3) is amended by striking “31 percent” and inserting “the rate applicable to the third income bracket in such section”.

(L) Section 3406(a)(1) is amended by striking “31 percent of such payment” and inserting “the product of such payment and the percentage applicable to the third income bracket in section 1(c)”.

(b) MINIMUM TAX RATES.—Subparagraph (A) of section 55(b)(1) is amended by adding at the end the following new clause:

“(iv) RATE REDUCTION.—In the case of taxable years beginning after 2000, each rate in clause (i) (without regard to this clause) shall be reduced by the number of percentage points (rounded to the next lowest tenth) equal to the applicable percentage (determined in accordance with section 1(f)(8)) of such rate.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

Subtitle B—Marriage Penalty Tax Relief

SEC. 111. ELIMINATION OF MARRIAGE PENALTY IN STANDARD DEDUCTION.

(a) IN GENERAL.—Paragraph (2) of section 63(c) (relating to standard deduction) is amended—

(1) by striking “$5,000” in subparagraph (A) and inserting “twice the dollar amount in effect under subparagraph (C) for the taxable year”,

(2) by adding “or” at the end of subparagraph (B),

(3) by striking “in the case of” and all that follows in subparagraph (C) and inserting “in any other case.”, and

(4) by striking subparagraph (D).

(b) PHASE-IN.—Subsection (c) of section 63 is amended by adding at the end the following new paragraph:

"(7) PHASE-IN OF INCREASE IN BASIC STANDARD DEDUCTION.—In the case of taxable years beginning before January 1, 2003—

"(A) paragraph (2)(A) shall be applied by substituting for 'twice'—

"(i) '1.778 times' in the case of taxable years beginning during 2001, and

"(ii) '1.889 times' in the case of taxable years beginning during 2002, and

"(B) the basic standard deduction for a married individual filing a separate return shall be one-half of the amount applicable under paragraph (2)(A).

If any amount determined under subparagraph (A) is not a multiple of $50, such amount shall be rounded to the next lowest multiple of $50.".

(c) TECHNICAL AMENDMENTS.—

(1) Subparagraph (B) of section 1(f)(6) is amended by striking "(other than with" and all that follows through "shall be applied" and inserting "(other than with respect to sections 63(c)(4) and 151(d)(4)(A)) shall be applied".

(2) Paragraph (4) of section 63(c) is amended by adding at the end the following flush sentence:

"The preceding sentence shall not apply to the amount referred to in paragraph (2)(A).".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 112. ELIMINATION OF MARRIAGE PENALTY IN DEDUCTION FOR INTEREST ON EDUCATION LOANS.

(a) IN GENERAL.—Subparagraph (B) of section 221(b)(2) (relating to limitation based on modified adjusted gross income) is amended—

(1) by striking "$60,000" in clause (i)(II) and inserting "twice such amount", and

(2) by inserting "($30,000 in the case of a joint return)" after "$15,000" in clause (ii).

(b) CONFORMING AMENDMENT.—Paragraph (1) of section 221(g) is amended by striking "and $60,000 amounts in subsection (b)(2) shall each" and inserting "amount in subsection (b)(2) shall".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 113. ROLLOVER FROM REGULAR IRA TO ROTH IRA.

(a) IN GENERAL.—Clause (i) of section 408A(c)(3)(B) is amended by inserting "($160,000 in the case of a joint return)" after "$100,000".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

Subtitle C—Repeal of Alternative Minimum Tax on Individuals

SEC. 121. REPEAL OF ALTERNATIVE MINIMUM TAX ON INDIVIDUALS.

(a) IN GENERAL.—Subsection (a) of section 55 is amended by adding at the end the following new flush sentence:

"For purposes of this title, the tentative minimum tax on any taxpayer other than a corporation for any taxable year beginning after December 31, 2007, shall be zero."

(b) REDUCTION OF TAX ON INDIVIDUALS PRIOR TO REPEAL.—Section 55 is amended by adding at the end the following new subsection:

"(f) PHASEOUT OF TAX ON INDIVIDUALS.—

"(1) IN GENERAL.—The tax imposed by this section on a taxpayer other than a corporation for any taxable year beginning after December 31, 2002, and before January 1, 2008, shall be the applicable percentage of the tax which would be imposed but for this subsection.

"(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	The applicable percentage is—
2003	80
2004	70
2005	60
2006 or 2007	50."

(c) NONREFUNDABLE PERSONAL CREDITS FULLY ALLOWED AGAINST REGULAR TAX LIABILITY.—

(1) IN GENERAL.—Subsection (a) of section 26 (relating to limitation based on amount of tax) is amended to read as follows:

"(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the taxpayer's regular tax liability for the taxable year."

(2) CHILD CREDIT.—Subsection (d) of section 24 is amended by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(d) LIMITATION ON USE OF CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.—Subsection (c) of section 53 is amended to read as follows:

"(c) LIMITATION.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the credit allowable under subsection (a) for any taxable year shall not exceed the excess (if any) of—

"(A) the regular tax liability of the taxpayer for such taxable year reduced by the sum of the credits allowable under subparts A, B, D, E, and F of this part, over

"(B) the tentative minimum tax for the taxable year.

"(2) TAXABLE YEARS BEGINNING AFTER 2007.—In the case of any taxable year beginning after 2007, the credit allowable under subsection (a) to a taxpayer other than a corporation for any taxable year shall not exceed 90 percent of the excess (if any) of—

"(A) regular tax liability of the taxpayer for such taxable year, over

"(B) the sum of the credits allowable under subparts A, B, D, E, and F of this part."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1998.

TITLE II—RELIEF FROM TAXATION ON SAVINGS AND INVESTMENTS

SEC. 201. EXEMPTION OF CERTAIN INTEREST AND DIVIDEND INCOME FROM TAX.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 (relating to amounts specifically excluded from gross income) is amended by inserting after section 115 the following new section:

"SEC. 116. PARTIAL EXCLUSION OF DIVIDENDS AND INTEREST RECEIVED BY INDIVIDUALS.

"(a) EXCLUSION FROM GROSS INCOME.—Gross income does not include dividends and interest otherwise includible in gross income which are received during the taxable year by an individual.

"(b) LIMITATIONS.—

"(1) MAXIMUM AMOUNT.—The aggregate amount excluded under subsection (a) for any taxable year shall not exceed—

"(A) in the case of any taxable year beginning in 2001 or 2002, $100 ($200 in the case of a joint return), and

"(B) in the case of any taxable year beginning after 2002, $200 ($400 in the case of a joint return).

"(2) CERTAIN DIVIDENDS EXCLUDED.—Subsection (a) shall not apply to any dividend from a corporation which for the taxable year of the corporation in which the distribution is made is a corporation exempt from tax under section 521 (relating to farmers' cooperative associations).

"(c) SPECIAL RULES.—For purposes of this section—

"(1) EXCLUSION NOT TO APPLY TO CAPITAL GAIN DIVIDENDS FROM REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

"For treatment of capital gain dividends, see sections 854(a) and 857(c).

"(2) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—In the case of a nonresident alien individual, subsection (a) shall apply only in determining the taxes imposed for the taxable year pursuant to sections 871(b)(1) and 877(b).

"(3) DIVIDENDS FROM EMPLOYEE STOCK OWNERSHIP PLANS.—Subsection (a) shall not apply to any dividend described in section 404(k).".

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (C) of section 32(c)(5) is amended by striking "or" at the end of clause (i), by striking the period at the end of clause (ii) and inserting "; or", and by inserting after clause (ii) the following new clause:

“(iii) interest and dividends received during the taxable year which are excluded from gross income under section 116.”.

(2) Subparagraph (A) of section 32(i)(2) is amended by inserting “(determined without regard to section 116)” before the comma.

(3) Subparagraph (B) of section 86(b)(2) is amended to read as follows:

“(B) increased by the sum of—

“(i) the amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax, and

“(ii) the amount of interest and dividends received during the taxable year which are excluded from gross income under section 116.”.

(4) Subsection (d) of section 135 is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

“(4) COORDINATION WITH SECTION 116.—This section shall be applied before section 116.”.

(5) Paragraph (2) of section 265(a) is amended by inserting before the period “, or to purchase or carry obligations or shares, or to make deposits, to the extent the interest thereon is excludable from gross income under section 116”.

(6) Subsection (c) of section 584 is amended by adding at the end the following new flush sentence:

“The proportionate share of each participant in the amount of dividends or interest received by the common trust fund and to which section 116 applies shall be considered for purposes of such section as having been received by such participant.”.

(7) Subsection (a) of section 643 is amended by redesignating paragraph (7) as paragraph (8) and by inserting after paragraph (6) the following new paragraph:

“(7) DIVIDENDS OR INTEREST.—There shall be included the amount of any dividends or interest excluded from gross income pursuant to section 116.”.

(8) Section 854(a) is amended by inserting “section 116 (relating to partial exclusion of dividends and interest received by individuals) and” after “For purposes of”.

(9) Section 857(c) is amended to read as follows:

“(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—

“(1) TREATMENT FOR SECTION 116.—For purposes of section 116 (relating to partial exclusion of dividends and interest received by individuals), a capital gain dividend (as defined in subsection (b)(3)(C)) received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

“(2) TREATMENT FOR SECTION 243.—For purposes of section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.”.

(10) The table of sections for part III of subchapter B of chapter 1 is amended by inserting after the item relating to section 115 the following new item:

“Sec. 116. Partial exclusion of dividends and interest received by individuals.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 202. REDUCTION IN INDIVIDUAL CAPITAL GAIN TAX RATES.

(a) IN GENERAL.—

(1) Sections 1(h)(1)(B) and 55(b)(3)(B) are each amended by striking “10 percent” and inserting “7.5 percent”.

(2) The following sections are each amended by striking “20 percent” and inserting “15 percent”:

(A) Section 1(h)(1)(C).

(B) Section 55(b)(3)(C).

(C) Section 1445(e)(1).

(D) The second sentence of section 7518(g)(6)(A).

(E) The second sentence of section 607(h)(6)(A) of the Merchant Marine Act, 1936.

(3) Sections 1(h)(1)(D) and 55(b)(3)(D) are each amended by striking “25 percent” and inserting “20 percent”.

(b) CONFORMING AMENDMENTS.—

(1) Section 311 of the Taxpayer Relief Act of 1997 is amended by striking subsection (e).

(2) Section 1(h) is amended—

(A) by striking paragraphs (2), (9), and (13),

(B) by redesignating paragraphs (3) through (8) as paragraphs (2) through (7), respectively, and

(C) by redesignating paragraphs (10), (11), and (12) as paragraphs (8), (9), and (10), respectively.

(3) Paragraph (3) of section 55(b) is amended by striking "In the case of taxable years beginning after December 31, 2000, rules similar to the rules of section 1(h)(2) shall apply for purposes of subparagraphs (B) and (C).".

(4) Paragraph (7) of section 57(a) is amended—

(A) by striking "42 percent" and inserting "6 percent", and

(B) by striking the last sentence.

(c) TRANSITIONAL RULES FOR TAXABLE YEARS WHICH INCLUDE JULY 1, 1999.—For purposes of applying section 1(h) of the Internal Revenue Code of 1986 in the case of a taxable year which includes July 1, 1999—

(1) The amount of tax determined under subparagraph (B) of section 1(h)(1) of such Code shall be the sum of—

(A) 7.5 percent of the lesser of—

(i) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year on or after such date (determined without regard to collectibles gain or loss, gain described in section (1)(h)(6)(A)(i) of such Code, and section 1202 gain), or

(ii) the amount on which a tax is determined under such subparagraph (without regard to this subsection), plus

(B) 10 percent of the excess (if any) of—

(i) the amount on which a tax is determined under such subparagraph (without regard to this subsection), over

(ii) the amount on which a tax is determined under subparagraph (A).

(2) The amount of tax determined under subparagraph (C) of section (1)(h)(1) of such Code shall be the sum of—

(A) 15 percent of the lesser of—

(i) the excess (if any) of the amount of net capital gain determined under subparagraph (A)(i) of paragraph (1) of this subsection over the amount on which a tax is determined under subparagraph (A) of paragraph (1) of this subsection, or

(ii) the amount on which a tax is determined under such subparagraph (C) (without regard to this subsection), plus

(B) 20 percent of the excess (if any) of—

(i) the amount on which a tax is determined under such subparagraph (C) (without regard to this subsection), over

(ii) the amount on which a tax is determined under subparagraph (A) of this paragraph.

(3) The amount of tax determined under subparagraph (D) of section (1)(h)(1) of such Code shall be the sum of—

(A) 20 percent of the lesser of—

(i) the amount which would be determined under section 1(h)(6)(A)(i) of such Code taking into account only gain properly taken into account for the portion of the taxable year on or after such date, or

(ii) the amount on which a tax is determined under such subparagraph (D) (without regard to this subsection), plus

(B) 25 percent of the excess (if any) of—

(i) the amount on which a tax is determined under such subparagraph (D) (without regard to this subsection), over

(ii) the amount on which a tax is determined under subparagraph (A) of this paragraph.

(4) For purposes of applying section 55(b)(3) of such Code, rules similar to the rules of paragraphs (1), (2), and (3) of this subsection shall apply.

(5) In applying this subsection with respect to any pass-thru entity, the determination of when gains and loss are properly taken into account shall be made at the entity level.

(6) Terms used in this subsection which are also used in section 1(h) of such Code shall have the respective meanings that such terms have in such section.

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided by this subsection, the amendments made by this section shall apply to taxable years ending after June 30, 1999.

(2) WITHHOLDING.—The amendment made by subsection (a)(2)(C) shall apply to amounts paid after the date of the enactment of this Act.

(3) SMALL BUSINESS STOCK.—The amendments made by subsection (b)(4) shall apply to dispositions on or after July 1, 1999.

SEC. 203. CAPITAL GAINS TAX RATES APPLIED TO CAPITAL GAINS OF DESIGNATED SETTLEMENT FUNDS.

(a) IN GENERAL.—Paragraph (1) of section 468B(b) (relating to taxation of designated settlement funds) is amended by inserting "(subject to section 1(h))" after "maximum rate".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 204. SPECIAL RULE FOR MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE, AND OTHER EMPLOYEES, IN DETERMINING EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

(a) IN GENERAL.—Subsection (d) of section 121 (relating to exclusion of gain from sale of principal residence) is amended by adding at the end the following new paragraphs:

"(9) MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE.—

"(A) IN GENERAL.—The running of the 5-year period described in subsection (a) shall be suspended with respect to an individual during any time that such individual or such individual's spouse is serving on qualified official extended duty as a member of the uniformed services or of the Foreign Service.

"(B) QUALIFIED OFFICIAL EXTENDED DUTY.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'qualified official extended duty' means any period of extended duty as a member of the uniformed services or a member of the Foreign Service during which the member serves at a duty station which is at least 50 miles from such property or is under Government orders to reside in Government quarters.

"(ii) UNIFORMED SERVICES.—The term 'uniformed services' has the meaning given such term by section 101(a)(5) of title 10, United States Code, as in effect on the date of the enactment of the Financial Freedom Act of 1999.

"(iii) FOREIGN SERVICE OF THE UNITED STATES.—The term 'member of the Foreign Service' has the meaning given the term 'member of the Service' by paragraph (1), (2), (3), (4), or (5) of section 103 of the Foreign Service Act of 1980, as in effect on the date of the enactment of the Financial Freedom Act of 1999.

"(iv) EXTENDED DUTY.—The term 'extended duty' means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

"(10) OTHER EMPLOYEES.—

"(A) IN GENERAL.—The running of the 5-year period described in subsection (a) shall be suspended with respect to an individual during any time that such individual or such individual's spouse is serving as an employee for a period in excess of 90 days in an assignment by the such employee's employer outside the United States.

"(B) LIMITATIONS AND SPECIAL RULES.—

"(i) MAXIMUM PERIOD OF SUSPENSION.—The suspension under subparagraph (A) with respect to a principal residence shall not exceed (in the aggregate) 5 years.

"(ii) MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE.—Subparagraph (A) shall not apply to an individual to whom paragraph (9) applies.

"(iii) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AN EMPLOYEE.—For purposes of this paragraph, the term 'employee' does not include an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to sales and exchanges after the date of the enactment of this Act.

SEC. 205. TREATMENT OF CERTAIN DEALER DERIVATIVE FINANCIAL INSTRUMENTS, HEDGING TRANSACTIONS, AND SUPPLIES AS ORDINARY ASSETS.

(a) IN GENERAL.—Section 1221 (defining capital assets) is amended—

(1) by striking "For purposes" and inserting the following:

"(a) IN GENERAL.—For purposes",

(2) by striking the period at the end of paragraph (5) and inserting a semicolon, and

(3) by adding at the end the following:

"(6) any commodities derivative financial instrument held by a commodities derivatives dealer, unless—

"(A) it is established to the satisfaction of the Secretary that such instrument has no connection to the activities of such dealer as a dealer, and

"(B) such instrument is clearly identified in such dealer's records as being described in subparagraph (A) before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe);

"(7) any hedging transaction which is clearly identified as such before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe); or

"(8) supplies of a type regularly used or consumed by the taxpayer in the ordinary course of a trade or business of the taxpayer.

"(b) DEFINITIONS AND SPECIAL RULES.—

"(1) COMMODITIES DERIVATIVE FINANCIAL INSTRUMENTS.—For purposes of subsection (a)(6)—

"(A) COMMODITIES DERIVATIVES DEALER.—The term 'commodities derivatives dealer' means a person which regularly offers to enter into, assume, offset, assign, or terminate positions in commodities derivative financial instruments with customers in the ordinary course of a trade or business.

"(B) COMMODITIES DERIVATIVE FINANCIAL INSTRUMENT.—

"(i) IN GENERAL.—The term 'commodities derivative financial instrument' means any contract or financial instrument with respect to commodities (other than a share of stock in a corporation, a beneficial interest in a partnership or trust, a note, bond, debenture, or other evidence of indebtedness, or a section 1256 contract (as defined in section 1256(b)) the value or settlement price of which is calculated by or determined by reference to a specified index.

"(ii) SPECIFIED INDEX.—The term 'specified index' means any one or more or any combination of—

"(I) a fixed rate, price, or amount, or

"(II) a variable rate, price, or amount,

which is based on any current, objectively determinable financial or economic information with respect to commodities which is not within the control of any of the parties to the contract or instrument and is not unique to any of the parties' circumstances.

"(2) HEDGING TRANSACTION.—

"(A) IN GENERAL.—For purposes of this section, the term 'hedging transaction' means any transaction entered into by the taxpayer in the normal course of the taxpayer's trade or business primarily—

"(i) to manage risk of price changes or currency fluctuations with respect to ordinary property which is held or to be held by the taxpayer, or

"(ii) to manage risk of interest rate or price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, by the taxpayer.

"(B) TREATMENT OF NONIDENTIFICATION OR IMPROPER IDENTIFICATION OF HEDGING TRANSACTIONS.—Notwithstanding subsection (a)(7), the Secretary shall prescribe regulations to properly characterize of any income, gain, expense, or loss arising from a transaction—

"(i) which is a hedging transaction but which was not identified as such in accordance with subsection (a)(7), or

"(ii) which was so identified but is not a hedging transaction.

"(3) REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (6) and (7) of subsection (a) in the case of transactions involving related parties.".

(b) MANAGEMENT OF RISK.—

(1) Section 475(c)(3) is amended by striking "reduces" and inserting "manages".

(2) Section 871(h)(4)(C)(iv) is amended by striking "to reduce" and inserting "to manage".

(3) Clauses (i) and (ii) of section 988(d)(2)(A) are each amended by striking "to reduce" and inserting "to manage".

(4) Paragraph (2) of section 1256(e) is amended to read as follows:

"(2) DEFINITION OF HEDGING TRANSACTION.—For purposes of this subsection, the term 'hedging transaction' means any hedging transaction (as defined in section 1221(b)(2)(A)) if, before the close of the day on which such transaction was entered into (or such earlier time as the Secretary may prescribe by regulations), the taxpayer clearly identifies such transaction as being a hedging transaction."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after the date of enactment of this Act.

SEC. 206. WORTHLESS SECURITIES OF FINANCIAL INSTITUTIONS.

(a) IN GENERAL.—The first sentence following section 165(g)(3)(B) (relating to securities of affiliated corporation) is amended to read as follows: "In computing gross receipts for purposes of the preceding sentence, (i) gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom, and (ii) gross receipts from royalties, rents, dividends, interest, annuities, and gains from sales or exchanges of stocks and securities derived from (or directly related to) the conduct of an active trade or business of an insurance company subject to tax under subchapter L or a qualified financial institution (as defined in subsection (l)(3)) shall be treated as from such sources other than royalties, rents, dividends, interest, annuities, and gains.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to securities which become worthless in taxable years beginning after December 31, 1999.

TITLE III—INCENTIVES FOR BUSINESS INVESTMENT AND JOB CREATION

SEC. 301. REDUCTION IN CORPORATE CAPITAL GAIN TAX RATE.

(a) IN GENERAL.—Section 1201 is amended to read as follows:

"SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.

"(a) GENERAL RULE.—If for any taxable year a corporation has a net capital gain, then, in lieu of the tax imposed by sections 11, 511, or 831(a) or (b), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

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

"(2) the applicable percentage of the net capital gain (or, if less, taxable income).

"(b) APPLICABLE PERCENTAGE.—For purposes of subsection (a), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	The applicable percentage is—
2000	34.1
2001	33.9
2002	32.7
2003	31.7
2004	30.8
2005	29.8
2006	29.2
2007	28.0
2008	27.4
2009	26.2
2010 and thereafter	25.0.

"(c) CROSS REFERENCES.—For computation of the alternative tax—

"(1) in the case of life insurance companies, see section 801(a)(2),

"(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3)(A) and (D), and

"(3) in the case of real estate investment trusts, see section 857(b)(3)(A)."

(b) TECHNICAL AMENDMENTS.—

(1) Paragraphs (1) and (2) of section 1445(e) are each amended by striking "35 percent" and inserting "the applicable percentage determined under section 1201(b) for the calendar year in which the payment is made".

(2)(A) The second sentence of section 7518(g)(6)(A) is amended by striking "34 percent" and inserting "the applicable percentage (within the meaning of section 1201(b))".

(B) The second sentence of section 607(h)(6)(A) of the Merchant Marine Act, 1936, is amended by striking "34 percent" and inserting "the applicable percentage (within the meaning of section 1201(b) of the Internal Revenue Code of 1986)".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1999.

(2) WITHHOLDING.—The amendment made by subsection (b)(1) shall apply to amounts paid after December 31, 1999.

SEC. 302. REPEAL OF ALTERNATIVE MINIMUM TAX ON CORPORATIONS.

(a) IN GENERAL.—The last sentence of section 55(a), as amended by section 121, is amended by striking "on any taxpayer other than a corporation".

(b) REPEAL OF 90 PERCENT LIMITATION ON FOREIGN TAX CREDIT.—

(1) IN GENERAL.—Section 59(a) (relating to alternative minimum tax foreign tax credit) is amended by striking paragraph (2) and by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

(2) CONFORMING AMENDMENT.—Section 53(d)(1)(B)(i)(II) is amended by striking "and if section 59(a)(2) did not apply".

(c) LIMITATION ON USE OF CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.—

(1) IN GENERAL.—Subsection (c) of section 53, as amended by section 121, is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

"(2) CORPORATIONS FOR TAXABLE YEARS BEGINNING AFTER 2002.—In the case of corporation for any taxable year beginning after 2002 and before 2008, the limitation under paragraph (1) shall be increased by the applicable percentage (determined in accordance with the following table) of the tentative minimum tax for the taxable year.

"For taxable years beginning in calendar year—	The applicable percentage is—
2003	20
2004	30
2005	40
2006 or 2007	50.

In no event shall the limitation determined under this paragraph be greater than the sum of the tax imposed by section 55 and the regular tax reduced by the sum of the credits allowed under subparts A, B, D, E, and F of this part."

(2) CONFORMING AMENDMENTS.—

(A) Section 55(e) is amended by striking paragraph (5).

(B) Paragraph (3) of section 53(c), as redesignated by paragraph (1), is amended by striking "to a taxpayer other than a corporation".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amendments made by this section shall apply to taxable years beginning after December 31, 2002.

(2) REPEAL OF 90 PERCENT LIMITATION ON FOREIGN TAX CREDIT.—The amendments made by subsection (b) shall apply to taxable years beginning after December 31, 2001.

(3) SUBSECTION (c)(2)(A).—The amendment made by subsection (c)(2)(A) shall apply to taxable years beginning after December 31, 2007.

TITLE IV—EDUCATION SAVINGS INCENTIVES

SEC. 401. MODIFICATIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

(a) MAXIMUM ANNUAL CONTRIBUTIONS.—

(1) IN GENERAL.—Section 530(b)(1)(A)(iii) (defining education individual retirement account) is amended by striking "$500" and inserting "$2,000".

(2) CONFORMING AMENDMENT.—Section 4973(e)(1)(A) is amended by striking "$500" and inserting "$2,000".

(b) TAX-FREE EXPENDITURES FOR ELEMENTARY AND SECONDARY SCHOOL EXPENSES.—

(1) IN GENERAL.—Section 530(b)(2) (defining qualified higher education expenses) is amended to read as follows:

"(2) QUALIFIED EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified education expenses' means—

"(i) qualified higher education expenses (as defined in section 529(e)(3)), and

"(ii) qualified elementary and secondary education expenses (as defined in paragraph (4)).

"(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include any contribution to a qualified State tuition program (as defined in section 529(b)) on behalf of the designated beneficiary (as defined in section

529(e)(1)); but there shall be no increase in the investment in the contract for purposes of applying section 72 by reason of any portion of such contribution which is not includible in gross income by reason of subsection (d)(2)."

(2) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—Section 530(b) (relating to definitions and special rules) is amended by adding at the end the following new paragraph:

"(4) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified elementary and secondary education expenses' means—

"(i) expenses for tuition, fees, academic tutoring, special needs services, books, supplies, computer equipment (including related software and services), and other equipment which are incurred in connection with the enrollment or attendance of the designated beneficiary of the trust as an elementary or secondary school student at a public, private, or religious school, and

"(ii) expenses for room and board, uniforms, transportation, and supplementary items and services (including extended day programs) which are required or provided by a public, private, or religious school in connection with such enrollment or attendance.

"(B) SPECIAL RULE FOR HOMESCHOOLING.—Such term shall include expenses described in subparagraph (A)(i) in connection with education provided by homeschooling if the requirements of any applicable State or local law are met with respect to such education.

"(C) SCHOOL.—The term 'school' means any school which provides elementary education or secondary education (kindergarten through grade 12), as determined under State law."

(3) CONFORMING AMENDMENTS.—Section 530 is amended—

(A) by striking "higher" each place it appears in subsections (b)(1) and (d)(2), and

(B) by striking "HIGHER" in the heading for subsection (d)(2).

(c) WAIVER OF AGE LIMITATIONS FOR CHILDREN WITH SPECIAL NEEDS.—Section 530(b)(1) (defining education individual retirement account) is amended by adding at the end the following flush sentence:

"The age limitations in subparagraphs (A)(ii) and (E) and paragraphs (5) and (6) of subsection (d) shall not apply to any designated beneficiary with special needs (as determined under regulations prescribed by the Secretary)."

(d) ENTITIES PERMITTED TO CONTRIBUTE TO ACCOUNTS.—Section 530(c)(1) (relating to reduction in permitted contributions based on adjusted gross income) is amended by striking "The maximum amount which a contributor" and inserting "In the case of a contributor who is an individual, the maximum amount the contributor".

(e) TIME WHEN CONTRIBUTIONS DEEMED MADE.—

(1) IN GENERAL.—Section 530(b) (relating to definitions and special rules), as amended by subsection (b)(2), is amended by adding at the end the following new paragraph:

"(5) TIME WHEN CONTRIBUTIONS DEEMED MADE.—An individual shall be deemed to have made a contribution to an education individual retirement account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof)."

(2) EXTENSION OF TIME TO RETURN EXCESS CONTRIBUTIONS.—Subparagraph (C) of section 530(d)(4) (relating to additional tax for distributions not used for educational expenses) is amended—

(A) by striking clause (i) and inserting the following new clause:

"(i) such distribution is made before the 1st day of the 6th month of the taxable year following the taxable year, and", and

(B) by striking "DUE DATE OF RETURN" in the heading and inserting "CERTAIN DATE".

(f) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS AND QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 530(d)(2)(C) is amended to read as follows:

"(C) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS AND QUALIFIED TUITION PROGRAMS.—For purposes of subparagraph (A)—

"(i) CREDIT COORDINATION.—The total amount of qualified higher education expenses with respect to an individual for the taxable year shall be reduced—

"(I) as provided in section 25A(g)(2), and

"(II) by the amount of such expenses which were taken into account in determining the credit allowed to the taxpayer or any other person under section 25A.

"(ii) COORDINATION WITH QUALIFIED TUITION PROGRAMS.—If, with respect to an individual for any taxable year—

"(I) the aggregate distributions during such year to which subparagraph (A) and section 529(c)(3)(B) apply, exceed

"(II) the total amount of qualified education expenses (after the application of clause (i)) for such year,

the taxpayer shall allocate such expenses among such distributions for purposes of determining the amount of the exclusion under subparagraph (A) and section 529(c)(3)(B)."

(2) CONFORMING AMENDMENTS.—

(A) Subsection (e) of section 25A is amended to read as follows:

"(e) ELECTION NOT TO HAVE SECTION APPLY.—A taxpayer may elect not to have this section apply with respect to the qualified tuition and related expenses of an individual for any taxable year."

(B) Section 135(d)(2)(A) is amended by striking "allowable" and inserting "allowed".

(C) Section 530(d)(2)(D) is amended—

(i) by striking "or credit", and

(ii) by striking "CREDIT OR" in the heading.

(D) Section 4973(e)(1) is amended by adding "and" at the end of subparagraph (A), by striking subparagraph (B), and by redesignating subparagraph (C) as subparagraph (B).

(g) RENAMING EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS AS EDUCATION SAVINGS ACCOUNTS.—

(1) IN GENERAL.—

(A) Section 530 (as amended by the preceding provisions of this section) is amended by striking "education individual retirement account" each place it appears and inserting "education savings account".

(B) The heading for paragraph (1) of section 530(b) is amended by striking "EDUCATION INDIVIDUAL RETIREMENT ACCOUNT" and inserting "EDUCATION SAVINGS ACCOUNT".

(C) The heading for section 530 is amended to read as follows:

"SEC. 530. EDUCATION SAVINGS ACCOUNTS.".

(D) The item in the table of contents for part VII of subchapter F of chapter 1 relating to section 530 is amended to read as follows:

"Sec. 530. Education savings accounts.".

(2) CONFORMING AMENDMENTS.—

(A) The following provisions are each amended by striking "education individual retirement" each place it appears and inserting "education savings":

(i) Section 25A(e)(2).

(ii) Section 26(b)(2)(E).

(iii) Section 72(e)(9).

(iv) Section 135(c)(2)(C).

(v) Subsections (a) and (e) of section 4973.

(vi) Subsections (c) and (e) of section 4975.

(vii) Section 6693(a)(2)(D).

(B) The headings for each of the following provisions are amended by striking "EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS" each place it appears and inserting "EDUCATION SAVINGS ACCOUNTS".

(i) Section 72(e)(9).

(ii) Section 135(c)(2)(C).

(iii) Section 4973(e).

(iv) Section 4975(c)(5).

(h) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) SUBSECTION (g).—The amendments made by subsection (g) shall take effect on the date of the enactment of this Act.

SEC. 402. MODIFICATIONS TO QUALIFIED TUITION PROGRAMS.

(a) ELIGIBLE EDUCATIONAL INSTITUTIONS PERMITTED TO MAINTAIN QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 529(b)(1) (defining qualified State tuition program) is amended by inserting "or by 1 or more eligible educational institutions" after "maintained by a State or agency or instrumentality thereof".

(2) PRIVATE QUALIFIED TUITION PROGRAMS LIMITED TO BENEFIT PLANS.—Clause (ii) of section 529(b)(1)(A) is amended by inserting "in the case of a program established and maintained by a State or agency or instrumentality thereof," before "may make".

(3) CONFORMING AMENDMENTS.—

(A) Sections 72(e)(9), 135(c)(2)(C), 135(d)(1)(D), 529, 530(b)(2)(B), 4973(e), and 6693(a)(2)(C) are each amended by striking "qualified State tuition" each place it appears and inserting "qualified tuition".

(B) The headings for sections 72(e)(9) and 135(c)(2)(C) are each amended by striking "QUALIFIED STATE TUITION" and inserting "QUALIFIED TUITION".

(C) The headings for sections 529(b) and 530(b)(2)(B) are each amended by striking "QUALIFIED STATE TUITION" and inserting "QUALIFIED TUITION".

(D) The heading for section 529 is amended by striking "state".

(E) The item relating to section 529 in the table of sections for part VIII of subchapter F of chapter 1 is amended by striking "State".

(b) EXCLUSION FROM GROSS INCOME OF EDUCATION DISTRIBUTIONS FROM QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 529(c)(3)(B) (relating to distributions) is amended to read as follows:

"(B) DISTRIBUTIONS FOR QUALIFIED HIGHER EDUCATION EXPENSES.—

"(i) IN GENERAL.—For purposes of this paragraph—

"(I) no amount shall be includible in gross income under subparagraph (A) by reason of a distribution which consists of providing a benefit to the distributee which, if paid for by the distributee, would constitute payment of a qualified higher education expense, and

"(II) in the case of distributions not described in subclause (I), the amount otherwise includible in gross income under subparagraph (A) shall be reduced by an amount which bears the same ratio to the otherwise includible amount as the qualified higher education expenses (other than expenses paid by distributions described in subclause (I)) bear to the aggregate of such distributions.

"(ii) EXCEPTION FOR INSTITUTIONAL PROGRAMS.—In the case of any taxable year beginning before January 1, 2004, clause (i) shall not apply with respect to any distribution during such taxable year under a qualified tuition program established and maintained by 1 or more eligible educational institutions.

"(iii) IN-KIND DISTRIBUTIONS.—Any benefit furnished to a designated beneficiary under a qualified tuition program shall be treated as a distribution to the beneficiary for purposes of this paragraph.

"(iv) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS.—The total amount of qualified higher education expenses with respect to an individual for the taxable year shall be reduced—

"(I) as provided in section 25A(g)(2), and

"(II) by the amount of such expenses which were taken into account in determining the credit allowed to the taxpayer or any other person under section 25A.

"(v) COORDINATION WITH EDUCATION SAVINGS ACCOUNTS.—If, with respect to an individual for any taxable year—

"(I) the aggregate distributions to which clause (i) and section 530(d)(2)(A) apply, exceed

"(II) the total amount of qualified higher education expenses otherwise taken into account under clause (i) (after the application of clause (iv)) for such year,

the taxpayer shall allocate such expenses among such distributions for purposes of determining the amount of the exclusion under clause (i) and section 530(d)(2)(A)."

(2) CONFORMING AMENDMENTS.—

(A) Section 135(d)(2)(B) is amended by striking "the exclusion under section 530(d)(2)" and inserting "the exclusions under sections 529(c)(3)(B)(i) and 530(d)(2)".

(B) Section 221(e)(2)(A) is amended by inserting "529," after "135,".

(c) ROLLOVER TO DIFFERENT PROGRAM FOR BENEFIT OF SAME DESIGNATED BENEFICIARY.—Section 529(c)(3)(C) (relating to change in beneficiaries) is amended—

(1) by striking "transferred to the credit" in clause (i) and inserting "transferred—

"(I) to another qualified tuition program for the benefit of the designated beneficiary, or

"(II) to the credit",

(2) by adding at the end the following new clause:

"(iii) LIMITATION ON CERTAIN ROLLOVERS.—Clause (i)(I) shall not apply to any amount transferred with respect to a designated beneficiary if, at any time during the 1-year period ending on the day of such transfer, any other amount was transferred which was not includible in gross income by reason of clause (i)(I).", and

(3) by inserting "OR PROGRAMS" after "BENEFICIARIES" in the heading.

(d) MEMBER OF FAMILY INCLUDES FIRST COUSIN.—Section 529(e)(2) (defining member of family) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and by inserting "; and", and by adding at the end the following new subparagraph:

"(D) any first cousin of such beneficiary."

(e) DEFINITION OF QUALIFIED HIGHER EDUCATION EXPENSES.—

(1) IN GENERAL.—Subparagraph (A) of section 529(e)(3) (relating to definition of qualified higher education expenses) is amended to read as follows:

"(A) IN GENERAL.—The term 'qualified higher education expenses' means—

"(i) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible educational institution for courses of instruction of such beneficiary at such institution, and

"(ii) expenses for books, supplies, and equipment which are incurred in connection with such enrollment or attendance, but not to exceed the allowance for books and supplies included in the cost of attendance (as defined in section 472 of the Higher Education Act of 1965 (20 U.S.C. 1087ll), as in effect on the date of enactment of the Financial Freedom Act of 1999) as determined by the eligible educational institution.".

(2) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC..—Paragraph (3) of section 529(e) (relating to qualified higher education expenses) is amended by adding at the end the following new subparagraph:

"(C) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC..—The term 'qualified higher education expenses' shall not include expenses with respect to any course or other education involving sports, games, or hobbies unless such course or other education is part of the beneficiary's degree program or is taken to acquire or improve job skills of the beneficiary.".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) QUALIFIED HIGHER EDUCATION EXPENSES.—The amendments made by subsection (e) shall apply to amounts paid for education furnished after December 31, 1999.

SEC. 403. EXCLUSION OF CERTAIN AMOUNTS RECEIVED UNDER THE NATIONAL HEALTH SERVICE CORPS SCHOLARSHIP PROGRAM, THE F. EDWARD HEBERT ARMED FORCES HEALTH PROFESSIONS SCHOLARSHIP AND FINANCIAL ASSISTANCE PROGRAM, AND CERTAIN OTHER PROGRAMS.

(a) IN GENERAL.—Section 117(c) (relating to the exclusion from gross income amounts received as a qualified scholarship) is amended—

(1) by striking "Subsections (a)" and inserting the following:

"(1) IN GENERAL.—Except as provided in paragraph (2), subsections (a)", and

(2) by adding at the end the following new paragraph:

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any amount received by an individual under—

"(A) the National Health Service Corps Scholarship program under section 338A(g)(1)(A) of the Public Health Service Act,

"(B) the Armed Forces Health Professions Scholarship and Financial Assistance program under subchapter I of chapter 105 of title 10, United States Code,

"(C) the National Institutes of Health Undergraduate Scholarship program under section 487D of the Public Health Service Act, or

"(D) any State program determined by the Secretary to have substantially similar objectives as such programs."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by subsection (a) shall apply to amounts received in taxable years beginning after December 31, 1993.

(2) STATE PROGRAMS.—Section 117(c)(2)(D) of the Internal Revenue Code of 1986 (as added by the amendments made by subsection (a)) shall apply to amounts received in taxable years beginning after December 31, 1999.

SEC. 404. ADDITIONAL INCREASE IN ARBITRAGE REBATE EXCEPTION FOR GOVERNMENTAL BONDS USED TO FINANCE EDUCATIONAL FACILITIES.

(a) IN GENERAL.—Section 148(f)(4)(D)(vii) (relating to increase in exception for bonds financing public school capital expenditures) is amended by striking "$5,000,000" the second place it appears and inserting "$10,000,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued in calendar years beginning after December 31, 1999.

SEC. 405. MODIFICATION OF ARBITRAGE REBATE RULES APPLICABLE TO PUBLIC SCHOOL CONSTRUCTION BONDS.

(a) IN GENERAL.—Subparagraph (C) of section 148(f)(4) is amended by adding at the end the following new clause:

"(xviii) 4-YEAR SPENDING REQUIREMENT FOR PUBLIC SCHOOL CONSTRUCTION ISSUE.—

"(I) IN GENERAL.—In the case of a public school construction issue, the spending requirements of clause (ii) shall be treated as met if at least 10 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 1-year period beginning on the date the bonds are issued, 30 percent of such proceeds are spent for such purposes within the 2-year period beginning on such date, 60 percent of such proceeds are spent for such purposes within the 3-year period beginning on such date, and 100 percent of such proceeds are spent for such purposes within the 4-year period beginning on such date.

"(II) PUBLIC SCHOOL CONSTRUCTION ISSUE.—For purposes of this clause, the term 'public school construction issue' means any construction issue if no bond which is part of such issue is a private activity bond and all of the available construction proceeds of such issue are to be used for the construction (as defined in clause (iv)) of public school facilities to provide education or training below the postsecondary level or for the acquisition of land that is functionally related and subordinate to such facilities.

"(III) OTHER RULES TO APPLY.—Rules similar to the rules of the preceding provisions of this subparagraph which apply to clause (ii) also apply to this clause.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to obligations issued after December 31, 1999.

SEC. 406. REPEAL OF 60-MONTH LIMITATION ON DEDUCTION FOR INTEREST ON EDUCATION LOANS.

(a) IN GENERAL.—Section 221 (relating to interest on education loans) is amended by striking subsection (d) and by redesignating subsections (e), (f), and (g) as subsections (d), (e), and (f), respectively.

(b) CONFORMING AMENDMENT.—Subsection (e) of section 6050S is amended by striking "section 221(e)(1)" and inserting "section 221(d)(1)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to loan interest payments made after December 31, 1999, in taxable years ending after such date.

TITLE V—HEALTH CARE PROVISIONS

SEC. 501. DEDUCTION FOR HEALTH AND LONG-TERM CARE INSURANCE COSTS OF INDIVIDUALS NOT PARTICIPATING IN EMPLOYER-SUBSIDIZED HEALTH PLANS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 is amended by redesignating section 222 as section 223 and by inserting after section 221 the following new section:

"SEC. 222. HEALTH AND LONG-TERM CARE INSURANCE COSTS.

"(a) IN GENERAL.—In the case of an individual, there shall be allowed as a deduction an amount equal to the applicable percentage of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, the taxpayer's spouse, and dependents.

"(b) APPLICABLE PERCENTAGE.—For purposes of subsection (a), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	The applicable percentage is—
2001	25
2002	40
2003, 2004, 2005, and 2006	50
2007	75
2008 and thereafter	100.

"(c) LIMITATION BASED ON OTHER COVERAGE.—

"(1) COVERAGE UNDER CERTAIN SUBSIDIZED EMPLOYER PLANS.—

"(A) IN GENERAL.—Subsection (a) shall not apply to any taxpayer for any calendar month for which the taxpayer participates in any health plan maintained by any employer of the taxpayer or of the spouse of the taxpayer if 50 percent or more of the cost of coverage under such plan (determined under section 4980B) is paid or incurred by the employer.

"(B) EMPLOYER CONTRIBUTIONS TO CAFETERIA PLANS, FLEXIBLE SPENDING ARRANGEMENTS, AND MEDICAL SAVINGS ACCOUNTS.—Employer contributions to a cafeteria plan, a flexible spending or similar arrangement, or a medical savings account which are excluded from gross income under section 106 shall be treated for purposes of subparagraph (A) as paid by the employer.

"(C) AGGREGATION OF PLANS OF EMPLOYER.—A health plan which is not otherwise described in subparagraph (A) shall be treated as described in such subparagraph if such plan would be so described if all health plans of persons treated as a single employer under subsections (b), (c), (m), or (o) of section 414 were treated as one health plan.

"(D) SEPARATE APPLICATION TO HEALTH INSURANCE AND LONG-TERM CARE INSURANCE.—Subparagraphs (A) and (C) shall be applied separately with respect to—

"(i) plans which include primarily coverage for qualified long-term care services or are qualified long-term care insurance contracts, and

"(ii) plans which do not include such coverage and are not such contracts.

"(2) COVERAGE UNDER CERTAIN FEDERAL PROGRAMS.—

"(A) IN GENERAL.—Subsection (a) shall not apply to any amount paid for any coverage for an individual for any calendar month if, as of the first day of such month, the individual is covered under any medical care program described in—

"(i) title XVIII, XIX, or XXI of the Social Security Act,

"(ii) chapter 55 of title 10, United States Code,

"(iii) chapter 17 of title 38, United States Code,

"(iv) chapter 89 of title 5, United States Code, or

"(v) the Indian Health Care Improvement Act.

"(B) EXCEPTIONS.—

"(i) QUALIFIED LONG-TERM CARE.—Subparagraph (A) shall not apply to amounts paid for coverage under a qualified long-term care insurance contract.

"(ii) CONTINUATION COVERAGE OF FEHBP.—Subparagraph (A)(iv) shall not apply to coverage which is comparable to continuation coverage under section 4980B.

"(d) LONG-TERM CARE DEDUCTION LIMITED TO QUALIFIED LONG-TERM CARE INSURANCE CONTRACTS.—In the case of a qualified long-term care insurance contract, only eligible long-term care premiums (as defined in section 213(d)(10)) may be taken into account under subsection (a).

"(e) SPECIAL RULES.—

"(1) COORDINATION WITH DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.—The amount taken into account by the taxpayer in computing the deduction under section 162(l) shall not be taken into account under this section.

"(2) COORDINATION WITH MEDICAL EXPENSE DEDUCTION.—The amount taken into account by the taxpayer in computing the deduction under this section shall not be taken into account under section 213.

"(f) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out this section, including regulations requiring employers to report to their employees and the Secretary such information as the Secretary determines to be appropriate."

(b) DEDUCTION ALLOWED WHETHER OR NOT TAXPAYER ITEMIZES OTHER DEDUCTIONS.—Subsection (a) of section 62 is amended by inserting after paragraph (17) the following new item:

"(18) HEALTH AND LONG-TERM CARE INSURANCE COSTS.—The deduction allowed by section 222."

(c) CLERICAL AMENDMENT.—The table of sections for part VII of subchapter B of chapter 1 is amended by striking the last item and inserting the following new items:

"Sec. 222. Health and long-term care insurance costs.
"Sec. 223. Cross reference."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 502. LONG-TERM CARE INSURANCE PERMITTED TO BE OFFERED UNDER CAFETERIA PLANS AND FLEXIBLE SPENDING ARRANGEMENTS.

(a) CAFETERIA PLANS.—Subsection (f) of section 125 (defining qualified benefits) is amended by inserting before the period at the end "unless such product is a qualified long-term care insurance contract (as defined in section 7702B)".

(b) FLEXIBLE SPENDING ARRANGEMENTS.—Section 106 (relating to contributions by employer to accident and health plans) is amended by striking subsection (c).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 503. EXPANSION OF AVAILABILITY OF MEDICAL SAVINGS ACCOUNTS.

(a) REPEAL OF LIMITATIONS ON NUMBER OF MEDICAL SAVINGS ACCOUNTS.—

(1) IN GENERAL.—Subsections (i) and (j) of section 220 are hereby repealed.

(2) CONFORMING AMENDMENT.—Paragraph (1) of section 220(c) is amended by striking subparagraph (D).

(b) ALL EMPLOYERS MAY OFFER MEDICAL SAVINGS ACCOUNTS.—

(1) IN GENERAL.—Subclause (I) of section 220(c)(1)(A)(iii) (defining eligible individual) is amended by striking "and such employer is a small employer".

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (1) of section 220(c) is amended by striking subparagraph (C).

(B) Subsection (c) of section 220 is amended by striking paragraph (4) and by redesignating paragraph (5) as paragraph (4).

(c) INCREASE IN AMOUNT OF DEDUCTION ALLOWED FOR CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.—

(1) IN GENERAL.—Paragraph (2) of section 220(b) is amended to read as follows:

"(2) MONTHLY LIMITATION.—The monthly limitation for any month is the amount equal to 1/12 of the annual deductible (as of the first day of such month) of the individual's coverage under the high deductible health plan.".

(2) CONFORMING AMENDMENT.—Clause (ii) of section 220(d)(1)(A) is amended by striking "75 percent of".

(d) BOTH EMPLOYERS AND EMPLOYEES MAY CONTRIBUTE TO MEDICAL SAVINGS ACCOUNTS.—Paragraph (5) of section 220(b) is amended to read as follows:

"(5) COORDINATION WITH EXCLUSION FOR EMPLOYER CONTRIBUTIONS.—The limitation which would (but for this paragraph) apply under this subsection to the taxpayer for any taxable year shall be reduced (but not below zero) by the amount which would (but for section 106(b)) be includible in the taxpayer's gross income for such taxable year.".

(e) REDUCTION OF PERMITTED DEDUCTIBLES UNDER HIGH DEDUCTIBLE HEALTH PLANS.—

(1) IN GENERAL.—Subparagraph (A) of section 220(c)(2) (defining high deductible health plan) is amended—

(A) by striking "$1,500" in clause (i) and inserting "$1,000", and

(B) by striking "$3,000" in clause (ii) and inserting "$2,000".

(2) CONFORMING AMENDMENT.—Subsection (g) of section 220 is amended to read as follows:

"(g) COST-OF-LIVING ADJUSTMENT.—

"(1) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 1998, each dollar amount in subsection (c)(2) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which such taxable year begins by substituting 'calendar year 1997' for 'calendar year 1992' in subparagraph (B) thereof.

"(2) SPECIAL RULES.—In the case of the $1,000 amount in subsection (c)(2)(A)(i) and the $2,000 amount in subsection (c)(2)(A)(ii), paragraph (1)(B) shall be applied by substituting 'calendar year 1999' for 'calendar year 1997'.

"(3) ROUNDING.—If any increase under paragraph (1) or (2) is not a multiple of $50, such increase shall be rounded to the nearest multiple of $50.

(f) MEDICAL SAVINGS ACCOUNTS MAY BE OFFERED UNDER CAFETERIA PLANS.—Subsection (f) of section 125 is amended by striking "106(b),".

(g) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 504. ADDITIONAL PERSONAL EXEMPTION FOR TAXPAYER CARING FOR ELDERLY FAMILY MEMBER IN TAXPAYER'S HOME.

(a) IN GENERAL.—Section 151 (relating to allowance of deductions for personal exemptions) is amended by adding at the end redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) ADDITIONAL EXEMPTION FOR CERTAIN ELDERLY FAMILY MEMBERS RESIDING WITH TAXPAYER.—

"(1) IN GENERAL.—An exemption of the exemption amount for each qualified family member of the taxpayer.

"(2) QUALIFIED FAMILY MEMBER.—For purposes of this subsection, the term 'qualified family member' means, with respect to any taxable year, any individual—

"(A) who is an ancestor of the taxpayer or of the taxpayer's spouse or who is the spouse of any such ancestor,

"(B) who is a member for the entire taxable year of a household maintained by the taxpayer, and

"(C) who has been certified, before the due date for filing the return of tax for the taxable year (without extensions), by a physician (as defined in section 1861(r)(1) of the Social Security Act) as being an individual with long-term care needs described in paragraph (3) for a period—

"(i) which is at least 180 consecutive days, and

"(ii) a portion of which occurs within the taxable year.

Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless within the 39½ month period ending on such due date (or such other period as the Secretary prescribes) a physician (as so defined) has certified that such individual meets such requirements.

"(3) INDIVIDUALS WITH LONG-TERM CARE NEEDS.—An individual is described in this paragraph if the individual—

"(A) is unable to perform (without substantial assistance from another individual) at least 2 activities of daily living (as defined in section 7702B(c)(2)(B)) due to a loss of functional capacity, or

"(B) requires substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment and is unable to perform, without reminding or cuing assistance, at least 1 activity of at least 1 activity of daily living (as so defined) or to the extent provided in regulations prescribed by the Secretary (in consultation with the Secretary of Health and Human Services), is unable to engage in age appropriate activities.

"(4) SPECIAL RULES.—Rules similar to the rules of paragraphs (1), (2), (3), (4), and (5) of section 21(e) shall apply for purposes of this subsection."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 505. EXPANDED HUMAN CLINICAL TRIALS QUALIFYING FOR ORPHAN DRUG CREDIT.

(a) IN GENERAL.—Subclause (I) of section 45C(b)(2)(A)(ii) is amended to read as follows:

"(I) after the date that the application is filed for designation under such section 526, and".

(b) CONFORMING AMENDMENT.—Clause (i) of section 45C(b)(2)(A) is amended by inserting "which is" before "being" and by inserting before the comma at the end "and which is designated under section 526 of such Act".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 1999.

SEC. 506. INCLUSION OF CERTAIN VACCINES AGAINST STREPTOCOCCUS PNEUMONIAE TO LIST OF TAXABLE VACCINES.

(a) IN GENERAL.—Section 4132(a)(1) (defining taxable vaccine) is amended by adding at the end the following new subparagraph:

"(L) Any conjugate vaccine against streptococcus pneumoniae."

(b) EFFECTIVE DATE.—

(1) SALES.—The amendment made by this section shall apply to vaccine sales beginning on the day after the date on which the Centers for Disease Control makes a final recommendation for routine administration to children of any conjugate vaccine against streptococcus pneumoniae.

(2) DELIVERIES.—For purposes of paragraph (1), in the case of sales on or before the date described in such paragraph for which delivery is made after such date, the delivery date shall be considered the sale date.

(c) REPORT.—Not later than December 31, 1999, the Comptroller General of the United States shall prepare and submit a report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate on the operation of the Vaccine Injury Compensation Trust Fund and on the adequacy of such Fund to meet future claims made under the Vaccine Injury Compensation Program.

SEC. 507. ABOVE-THE-LINE DEDUCTION FOR PRESCRIPTION DRUG INSURANCE COVERAGE OF MEDICARE BENEFICIARIES IF CERTAIN MEDICARE AND LOW-INCOME ASSISTANCE PROVISIONS IN EFFECT.

(a) IN GENERAL.—Subsection (a) of section 213 is amended by adding at the end the following new sentence: "The 7.5 percent adjusted gross income threshold in the preceding sentence shall not apply to the expenses paid during the taxable year for prescription drug insurance coverage of a medicare beneficiary who is the taxpayer, the taxpayer's spouse, or a dependent (as defined in section 152) if—

"(1) the Secretary certifies that, throughout such taxable year, the conditions specified in subsection (e) are met, and

"(2) the amount paid for such coverage is either separately stated in the contract or furnished to the policyholder by the insurance company in a separate statement.

Expenses to which the preceding sentence applies shall not be taken into account in applying such threshold to other expenses. For purposes of this subsection, the term 'medicare beneficiary' means an individual who is entitled to benefits under part A, B, or C of title XVIII of the Social Security Act."

(b) CONDITIONS.—Section 213 is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) CONDITIONS FOR SEPARATE DEDUCTION FOR PRESCRIPTION DRUG INSURANCE COVERAGE.—For purposes of subsection (a), the conditions specified in this subsection are met if all of the following are in effect:

"(1) ASSISTANCE FOR PRESCRIPTION DRUGS FOR LOW-INCOME MEDICARE BENEFICIARIES.—

"(A) Low-income assistance to enable the purchase of coverage of prescription drugs as described in paragraph (2) or (3) for medicare beneficiaries with incomes under 135 percent of the applicable Federal poverty level, with such assistance phasing out for beneficiaries with incomes between 135 percent and 150 percent of such level.

"(B) The Federal Government provides funding for the costs of such assistance.

"(2) SUPPLEMENTAL COVERAGE OF PRESCRIPTION DRUGS.—All policies supplemental to Medicare include coverage for costs of prescription drugs.

"(3) STRUCTURAL MEDICARE REFORM.—Coverage for outpatient prescription drugs for medicare beneficiaries is provided only through integrated comprehensive health plans which offer current Medicare covered services and maximum limitations on out-of-pocket spending and such comprehensive plans sponsored by the Health Care Financing Administration compete on the same basis as private plans."

(c) DEDUCTION FOR PRESCRIPTION DRUG INSURANCE COVERAGE ALLOWED WHETHER OR NOT TAXPAYER ITEMIZES OTHER DEDUCTIONS.—Subsection (a) of section 62 (defining adjusted gross income) is amended by inserting after paragraph (18) the following new paragraph:

"(19) PRESCRIPTION DRUG INSURANCE COVERAGE.—The deduction allowed by section 213(a) to the extent of the expenses described in the second sentence thereof."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

TITLE VI—ESTATE TAX RELIEF

Subtitle A—Repeal of Estate, Gift, and Generation-Skipping Taxes; Repeal of Step Up in Basis At Death

SEC. 601. REPEAL OF ESTATE, GIFT, AND GENERATION-SKIPPING TAXES.

(a) IN GENERAL.—Subtitle B is hereby repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to the estates of decedents dying, and gifts and generation-skipping transfers made, after December 31, 2008.

SEC. 602. TERMINATION OF STEP UP IN BASIS AT DEATH.

(a) TERMINATION OF APPLICATION OF SECTION 1014.—Section 1014 (relating to basis of property acquired from a decedent) is amended by adding at the end the following:

"(f) TERMINATION.—In the case of a decedent dying after December 31, 2008, this section shall not apply to property for which basis is provided by section 1022."

(b) CONFORMING AMENDMENT.—Subsection (a) of section 1016 (relating to adjustments to basis) is amended by striking "and" at the end of paragraph (26), by striking the period at the end of paragraph (27) and inserting "; and", and by adding at the end the following:

"(28) to the extent provided in section 1022 (relating to basis for certain property acquired from a decedent dying after December 31, 2008)."

SEC. 603. CARRYOVER BASIS AT DEATH.

(a) GENERAL RULE.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by inserting after section 1021 the following:

"SEC. 1022. CARRYOVER BASIS FOR CERTAIN PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2008.

"(a) CARRYOVER BASIS.—Except as otherwise provided in this section, the basis of carryover basis property in the hands of a person acquiring such property from a decedent shall be determined under section 1015.

"(b) CARRYOVER BASIS PROPERTY DEFINED.—

"(1) IN GENERAL.—For purposes of this section, the term 'carryover basis property' means any property—

"(A) which is acquired from or passed from a decedent who died after December 31, 2008, and

"(B) which is not excluded pursuant to paragraph (2).

The property taken into account under subparagraph (A) shall be determined under section 1014(b) without regard to subparagraph (A) of the last sentence of paragraph (9) thereof.

"(2) CERTAIN PROPERTY NOT CARRYOVER BASIS PROPERTY.—The term 'carryover basis property' does not include—

"(A) any item of gross income in respect of a decedent described in section 691,

"(B) property which was acquired from the decedent by the surviving spouse of the decedent, the value of which would have been deductible from the value of the taxable estate of the decedent under section 2056, as in effect on the day before the date of enactment of the Financial Freedom Act of 1999, and

"(C) any includible property of the decedent if the aggregate adjusted fair market value of such property does not exceed $2,000,000.

For purposes of this paragraph and paragraph (3), the term 'adjusted fair market value' means, with respect to any property, fair market value reduced by any indebtedness secured by such property.

"(3) PHASEIN OF CARRYOVER BASIS IF INCLUDIBLE PROPERTY EXCEEDS $1,300,000.—

"(A) IN GENERAL.—If the adjusted fair market value of the includible property of the decedent exceeds $1,300,000, but does not exceed $2,000,000, the amount of the increase in the basis of such property which would (but for this paragraph) result under section 1014 shall be reduced by the amount which bears the same ratio to such increase as such excess bears to $700,000.

"(B) ALLOCATION OF REDUCTION.—The reduction under subparagraph (A) shall be allocated among only the includible property having net appreciation and shall be allocated in proportion to the respective amounts of such net appreciation. For purposes of the preceding sentence, the term 'net appreciation' means the excess of the adjusted fair market value over the decedent's adjusted basis immediately before such decedent's death.

"(4) INCLUDIBLE PROPERTY.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'includible property' means property which would be included in the gross estate of the decedent under any of the following provisions as in effect on the day before the date of the enactment of the Financial Freedom Act of 1999:

"(i) Section 2033.

"(ii) Section 2038.

"(iii) Section 2040.

"(iv) Section 2041.

"(v) Section 2042(a)(1).

"(B) EXCLUSION OF PROPERTY ACQUIRED BY SPOUSE.—Such term shall not include property described in paragraph (2)(B).

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

(b) MISCELLANEOUS AMENDMENTS RELATED TO CARRYOVER BASIS.—

(1) CAPITAL GAIN TREATMENT FOR INHERITED ART WORK OR SIMILAR PROPERTY.—

(A) IN GENERAL.—Subparagraph (C) of section 1221(3) (defining capital asset) is amended by inserting "(other than by reason of section 1022)" after "is determined".

(B) COORDINATION WITH SECTION 170.—Paragraph (1) of section 170(e) (relating to certain contributions of ordinary income and capital gain property) is amended by adding at the end the following: "For purposes of this paragraph, the determination of whether property is a capital asset shall be made without regard to the exception contained in section 1221(3)(C) for basis determined under section 1022."

(2) DEFINITION OF EXECUTOR.—Section 7701(a) (relating to definitions) is amended by adding at the end the following:

"(47) EXECUTOR.—The term 'executor' means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent."

(3) CLERICAL AMENDMENT.—The table of sections for part II of subchapter O of chapter 1 is amended by adding at the end the following new item:

"Sec. 1022. Carryover basis for certain property acquired from a decedent dying after December 31, 2008."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 2008.

Subtitle B—Reductions of Estate and Gift Tax Rates Prior to Repeal

SEC. 611. ADDITIONAL REDUCTIONS OF ESTATE AND GIFT TAX RATES.

(a) MAXIMUM RATE OF TAX REDUCED TO 50 PERCENT.—The table contained in section 2001(c)(1) is amended by striking the 2 highest brackets and inserting the following:

Over $2,500,000	$1,025,800, plus 50% of the excess over $2,500,000."

(b) REPEAL OF PHASEOUT OF GRADUATED RATES.—Subsection (c) of section 2001 is amended by striking paragraph (2).

(c) ADDITIONAL REDUCTIONS OF RATES OF TAX.—Subsection (c) of section 2001, as amended by subsection (b), is amended by adding at the end the following new paragraph:

"(2) PHASEDOWN OF TAX.—In the case of estates of decedents dying, and gifts made, during any calendar year after 2001 and before 2009—

"(A) IN GENERAL.—Except as provided in subparagraph (C), the tentative tax under this subsection shall be determined by using a table prescribed by the Secretary (in lieu of using the table contained in paragraph (1)) which is the same as such table; except that—

"(i) each of the rates of tax shall be reduced by the number of percentage points determined under subparagraph (B), and

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

"(B) PERCENTAGE POINTS OF REDUCTION.—

"For calendar year:	The number of percentage points is:
2002	1
2003	2
2004	3
2005	5
2006	7
2007	9
2008	11.

"(C) COORDINATION WITH INCOME TAX RATES.—The reductions under subparagraph (A)—

"(i) shall not reduce any rate under paragraph (1) below the lowest rate in section 1(c), and

"(ii) shall not reduce the highest rate under paragraph (1) below the highest rate in section 1(c).

"(D) COORDINATION WITH CREDIT FOR STATE DEATH TAXES.—Rules similar to the rules of subparagraph (A) shall apply to the table contained in section 2011(b) except that the Secretary shall prescribe percentage point reductions which maintain the proportionate relationship (as in effect before any reduction under this paragraph) between the credit under section 2011 and the tax rates under subsection (c)."

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b).—The amendments made by subsections (a) and (b) shall apply to estates of decedents dying, and gifts made, after December 31, 2000.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to estates of decedents dying, and gifts made, after December 31, 2001.

Subtitle C—Unified Credit Replaced With Unified Exemption Amount

SEC. 621. UNIFIED CREDIT AGAINST ESTATE AND GIFT TAXES REPLACED WITH UNIFIED EXEMPTION AMOUNT.

(a) IN GENERAL.—

(1) ESTATE TAX.—Part IV of subchapter A of chapter 11 is amended by inserting after section 2051 the following new section:

"SEC. 2052. EXEMPTION.

"(a) IN GENERAL.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate an amount equal to the excess (if any) of—

"(1) the exemption amount for the calendar year in which the decedent died, over

"(2) the sum of—

"(A) the aggregate amount allowed as an exemption under section 2521 with respect to gifts made by the decedent after December 31, 2000, and

"(B) the aggregate amount of gifts made by the decedent for which credit was allowed by section 2505 (as in effect on the day before the date of the enactment of the Financial Freedom Act of 1999).

Gifts which are includible in the gross estate of the decedent shall not be taken into account in determining the amounts under paragraph (2).

"(b) EXEMPTION AMOUNT.—For purposes of subsection (a), the term 'exemption amount' means the amount determined in accordance with the following table:

"In the case of calendar year:	The exemption amount is:
2001	$675,000
2002 and 2003	$700,000
2004	$850,000
2005	$950,000
2006 or thereafter	$1,000,000."

(2) GIFT TAX.—Subchapter C of chapter 12 (relating to deductions) is amended by inserting before section 2522 the following new section:

"SEC. 2521. EXEMPTION.

"(a) IN GENERAL.—In computing taxable gifts for any calendar year, there shall be allowed as a deduction in the case of a citizen or resident of the United States an amount equal to the excess of—

"(1) the exemption amount determined under section 2052 for such calendar year, over

"(2) the sum of—

"(A) the aggregate amount allowed as an exemption under this section for all preceding calendar years after 2000, and

"(B) the aggregate amount of gifts for which credit was allowed by section 2505 (as in effect on the day before the date of the enactment of the Financial Freedom Act of 1999)."

(b) REPEAL OF UNIFIED CREDITS.—

(1) Section 2010 (relating to unified credit against estate tax) is hereby repealed.

(2) Section 2505 (relating to unified credit against gift tax) is hereby repealed.

(c) CONFORMING AMENDMENTS.—

(1)(A) Subparagraph (B) of section 2001(b)(1) is amended by inserting before the comma "reduced by the amount of described in section 2052(a)(2)".

(B) Subsection (b) of section 2001 is amended by adding at the end the following new sentence: "For purposes of paragraph (2), the amount of the tax payable under chapter 12 shall be determined without regard to the credit provided by section 2505 (as in effect on the day before the date of the enactment of the Financial Freedom Act of 1999)."

(2) Subsection (f) of section 2011 is amended by striking ", reduced by the amount of the unified credit provided by section 2010".

(3) Subsection (a) of section 2012 is amended by striking "and the unified credit provided by section 2010".

(4) Subsection (b) of section 2013 is amended by inserting before the period at the end of the first sentence "and increased by the exemption allowed under section 2052 or 2106(a)(4) (or the corresponding provisions of prior law) in determining the taxable estate of the transferor for purposes of the estate tax".

(5) Subparagraph (A) of section 2013(c)(1) is amended by striking "2010,".

(6) Paragraph (2) of section 2014(b) is amended by striking "2010,".

(7) Clause (ii) of section 2056A(b)(12)(C) is amended to read as follows:

"(ii) to treat any reduction in the tax imposed by paragraph (1)(A) by reason of the credit allowable under section 2010 (as in effect on the day before the date of the enactment of the Financial Freedom Act of 1999) or the exemption allowable under section 2052 with respect to the decedent as such a credit or exemption (as the case may be) allowable to such surviving spouse for purposes of determining the amount of the exemption allowable under section 2521 with respect to taxable gifts made by the surviving spouse during the year in which the spouse becomes a citizen or any subsequent year,".

(8) Section 2102 is amended by striking subsection (c).

(9) Subsection (a) of section 2106 is amended by adding at the end the following new paragraph:

"(4) EXEMPTION.—

"(A) IN GENERAL.—An exemption of $60,000.

"(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a nonresident not a citizen of the United States under section 2209, the exemption under this paragraph shall be the greater of—

"(i) $60,000, or

"(ii) that proportion of $175,000 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

"(C) SPECIAL RULES.—

"(i) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the exemption allowed under this paragraph shall be equal to the amount which bears the same ratio to the exemption amount under section 2052 (for the calendar year in which the decedent died) as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

"(ii) COORDINATION WITH GIFT TAX EXEMPTION AND UNIFIED CREDIT.—If an exemption has been allowed under section 2521 (or a credit has been allowed under section 2505 as in effect on the day before the date of the enactment of the Financial Freedom Act of 1999) with respect to any gift made by the decedent, each dollar amount contained in subparagraph (A) or (B) or the exemption amount applicable under clause (i) of this subparagraph (whichever applies) shall be reduced by the exemption so allowed under 2521 (or, in the case of such a credit, by the amount of the gift for which the credit was so allowed)."

(10) Subsection (c) of section 2107 is amended—

(A) by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively, and

(B) by striking the second sentence of paragraph (2) (as so redesignated).

(11) Section 2206 is amended by striking "the taxable estate" in the first sentence and inserting "the sum of the taxable estate and the amount of the exemption allowed under section 2052 or 2106(a)(4) in computing the taxable estate".

(12) Section 2207 is amended by striking "the taxable estate" in the first sentence and inserting "the sum of the taxable estate and the amount of the exemption allowed under section 2052 or 2106(a)(4) in computing the taxable estate".

(13) Subparagraph (B) of section 2207B(a)(1) is amended to read as follows:

"(B) the sum of the taxable estate and the amount of the exemption allowed under section 2052 or 2106(a)(4) in computing the taxable estate."

(14) Subsection (a) of section 2503 is amended by striking "section 2522" and inserting "section 2521".

(15) Paragraph (1) of section 6018(a) is amended by striking "$600,000" and inserting "the exemption amount under section 2052 for the calendar year which includes the date of death".

(16) Subparagraph (A) of section 6601(j)(2) is amended to read as follows:

"(A) the amount of the tax which would be imposed by chapter 11 on an amount of taxable estate equal to the excess of $1,000,000 over the exemption amount allowable under section 2052, or".

(17) The table of sections for part II of subchapter A of chapter 11 is amended by striking the item relating to section 2010.

(18) The table of sections for subchapter A of chapter 12 is amended by striking the item relating to section 2505.

(d) EFFECTIVE DATE.—The amendments made by this section—

(1) insofar as they relate to the tax imposed by chapter 11 of the Internal Revenue Code of 1986, shall apply to estates of decedents dying after December 31, 2000, and

(2) insofar as they relate to the tax imposed by chapter 12 of such Code, shall apply to gifts made after December 31, 2000.

Subtitle D—Modifications of Generation-Skipping Transfer Tax

SEC. 631. DEEMED ALLOCATION OF GST EXEMPTION TO LIFETIME TRANSFERS TO TRUSTS; RETROACTIVE ALLOCATIONS.

(a) IN GENERAL.—Section 2632 (relating to special rules for allocation of GST exemption) is amended by redesignating subsection (c) as subsection (e) and by inserting after subsection (b) the following new subsections:

"(c) DEEMED ALLOCATION TO CERTAIN LIFETIME TRANSFERS TO GST TRUSTS.—

"(1) IN GENERAL.—If any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

"(2) UNUSED PORTION.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been—

"(A) allocated by such individual,

"(B) treated as allocated under subsection (b) with respect to a direct skip occurring during or before the calendar year in which the indirect skip is made, or

"(C) treated as allocated under paragraph (1) with respect to a prior indirect skip.

"(3) DEFINITIONS.—

"(A) INDIRECT SKIP.—For purposes of this subsection, the term 'indirect skip' means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust.

"(B) GST TRUST.—The term 'GST trust' means a trust that could have a generation-skipping transfer with respect to the transferor unless—

"(i) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons—

"(I) before the date that the individual attains age 46,

"(II) on or before 1 or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or

"(III) upon the occurrence of an event that, in accordance with regulations prescribed by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

"(ii) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

"(iii) the trust instrument provides that, if 1 or more individuals who are non-skip persons die on or before a date or event described in clause (i) or (ii), more than 25 percent of the trust corpus either must be distributed to the estate or estates of 1 or more of such individuals or is subject to a general power of appointment exercisable by 1 or more of such individuals;

"(iv) the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

"(v) the trust is a charitable lead annuity trust (within the meaning of section 2642(e)(3)(A)) or a charitable remainder annuity trust or a charitable remainder unitrust (within the meaning of section 664(d)); or

"(vi) the trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

For purposes of this subparagraph, the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in section 2503(b) with respect to any transferor, and it shall be assumed that powers of appointment held by non-skip persons will not be exercised.

"(4) AUTOMATIC ALLOCATIONS TO CERTAIN GST TRUSTS.—For purposes of this subsection, an indirect skip to which section 2642(f) applies shall be deemed to have been made only at the close of the estate tax inclusion period. The fair market value of such transfer shall be the fair market value of the trust property at the close of the estate tax inclusion period.

"(5) APPLICABILITY AND EFFECT.—

"(A) IN GENERAL.—An individual—

"(i) may elect to have this subsection not apply to—

"(I) an indirect skip, or

"(II) any or all transfers made by such individual to a particular trust, and

"(ii) may elect to treat any trust as a GST trust for purposes of this subsection with respect to any or all transfers made by such individual to such trust.

"(B) ELECTIONS.—

"(i) ELECTIONS WITH RESPECT TO INDIRECT SKIPS.—An election under subparagraph (A)(i)(I) shall be deemed to be timely if filed on a timely filed gift tax return for the calendar year in which the transfer was made or deemed to have been made pursuant to paragraph (4) or on such later date or dates as may be prescribed by the Secretary.

"(ii) OTHER ELECTIONS.—An election under clause (i)(II) or (ii) of subparagraph (A) may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

"(d) RETROACTIVE ALLOCATIONS.—

"(1) IN GENERAL.—If—

"(A) a non-skip person has an interest or a future interest in a trust to which any transfer has been made,

"(B) such person—

"(i) is a lineal descendant of a grandparent of the transferor or of a grandparent of the transferor's spouse or former spouse, and

"(ii) is assigned to a generation below the generation assignment of the transferor, and

"(C) such person predeceases the transferor,

then the transferor may make an allocation of any of such transferor's unused GST exemption to any previous transfer or transfers to the trust on a chronological basis.

"(2) SPECIAL RULES.—If the allocation under paragraph (1) by the transferor is made on a gift tax return filed on or before the date prescribed by section 6075(b) for gifts made within the calendar year within which the non-skip person's death occurred—

"(A) the value of such transfer or transfers for purposes of section 2642(a) shall be determined as if such allocation had been made on a timely filed gift tax return for each calendar year within which each transfer was made,

"(B) such allocation shall be effective immediately before such death, and

"(C) the amount of the transferor's unused GST exemption available to be allocated shall be determined immediately before such death.

"(3) FUTURE INTEREST.—For purposes of this subsection, a person has a future interest in a trust if the trust may permit income or corpus to be paid to such person on a date or dates in the future.".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 2632(b) is amended by striking "with respect to a direct skip" and inserting "or subsection (c)(1)".

(c) EFFECTIVE DATES.—

(1) DEEMED ALLOCATION.—Section 2632(c) of the Internal Revenue Code of 1986 (as added by subsection (a)), and the amendment made by subsection (b), shall apply to transfers subject to chapter 11 or 12 made after December 31, 1999, and to estate tax inclusion periods ending after December 31, 1999.

(2) RETROACTIVE ALLOCATIONS.—Section 2632(d) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to deaths of non-skip persons occurring after the date of the enactment of this Act.

SEC. 632. SEVERING OF TRUSTS.

(a) IN GENERAL.—Subsection (a) of section 2642 (relating to inclusion ratio) is amended by adding at the end the following new paragraph:

"(3) SEVERING OF TRUSTS.—

"(A) IN GENERAL.—If a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of this chapter.

"(B) QUALIFIED SEVERANCE.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'qualified severance' means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of 2 or more trusts if—

"(I) the single trust was divided on a fractional basis, and

"(II) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

"(ii) TRUSTS WITH INCLUSION RATIO GREATER THAN ZERO.—If a trust has an inclusion ratio of greater than zero and less than 1, a severance is a qualified severance only if the single trust is divided into 2 trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of 1.

"(iii) REGULATIONS.—The term 'qualified severance' includes any other severance permitted under regulations prescribed by the Secretary.

"(C) TIMING AND MANNER OF SEVERANCES.—A severance pursuant to this paragraph may be made at any time. The Secretary shall prescribe by forms or regulations the manner in which the qualified severance shall be reported to the Secretary.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to severances after the date of the enactment of this Act.

SEC. 633. MODIFICATION OF CERTAIN VALUATION RULES.

(a) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—Paragraph (1) of section 2642(b) (relating to valuation rules, etc.) is amended to read as follows:

"(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by section 6075(b) for such transfer or is deemed to be made under section 2632 (b)(1) or (c)(1)—

"(A) the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of section 2001(f)(2)), or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, its value at the time of the close of the estate tax inclusion period, and

"(B) such allocation shall be effective on and after the date of such transfer, or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, on and after the close of such estate tax inclusion period.".

(b) TRANSFERS AT DEATH.—Subparagraph (A) of section 2642(b)(2) is amended to read as follows:

"(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendments made by section 1431 of the Tax Reform Act of 1986.

SEC. 634. RELIEF PROVISIONS.

(a) IN GENERAL.—Section 2642 is amended by adding at the end the following new subsection:

"(g) RELIEF PROVISIONS.—

"(1) RELIEF FOR LATE ELECTIONS.—

"(A) IN GENERAL.—The Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make—

"(i) an allocation of GST exemption described in paragraph (1) or (2) of subsection (b), and

"(ii) an election under subsection (b)(3) or (c)(5) of section 2632.

Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of enactment of this paragraph.

"(B) BASIS FOR DETERMINATIONS.—In determining whether to grant relief under this paragraph, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

"(2) SUBSTANTIAL COMPLIANCE.—An allocation of GST exemption under section 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer or a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant.".

(b) EFFECTIVE DATES.—

(1) RELIEF FOR LATE ELECTIONS.—Section 2642(g)(1) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to requests pending on, or filed after, the date of the enactment of this Act.

(2) SUBSTANTIAL COMPLIANCE.—Section 2642(g)(2) of such Code (as so added) shall take effect on the date of the enactment of this Act and shall apply to allocations made prior to such date for purposes of determining the tax consequences of generation-skipping transfers with respect to which the period of time for filing claims for refund has not expired. No negative implication is intended with respect to the availability of relief for late elections or the application of a rule of substantial compliance prior to the enactment of this amendment.

TITLE VII—TAX RELIEF FOR DISTRESSED COMMUNITIES AND INDUSTRIES

Subtitle A—American Community Renewal Act of 1999

SEC. 701. SHORT TITLE.

This subtitle may be cited as the “American Community Renewal Act of 1999”.

SEC. 702. DESIGNATION OF AND TAX INCENTIVES FOR RENEWAL COMMUNITIES.

(a) IN GENERAL.—Chapter 1 is amended by adding at the end the following new subchapter:

“Subchapter X—Renewal Communities

“PART I—DESIGNATION

“SEC. 1400E. DESIGNATION OF RENEWAL COMMUNITIES.

“(a) DESIGNATION.—

“(1) DEFINITIONS.—For purposes of this title, the term ‘renewal community’ means any area—

“(A) which is nominated by one or more local governments and the State or States in which it is located for designation as a renewal community (hereinafter in this section referred to as a ‘nominated area’); and

“(B) which the Secretary of Housing and Urban Development designates as a renewal community, after consultation with—

“(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury; the Director of the Office of Management and Budget; and the Administrator of the Small Business Administration; and

“(ii) in the case of an area on an Indian reservation, the Secretary of the Interior.

“(2) NUMBER OF DESIGNATIONS.—

“(A) IN GENERAL.—The Secretary of Housing and Urban Development may designate not more than 20 nominated areas as renewal communities.

“(B) MINIMUM DESIGNATION IN RURAL AREAS.—Of the areas designated under paragraph (1), at least 4 must be areas—

“(i) which are within a local government jurisdiction or jurisdictions with a population of less than 50,000,

“(ii) which are outside of a metropolitan statistical area (within the meaning of section 143(k)(2)(B)), or

“(iii) which are determined by the Secretary of Housing and Urban Development, after consultation with the Secretary of Commerce, to be rural areas.

“(3) AREAS DESIGNATED BASED ON DEGREE OF POVERTY, ETC.—

“(A) IN GENERAL.—Except as otherwise provided in this section, the nominated areas designated as renewal communities under this subsection shall be those nominated areas with the highest average ranking with respect to the criteria described in subparagraphs (B), (C), and (D) of subsection (c)(3). For purposes of the preceding sentence, an area shall be ranked within each such criterion on the basis of the amount by which the area exceeds such criterion, with the area which exceeds such criterion by the greatest amount given the highest ranking.

"(B) EXCEPTION WHERE INADEQUATE COURSE OF ACTION, ETC.—An area shall not be designated under subparagraph (A) if the Secretary of Housing and Urban Development determines that the course of action described in subsection (d)(2) with respect to such area is inadequate.

"(C) PRIORITY FOR EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES WITH RESPECT TO FIRST HALF OF DESIGNATIONS.—With respect to the first 10 designations made under this section—

"(i) all shall be chosen from nominated areas which are empowerment zones or enterprise communities (and are otherwise eligible for designation under this section); and

"(ii) 2 shall be areas described in paragraph (2)(B).

"(4) LIMITATION ON DESIGNATIONS.—

"(A) PUBLICATION OF REGULATIONS.—The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)—

"(i) the procedures for nominating an area under paragraph (1)(A);

"(ii) the parameters relating to the size and population characteristics of a renewal community; and

"(iii) the manner in which nominated areas will be evaluated based on the criteria specified in subsection (d).

"(B) TIME LIMITATIONS.—The Secretary of Housing and Urban Development may designate nominated areas as renewal communities only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

"(C) PROCEDURAL RULES.—The Secretary of Housing and Urban Development shall not make any designation of a nominated area as a renewal community under paragraph (2) unless—

"(i) the local governments and the States in which the nominated area is located have the authority—

"(I) to nominate such area for designation as a renewal community;

"(II) to make the State and local commitments described in subsection (d); and

"(III) to provide assurances satisfactory to the Secretary of Housing and Urban Development that such commitments will be fulfilled,

"(ii) a nomination regarding such area is submitted in such a manner and in such form, and contains such information, as the Secretary of Housing and Urban Development shall by regulation prescribe; and

"(iii) the Secretary of Housing and Urban Development determines that any information furnished is reasonably accurate.

"(5) NOMINATION PROCESS FOR INDIAN RESERVATIONS.—For purposes of this subchapter, in the case of a nominated area on an Indian reservation, the reservation governing body (as determined by the Secretary of the Interior) shall be treated as being both the State and local governments with respect to such area.

"(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—

"(1) IN GENERAL.—Any designation of an area as a renewal community shall remain in effect during the period beginning on the date of the designation and ending on the earliest of—

"(A) December 31, 2007,

"(B) the termination date designated by the State and local governments in their nomination, or

"(C) the date the Secretary of Housing and Urban Development revokes such designation.

"(2) REVOCATION OF DESIGNATION.—The Secretary of Housing and Urban Development may revoke the designation under this section of an area if such Secretary determines that the local government or the State in which the area is located—

"(A) has modified the boundaries of the area, or

"(B) is not complying substantially with, or fails to make progress in achieving, the State or local commitments, respectively, described in subsection (d).

"(c) AREA AND ELIGIBILITY REQUIREMENTS.—

"(1) IN GENERAL.—The Secretary of Housing and Urban Development may designate a nominated area as a renewal community under subsection (a) only if the area meets the requirements of paragraphs (2) and (3) of this subsection.

"(2) AREA REQUIREMENTS.—A nominated area meets the requirements of this paragraph if—

"(A) the area is within the jurisdiction of one or more local governments;

"(B) the boundary of the area is continuous; and

"(C) the area—

"(i) has a population, of at least—

"(I) 4,000 if any portion of such area (other than a rural area described in subsection (a)(2)(B)(i)) is located within a metropolitan statistical area (within the meaning of section 143(k)(2)(B)) which has a population of 50,000 or greater; or

"(II) 1,000 in any other case; or

"(ii) is entirely within an Indian reservation (as determined by the Secretary of the Interior).

"(3) ELIGIBILITY REQUIREMENTS.—A nominated area meets the requirements of this paragraph if the State and the local governments in which it is located certify (and the Secretary of Housing and Urban Development, after such review of supporting data as he deems appropriate, accepts such certification) that—

"(A) the area is one of pervasive poverty, unemployment, and general distress;

"(B) the unemployment rate in the area, as determined by the most recent available data, was at least 1½ times the national unemployment rate for the period to which such data relate;

"(C) the poverty rate for each population census tract within the nominated area is at least 20 percent; and

"(D) in the case of an urban area, at least 70 percent of the households living in the area have incomes below 80 percent of the median income of households within the jurisdiction of the local government (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974).

"(4) CONSIDERATION OF HIGH INCIDENCE OF CRIME.—The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, the extent to which such areas have a high incidence of crime.

"(5) CONSIDERATION OF COMMUNITIES IDENTIFIED IN GAO STUDY.—The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, if the area has census tracts identified in the May 12, 1998, report of the Government Accounting Office regarding the identification of economically distressed areas.

"(d) REQUIRED STATE AND LOCAL COMMITMENTS.—

"(1) IN GENERAL.—The Secretary of Housing and Urban Development may designate any nominated area as a renewal community under subsection (a) only if—

"(A) the local government and the State in which the area is located agree in writing that, during any period during which the area is a renewal community, such governments will follow a specified course of action which meets the requirements of paragraph (2) and is designed to reduce the various burdens borne by employers or employees in such area; and

"(B) the economic growth promotion requirements of paragraph (3) are met.

"(2) COURSE OF ACTION.—

"(A) IN GENERAL.—A course of action meets the requirements of this paragraph if such course of action is a written document, signed by a State (or local government) and neighborhood organizations, which evidences a partnership between such State or government and community-based organizations and which commits each signatory to specific and measurable goals, actions, and timetables. Such course of action shall include at least five of the following:

"(i) A reduction of tax rates or fees applying within the renewal community.

“(ii) An increase in the level of efficiency of local services within the renewal community.

“(iii) Crime reduction strategies, such as crime prevention (including the provision of such services by nongovernmental entities).

“(iv) Actions to reduce, remove, simplify, or streamline governmental requirements applying within the renewal community.

“(v) Involvement in the program by private entities, organizations, neighborhood organizations, and community groups, particularly those in the renewal community, including a commitment from such private entities to provide jobs and job training for, and technical, financial, or other assistance to, employers, employees, and residents from the renewal community.

“(vi) State or local income tax benefits for fees paid for services performed by a nongovernmental entity which were formerly performed by a governmental entity.

“(vii) The gift (or sale at below fair market value) of surplus real property (such as land, homes, and commercial or industrial structures) in the renewal community to neighborhood organizations, community development corporations, or private companies.

“(B) RECOGNITION OF PAST EFFORTS.—For purposes of this section, in evaluating the course of action agreed to by any State or local government, the Secretary of Housing and Urban Development shall take into account the past efforts of such State or local government in reducing the various burdens borne by employers and employees in the area involved.

“(3) ECONOMIC GROWTH PROMOTION REQUIREMENTS.—The economic growth promotion requirements of this paragraph are met with respect to a nominated area if the local government and the State in which such area is located certify in writing that such government and State, respectively, have repealed or otherwise will not enforce within the area, if such area is designated as a renewal community—

“(A) licensing requirements for occupations that do not ordinarily require a professional degree;

“(B) zoning restrictions on home-based businesses which do not create a public nuisance;

“(C) permit requirements for street vendors who do not create a public nuisance;

“(D) zoning or other restrictions that impede the formation of schools or child care centers; and

“(E) franchises or other restrictions on competition for businesses providing public services, including but not limited to taxicabs, jitneys, cable television, or trash hauling,

except to the extent that such regulation of businesses and occupations is necessary for and well-tailored to the protection of health and safety.

“(e) COORDINATION WITH TREATMENT OF EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES.—For purposes of this title, if there are in effect with respect to the same area both—

“(1) a designation as a renewal community; and

“(2) a designation as an empowerment zone or enterprise community,

both of such designations shall be given full effect with respect to such area.

“(f) DEFINITIONS AND SPECIAL RULES.—For purposes of this subchapter—

“(1) GOVERNMENTS.—If more than one government seeks to nominate an area as a renewal community, any reference to, or requirement of, this section shall apply to all such governments.

“(2) STATE.—The term ‘State’ includes Puerto Rico, the Virgin Islands of the United States, Guam, American Samoa, the Northern Mariana Islands, and any other possession of the United States.

“(3) LOCAL GOVERNMENT.—The term ‘local government’ means—

“(A) any county, city, town, township, parish, village, or other general purpose political subdivision of a State;

“(B) any combination of political subdivisions described in subparagraph (A) recognized by the Secretary of Housing and Urban Development; and

“(C) the District of Columbia.

“(4) APPLICATION OF RULES RELATING TO CENSUS TRACTS AND CENSUS DATA.—The rules of sections 1392(b)(4) and 1393(a)(9) shall apply.

"PART II—RENEWAL COMMUNITY CAPITAL GAIN; RENEWAL COMMUNITY BUSINESS

"SEC. 1400F. RENEWAL COMMUNITY CAPITAL GAIN.

"(a) GENERAL RULE.—Gross income does not include any qualified capital gain recognized on the sale or exchange of a qualified community asset held for more than 5 years.

"(b) QUALIFIED COMMUNITY ASSET.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified community asset' means—

"(A) any qualified community stock;

"(B) any qualified community partnership interest; and

"(C) any qualified community business property.

"(2) QUALIFIED COMMUNITY STOCK.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'qualified community stock' means any stock in a domestic corporation if—

"(i) such stock is acquired by the taxpayer after December 31, 2000, and before January 1, 2008, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash;

"(ii) as of the time such stock was issued, such corporation was a renewal community business (or, in the case of a new corporation, such corporation was being organized for purposes of being a renewal community business); and

"(iii) during substantially all of the taxpayer's holding period for such stock, such corporation qualified as a renewal community business.

"(B) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

"(3) QUALIFIED COMMUNITY PARTNERSHIP INTEREST.—The term 'qualified community partnership interest' means any capital or profits interest in a domestic partnership if—

"(A) such interest is acquired by the taxpayer after December 31, 2000, and before January 1, 2008;

"(B) as of the time such interest was acquired, such partnership was a renewal community business (or, in the case of a new partnership, such partnership was being organized for purposes of being a renewal community business); and

"(C) during substantially all of the taxpayer's holding period for such interest, such partnership qualified as a renewal community business.

A rule similar to the rule of paragraph (2)(B) shall apply for purposes of this paragraph.

"(4) QUALIFIED COMMUNITY BUSINESS PROPERTY.—

"(A) IN GENERAL.—The term 'qualified community business property' means tangible property if—

"(i) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 2000, and before January 1, 2008;

"(ii) the original use of such property in the renewal community commences with the taxpayer; and

"(iii) during substantially all of the taxpayer's holding period for such property, substantially all of the use of such property was in a renewal community business of the taxpayer.

"(B) SPECIAL RULE FOR SUBSTANTIAL IMPROVEMENTS.—The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as satisfied with respect to—

"(i) property which is substantially improved (within the meaning of section 1400B(b)(4)(B)(ii)) by the taxpayer before January 1, 2008; and

"(ii) any land on which such property is located.

"(c) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (b), and subsections (e), (f), and (g), of section 1400B shall apply for purposes of this section.

"SEC. 1400G. RENEWAL COMMUNITY BUSINESS DEFINED.

"For purposes of this part, the term 'renewal community business' means any entity or proprietorship which would be a qualified business entity or qualified proprietorship under section 1397B if—

"(1) references to renewal communities were substituted for references to empowerment zones in such section; and

"(2) '80 percent' were substituted for '50 percent' in subsections (b)(2) and (c)(1) of such section.

"PART III—FAMILY DEVELOPMENT ACCOUNTS

"SEC. 1400H. FAMILY DEVELOPMENT ACCOUNTS FOR RENEWAL COMMUNITY EITC RECIPIENTS.

"(a) ALLOWANCE OF DEDUCTION.—

"(1) IN GENERAL.—There shall be allowed as a deduction—

"(A) in the case of a qualified individual, the amount paid in cash for the taxable year by such individual to any family development account for such individual's benefit; and

"(B) in the case of any person other than a qualified individual, the amount paid in cash for the taxable year by such person to any family development account for the benefit of a qualified individual but only if the amount so paid is designated for purposes of this section by such individual.

No deduction shall be allowed under this paragraph for any amount deposited in a family development account under section 1400I (relating to demonstration program to provide matching amounts in renewal communities).

"(2) LIMITATION.—

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

"(i) $2,000, or

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

"(B) PERSONS DONATING TO FAMILY DEVELOPMENT ACCOUNTS OF OTHERS.—The amount which may be designated under paragraph (1)(B) by any qualified individual for any taxable year of such individual shall not exceed $1,000.

"(3) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS.—Rules similar to rules of section 219(c) shall apply to the limitation in paragraph (2)(A).

"(4) COORDINATION WITH IRAS.—No deduction shall be allowed under this section for any taxable year to any person by reason of a payment to an account for the benefit of a qualified individual if any amount is paid for such taxable year into an individual retirement account (including a Roth IRA) for the benefit of such individual.

"(5) ROLLOVERS.—No deduction shall be allowed under this section with respect to any rollover contribution.

"(b) TAX TREATMENT OF DISTRIBUTIONS.—

"(1) INCLUSION OF AMOUNTS IN GROSS INCOME.—Except as otherwise provided in this subsection, any amount paid or distributed out of a family development account shall be included in gross income by the payee or distributee, as the case may be.

"(2) EXCLUSION OF QUALIFIED FAMILY DEVELOPMENT DISTRIBUTIONS.—Paragraph (1) shall not apply to any qualified family development distribution.

"(c) QUALIFIED FAMILY DEVELOPMENT DISTRIBUTION.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified family development distribution' means any amount paid or distributed out of a family development account which would otherwise be includible in gross income, to the extent that such payment or distribution is used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder.

"(2) QUALIFIED FAMILY DEVELOPMENT EXPENSES.—The term 'qualified family development expenses' means any of the following:

"(A) Qualified higher education expenses.

"(B) Qualified first-time homebuyer costs.

"(C) Qualified business capitalization costs.

"(D) Qualified medical expenses.

"(E) Qualified rollovers.

"(3) QUALIFIED HIGHER EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified higher education expenses' has the meaning given such term by section 72(t)(7), determined by treating postsecondary vocational educational schools as eligible educational institutions.

"(B) POSTSECONDARY VOCATIONAL EDUCATION SCHOOL.—The term 'postsecondary vocational educational school' means an area vocational education school (as defined in subparagraph (C) or (D) of section 521(4) of the Carl D. Perkins Vocational and Applied Technology Education Act (20 U.S.C. 2471(4))) which is in any State (as defined in section 521(33) of such Act), as such sections are in effect on the date of the enactment of this section.

"(C) COORDINATION WITH OTHER BENEFITS.—The amount of qualified higher education expenses for any taxable year shall be reduced as provided in section 25A(g)(2).

"(4) QUALIFIED FIRST-TIME HOMEBUYER COSTS.—The term 'qualified first-time homebuyer costs' means qualified acquisition costs (as defined in section 72(t)(8) without regard to subparagraph (B) thereof) with respect to a principal residence (within the meaning of section 121) for a qualified first-time homebuyer (as defined in section 72(t)(8)).

"(5) QUALIFIED BUSINESS CAPITALIZATION COSTS.—

"(A) IN GENERAL.—The term 'qualified business capitalization costs' means qualified expenditures for the capitalization of a qualified business pursuant to a qualified plan.

"(B) QUALIFIED EXPENDITURES.—The term 'qualified expenditures' means expenditures included in a qualified plan, including capital, plant, equipment, working capital, and inventory expenses.

"(C) QUALIFIED BUSINESS.—The term 'qualified business' means any trade or business other than any trade or business—

"(i) which consists of the operation of any facility described in section 144(c)(6)(B), or

"(ii) which contravenes any law.

"(D) QUALIFIED PLAN.—The term 'qualified plan' means a business plan which meets such requirements as the Secretary may specify.

"(6) QUALIFIED MEDICAL EXPENSES.—The term 'qualified medical expenses' means any amount paid during the taxable year, not compensated for by insurance or otherwise, for medical care (as defined in section 213(d)) of the taxpayer, his spouse, or his dependent (as defined in section 152).

"(7) QUALIFIED ROLLOVERS.—The term 'qualified rollover' means any amount paid from a family development account of a taxpayer into another such account established for the benefit of—

"(A) such taxpayer, or

"(B) any qualified individual who is—

"(i) the spouse of such taxpayer, or

"(ii) any dependent (as defined in section 152) of the taxpayer.

Rules similar to the rules of section 408(d)(3) shall apply for purposes of this paragraph.

"(d) TAX TREATMENT OF ACCOUNTS.—

"(1) IN GENERAL.—Any family development account is exempt from taxation under this subtitle unless such account has ceased to be a family development account by reason of paragraph (2). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc., organizations). Notwithstanding any other provision of this title (including chapters 11 and 12), the basis of any person in such an account is zero.

"(2) LOSS OF EXEMPTION IN CASE OF PROHIBITED TRANSACTIONS.—For purposes of this section, rules similar to the rules of section 408(e) shall apply.

"(3) OTHER RULES TO APPLY.—Rules similar to the rules of paragraphs (4), (5), and (6) of section 408(d) shall apply for purposes of this section.

"(e) FAMILY DEVELOPMENT ACCOUNT.—For purposes of this title, the term 'family development account' means a trust created or organized in the United States for the exclusive benefit of a qualified individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements:

"(1) Except in the case of a qualified rollover (as defined in subsection (c)(7))—

"(A) no contribution will be accepted unless it is in cash; and

"(B) contributions will not be accepted for the taxable year in excess of $3,000 (determined without regard to any contribution made under section 1400I (relating to demonstration program to provide matching amounts in renewal communities)).

"(2) The requirements of paragraphs (2) through (6) of section 408(a) are met.

"(f) QUALIFIED INDIVIDUAL.—For purposes of this section, the term 'qualified individual' means, for any taxable year, an individual—

"(1) who is a bona fide resident of a renewal community throughout the taxable year; and

"(2) to whom a credit was allowed under section 32 for the preceding taxable year.

"(g) OTHER DEFINITIONS AND SPECIAL RULES.—

"(1) COMPENSATION.—The term 'compensation' has the meaning given such term by section 219(f)(1).

"(2) MARRIED INDIVIDUALS.—The maximum deduction under subsection (a) 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 a family development account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).

"(4) EMPLOYER PAYMENTS; CUSTODIAL ACCOUNTS.—Rules similar to the rules of sections 219(f)(5) and 408(h) shall apply for purposes of this section.

"(5) REPORTS.—The trustee of a family development account shall make such reports regarding such account to the Secretary and to the individual for whom the account is maintained with respect to contributions (and the years to which they relate), distributions, and such other matters as the Secretary may require under regulations. The reports required by this paragraph—

"(A) shall be filed at such time and in such manner as the Secretary prescribes in such regulations; and

"(B) shall be furnished to individuals—

"(i) not later than January 31 of the calendar year following the calendar year to which such reports relate; and

"(ii) in such manner as the Secretary prescribes in such regulations.

"(6) INVESTMENT IN COLLECTIBLES TREATED AS DISTRIBUTIONS.—Rules similar to the rules of section 408(m) shall apply for purposes of this section.

"(h) PENALTY FOR DISTRIBUTIONS NOT USED FOR QUALIFIED FAMILY DEVELOPMENT EXPENSES.—

"(1) IN GENERAL.—If any amount is distributed from a family development account and is not used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder, the tax imposed by this chapter for the taxable year of such distribution shall be increased by the sum of—

"(A) 100 percent of the portion of such amount which is includible in gross income and is attributable to amounts contributed under section 1400I (relating to demonstration program to provide matching amounts in renewal communities); and

"(B) 10 percent of the portion of such amount which is includible in gross income and is not described in subparagraph (A).

For purposes of this subsection, distributions which are includable in gross income shall be treated as attributable to amounts contributed under section 1400I to the extent thereof. For purposes of the preceding sentence, all family development accounts of an individual shall be treated as one account.

"(2) EXCEPTION FOR CERTAIN DISTRIBUTIONS.—Paragraph (1) shall not apply to distributions which are—

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

"(B) made to a beneficiary (or the estate of the account holder) on or after the death of the account holder, or

"(C) attributable to the account holder's being disabled within the meaning of section 72(m)(7).

"(i) APPLICATION OF SECTION.—This section shall apply to amounts paid to a family development account for any taxable year beginning after December 31, 2000, and before January 1, 2008.

"SEC. 1400I. DEMONSTRATION PROGRAM TO PROVIDE MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS IN CERTAIN RENEWAL COMMUNITIES.

"(a) DESIGNATION.—

"(1) DEFINITIONS.—For purposes of this section, the term 'FDA matching demonstration area' means any renewal community—

"(A) which is nominated under this section by each of the local governments and States which nominated such community for designation as a renewal community under section 1400E(a)(1)(A); and

"(B) which the Secretary of Housing and Urban Development designates as an FDA matching demonstration area after consultation with—

"(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration; and

"(ii) in the case of a community on an Indian reservation, the Secretary of the Interior.

"(2) NUMBER OF DESIGNATIONS.—

"(A) IN GENERAL.—The Secretary of Housing and Urban Development may designate not more than 5 renewal communities as FDA matching demonstration areas.

"(B) MINIMUM DESIGNATION IN RURAL AREAS.—Of the areas designated under subparagraph (A), at least 2 must be areas described in section 1400E(a)(2)(B).

"(3) LIMITATIONS ON DESIGNATIONS.—

"(A) PUBLICATION OF REGULATIONS.—The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)—

"(i) the procedures for nominating a renewal community under paragraph (1)(A) (including procedures for coordinating such nomination with the nomination of an area for designation as a renewal community under section 1400E); and

"(ii) the manner in which nominated renewal communities will be evaluated for purposes of this section.

"(B) TIME LIMITATIONS.—The Secretary of Housing and Urban Development may designate renewal communities as FDA matching demonstration areas only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

"(4) DESIGNATION BASED ON DEGREE OF POVERTY, ETC.—The rules of section 1400E(a)(3) shall apply for purposes of designations of FDA matching demonstration areas under this section.

"(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—Any designation of a renewal community as an FDA matching demonstration area shall remain in effect during the period beginning on the date of such designation and ending on the date on which such area ceases to be a renewal community.

"(c) MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS.—

"(1) IN GENERAL.—Not less than once each taxable year, the Secretary shall deposit (to the extent provided in appropriation Acts) into a family development account of each qualified individual (as defined in section 1400H(f))—

"(A) who is a resident throughout the taxable year of an FDA matching demonstration area; and

"(B) who requests (in such form and manner as the Secretary prescribes) such deposit for the taxable year,

an amount equal to the sum of the amounts deposited into all of the family development accounts of such individual during such taxable year (determined without regard to any amount contributed under this section).

"(2) LIMITATIONS.—

"(A) ANNUAL LIMIT.—The Secretary shall not deposit more than $1000 under paragraph (1) with respect to any individual for any taxable year.

"(B) AGGREGATE LIMIT.—The Secretary shall not deposit more than $2000 under paragraph (1) with respect to any individual for all taxable years.

"(3) EXCLUSION FROM INCOME.—Except as provided in section 1400H, gross income shall not include any amount deposited into a family development account under paragraph (1).

"(d) NOTICE OF PROGRAM.—The Secretary shall provide appropriate notice to residents of FDA matching demonstration areas of the availability of the benefits under this section.

"(e) TERMINATION.—No amount may be deposited under this section for any taxable year beginning after December 31, 2007.

“SEC. 1400J. DESIGNATION OF EARNED INCOME TAX CREDIT PAYMENTS FOR DEPOSIT TO FAMILY DEVELOPMENT ACCOUNT.

“(a) IN GENERAL.—With respect to the return of any qualified individual (as defined in section 1400H(f)) for the taxable year of the tax imposed by this chapter, such individual may designate that a specified portion (not less than $1) of any overpayment of tax for such taxable year which is attributable to the earned income tax credit shall be deposited by the Secretary into a family development account of such individual. The Secretary shall so deposit such portion designated under this subsection.

“(b) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year—

“(1) at the time of filing the return of the tax imposed by this chapter for such taxable year, or

“(2) at any other time (after the time of filing the return of the tax imposed by this chapter for such taxable year) specified in regulations prescribed by the Secretary.

Such designation shall be made in such manner as the Secretary prescribes by regulations.

“(c) PORTION ATTRIBUTABLE TO EARNED INCOME TAX CREDIT.—For purposes of subsection (a), an overpayment for any taxable year shall be treated as attributable to the earned income tax credit to the extent that such overpayment does not exceed the credit allowed to the taxpayer under section 32 for such taxable year.

“(d) OVERPAYMENTS TREATED AS REFUNDED.—For purposes of this title, any portion of an overpayment of tax designated under subsection (a) shall be treated as being refunded to the taxpayer as of the last date prescribed for filing the return of tax imposed by this chapter (determined without regard to extensions) or, if later, the date the return is filed.

“(e) TERMINATION.—This section shall not apply to any taxable year beginning after December 31, 2007.

“PART IV—ADDITIONAL INCENTIVES

“SEC. 1400K. COMMERCIAL REVITALIZATION DEDUCTION.

“(a) GENERAL RULE.—At the election of the taxpayer, either—

“(1) one-half of any qualified revitalization expenditures chargeable to capital account with respect to any qualified revitalization building shall be allowable as a deduction for the taxable year in which the building is placed in service, or

“(2) a deduction for all such expenditures shall be allowable ratably over the 120-month period beginning with the month in which the building is placed in service.

The deduction provided by this section with respect to such expenditure shall be in lieu of any depreciation deduction otherwise allowable on account of such expenditure.

“(b) QUALIFIED REVITALIZATION BUILDINGS AND EXPENDITURES.—For purposes of this section—

“(1) QUALIFIED REVITALIZATION BUILDING.—The term ‘qualified revitalization building’ means any building (and its structural components) if—

“(A) such building is located in a renewal community and is placed in service after December 31, 2000;

“(B) a commercial revitalization deduction amount is allocated to the building under subsection (d); and

“(C) depreciation (or amortization in lieu of depreciation) is allowable with respect to the building (without regard to this section).

“(2) QUALIFIED REVITALIZATION EXPENDITURE.—

“(A) IN GENERAL.—The term ‘qualified revitalization expenditure’ means any amount properly chargeable to capital account—

“(i) for property for which depreciation is allowable under section 168 (without regard to this section) and which is—

“(I) nonresidential real property; or

“(II) an addition or improvement to property described in subclause (I);

“(ii) in connection with the construction of any qualified revitalization building which was not previously placed in service or in connection with the substantial rehabilitation (within the meaning of section

47(c)(1)(C)) of a building which was placed in service before the beginning of such rehabilitation; and

"(iii) for land (including land which is functionally related to such property and subordinate thereto).

"(B) DOLLAR LIMITATION.—The aggregate amount which may be treated as qualified revitalization expenditures with respect to any qualified revitalization building for any taxable year shall not exceed the excess of—

"(i) $10,000,000, reduced by

"(ii) any such expenditures with respect to the building taken into account by the taxpayer or any predecessor in determining the amount of the deduction under this section for all preceding taxable years.

"(C) CERTAIN EXPENDITURES NOT INCLUDED.—The term 'qualified revitalization expenditure' does not include—

"(i) ACQUISITION COSTS.—The costs of acquiring any building or interest therein and any land in connection with such building to the extent that such costs exceed 30 percent of the qualified revitalization expenditures determined without regard to this clause.

"(ii) CREDITS.—Any expenditure which the taxpayer may take into account in computing any credit allowable under this title unless the taxpayer elects to take the expenditure into account only for purposes of this section.

"(c) WHEN EXPENDITURES TAKEN INTO ACCOUNT.—Qualified revitalization expenditures with respect to any qualified revitalization building shall be taken into account for the taxable year in which the qualified revitalization building is placed in service. For purposes of the preceding sentence, a substantial rehabilitation of a building shall be treated as a separate building.

"(d) LIMITATION ON AGGREGATE DEDUCTIONS ALLOWABLE WITH RESPECT TO BUILDINGS LOCATED IN A STATE.—

"(1) IN GENERAL.—The amount of the deduction determined under this section for any taxable year with respect to any building shall not exceed the commercial revitalization deduction amount (in the case of an amount determined under subsection (a)(2), the present value of such amount as determined under the rules of section 42(b)(2)(C) by substituting '100 percent' for '72 percent' in clause (ii) thereof) allocated to such building under this subsection by the commercial revitalization agency. Such allocation shall be made at the same time and in the same manner as under paragraphs (1) and (7) of section 42(h).

"(2) COMMERCIAL REVITALIZATION DEDUCTION AMOUNT FOR AGENCIES.—

"(A) IN GENERAL.—The aggregate commercial revitalization deduction amount which a commercial revitalization agency may allocate for any calendar year is the amount of the State commercial revitalization deduction ceiling determined under this paragraph for such calendar year for such agency.

"(B) STATE COMMERCIAL REVITALIZATION DEDUCTION CEILING.—The State commercial revitalization deduction ceiling applicable to any State—

"(i) for each calendar year after 2000 and before 2008 is $6,000,000 for each renewal community in the State; and

"(ii) zero for each calendar year thereafter.

"(C) COMMERCIAL REVITALIZATION AGENCY.—For purposes of this section, the term 'commercial revitalization agency' means any agency authorized by a State to carry out this section.

"(e) RESPONSIBILITIES OF COMMERCIAL REVITALIZATION AGENCIES.—

"(1) PLANS FOR ALLOCATION.—Notwithstanding any other provision of this section, the commercial revitalization deduction amount with respect to any building shall be zero unless—

"(A) such amount was allocated pursuant to a qualified allocation plan of the commercial revitalization agency which is approved (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) by the governmental unit of which such agency is a part; and

"(B) such agency notifies the chief executive officer (or its equivalent) of the local jurisdiction within which the building is located of such allocation and provides such individual a reasonable opportunity to comment on the allocation.

"(2) QUALIFIED ALLOCATION PLAN.—For purposes of this subsection, the term 'qualified allocation plan' means any plan—

"(A) which sets forth selection criteria to be used to determine priorities of the commercial revitalization agency which are appropriate to local conditions;

"(B) which considers—

"(i) the degree to which a project contributes to the implementation of a strategic plan that is devised for a renewal community through a citizen participation process;

"(ii) the amount of any increase in permanent, full-time employment by reason of any project; and

"(iii) the active involvement of residents and nonprofit groups within the renewal community; and

"(C) which provides a procedure that the agency (or its agent) will follow in monitoring compliance with this section.

"(f) REGULATIONS.—For purposes of this section, the Secretary shall, by regulations, provide for the application of rules similar to the rules of section 49 and subsections (a) and (b) of section 50.

"(g) TERMINATION.—This section shall not apply to any building placed in service after December 31, 2007.

"SEC. 1400L. INCREASE IN EXPENSING UNDER SECTION 179.

"(a) GENERAL RULE.—In the case of a renewal community business (as defined in section 1400G), for purposes of section 179—

"(1) the limitation under section 179(b)(1) shall be increased by the lesser of—

"(A) $35,000; or

"(B) the cost of section 179 property which is qualified renewal property placed in service during the taxable year; and

"(2) the amount taken into account under section 179(b)(2) with respect to any section 179 property which is qualified renewal property shall be 50 percent of the cost thereof.

"(b) RECAPTURE.—Rules similar to the rules under section 179(d)(10) shall apply with respect to any qualified renewal property which ceases to be used in a renewal community by a renewal community business.

"(c) QUALIFIED RENEWAL PROPERTY.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified renewal property' means any property to which section 168 applies (or would apply but for section 179) if—

"(A) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 2000, and before January 1, 2008; and

"(B) such property would be qualified zone property (as defined in section 1397C) if references to renewal communities were substituted for references to empowerment zones in section 1397C.

"(2) CERTAIN RULES TO APPLY.—The rules of subsections (a)(2) and (b) of section 1397C shall apply for purposes of this section.".

SEC. 703. EXTENSION OF EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS TO RENEWAL COMMUNITIES.

(a) EXTENSION.—Paragraph (2) of section 198(c) (defining targeted area) is amended by redesignating subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

"(C) RENEWAL COMMUNITIES INCLUDED.—Except as provided in subparagraph (B), such term shall include a renewal community (as defined in section 1400E) with respect to expenditures paid or incurred after December 31, 2000.".

(b) EXTENSION OF TERMINATION DATE FOR RENEWAL COMMUNITIES.—Subsection (h) of section 198 is amended by inserting before the period "(December 31, 2007, in the case of a renewal community, as defined in section 1400E).".

SEC. 704. EXTENSION OF WORK OPPORTUNITY TAX CREDIT FOR RENEWAL COMMUNITIES

(a) EXTENSION.—Subsection (c) of section 51 (relating to termination) is amended by adding at the end the following new paragraph:

"(5) EXTENSION OF CREDIT FOR RENEWAL COMMUNITIES.—

"(A) IN GENERAL.—In the case of an individual who begins work for the employer after the date contained in paragraph (4)(B), for purposes of section 38—

"(i) in lieu of applying subsection (a), the amount of the work opportunity credit determined under this section for the taxable year shall be equal to—

"(I) 15 percent of the qualified first-year wages for such year; and

"(II) 30 percent of the qualified second-year wages for such year;

"(ii) subsection (b)(3) shall be applied by substituting '$10,000' for '$6,000';

"(iii) paragraph (4)(B) shall be applied by substituting for the date contained therein the last day for which the designation under section 1400E of the renewal community referred to in subparagraph (B)(i) is in effect; and

"(iv) rules similar to the rules of section 51A(b)(5)(C) shall apply.

"(B) QUALIFIED FIRST- AND SECOND-YEAR WAGES.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'qualified wages' means, with respect to each 1-year period referred to in clause (ii) or (iii), as the case may be, the wages paid or incurred by the employer during the taxable year to any individual but only if—

"(I) the employer is engaged in a trade or business in a renewal community throughout such 1-year period;

"(II) the principal place of abode of such individual is in such renewal community throughout such 1-year period; and

"(III) substantially all of the services which such individual performs for the employer during such 1-year period are performed in such renewal community.

"(ii) QUALIFIED FIRST-YEAR WAGES.—The term 'qualified first-year wages' means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning with the day the individual begins work for the employer.

"(iii) QUALIFIED SECOND-YEAR WAGES.—The term 'qualified second-year wages' means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning on the day after the last day of the 1-year period with respect to such individual determined under clause (ii).".

(b) CONGRUENT TREATMENT OF RENEWAL COMMUNITIES AND ENTERPRISE ZONES FOR PURPOSES OF YOUTH RESIDENCE REQUIREMENTS.—

(1) HIGH-RISK YOUTH.—Subparagraphs (A)(ii) and (B) of section 51(d)(5) are each amended by striking "empowerment zone or enterprise community" and inserting "empowerment zone, enterprise community, or renewal community".

(2) QUALIFIED SUMMER YOUTH EMPLOYEE.—Clause (iv) of section 51(d)(7)(A) is amended by striking "empowerment zone or enterprise community" and inserting "empowerment zone, enterprise community, or renewal community".

(3) HEADINGS.—Paragraphs (5)(B) and (7)(C) of section 51(d) are each amended by inserting "OR COMMUNITY" in the heading after "ZONE".

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to individuals who begin work for the employer after December 31, 2000.

SEC. 705. CONFORMING AND CLERICAL AMENDMENTS.

(a) DEDUCTION FOR CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS ALLOWABLE WHETHER OR NOT TAXPAYER ITEMIZES.—Subsection (a) of section 62 (relating to adjusted gross income defined) is amended by inserting after paragraph (19) the following new paragraph:

"(20) FAMILY DEVELOPMENT ACCOUNTS.—The deduction allowed by section 1400H(a)(1).".

(b) TAX ON EXCESS CONTRIBUTIONS.—

(1) TAX IMPOSED.—Subsection (a) of section 4973 is amended by striking "or" at the end of paragraph (3), adding "or" at the end of paragraph (4), and inserting after paragraph (4) the following new paragraph:

"(5) a family development account (within the meaning of section 1400H(e)),".

(2) EXCESS CONTRIBUTIONS.—Section 4973 is amended by adding at the end the following new subsection:

"(g) FAMILY DEVELOPMENT ACCOUNTS.—For purposes of this section, in the case of family development accounts, the term 'excess contributions' means the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year to the accounts (other than a qualified rollover, as defined in section 1400H(c)(7), or a contribution under section 1400I), over

"(B) the amount allowable as a deduction under section 1400H for such contributions; and

"(2) the amount determined under this subsection for the preceding taxable year reduced by the sum of—

"(A) the distributions out of the accounts for the taxable year which were included in the gross income of the payee under section 1400H(b)(1);

"(B) the distributions out of the accounts for the taxable year to which rules similar to the rules of section 408(d)(5) apply by reason of section 1400H(d)(3); and

"(C) the excess (if any) of the maximum amount allowable as a deduction under section 1400H for the taxable year over the amount contributed to the account for the taxable year (other than a contribution under section 1400I).

For purposes of this subsection, any contribution which is distributed from the family development account in a distribution to which rules similar to the rules of section 408(d)(4) apply by reason of section 1400H(d)(3) shall be treated as an amount not contributed.".

(c) TAX ON PROHIBITED TRANSACTIONS.—Section 4975 is amended—

(1) by adding at the end of subsection (c) the following new paragraph:

"(6) SPECIAL RULE FOR FAMILY DEVELOPMENT ACCOUNTS.—An individual for whose benefit a family development account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a family development account by reason of the application of section 1400H(d)(2) to such account."; and

(2) in subsection (e)(1), by striking "or" at the end of subparagraph (E), by redesignating subparagraph (F) as subparagraph (G), and by inserting after subparagraph (E) the following new subparagraph:

"(F) a family development account described in section 1400H(e), or".

(d) INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY PLANS.—Subsection (c) of section 6047 is amended—

(1) by inserting "or section 1400H" after "section 219"; and

(2) by inserting ", of any family development account described in section 1400H(e),", after "section 408(a)".

(e) INSPECTION OF APPLICATIONS FOR TAX EXEMPTION.—Clause (i) of section 6104(a)(1)(B) is amended by inserting "a family development account described in section 1400H(e)," after "section 408(a),".

(f) FAILURE TO PROVIDE REPORTS ON FAMILY DEVELOPMENT ACCOUNTS.—Paragraph (2) of section 6693(a) is amended by striking "and" at the end of subparagraph (C), by striking the period and inserting ", and" at the end of subparagraph (D), and by adding at the end the following new subparagraph:

"(E) section 1400H(g)(6) (relating to family development accounts).".

(g) CONFORMING AMENDMENTS REGARDING COMMERCIAL REVITALIZATION DEDUCTION.—

(1) Section 172 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) NO CARRYBACK OF SECTION 1400K DEDUCTION BEFORE DATE OF ENACTMENT.—No portion of the net operating loss for any taxable year which is attributable to any commercial revitalization deduction determined under section 1400K may be carried back to a taxable year ending before the date of the enactment of section 1400K.".

(2) Subparagraph (B) of section 48(a)(2) is amended by inserting "or commercial revitalization" after "rehabilitation" each place it appears in the text and heading.

(3) Subparagraph (C) of section 469(i)(3) is amended—

(A) by inserting "or section 1400K" after "section 42"; and

(B) by inserting "AND COMMERCIAL REVITALIZATION DEDUCTION" after "CREDIT" in the heading.

(h) CLERICAL AMENDMENTS.—The table of subchapters for chapter 1 is amended by adding at the end the following new item:

"Subchapter X. Renewal Communities.".

SEC. 706. EVALUATION AND REPORTING REQUIREMENTS.

Not later than the close of the fourth calendar year after the year in which the Secretary of Housing and Urban Development first designates an area as a renewal community under section 1400E of the Internal Revenue Code of 1986, and at the close of each fourth calendar year thereafter, such Secretary shall prepare and submit to the Congress a report on the effects of such designations in stimulating the creation of new jobs, particularly for disadvantaged workers and long-term unemployed individuals, and promoting the revitalization of economically distressed areas.

Subtitle B—Farming Incentive

SEC. 711. PRODUCTION FLEXIBILITY CONTRACT PAYMENTS.

Any option to accelerate the receipt of any payment under a production flexibility contract which is payable under the Federal Agriculture Improvement and Reform Act of 1996 (7 U.S.C. 7200 et seq.), as in effect on the date of the enactment of this Act, shall be disregarded in determining the taxable year for which such payment is properly includible in gross income for purposes of the Internal Revenue Code of 1986.

Subtitle C—Oil and Gas Incentives

SEC. 721. 5-YEAR NET OPERATING LOSS CARRYBACK FOR LOSSES ATTRIBUTABLE TO OPERATING MINERAL INTERESTS OF INDEPENDENT OIL AND GAS PRODUCERS.

(a) IN GENERAL.—Paragraph (1) of section 172(b) (relating to years to which loss may be carried) is amended by adding at the end the following new subparagraph:

"(H) LOSSES ON OPERATING MINERAL INTERESTS OF INDEPENDENT OIL AND GAS PRODUCERS.—In the case of a taxpayer—

"(i) which has an eligible oil and gas loss (as defined in subsection (j)) for a taxable year, and

"(ii) which is not an integrated oil company (as defined in section 291(b)(4)),

such eligible oil and gas loss shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss."

(b) ELIGIBLE OIL AND GAS LOSS.—Section 172 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) ELIGIBLE OIL AND GAS LOSS.—For purposes of this section—

"(1) IN GENERAL.—The term 'eligible oil and gas loss' means the lesser of—

"(A) the amount which would be the net operating loss for the taxable year if only income and deductions attributable to operating mineral interests (as defined in section 614(d)) in oil and gas wells are taken into account, or

"(B) the amount of the net operating loss for such taxable year.

"(2) COORDINATION WITH SUBSECTION (b)(2).—For purposes of applying subsection (b)(2), an eligible oil and gas loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated.

"(3) ELECTION.—Any taxpayer entitled to a 5-year carryback under subsection (b)(1)(H) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to subsection (b)(1)(H)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to net operating losses for taxable years beginning after December 31, 1998.

SEC. 722. DEDUCTION FOR DELAY RENTAL PAYMENTS.

(a) IN GENERAL.—Section 263 (relating to capital expenditures) is amended by adding after subsection (i) the following new subsection:

"(j) DELAY RENTAL PAYMENTS FOR DOMESTIC OIL AND GAS WELLS.—

"(1) IN GENERAL.—Notwithstanding subsection (a), a taxpayer may elect to treat delay rental payments incurred in connection with the development of oil or gas within the United States (as defined in section 638) as payments which are not chargeable to capital account. Any payments so treated shall be allowed as a deduction in the taxable year in which paid or incurred.

"(2) DELAY RENTAL PAYMENTS.—For purposes of paragraph (1), the term 'delay rental payment' means an amount paid for the privilege of deferring development of an oil or gas well."

(b) CONFORMING AMENDMENT.—Section 263A(c)(3) is amended by inserting "263(j)," after "263(i),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 1999.

SEC. 723. ELECTION TO EXPENSE GEOLOGICAL AND GEOPHYSICAL EXPENDITURES.

(a) IN GENERAL.—Section 263 (relating to capital expenditures) is amended by adding after subsection (j) the following new subsection:

"(k) GEOLOGICAL AND GEOPHYSICAL EXPENDITURES FOR DOMESTIC OIL AND GAS WELLS.—Notwithstanding subsection (a), a taxpayer may elect to treat geological and geophysical expenses incurred in connection with the exploration for, or development of, oil or gas within the United States (as defined in section 638) as expenses which are not chargeable to capital account. Any expenses so treated shall be allowed as a deduction in the taxable year in which paid or incurred."

(b) CONFORMING AMENDMENT.—Section 263A(c)(3) is amended by inserting "263(k)," after "263(j),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to costs paid or incurred in taxable years beginning after December 31, 1999.

SEC. 724. TEMPORARY SUSPENSION OF LIMITATION BASED ON 65 PERCENT OF TAXABLE INCOME.

(a) IN GENERAL.—Subsection (d) of section 613A (relating to limitation on percentage depletion in case of oil and gas wells) is amended by adding at the end the following new paragraph:

"(6) TEMPORARY SUSPENSION OF TAXABLE INCOME LIMIT.—Paragraph (1) shall not apply to taxable years beginning after December 31, 1998, and before January 1, 2005, including with respect to amounts carried under the second sentence of paragraph (1) to such taxable years."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1998.

SEC. 725. DETERMINATION OF SMALL REFINER EXCEPTION TO OIL DEPLETION DEDUCTION.

(a) IN GENERAL.—Paragraph (4) of section 613A(d) (relating to certain refiners excluded) is amended to read as follows:

"(4) CERTAIN REFINERS EXCLUDED.—If the taxpayer or a related person engages in the refining of crude oil, subsection (c) shall not apply to the taxpayer for a taxable year if the average daily refinery runs of the taxpayer and the related person for the taxable year exceed 50,000 barrels. For purposes of this paragraph, the average daily refinery runs for any taxable year shall be determined by dividing the aggregate refinery runs for the taxable year by the number of days in the taxable year."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

Subtitle D—Timber Incentives

SEC. 731. TEMPORARY SUSPENSION OF MAXIMUM AMOUNT OF AMORTIZABLE REFORESTATION EXPENDITURES.

(a) INCREASE IN DOLLAR LIMITATION.—Paragraph (1) of section 194(b) (relating to amortization of reforestation expenditures) is amended by striking "$10,000 ($5,000" and inserting "$25,000 ($12,500".

(b) TEMPORARY SUSPENSION OF INCREASED DOLLAR LIMITATION.—Subsection (b) of section 194(b) (relating to amortization of reforestation expenditures) is amended by adding at the end the following new paragraph:

"(5) SUSPENSION OF DOLLAR LIMITATION.—Paragraph (1) shall not apply to taxable years beginning after December 31, 1999, and before January 1, 2004.

(c) CONFORMING AMENDMENT.—Paragraph (1) of section 48(b) is amended by striking "section 194(b)(1)" and inserting "section 194(b)(1) and without regard to section 194(b)(5)".".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1998.

SEC. 732. CAPITAL GAIN TREATMENT UNDER SECTION 631(b) TO APPLY TO OUTRIGHT SALES BY LAND OWNER.

(a) IN GENERAL.—Subsection (b) of section 631 (relating to disposal of timber with a retained economic interest) is amended—

(1) by inserting "AND OUTRIGHT SALES OF TIMBER" after ECONOMIC INTEREST" in the subsection heading, and

(2) by adding before the last sentence the following new sentence: "The requirement in the first sentence of this subsection to retain an economic interest in timber shall not apply to an outright sale of such timber by the owner thereof if such owner owned the land (at the time of such sale) from which the timber is cut."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to sales after the date of the enactment of this Act.

Subtitle E—Steel Industry Incentive

SEC. 741. MINIMUM TAX RELIEF FOR STEEL INDUSTRY.

(a) IN GENERAL.—Subsection (c) of section 53 (as amended by section 302) is amended by adding at the end the following new paragraph:

"(4) STEEL COMPANIES.—

"(A) IN GENERAL.—In the case of a corporation engaged in the trade or business of manufacturing steel in the United States for sale to customers, in lieu of applying paragraph (2), the limitation under paragraph (1) for any taxable year beginning after December 31, 1998, shall be increased (subject to the rule of the last sentence of paragraph (2)) by 90 percent of the tentative minimum tax.

"(B) LIMITATION.—The increase in the credit allowed by this section by reason of this paragraph for any taxable year shall not exceed the increase in the credit which would be so allowed if the trade or business of such corporation of manufacturing steel in the United States for sale to customers were a separate taxpayer.

"(C) REGULATIONS.—The Secretary shall prescribe regulations to prevent the abuse of the purposes of this paragraph, including regulations to prevent the benefits of this paragraph from becoming available to any other corporation through any reorganization or other acquisition."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1998.

TITLE VIII—RELIEF FOR SMALL BUSINESSES

SEC. 801. DEDUCTION FOR 100 PERCENT OF HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) IN GENERAL.—Paragraph (1) of section 162(l) is amended to read as follows:

"(1) ALLOWANCE OF DEDUCTION.—In the case of an individual who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to 100 percent of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 802. INCREASE IN EXPENSE TREATMENT FOR SMALL BUSINESSES.

(a) IN GENERAL.—Paragraph (1) of section 179(b) (relating to dollar limitation) is amended to read as follows:

"(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $30,000.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 803. REPEAL OF FEDERAL UNEMPLOYMENT SURTAX.

(a) IN GENERAL.—Section 3301 (relating to rate of Federal unemployment tax) is amended—

(1) by striking "2007" and inserting "2004", and

(2) by striking "2008" and inserting "2005".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to calendar years beginning after the date of the enactment of this Act.

SEC. 804. RESTORATION OF 80 PERCENT DEDUCTION FOR MEAL EXPENSES.

(a) IN GENERAL.—Paragraph (1) of section 274(n) (relating to only 50 percent of meal and entertainment expenses allowed as deduction) is amended by striking "50 percent" in the text and inserting "the allowable percentage".

(b) ALLOWABLE PERCENTAGES.—Subsection (n) of section 274 is amended by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (2) the following new paragraph:

"(2) ALLOWABLE PERCENTAGE.—For purposes of paragraph (1), the allowable percentage is—

"(A) in the case of amounts for items described in paragraph (1)(B), 50 percent, and

"(B) in the case of expenses for food or beverages, the percentage determined in accordance with the following table:

“For taxable years beginning in calendar year—	The allowable percentage is—
2000 through 2004	50
2005	55
2006	60
2007	65
2008	70
2009	75
2010 and thereafter	80.”

(b) CONFORMING AMENDMENTS.—

(1) The heading for subsection (n) of section 274 is amended by striking “50 PERCENT” and inserting “LIMITED PERCENTAGES”.

(2) Subparagraph (A) of section 274(n)(4), as redesignated by subsection (a), is amended by striking “50 percent” and inserting “the allowable percentage”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

TITLE IX—INTERNATIONAL TAX RELIEF

SEC. 901. INTEREST ALLOCATION RULES.

(a) ELECTION TO ALLOCATE INTEREST ON A WORLDWIDE BASIS.—Subsection (e) of section 864 (relating to rules for allocating interest, etc.) is amended by redesignating paragraphs (6) and (7) as paragraphs (7) and (8), respectively, and by inserting after paragraph (5) the following new paragraph:

“(6) ELECTION TO ALLOCATE INTEREST ON A WORLDWIDE BASIS.—

“(A) IN GENERAL.—Except as provided in this paragraph, this subsection shall be applied by treating each worldwide affiliated group for which an election under this paragraph is in effect as an affiliated group solely for purposes of allocating and apportioning interest expense of domestic corporations which are members of such group.

“(B) WORLDWIDE AFFILIATED GROUP.—For purposes of this paragraph, the term ‘worldwide affiliated group’ means the group of corporations which consists of—

“(i) all corporations in an affiliated group (as defined in paragraph (5)), and

“(ii) all foreign corporations (other than a FSC, as defined in section 922(a)) with respect to which corporations described in clause (i) own stock meeting the ownership requirements of section 957(a) (without regard to stock considered as owned under section 958(b)).

“(C) ALLOCATION.—

“(i) IN GENERAL.—For purposes of paragraph (1), only the applicable percentage of the interest expense and assets of a foreign corporation described in subparagraph (B)(ii) shall be taken into account.

“(ii) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the term ‘applicable percentage’ means, with respect to any foreign corporation, the percentage equal to the ratio which the value of the stock in such corporation taken into account under subparagraph (B)(ii) bears to the aggregate value of all stock in such corporation.

“(D) TREATMENT OF FOREIGN INTEREST EXPENSE.—Interest expense of domestic corporations which are members of an electing worldwide affiliated group which is allocated to foreign source income under this subsection shall be reduced (but not below zero) by the applicable percentage of the interest expense incurred by any foreign corporation in the electing worldwide affiliated group to the extent such interest expense of such foreign corporation would have been allocated and apportioned to foreign source income of such foreign corporation if this subsection were applied to a group consisting of all the foreign corporations in such affiliated group.

“(E) ELECTION.—An election under this paragraph with respect to any worldwide affiliated group may be made only by the common parent of the affiliated group referred to in subparagraph (B)(i) and may be made only for the first taxable year beginning after December 31, 2001, in which a worldwide affiliated group exists which includes such affiliated group and at least 1 corporation described in subparagraph (B)(ii). Such an election, once made, shall apply to such parent and all other corporations which are included in such worldwide affiliated group for such taxable year and all subsequent years unless revoked with the consent of the Secretary.”.

(b) ELECTION TO ALLOCATE INTEREST WITHIN FINANCIAL INSTITUTION GROUPS AND SUBSIDIARY GROUPS.—Section 864 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) ELECTION TO APPLY SUBSECTION (e) ON BASIS OF FINANCIAL INSTITUTION GROUP AND SUBSIDIARY GROUPS.—

"(1) IN GENERAL.—Subsection (e) shall be applied—

"(A) as if the electing financial institution group were a separate affiliated group, and

"(B) for purposes of allocating interest expense with respect to qualified indebtedness of members of an electing subsidiary group, as if each electing subsidiary group were a separate affiliated group.

Subsection (e) shall apply to any such electing group in the same manner as subsection (e) applies to the pre-election affiliated group of which such electing group is a part.

"(2) ELECTING FINANCIAL INSTITUTION GROUP.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'electing financial institution group' means any group of corporations if—

"(i) such group consists only of all of the financial corporations in the pre-election affiliated group, and

"(ii) an election under this paragraph is in effect for such group of corporations.

"(B) FINANCIAL CORPORATION.—The term 'financial corporation' means any corporation if at least 80 percent of its gross income is income described in section 904(d)(2)(C)(ii) and the regulations thereunder. To the extent provided in regulations prescribed by the Secretary, such term includes a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956).

"(C) EFFECT OF CERTAIN TRANSACTIONS.—Rules similar to the rules of paragraph (3)(D) shall apply to transactions between any member of the electing financial institution group and any member of the pre-election affiliated group (other than a member of the electing financial institution group).

"(D) ELECTION.—An election under this paragraph with respect to any financial institution group may be made only by the common parent of the pre-election affiliated group. Such an election, once made, shall apply only to the taxable year for which made.

"(3) ELECTING SUBSIDIARY GROUPS.—

"(A) IN GENERAL.—The term 'electing subsidiary group' means any group of corporations if—

"(i) such group consists only of corporations in the pre-election affiliated group,

"(ii) such group includes—

"(I) a domestic corporation (which is not the common parent of the pre-election affiliated group or a member of an electing financial institution group) which incurs interest expense with respect to qualified indebtedness, and

"(II) every other corporation (other than a member of an electing financial institution group) which is in the pre-election affiliated group and which would be a member of an affiliated group having such domestic corporation as the common parent, and

"(iii) an election under this paragraph is in effect for such group.

"(B) EQUALIZATION RULE.—All interest expense of a domestic corporation which is a member of a pre-election affiliated group (other than subsidiary group interest expense) shall be treated as allocated to foreign source income to the extent such expense does not exceed the excess (if any) of—

"(i) the interest expense of the pre-election affiliated group (including subsidiary group interest expense) which would (but for any election under this paragraph) be allocated to foreign source income, over

"(ii) the subsidiary group interest expense allocated to foreign source income.

For purposes of the preceding sentence, the subsidiary group interest expense is the interest expense to which subsection (e) applies separately by reason of paragraph (1)(B).

"(C) QUALIFIED INDEBTEDNESS.—For purposes of this subsection, the term 'qualified indebtedness' means any indebtedness of a domestic corporation—

"(i) which is held by an unrelated person, and "(ii) which is not guaranteed (or otherwise supported) by any corporation which is a member of the pre-election affiliated group other than a corporation which is a member of the electing subsidiary group.

For purposes of this subparagraph, the term 'unrelated person' means any person not bearing a relationship specified in section 267(b) or 707(b)(1) to the corporation.

"(D) EFFECT OF CERTAIN TRANSACTIONS ON QUALIFIED INDEBTEDNESS.—In the case of a corporation which is a member of an electing subsidiary group, to the extent that such corporation—

"(i) distributes dividends or makes other distributions with respect to its stock after the date of the enactment of this paragraph to any member of the pre-election affiliated group (other than to a member of the electing subsidiary group) in excess of the greater of—

"(I) its average annual dividend (expressed as a percentage of current earnings and profits) during the 5-taxable-year period ending with the taxable year preceding the taxable year, or

"(II) 25 percent of its average annual earnings and profits for such 5 taxable year period, or

"(ii) deals with any person in any manner not clearly reflecting the income of the corporation (as determined under principles similar to the principles of section 482),

an amount of qualified indebtedness equal to the excess distribution or the understatement or overstatement of income, as the case may be, shall be recharacterized (for the taxable year and subsequent taxable years) for purposes of this subsection as indebtedness which is not qualified indebtedness. If a corporation has not been in existence for 5 taxable years, this subparagraph shall be applied with respect to the period it was in existence.

"(E) ELECTION.—An election under this paragraph with respect to any electing subsidiary group may be made only by the common parent of the pre-election affiliated group. Such an election, once made, shall apply only to the taxable year for which made. No election may be made under this paragraph if the effect of the election would be to have the same member of the pre-election affiliated group included in more than 1 electing subsidiary group.

"(4) PRE-ELECTION AFFILIATED GROUP.—For purposes of this subsection, the term 'pre-election affiliated group' means, with respect to a corporation, the affiliated group or electing worldwide affiliated group of which such corporation would (but for an election under this subsection) be a member for purposes of applying subsection (e).

"(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out this subsection and subsection (e), including regulations—

"(A) providing for the direct allocation of interest expense in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,

"(B) preventing assets or interest expense from being taken into account more than once, and

"(C) dealing with changes in members of any group (through acquisitions or otherwise) treated under this subsection as an affiliated group for purposes of subsection (e)."

(c) INSURANCE COMPANIES INCLUDED IN AFFILIATED GROUPS.—Paragraph (5) of section 864(e) is amended to read as follows:

"(5) AFFILIATED GROUP.—The term 'affiliated group' has the meaning given such term by section 1504 (determined without regard to paragraphs (2) and (4) of section 1504(b)).".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 902. LOOK-THRU RULES TO APPLY TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.

(a) IN GENERAL.—Section 904(d)(4) (relating to application of look-thru rules to dividends from noncontrolled section 902 corporations) is amended to read as follows:

"(4) LOOK-THRU APPLIES TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.—

"(A) IN GENERAL.—For purposes of this subsection, any dividend from a noncontrolled section 902 corporation with respect to the taxpayer shall be treated as income in a separate category in proportion to the ratio of—

"(i) the portion of earnings and profits attributable to income in such category, to

"(ii) the total amount of earnings and profits.

"(B) SPECIAL RULES.—For purposes of this paragraph—

"(i) IN GENERAL.—Rules similar to the rules of paragraph (3)(F) shall apply; except that the term 'separate category' shall include the category of income described in paragraph (1)(I).

"(ii) EARNINGS AND PROFITS.—

"(I) IN GENERAL.—The rules of section 316 shall apply.

"(II) REGULATIONS.—The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods before the taxpayer's acquisition of the stock to which the distributions relate.

"(iii) DIVIDENDS NOT ALLOCABLE TO SEPARATE CATEGORY.—The portion of any dividend from a noncontrolled section 902 corporation which is not treated as income in a separate category under subparagraph (A) shall be treated as a dividend to which subparagraph (A) does not apply.

"(iv) LOOK-THRU WITH RESPECT TO CARRYFORWARDS OF CREDIT.—Rules similar to subparagraph (A) also shall apply to any carryforward under subsection (c) from a taxable year beginning before January 1, 2002, of tax allocable to a dividend from a noncontrolled section 902 corporation with respect to the taxpayer."

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (E) of section 904(d)(1), as in effect both before and after the amendments made by section 1105 of the Taxpayer Relief Act of 1997, is hereby repealed.

(2) Section 904(d)(2)(C)(iii), as so in effect, is amended by striking subclause (II) and by redesignating subclause (III) as subclause (II).

(3) The last sentence of section 904(d)(2)(D), as so in effect, is amended to read as follows: "Such term does not include any financial services income."

(4) Section 904(d)(2)(E) is amended by striking clauses (ii) and (iv) and by redesignating clause (iii) as clause (ii).

(5) Section 904(d)(3)(F) is amended by striking "(D), or (E)" and inserting "or (D)".

(6) Section 864(d)(5)(A)(i) is amended by striking "(C)(iii)(III)" and inserting "(C)(iii)(II)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 903. CLARIFICATION OF TREATMENT OF PIPELINE TRANSPORTATION INCOME.

(a) IN GENERAL.—Section 954(g)(1) (defining foreign base company oil related income) is amended by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by inserting after subparagraph (B) the following new subparagraph:

"(C) the pipeline transportation of oil or gas within such foreign country."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years of controlled foreign corporations beginning after December 31, 2001, and taxable years of United States shareholders with or within which such taxable years of controlled foreign corporations end.

SEC. 904. SUBPART F TREATMENT OF INCOME FROM TRANSMISSION OF HIGH VOLTAGE ELECTRICITY.

(a) IN GENERAL.—Paragraph (2) of section 954(e) (relating to foreign base company services income) is amended by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by inserting after subparagraph (B) the following new subparagraph:

"(C) the transmission of high voltage electricity."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years of controlled foreign corporations beginning after December 31, 2001, and taxable years of United States shareholders with or within which such taxable years of controlled foreign corporations end.

SEC. 905. RECHARACTERIZATION OF OVERALL DOMESTIC LOSS.

(a) GENERAL RULE.—Section 904 is amended by redesignating subsections (g), (h), (i), (j), and (k) as subsections (h), (i), (j), (k), and (l), respectively, and by inserting after subsection (f) the following new subsection:

"(g) RECHARACTERIZATION OF OVERALL DOMESTIC LOSS.—

"(1) GENERAL RULE.—For purposes of this subpart and section 936, in the case of any taxpayer who sustains an overall domestic loss for any taxable year beginning after December 31, 2004, that portion of the taxpayer's taxable income from sources within the United States for each succeeding taxable year which is equal to the lesser of—

"(A) the amount of such loss (to the extent not used under this paragraph in prior taxable years), or

"(B) 50 percent of the taxpayer's taxable income from sources within the United States for such succeeding taxable year,

shall be treated as income from sources without the United States (and not as income from sources within the United States).

"(2) OVERALL DOMESTIC LOSS DEFINED.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'overall domestic loss' means any domestic loss to the extent such loss offsets taxable income from sources without the United States for the taxable year or for any preceding taxable year by reason of a carryback. For purposes of the preceding sentence, the term 'domestic loss' means the amount by which the gross income for the taxable year from sources within the United States is exceeded by the sum of the deductions properly apportioned or allocated thereto (determined without regard to any carryback from a subsequent taxable year).

"(B) TAXPAYER MUST HAVE ELECTED FOREIGN TAX CREDIT FOR YEAR OF LOSS.—The term 'overall domestic loss' shall not include any loss for any taxable year unless the taxpayer chose the benefits of this subpart for such taxable year.

"(3) CHARACTERIZATION OF SUBSEQUENT INCOME.—

"(A) IN GENERAL.—Any income from sources within the United States that is treated as income from sources without the United States under paragraph (1) shall be allocated among and increase the income categories in proportion to the loss from sources within the United States previously allocated to those income categories.

"(B) INCOME CATEGORY.—For purposes of this paragraph, the term 'income category' has the meaning given such term by subsection (f)(5)(E)(i).

"(4) COORDINATION WITH SUBSECTION (f).—The Secretary shall prescribe such regulations as may be necessary to coordinate the provisions of this subsection with the provisions of subsection (f)."

(b) CONFORMING AMENDMENTS.—

(1) Section 535(d)(2) is amended by striking "section 904(g)(6)" and inserting "section 904(h)(6)".

(2) Subparagraph (A) of section 936(a)(2) is amended by striking "section 904(f)" and inserting "subsections (f) and (g) of section 904".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to losses for taxable years beginning after December 31, 2004.

SEC. 906. TREATMENT OF MILITARY PROPERTY OF FOREIGN SALES CORPORATIONS.

(a) IN GENERAL.—Section 923(a) (defining exempt foreign trade income) is amended by striking paragraph (5) and by redesignating paragraph (6) as paragraph (5).

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 907. TREATMENT OF CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.

(a) TREATMENT OF CERTAIN DIVIDENDS.—

(1) NONRESIDENT ALIEN INDIVIDUALS.—Section 871 (relating to tax on nonresident alien individuals) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) EXEMPTION FOR CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.—

"(1) INTEREST-RELATED DIVIDENDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any interest-related dividend received from a regulated investment company.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply—

"(i) to any interest-related dividend received from a regulated investment company by a person to the extent such dividend is attributable to interest (other than interest described in clause (i), (iii), or the last sentence of subparagraph (E)) received by such company on indebtedness issued by such person or by any corporation or partnership with respect to which such person is a 10-percent shareholder,

"(ii) to any interest-related dividend with respect to stock of a regulated investment company unless the person who would otherwise be required to deduct and withhold tax from such dividend under chapter 3 receives a statement (which meets requirements similar to the requirements of subsection (h)(5)) that the beneficial owner of such stock is not a United States person, and

"(iii) to any interest-related dividend paid to any person within a foreign country (or any interest-related dividend payment addressed to, or for the account of, persons within such foreign country) during any period described in subsection (h)(6) with respect to such country.

Clause (iii) shall not apply to any dividend with respect to any stock the holding period of which begins on or before the date of the publication of the Secretary's determination under subsection (h)(6).

"(C) INTEREST-RELATED DIVIDEND.—For purposes of this paragraph, an interest-related dividend is any dividend (or part thereof) which is designated by the regulated investment company as an interest-related dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified net interest income of the company for such taxable year, the portion of each distribution which shall be an interest-related dividend shall be only that portion of the amounts so designated which such qualified net interest income bears to the aggregate amount so designated.

"(D) QUALIFIED NET INTEREST INCOME.—For purposes of subparagraph (C), the term 'qualified net interest income' means the qualified interest income of the regulated investment company reduced by the deductions properly allocable to such income.

"(E) QUALIFIED INTEREST INCOME.—For purposes of subparagraph (D), the term 'qualified interest income' means the sum of the following amounts derived by the regulated investment company from sources within the United States:

"(i) Any amount includible in gross income as original issue discount (within the meaning of section 1273) on an obligation payable 183 days or less from the date of original issue (without regard to the period held by the company).

"(ii) Any interest includible in gross income (including amounts recognized as ordinary income in respect of original issue discount or market discount or acquisition discount under part V of subchapter P and such other amounts as regulations may provide) on an obligation which is in registered form; except that this clause shall not apply to—

"(I) any interest on an obligation issued by a corporation or partnership if the regulated investment company is a 10-percent shareholder in such corporation or partnership, and

"(II) any interest which is treated as not being portfolio interest under the rules of subsection (h)(4).

"(iii) Any interest referred to in subsection (i)(2)(A) (without regard to the trade or business of the regulated investment company).

"(iv) Any interest-related dividend includable in gross income with respect to stock of another regulated investment company.

Such term includes any interest derived by the regulated investment company from sources outside the United States other than interest that is subject to a tax imposed by a foreign jurisdiction if the amount of such tax is reduced (or eliminated) by a treaty with the United States.

"(F) 10-PERCENT SHAREHOLDER.—For purposes of this paragraph, the term '10-percent shareholder' has the meaning given such term by subsection (h)(3)(B).

"(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any short-term capital gain dividend received from a regulated investment company.

"(B) EXCEPTION FOR ALIENS TAXABLE UNDER SUBSECTION (a)(2).—Subparagraph (A) shall not apply in the case of any nonresident alien individual subject to tax under subsection (a)(2).

"(C) SHORT-TERM CAPITAL GAIN DIVIDEND.—For purposes of this paragraph, a short-term capital gain dividend is any dividend (or part thereof) which is designated by the regulated investment company as a short-term capital gain dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified short-term gain of the company for such taxable year, the portion of each distribution which shall be a short-term capital gain dividend shall be only that portion of the amounts so designated which such qualified short-term gain bears to the aggregate amount so designated.

"(D) QUALIFIED SHORT-TERM GAIN.—For purposes of subparagraph (C), the term 'qualified short-term gain' means the excess of the net short-term capital gain of the regulated investment company for the taxable year over the net long-term capital loss (if any) of such company for such taxable year. For purposes of this subparagraph—

"(i) the net short-term capital gain of the regulated investment company shall be computed by treating any short-term capital gain dividend includible in gross income with respect to stock of another regulated investment company as a short-term capital gain, and

"(ii) the excess of the net short-term capital gain for a taxable year over the net long-term capital loss for a taxable year (to which an election under section 4982(e)(4) does not apply) shall be determined without regard to any net capital loss or net short-term capital loss attributable to transactions after October 31 of such year, and any such net capital loss or net short-term capital loss shall be treated as arising on the 1st day of the next taxable year.

To the extent provided in regulations, clause (ii) shall apply also for purposes of computing the taxable income of the regulated investment company."

(2) FOREIGN CORPORATIONS.—Section 881 (relating to tax on income of foreign corporations not connected with United States business) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) TAX NOT TO APPLY TO CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.—

"(1) INTEREST-RELATED DIVIDENDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1) of subsection (a) on any interest-related dividend (as defined in section 871(k)(1)) received from a regulated investment company.

"(B) EXCEPTION.—Subparagraph (A) shall not apply—

"(i) to any dividend referred to in section 871(k)(1)(B), and

"(ii) to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company from a person who is a related person (within the meaning of section 864(d)(4)) with respect to such controlled foreign corporation.

"(C) TREATMENT OF DIVIDENDS RECEIVED BY CONTROLLED FOREIGN CORPORATIONS.—The rules of subsection (c)(5)(A) shall apply to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company which is described in clause (ii) of section 871(k)(1)(E) (and not described in clause (i), (iii), or the last sentence of such section).

"(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—No tax shall be imposed under paragraph (1) of subsection (a) on any short-term capital gain dividend (as defined in section 871(k)(2)) received from a regulated investment company."

(3) WITHHOLDING TAXES.—

(A) Section 1441(c) (relating to exceptions) is amended by adding at the end the following new paragraph:

"(12) CERTAIN DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANIES.—

"(A) IN GENERAL.—No tax shall be required to be deducted and withheld under subsection (a) from any amount exempt from the tax imposed by section 871(a)(1)(A) by reason of section 871(k).

"(B) SPECIAL RULE.—For purposes of subparagraph (A), clause (i) of section 871(k)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause. A similar rule shall apply with respect to the exception contained in section 871(k)(2)(B)."

(B) Section 1442(a) (relating to withholding of tax on foreign corporations) is amended—

(i) by striking "and the reference in section 1441(c)(10)" and inserting "the reference in section 1441(c)(10)", and

(ii) by inserting before the period at the end the following: ", and the references in section 1441(c)(12) to sections 871(a) and 871(k) shall be treated as referring to sections 881(a) and 881(e) (except that for purposes of applying subparagraph (A) of section 1441(c)(12), as so modified, clause (ii) of section 881(e)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause)".

(b) ESTATE TAX TREATMENT OF INTEREST IN CERTAIN REGULATED INVESTMENT COMPANIES.—Section 2105 (relating to property without the United States for estate tax purposes) is amended by adding at the end the following new subsection:

"(d) STOCK IN A RIC.—

"(1) IN GENERAL.—For purposes of this subchapter, stock in a regulated investment company (as defined in section 851) owned by a nonresident not a citizen of the United States shall not be deemed property within the United States in the proportion that, at the end of the quarter of such investment company's taxable year immediately preceding a decedent's date of death (or at such other time as the Secretary may designate in regulations), the assets of the investment company that were qualifying assets with respect to the decedent bore to the total assets of the investment company.

"(2) QUALIFYING ASSETS.—For purposes of this subsection, qualifying assets with respect to a decedent are assets that, if owned directly by the decedent, would have been—

"(A) amounts, deposits, or debt obligations described in subsection (b) of this section,

"(B) debt obligations described in the last sentence of section 2104(c), or

"(C) other property not within the United States."

(c) TREATMENT OF REGULATED INVESTMENT COMPANIES UNDER SECTION 897.—

(1) Paragraph (1) of section 897(h) is amended by striking "REIT" each place it appears and inserting "qualified investment entity".

(2) Paragraphs (2) and (3) of section 897(h) are amended to read as follows:

"(2) SALE OF STOCK IN DOMESTICALLY CONTROLLED ENTITY NOT TAXED.—The term 'United States real property interest' does not include any interest in a domestically controlled qualified investment entity.

"(3) DISTRIBUTIONS BY DOMESTICALLY CONTROLLED QUALIFIED INVESTMENT ENTITIES.—In the case of a domestically controlled qualified investment entity, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain."

(3) Subparagraphs (A) and (B) of section 897(h)(4) are amended to read as follows:

"(A) QUALIFIED INVESTMENT ENTITY.—The term 'qualified investment entity' means any real estate investment trust and any regulated investment company.

"(B) DOMESTICALLY CONTROLLED.—The term 'domestically controlled qualified investment entity' means any qualified investment entity in which at all times during the testing period less than 50 percent in value of the stock was held directly or indirectly by foreign persons."

(4) Subparagraphs (C) and (D) of section 897(h)(4) are each amended by striking "REIT" and inserting "qualified investment entity".

(5) The subsection heading for subsection (h) of section 897 is amended by striking "REITS" and inserting "CERTAIN INVESTMENT ENTITIES".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to dividends with respect to taxable years of regulated investment companies beginning after December 31, 2004.

(2) ESTATE TAX TREATMENT.—The amendment made by subsection (b) shall apply to estates of decedents dying after December 31, 2004.

(3) CERTAIN OTHER PROVISIONS.—The amendments made by subsection (c) (other than paragraph (1) thereof) shall take effect on January 1, 2005.

SEC. 908. REPEAL OF SPECIAL RULES FOR APPLYING FOREIGN TAX CREDIT IN CASE OF FOREIGN OIL AND GAS INCOME.

(a) IN GENERAL.—Section 907 (relating to special rules in case of foreign oil and gas income) is repealed.

(b) CONFORMING AMENDMENTS.—

(1) Each of the following provisions are amended by striking "907,":

(A) Section 245(a)(10).

(B) Section 865(h)(1)(B).

(C) Section 904(d)(1).

(D) Section 904(g)(10)(A).

(2) Section 904(f)(5)(E)(iii) is amended by inserting ", as in effect before its repeal by the Financial Freedom Act of 1999" after "section 907(c)(4)(B)".

(3) Section 954(g)(1) is amended by inserting ", as in effect before its repeal by the Financial Freedom Act of 1999" after "907(c)".

(4) Section 6501(i) is amended—

(A) by striking ", or under section 907(f) (relating to carryback and carryover of disallowed oil and gas extraction taxes)", and

(B) by striking "or 907(f)".

(5) The table of sections for subpart A of part III of subchapter N of chapter 1 is amended by striking the item relating to section 907.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2004.

SEC. 909. STUDY OF PROPER TREATMENT OF EUROPEAN UNION UNDER SAME COUNTRY EXCEPTIONS.

(a) STUDY.—The Secretary of the Treasury or the Secretary's delegate shall conduct a study on the feasibility of treating all countries included in the European Union as 1 country for purposes of applying the same country exceptions under subpart F of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1986.

(b) REPORT.—Not later than 6 months after the date of the enactment of this Act, the Secretary of the Treasury shall report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate the results of the study conducted under subsection (a), including recommendations (if any) for legislation.

SEC. 910. APPLICATION OF DENIAL OF FOREIGN TAX CREDIT WITH RESPECT TO CERTAIN FOREIGN COUNTRIES.

(a) IN GENERAL.—Clause (ii) of section 901(j)(2)(B) (relating to denial of foreign tax credit, etc., with respect to certain foreign countries) is amended by inserting before the period "or, if earlier, ending on the date that the President determines that the application of this subsection to such foreign country is no longer in the national interests of the United States".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 911. ADVANCE PRICING AGREEMENTS TREATED AS CONFIDENTIAL TAXPAYER INFORMATION.

(a) IN GENERAL.—

(1) TREATMENT AS RETURN INFORMATION.—Paragraph (2) of section 6103(b) (defining return information) is amended by striking "and" at the end of subparagraph (A), by inserting "and" at the end of subparagraph (B), and by inserting after subparagraph (B) the following new subparagraph:

"(C) any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement,".

(2) EXCEPTION FROM PUBLIC INSPECTION AS WRITTEN DETERMINATION.—Paragraph (1) of section 6110(b) (defining written determination) is amended by adding at the end the following new sentence: "Such term shall not include any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement.".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on the date of the enactment of this Act.

(b) ANNUAL REPORT REGARDING ADVANCE PRICING AGREEMENTS.—

(1) IN GENERAL.—Not later than 90 days after the end of each calendar year, the Secretary of the Treasury shall prepare and publish a report regarding advance pricing agreements.

(2) CONTENTS OF REPORT.—The report shall include the following for the calendar year to which such report relates:

(A) Information about the structure, composition, and operation of the advance pricing agreement program office.

(B) A copy of each model advance pricing agreement.

(C) The number of—

(i) applications filed during such calendar year for advanced pricing agreements;

(ii) advance pricing agreements executed cumulatively to date and during such calendar year;

(iii) renewals of advanced pricing agreements issued;

(iv) pending requests for advance pricing agreements;

(v) pending renewals of advance pricing agreements;

(vi) for each of the items in clauses (ii) through (v), the number that are unilateral, bilateral, and multilateral, respectively;

(vii) advance pricing agreements revoked or canceled, and the number of withdrawals from the advance pricing agreement program; and

(viii) advanced pricing agreements finalized or renewed by industry.

(D) General descriptions of—

(i) the nature of the relationships between the related organizations, trades, or businesses covered by advance pricing agreements;

(ii) the covered transactions and the business functions performed and risks assumed by such organizations, trades, or businesses;

(iii) the related organizations, trades, or businesses whose prices or results are tested to determine compliance with transfer pricing methodologies prescribed in advanced pricing agreements;

(iv) methodologies used to evaluate tested parties and transactions and the circumstances leading to the use of those methodologies;

(v) critical assumptions made and sources of comparables used;

(vi) comparable selection criteria and the rationale used in determining such criteria;

(vii) the nature of adjustments to comparables or tested parties;

(viii) the nature of any ranges agreed to, including information regarding when no range was used and why, when interquartile ranges were used, and when there was a statistical narrowing of the comparables;

(ix) adjustment mechanisms provided to rectify results that fall outside of the agreed upon advance pricing agreement range;

(x) the various term lengths for advance pricing agreements, including rollback years, and the number of advance pricing agreements with each such term length;

(xi) the nature of documentation required; and

(xii) approaches for sharing of currency or other risks.

(E) Statistics regarding the amount of time taken to complete new and renewal advance pricing agreements.

(3) CONFIDENTIALITY.—The reports required by this subsection shall be treated as authorized by the Internal Revenue Code of 1986 for purposes of section 6103 of such Code, but the reports shall not include information—

(A) which would not be permitted to be disclosed under section 6110(c) of such Code if such report were a written determination as defined in section 6110 of such Code, or

(B) which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

(4) FIRST REPORT.—The report for calendar year 1999 shall include prior calendar years after 1990.

(c) USER FEE.—Section 7527, as added by title XV of this Act, is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) ADVANCE PRICING AGREEMENTS.—

"(1) IN GENERAL.—In addition to any fee otherwise imposed under this section, the fee imposed for requests for advance pricing agreements shall be increased by $500.

"(2) REDUCED FEE FOR SMALL BUSINESSES.—The Secretary shall provide an appropriate reduction in the amount imposed by reason of paragraph (1) for requests for advance pricing agreements for small businesses."

(d) REGULATIONS.—The Secretary of the Treasury or the Secretary's delegate shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 6103(b)(2)(C), and the last sentence of section 6110(b)(1), of the Internal Revenue Code of 1986, as added by this section.

SEC. 912. INCREASE IN DOLLAR LIMITATION ON SECTION 911 EXCLUSION.

(a) GENERAL RULE.—The table contained in clause (i) of section 911(b)(2)(D) is amended to read as follows:

“For calendar year—	The exclusion amount is—
2000	$76,000
2001	78,000
2002	80,000
2003	83,000
2004	86,000
2005	89,000
2006	92,000
2007 and thereafter	95,000.”

(b) CONFORMING AMENDMENT.—Clause (ii) of section 911(b)(2)(D) is amended by striking “$80,000” and inserting “$95,000”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

TITLE X—PROVISIONS RELATING TO TAX-EXEMPT ORGANIZATIONS

SEC. 1001. EXEMPTION FROM INCOME TAX FOR STATE-CREATED ORGANIZATIONS PROVIDING PROPERTY AND CASUALTY INSURANCE FOR PROPERTY FOR WHICH SUCH COVERAGE IS OTHERWISE UNAVAILABLE.

(a) IN GENERAL.—Subsection (c) of section 501 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by adding at the end the following new paragraph:

“(28)(A) Any association created before January 1, 1999, by State law and organized and operated exclusively to provide property and casualty insurance coverage for property located within the State for which the State has determined that coverage in the authorized insurance market is limited or unavailable at reasonable rates, if—

“(i) no part of the net earnings of which inures to the benefit of any private shareholder or individual,

“(ii) except as provided in clause (v), no part of the assets of which may be used for, or diverted to, any purpose other than—

“(I) to satisfy, in whole or in part, the liability of the association for, or with respect to, claims made on policies written by the association,

“(II) to invest in investments authorized by applicable law,

“(III) to pay reasonable and necessary administration expenses in connection with the establishment and operation of the association and the processing of claims against the association, or

“(IV) to make remittances pursuant to State law to be used by the State to provide for the payment of claims on policies written by the association, purchase reinsurance covering losses under such policies, or to support governmental programs to prepare for or mitigate the effects of natural catastrophic events,

“(iii) the State law governing the association permits the association to levy assessments on insurance companies authorized to sell property and casualty insurance in the State, or on property and casualty insurance policyholders with insurable interests in property located in the State to fund deficits of the association, including the creation of reserves,

“(iv) the plan of operation of the association is subject to approval by the chief executive officer or other official of the State, by the State legislature, or both, and

“(v) the assets of the association revert upon dissolution to the State, the State’s designee, or an entity designated by the State law governing the association, or State law does not permit the dissolution of the association.

“(B)(i) An entity described in clause (ii) shall be disregarded as a separate entity and treated as part of the association described in subparagraph (A) from which it receives remittances described in clause (ii) if an election is made within 30 days after the date that such association is determined to be exempt from tax.

“(ii) An entity is described in this clause if it is an entity or fund created before January 1, 1999, pursuant to State law and organized and operated exclusively to receive, hold, and invest remittances from an association described in subparagraph (A) and exempt from tax under subsection (a), to make disbursements to pay claims on insurance contracts issued by such association, and to make disbursements to support governmental programs to prepare for or mitigate the effects of natural catastrophic events.”

(b) UNRELATED BUSINESS TAXABLE INCOME.—Subsection (a) of section 512 (relating to unrelated business taxable income) is amended by adding at the end the following new paragraph:

"(6) SPECIAL RULE APPLICABLE TO ORGANIZATIONS DESCRIBED IN SECTION 501(C)(28).—In the case of an organization described in section 501(c)(28), the term 'unrelated business taxable income' means taxable income for a taxable year computed without the application of section 501(c)(28) if at the end of the immediately preceding taxable year the organization's net equity exceeded 15 percent of the total coverage in force under insurance contracts issued by the organization and outstanding at the end of such preceding year."

(c) TRANSITIONAL RULE.—No income or gain shall be recognized by an association as a result of a change in status to that of an association described by section 501(c)(28) of the Internal Revenue Code of 1986, as amended by subsection (a).

(d) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1999.

SEC. 1002. MODIFICATION OF SPECIAL ARBITRAGE RULE FOR CERTAIN FUNDS.

(a) IN GENERAL.—Paragraph (1) of section 648 of the Tax Reform Act of 1984 is amended to read as follows:

"(1) such securities or obligations are held in a fund—

"(A) which, except to the extent of the investment earnings on such securities or obligations, cannot be used, under State constitutional or statutory restrictions continuously in effect since October 9, 1969, through the date of issue of the bond issue, to pay debt service on the bond issue or to finance the facilities that are to be financed with the proceeds of the bonds, or

"(B) the annual distributions from which cannot exceed 7 percent of the average fair market value of the assets held in such fund except to the extent distributions are necessary to pay debt service on the bond issue,".

(b) CONFORMING AMENDMENT.—Paragraph (3) of such section is amended by striking "the investment earnings of" and inserting "distributions from".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 2000.

SEC. 1003. CHARITABLE SPLIT-DOLLAR LIFE INSURANCE, ANNUITY, AND ENDOWMENT CONTRACTS.

(a) IN GENERAL.—Subsection (f) of section 170 (relating to disallowance of deduction in certain cases and special rules) is amended by adding at the end the following new paragraph:

"(10) SPLIT-DOLLAR LIFE INSURANCE, ANNUITY, AND ENDOWMENT CONTRACTS.—

"(A) IN GENERAL.—Nothing in this section or in section 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522 shall be construed to allow a deduction, and no deduction shall be allowed, for any transfer to or for the use of an organization described in subsection (c) if in connection with such transfer—

"(i) the organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or

"(ii) there is an understanding or expectation that any person will directly or indirectly pay any premium on any personal benefit contract with respect to the transferor.

"(B) PERSONAL BENEFIT CONTRACT.—For purposes of subparagraph (A), the term 'personal benefit contract' means, with respect to the transferor, any life insurance, annuity, or endowment contract if any direct or indirect beneficiary under such contract is the transferor, any member of the transferor's family, or any other person (other than an organization described in subsection (c)) designated by the transferor.

"(C) APPLICATION TO CHARITABLE REMAINDER TRUSTS.—In the case of a transfer to a trust referred to in subparagraph (E), references in subparagraphs (A) and (F) to an organization described in subsection (c) shall be treated as a reference to such trust.

"(D) EXCEPTION FOR CERTAIN ANNUITY CONTRACTS.—If, in connection with a transfer to or for the use of an organization described in subsection (c), such organization incurs an obligation to pay a charitable gift annuity (as defined in section 501(m)) and such organization purchases any annuity contract to fund such obligation, persons receiving payments under the charitable gift annuity shall not be treated for purposes of subparagraph (B) as indirect beneficiaries under such contract if—

"(i) such organization possesses all of the incidents of ownership under such contract,

"(ii) such organization is entitled to all the payments under such contract, and

"(iii) the timing and amount of payments under such contract are substantially the same as the timing and amount of payments to each such person under such obligation (as such obligation is in effect at the time of such transfer).

"(E) EXCEPTION FOR CERTAIN CONTRACTS HELD BY CHARITABLE REMAINDER TRUSTS.—A person shall not be treated for purposes of subparagraph (B) as an indirect beneficiary under any life insurance, annuity, or endowment contract held by a charitable remainder annuity trust or a charitable remainder unitrust (as defined in section 664(d)) solely by reason of being entitled to any payment referred to in paragraph (1)(A) or (2)(A) of section 664(d) if—

"(i) such trust possesses all of the incidents of ownership under such contract, and

"(ii) such trust is entitled to all the payments under such contract.

"(F) EXCISE TAX ON PREMIUMS PAID.—

"(i) IN GENERAL.—There is hereby imposed on any organization described in subsection (c) an excise tax equal to the premiums paid by such organization on any life insurance, annuity, or endowment contract if the payment of premiums on such contract is in connection with a transfer for which a deduction is not allowable under subparagraph (A), determined without regard to when such transfer is made.

"(ii) PAYMENTS BY OTHER PERSONS.—For purposes of clause (i), payments made by any other person pursuant to an understanding or expectation referred to in subparagraph (A) shall be treated as made by the organization.

"(iii) REPORTING.—Any organization on which tax is imposed by clause (i) with respect to any premium shall file an annual return which includes—

"(I) the amount of such premiums paid during the year and the name and TIN of each beneficiary under the contract to which the premium relates, and

"(II) such other information as the Secretary may require.

The penalties applicable to returns required under section 6033 shall apply to returns required under this clause. Returns required under this clause shall be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

"(iv) CERTAIN RULES TO APPLY.—The tax imposed by this subparagraph shall be treated as imposed by chapter 42 for purposes of this title other than subchapter B of chapter 42.

"(G) SPECIAL RULE WHERE STATE REQUIRES SPECIFICATION OF CHARITABLE GIFT ANNUITANT IN CONTRACT.—In the case of an obligation to pay a charitable gift annuity referred to in subparagraph (D) which is entered into under the laws of a State which requires, in order for the charitable gift annuity to be exempt from insurance regulation by such State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in such State, the requirements of clauses (i) and (ii) of subparagraph (D) shall be treated as met if—

"(i) such State law requirement was in effect on February 8, 1999,

"(ii) each such beneficiary under the charitable gift annuity is a bona fide resident of such State at the time the obligation to pay a charitable gift annuity is entered into, and

"(iii) the only persons entitled to payments under such contract are persons entitled to payments as beneficiaries under such obligation on the date such obligation is entered into.

"(H) MEMBER OF FAMILY.—For purposes of this paragraph, an individual's family consists of the individual's grandparents, the grandparents of such individual's spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.

"(I) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations to prevent the avoidance of such purposes."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this section, the amendment made by this section shall apply to transfers made after February 8, 1999.

(2) EXCISE TAX.—Except as provided in paragraph (3) of this subsection, section 170(f)(10)(F) of the Internal Revenue Code of 1986 (as added by this section) shall apply to premiums paid after the date of the enactment of this Act.

(3) REPORTING.—Clause (iii) of such section 170(f)(10)(F) shall apply to premiums paid after February 8, 1999 (determined as if the tax imposed by such section applies to premiums paid after such date).

SEC. 1004. EXEMPTION PROCEDURE FROM TAXES ON SELF-DEALING.

(a) IN GENERAL.—Subsection (d) of section 4941 (relating to taxes on self-dealing) is amended by adding at the end the following new paragraph:

"(3) SPECIAL EXEMPTION.—The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, the Secretary may grant a conditional or unconditional exemption of any disqualified person or transaction or class of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1). The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is—

"(A) administratively feasible,

"(B) in the interests of the private foundation, and

"(C) protective of the rights of the private foundation.

Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to transactions occurring after the date of the enactment of this Act.

SEC. 1005. EXPANSION OF DECLARATORY JUDGMENT REMEDY TO TAX-EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Subsection (a) of section 7428 (relating to creation of remedy) is amended—

(1) in subparagraph (B) by inserting after "509(a))" the following: "or as a private operating foundation (as defined in section 4942(j)(3))", and

(2) by amending subparagraph (C) to read as follows:

"(C) with respect to the initial qualification or continuing qualification of an organization as an organization described in section 501(c) (other than paragraph (3)) which is exempt from tax under section 501(a), or".

(b) COURT JURISDICTION.—Subsection (a) of section 7428 is amended in the material following paragraph (2) by striking "United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia" and inserting the following: "United States Tax Court (in the case of any such determination or failure) or the United States Claims Court or the district court of the United States for the District of Columbia (in the case of a determination or failure with respect to an issue referred to in subparagraph (A) or (B) of paragraph (1)),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to pleadings filed with respect to determinations (or requests for determinations) made after the date of the enactment of this Act.

SEC. 1006. MODIFICATIONS TO SECTION 512(b)(13).

(a) IN GENERAL.—Paragraph (13) of section 512(b) is amended by redesignating subparagraph (E) as subparagraph (F) and by inserting after subparagraph (D) the following new paragraph:

"(E) PARAGRAPH TO APPLY ONLY TO EXCESS PAYMENTS.—

"(i) IN GENERAL.—Subparagraph (A) shall apply only to the portion of a specified payment received by the controlling organization that exceeds the amount which would have been paid if such payment met the requirements prescribed under section 482.

"(ii) ADDITION TO TAX FOR VALUATION MISSTATEMENTS.—The tax imposed by this chapter on the controlling organization shall be increased by an amount equal to 20 percent of such excess."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to payments received or accrued after December 31, 1999.

(2) PAYMENTS SUBJECT TO BINDING CONTRACT TRANSITION RULE.—If the amendments made by section 1041 of the Taxpayer Relief Act of 1997 do not apply to any amount received or accrued after the date of the enactment of this Act under any contract described in subsection (b)(2) of such section, such

amendments also shall not apply to amounts received or accrued under such contract before January 1, 2000.

TITLE XI—REAL ESTATE PROVISIONS

Subtitle A—Provisions Relating to Real Estate Investment Trusts

PART I—TREATMENT OF INCOME AND SERVICES PROVIDED BY TAXABLE REIT SUBSIDIARIES

SEC. 1101. MODIFICATIONS TO ASSET DIVERSIFICATION TEST.

(a) IN GENERAL.—Subparagraph (B) of section 856(c)(4) is amended to read as follows:

"(B)(i) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)), and

"(ii) except with respect to a taxable REIT subsidiary and securities includible under subparagraph (A)—

"(I) not more than 5 percent of the value of its total assets is represented by securities of any 1 issuer,

"(II) the trust does not hold securities possessing more than 10 percent of the total voting power of the outstanding securities of any 1 issuer, and

"(III) the trust does not hold securities having a value of more than 10 percent of the total value of the outstanding securities of any 1 issuer."

(b) EXCEPTION FOR STRAIGHT DEBT SECURITIES.—Subsection (c) of section 856 is amended by adding at the end the following new paragraph:

"(7) STRAIGHT DEBT SAFE HARBOR IN APPLYING PARAGRAPH (4).—Securities of an issuer which are straight debt (as defined in section 1361(c)(5) without regard to subparagraph (B)(iii) thereof) shall not be taken into account in applying paragraph (4)(B)(ii)(III) if—

"(A) the only securities of such issuer which are held by the trust or a taxable REIT subsidiary of the trust are straight debt (as so defined), or

"(B) the issuer is a partnership and the trust holds at least a 20 percent profits interest in the partnership."

SEC. 1102. TREATMENT OF INCOME AND SERVICES PROVIDED BY TAXABLE REIT SUBSIDIARIES.

(a) INCOME FROM TAXABLE REIT SUBSIDIARIES NOT TREATED AS IMPERMISSIBLE TENANT SERVICE INCOME.—Clause (i) of section 856(d)(7)(C) (relating to exceptions to impermissible tenant service income) is amended by inserting "or through a taxable REIT subsidiary of such trust" after "income".

(b) CERTAIN INCOME FROM TAXABLE REIT SUBSIDIARIES NOT EXCLUDED FROM RENTS FROM REAL PROPERTY.—

(1) IN GENERAL.—Subsection (d) of section 856 (relating to rents from real property defined) is amended by adding at the end the following new paragraphs:

"(8) SPECIAL RULE FOR TAXABLE REIT SUBSIDIARIES.—For purposes of this subsection, amounts paid to a real estate investment trust by a taxable REIT subsidiary of such trust shall not be excluded from rents from real property by reason of paragraph (2)(B) if the requirements of subparagraph (A) or (B) are met.

"(A) LIMITED RENTAL EXCEPTION.—The requirements of this subparagraph are met with respect to any property if at least 90 percent of the leased space of the property is rented to persons other than taxable REIT subsidiaries of such trust and other than persons described in section 856(d)(2)(B). The preceding sentence shall apply only to the extent that the amounts paid to the trust as rents from real property (as defined in paragraph (1) without regard to paragraph (2)(B)) from such property are substantially comparable to such rents made by the other tenants of the trust's property for comparable space.

"(B) EXCEPTION FOR CERTAIN LODGING FACILITIES.—The requirements of this subparagraph are met with respect to an interest in real property which is a qualified lodging facility leased by the trust to a taxable REIT subsidiary of the trust if the property is operated on behalf of such subsidiary by a person who is an eligible independent contractor.

"(9) ELIGIBLE INDEPENDENT CONTRACTOR.—For purposes of paragraph (8)(B)—

"(A) IN GENERAL.—The term 'eligible independent contractor' means, with respect to any qualified lodging facility, any independent contractor if, at the time such contractor enters into a management agreement or other similar service contract with the taxable REIT subsidiary to operate the facility, such contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities for any person who is not a related person with respect to the real estate investment trust or the taxable REIT subsidiary.

"(B) SPECIAL RULES.—Solely for purposes of this paragraph and paragraph (8)(B), a person shall not fail to be treated as an independent contractor with respect to any qualified lodging facility by reason of any of the following:

"(i) The taxable REIT subsidiary bears the expenses for the operation of the facility pursuant to the management agreement or other similar service contract.

"(ii) The taxable REIT subsidiary receives the revenues from the operation of such facility, net of expenses for such operation and fees payable to the operator pursuant to such agreement or contract.

"(iii) The real estate investment trust receives income from such person with respect to another property that is attributable to a lease of such other property to such person that was in effect as on the later of—

"(I) January 1, 1999, or

"(II) the earliest date that any taxable REIT subsidiary of such trust entered into a management agreement or other similar service contract with such person with respect to such qualified lodging facility.

"(C) RENEWALS, ETC., OF EXISTING LEASES.—For purposes of subparagraph (B)(iii)—

"(i) a lease shall be treated as in effect on January 1, 1999, without regard to its renewal after such date, so long as such renewal is pursuant to the terms of such lease as in effect on whichever of the dates under subparagraph (B)(iii) is the latest, and

"(ii) a lease of a property entered into after whichever of the dates under subparagraph (B)(iii) is the latest shall be treated as in effect on such date if—

"(I) on such date, a lease of such property from the trust was in effect, and

"(II) under the terms of the new lease, such trust receives a substantially similar or lesser benefit in comparison to the lease referred to in subclause (I).

"(D) QUALIFIED LODGING FACILITY.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'qualified lodging facility' means any lodging facility unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility.

"(ii) LODGING FACILITY.—The term 'lodging facility' means a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis.

"(iii) CUSTOMARY AMENITIES AND FACILITIES.—The term 'lodging facility' includes customary amenities and facilities operated as part of, or associated with, the lodging facility so long as such amenities and facilities are customary for other properties of a comparable size and class owned by other owners unrelated to such real estate investment trust.

"(E) OPERATE INCLUDES MANAGE.—References in this paragraph to operating a property shall be treated as including a reference to managing the property.

"(F) RELATED PERSON.—Persons shall be treated as related to each other if such persons are treated as a single employer under subsection (a) or (b) of section 52.".

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 856(d)(2) is amended by inserting "except as provided in paragraph (8)," after "(B)".

SEC. 1103. TAXABLE REIT SUBSIDIARY.

(a) IN GENERAL.—Section 856 is amended by adding at the end the following new subsection:

"(l) TAXABLE REIT SUBSIDIARY.—For purposes of this part—

"(1) IN GENERAL.—The term 'taxable REIT subsidiary' means, with respect to a real estate investment trust, a corporation (other than a real estate investment trust) if—

"(A) such trust directly or indirectly owns stock in such corporation, and

"(B) such trust and such corporation jointly elect that such corporation shall be treated as a taxable REIT subsidiary of such trust for purposes of this part.

Such an election, once made, shall be irrevocable unless both such trust and corporation consent to its revocation. Such election, and any revocation thereof, may be made without the consent of the Secretary.

"(2) 35 PERCENT OWNERSHIP IN ANOTHER TAXABLE REIT SUBSIDIARY.—The term 'taxable REIT subsidiary' includes, with respect to any real estate investment trust, any corporation (other than a real estate investment trust) with respect to which a taxable REIT subsidiary of such trust owns directly or indirectly—

"(A) securities possessing more than 35 percent of the total voting power of the outstanding securities of such corporation, or

"(B) securities having a value of more than 35 percent of the total value of the outstanding securities of such corporation.

The preceding sentence shall not apply to a qualified REIT subsidiary (as defined in subsection (i)(2)). The rule of section 856(c)(7) shall apply for purposes of subparagraph (B).

"(3) EXCEPTIONS.—The term 'taxable REIT subsidiary' shall not include—

"(A) any corporation which directly or indirectly operates or manages a lodging facility or a health care facility, and

"(B) any corporation which directly or indirectly provides to any other person (under a franchise, license, or otherwise) rights to any brand name under which any lodging facility or health care facility is operated.

Subparagraph (B) shall not apply to rights provided to an eligible independent contractor to operate or manage a lodging facility if such rights are held by such corporation as a franchisee, licensee, or in a similar capacity and such lodging facility is either owned by such corporation or is leased to such corporation from the real estate investment trust.

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

"(A) LODGING FACILITY.—The term 'lodging facility' has the meaning given to such term by paragraph (9)(D)(ii).

"(B) HEALTH CARE FACILITY.—The term 'health care facility' has the meaning given to such term by subsection (e)(6)(D)(ii).".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 856(i) is amended by adding at the end the following new sentence: "Such term shall not include a taxable REIT subsidiary."

SEC. 1104. LIMITATION ON EARNINGS STRIPPING.

Paragraph (3) of section 163(j) (relating to limitation on deduction for interest on certain indebtedness) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) any interest paid or accrued (directly or indirectly) by a taxable REIT subsidiary (as defined in section 856(l)) of a real estate investment trust to such trust.".

SEC. 1105. 100 PERCENT TAX ON IMPROPERLY ALLOCATED AMOUNTS.

(a) IN GENERAL.—Subsection (b) of section 857 (relating to method of taxation of real estate investment trusts and holders of shares or certificates of beneficial interest) is amended by redesignating paragraphs (7) and (8) as paragraphs (8) and (9), respectively, and by inserting after paragraph (6) the following new paragraph:

"(7) INCOME FROM REDETERMINED RENTS, REDETERMINED DEDUCTIONS, AND EXCESS INTEREST.—

"(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year of the real estate investment trust a tax equal to 100 percent of redetermined rents, redetermined deductions, and excess interest.

"(B) REDETERMINED RENTS.—

"(i) IN GENERAL.—The term 'redetermined rents' means rents from real property (as defined in subsection 856(d)) the amount of which would (but for subparagraph (E)) be reduced on distribution, apportionment, or allocation under section 482 to clearly reflect income as a result of services furnished or rendered by a taxable REIT subsidiary of the real estate investment trust to a tenant of such trust.

"(ii) EXCEPTION FOR CERTAIN SERVICES.—Clause (i) shall not apply to amounts received directly or indirectly by a real estate investment trust for services described in paragraph (1)(B) or (7)(C)(i) of section 856(d).

"(iii) EXCEPTION FOR DE MINIMIS AMOUNTS.—Clause (i) shall not apply to amounts described in section 856(d)(7)(A) with respect to a property to the extent such amounts do not exceed the one percent threshold described in section 856(d)(7)(B) with respect to such property.

"(iv) EXCEPTION FOR COMPARABLY PRICED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

"(I) such subsidiary renders a significant amount of similar services to persons other than such trust and tenants of such trust who are unrelated (within the meaning of section 856(d)(8)(F)) to such subsidiary, trust, and tenants, but

"(II) only to the extent the charge for such service so rendered is substantially comparable to the charge for the similar services rendered to persons referred to in subclause (I).

"(v) EXCEPTION FOR CERTAIN SEPARATELY CHARGED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

"(I) the rents paid to the trust by tenants (leasing at least 25 percent of the net leasable space in the trust's property) who are not receiving such service from such subsidiary are substantially comparable to the rents paid by tenants leasing comparable space who are receiving such service from such subsidiary, and

"(II) the charge for such service from such subsidiary is separately stated.

"(vi) EXCEPTION FOR CERTAIN SERVICES BASED ON SUBSIDIARY'S INCOME FROM THE SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if the gross income of such subsidiary from such service is not less than 150 percent of such subsidiary's direct cost in furnishing or rendering the service.

"(vii) EXCEPTIONS GRANTED BY SECRETARY.—The Secretary may waive the tax otherwise imposed by subparagraph (A) if the trust establishes to the satisfaction of the Secretary that rents charged to tenants were established on an arms' length basis even though a taxable REIT subsidiary of the trust provided services to such tenants.

"(C) REDETERMINED DEDUCTIONS.—The term 'redetermined deductions' means deductions (other than redetermined rents) of a taxable REIT subsidiary of a real estate investment trust if the amount of such deductions would (but for subparagraph (E)) be increased on distribution, apportionment, or allocation under section 482 to clearly reflect income as between such subsidiary and such trust.

"(D) EXCESS INTEREST.—The term 'excess interest' means any deductions for interest payments by a taxable REIT subsidiary of a real estate investment trust to such trust to the extent that the interest payments are in excess of a rate that is commercially reasonable.

"(E) COORDINATION WITH SECTION 482.—The imposition of tax under subparagraph (A) shall be in lieu of any distribution, apportionment, or allocation under section 482.

"(F) REGULATORY AUTHORITY.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph. Until the Secretary prescribes such regulations, real estate investment trusts and their taxable REIT subsidiaries may base their allocations on any reasonable method.".

(b) AMOUNT SUBJECT TO TAX NOT REQUIRED TO BE DISTRIBUTED.—Subparagraph (E) of section 857(b)(2) (relating to real estate investment trust taxable income) is amended by striking "paragraph (5)" and inserting "paragraphs (5) and (7)".

SEC. 1106. EFFECTIVE DATE.

(a) IN GENERAL.—The amendments made by this part shall apply to taxable years beginning after December 31, 2000.

(b) TRANSITIONAL RULES RELATED TO SECTION 1101.—

(1) EXISTING ARRANGEMENTS.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amendment made by section 1101 shall not apply to a real estate investment trust with respect to—

(i) securities of a corporation held directly or indirectly by such trust on July 12, 1999,

(ii) securities of a corporation held by an entity on July 12, 1999, if such trust acquires control of such entity pursuant to a written binding contract in effect on such date and at all times thereafter before such acquisition,

(iii) securities received by such trust (or a successor) in exchange for, or with respect to, securities described in clause (i) or (ii) in a transaction in which gain or loss is not recognized, and

(iv) securities acquired directly or indirectly by such trust as part of a reorganization (as defined in section 368(a)(1) of the Internal Revenue Code of 1986) with respect to such trust if such securities are described in clause (i), (ii), or (iii) with respect to any other real estate investment trust.

(B) NEW TRADE OR BUSINESS OR SUBSTANTIAL NEW ASSETS.—Subparagraph (A) shall cease to apply to securities of a corporation as of the first day after July 12, 1999, on which such corporation engages in a substantial new line of business, or acquires any substantial asset, other than—

(i) pursuant to a binding contract in effect on such date and at all times thereafter before the acquisition of such asset,

(ii) in a transaction in which gain or loss is not recognized by reason of section 1031 or 1033 of the Internal Revenue Code of 1986, or

(iii) in a reorganization (as so defined) with another corporation the securities of which are described in paragraph (1)(A) of this subsection.

(2) TAX-FREE CONVERSION.—If—

(A) at the time of an election for a corporation to become a taxable REIT subsidiary, the amendment made by section 1101 does not apply to such corporation by reason of paragraph (1), and

(B) such election first takes effect before January 1, 2004,

such election shall be treated as a reorganization qualifying under section 368(a)(1)(A) of such Code.

PART II—HEALTH CARE REITS

SEC. 1111. HEALTH CARE REITS.

(a) SPECIAL FORECLOSURE RULE FOR HEALTH CARE PROPERTIES.—Subsection (e) of section 856 (relating to special rules for foreclosure property) is amended by adding at the end the following new paragraph:

"(6) SPECIAL RULE FOR QUALIFIED HEALTH CARE PROPERTIES.—For purposes of this subsection—

"(A) ACQUISITION AT EXPIRATION OF LEASE.—The term 'foreclosure property' shall include any qualified health care property acquired by a real estate investment trust as the result of the termination of a lease of such property (other than a termination by reason of a default, or the imminence of a default, on the lease).

"(B) GRACE PERIOD.—In the case of a qualified health care property which is foreclosure property solely by reason of subparagraph (A), in lieu of applying paragraphs (2) and (3)—

"(i) the qualified health care property shall cease to be foreclosure property as of the close of the second taxable year after the taxable year in which such trust acquired such property, and

"(ii) if the real estate investment trust establishes to the satisfaction of the Secretary that an extension of the grace period in clause (i) is necessary to the orderly leasing or liquidation of the trust's interest in such qualified health care property, the Secretary may grant 1 or more extensions of the grace period for such qualified health care property.

Any such extension shall not extend the grace period beyond the close of the 6th year after the taxable year in which such trust acquired such qualified health care property.

"(C) INCOME FROM INDEPENDENT CONTRACTORS.—For purposes of applying paragraph (4)(C) with respect to qualified health care property which is foreclosure property by reason of subparagraph (A) or paragraph (1), income derived or received by the trust from an independent contractor shall be disregarded to the extent such income is attributable to—

“(i) any lease of property in effect on the date the real estate investment trust acquired the qualified health care property (without regard to its renewal after such date so long as such renewal is pursuant to the terms of such lease as in effect on such date), or

“(ii) any lease of property entered into after such date if—

“(I) on such date, a lease of such property from the trust was in effect, and

“(II) under the terms of the new lease, such trust receives a substantially similar or lesser benefit in comparison to the lease referred to in subclause (I).

“(D) QUALIFIED HEALTH CARE PROPERTY.—

“(i) IN GENERAL.—The term ‘qualified health care property’ means any real property (including interests therein), and any personal property incident to such real property, which—

“(I) is a health care facility, or

“(II) is necessary or incidental to the use of a health care facility.

“(ii) HEALTH CARE FACILITY.—For purposes of clause (i), the term ‘health care facility’ means a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients and which, immediately before the termination, expiration, default, or breach of the lease of or mortgage secured by such facility, was operated by a provider of such services which was eligible for participation in the medicare program under title XVIII of the Social Security Act with respect to such facility.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

PART III—CONFORMITY WITH REGULATED INVESTMENT COMPANY RULES

SEC. 1121. CONFORMITY WITH REGULATED INVESTMENT COMPANY RULES.

(a) DISTRIBUTION REQUIREMENT.—Clauses (i) and (ii) of section 857(a)(1)(A) (relating to requirements applicable to real estate investment trusts) are each amended by striking “95 percent (90 percent for taxable years beginning before January 1, 1980)” and inserting “90 percent”.

(b) IMPOSITION OF TAX.—Clause (i) of section 857(b)(5)(A) (relating to imposition of tax in case of failure to meet certain requirements) is amended by striking “95 percent (90 percent in the case of taxable years beginning before January 1, 1980)” and inserting “90 percent”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

PART IV—CLARIFICATION OF EXCEPTION FROM IMPERMISSIBLE TENANT SERVICE INCOME

SEC. 1131. CLARIFICATION OF EXCEPTION FOR INDEPENDENT OPERATORS.

(a) IN GENERAL.—Paragraph (3) of section 856(d) (relating to independent contractor defined) is amended by adding at the end the following flush sentence:

“In the event that any class of stock of either the real estate investment trust or such person is regularly traded on an established securities market, only persons who own, directly or indirectly, more than 5 percent of such class of stock shall be taken into account as owning any of the stock of such class for purposes of applying the 35 percent limitation set forth in subparagraph (B) (but all of the outstanding stock of such class shall be considered outstanding in order to compute the denominator for purpose of determining the applicable percentage of ownership).”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

PART V—MODIFICATION OF EARNINGS AND PROFITS RULES

SEC. 1141. MODIFICATION OF EARNINGS AND PROFITS RULES.

(a) RULES FOR DETERMINING WHETHER REGULATED INVESTMENT COMPANY HAS EARNINGS AND PROFITS FROM NON-RIC YEAR.—Subsection (c) of section 852 is amended by adding at the end the following new paragraph:

"(3) DISTRIBUTIONS TO MEET REQUIREMENTS OF SUBSECTION (a)(2)(B).—Any distribution which is made in order to comply with the requirements of subsection (a)(2)(B)—

"(A) shall be treated for purposes of this subsection and subsection (a)(2)(B) as made from the earliest earnings and profits accumulated in any taxable year to which the provisions of this part did not apply rather than the most recently accumulated earnings and profits, and

"(B) to the extent treated under subparagraph (A) as made from accumulated earnings and profits, shall not be treated as a distribution for purposes of subsection (b)(2)(D) and section 855.".

(b) CLARIFICATION OF APPLICATION OF REIT SPILLOVER DIVIDEND RULES TO DISTRIBUTIONS TO MEET QUALIFICATION REQUIREMENT.—Subparagraph (B) of section 857(d)(3) is amended by inserting before the period "and section 858".

(c) APPLICATION OF DEFICIENCY DIVIDEND PROCEDURES.—Paragraph (1) of section 852(e) is amended by adding at the end the following new sentence: "If the determination under subparagraph (A) is solely as a result of the failure to meet the requirements of subsection (a)(2), the preceding sentence shall also apply for purposes of applying subsection (a)(2) to the non-RIC year."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

PART VI—STUDY RELATING TO TAXABLE REIT SUBSIDIARIES

SEC. 1151. STUDY RELATING TO TAXABLE REIT SUBSIDIARIES.

The Commissioner of the Internal Revenue shall conduct a study to determine how many taxable REIT subsidiaries are in existence and the aggregate amount of taxes paid by such subsidiaries. The Secretary shall submit a report to the Congress describing the results of such study.

Subtitle B—Modification of At-Risk Rules for Publicly Traded Nonrecourse Debt

SEC. 1161. TREATMENT UNDER AT-RISK RULES OF PUBLICLY TRADED NONRECOURSE DEBT.

(a) IN GENERAL.—Subparagraph (A) of section 465(b)(6) (relating to qualified nonrecourse financing treated as amount at risk) is amended by striking "share of" and all that follows and inserting "share of—

"(i) any qualified nonrecourse financing which is secured by real property used in such activity, and

"(ii) any other financing which—

"(I) would (but for subparagraph (B)(ii)) be qualified nonrecourse financing,

"(II) is qualified publicly traded debt, and

"(III) is not borrowed by the taxpayer from a person described in subclause (I), (II), or (III) of section 49(a)(1)(D)(iv)."

(b) QUALIFIED PUBLICLY TRADED DEBT.—Paragraph (6) of section 465(b) is amended by adding at the end the following new subparagraph:

"(F) QUALIFIED PUBLICLY TRADED DEBT.—For purposes of subparagraph (A), the term 'qualified publicly traded debt' means any debt instrument which is readily tradable on an established securities market. Such term shall not include any debt instrument which has a yield to maturity which equals or exceeds the limitation in section 163(i)(1)(B)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to debt instruments issued after December 31, 1999.

Subtitle C—Treatment of Construction Allowances and Certain Contributions to Capital of Retailers

SEC. 1171. EXCLUSION FROM GROSS INCOME OF QUALIFIED LESSEE CONSTRUCTION ALLOWANCES NOT LIMITED FOR CERTAIN RETAILERS TO SHORT-TERM LEASES.

(a) IN GENERAL.—Subsection (a) section 110 (relating to qualified lessee construction allowances for short-term leases) is amended by adding at the end the following new sentence: "Paragraph (1) shall not apply if the lessee is a qualified retail business (as defined by section 118(d)(3) without regard to the proximity requirement in subparagraph (A) thereof).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to leases entered into after December 31, 1999.

SEC. 1172. EXCLUSION FROM GROSS INCOME FOR CERTAIN CONTRIBUTIONS TO THE CAPITAL OF CERTAIN RETAILERS.

(a) IN GENERAL.—Section 118 (relating to contributions to the capital of a corporation) is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) SAFE HARBOR FOR CONTRIBUTIONS TO CERTAIN RETAILERS.—

"(1) GENERAL RULE.—For purposes of this section, the term 'contribution to the capital of the taxpayer' includes any amount of money or other property received by the taxpayer if—

"(A) the taxpayer has entered into an agreement to operate (or cause to be operated) a qualified retail business at a particular location for a period of at least 15 years,

"(B)(i) immediately after the receipt of such money or other property, the taxpayer owns the land and the structure to be used by the taxpayer in carrying on a qualified retail business at such location, or

"(ii) the taxpayer uses such amount to acquire ownership of at least such land and structure,

"(C) such amount meets the requirements of the expenditure rule of paragraph (2), and

"(D) the contributor of such amount does not hold a beneficial interest in any property located on the premises of such qualified retail business other than de minimis amounts of property associated with the operation of property adjacent to such premises.

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

"(A) an amount equal to such amount is expended for the acquisition of land or for acquisition or construction of other property described in section 1231(b)—

"(i) which was the purpose motivating the contribution, and

"(ii) which is used predominantly in a qualified retail business at the location referred to in paragraph (1)(A),

"(B) the expenditure referred to in subparagraph (A) occurs before the end of the second taxable year after the year in which such amount was received, and

"(C) accurate records are kept of the amounts contributed and expenditures made on the basis of the project for which the contribution was made and on the basis of the year of the contribution expenditure.

"(3) DEFINITION OF QUALIFIED RETAIL BUSINESS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'qualified retail business' means a trade or business of selling tangible personal property to the general public if the premises on which such trade or business is conducted is in close proximity to property that the contributor of the amount referred to in paragraph (1) is developing or operating for profit (or, in the case of a contributor which is a governmental entity, is attempting to revitalize).

"(B) SERVICES.—A trade or business shall not fail to be treated as a qualified retail business by reason of sales of services if such sales are incident to the sale of tangible personal property or if the services are de minimis in amount.

"(4) SPECIAL RULES.—

"(A) LEASES.—For purposes of paragraph (1)(B)(i), property shall be treated as owned by the taxpayer if the taxpayer is the lessee of such property under a lease having a term of at least 30 years and on which only nominal rent is required.

"(B) CONTROLLED GROUPS.—For purposes of this subsection, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as 1 person.

"(5) DISALLOWANCE OF DEDUCTIONS AND CREDITS; ADJUSTED BASIS.—Notwithstanding any other provision of this subtitle, no deduction or credit shall be allowed for, or by reason of, any amount received by the taxpayer which constitutes a contribution to capital to which this subsection applies. The adjusted basis of any property acquired with the contributions to which this subsection applies shall be reduced by the amount of the contributions to which this subsection applies.

"(6) REGULATIONS.—The Secretary shall prescribe such regulations are appropriate to prevent the abuse of the purposes of the subsection, including regulations which allocate income and deductions (or adjust the amount excludable under this subsection) in cases in which—

"(A) payments in excess of fair market value are paid to the contributor by the taxpayer, or

"(B) the contributor and the taxpayer are related parties."

(b) CONFORMING AMENDMENT.—Subsection (e) of section 118 (as redesignated by subsection (a)) is amended by adding at the end the following flush sentence:
"Rules similar to the rules of the preceding sentence shall apply to any amount treated as a contribution to the capital of the taxpayer under subsection (d)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts received after December 31, 1999.

TITLE XII—PROVISIONS RELATING TO PENSIONS

Subtitle A—Expanding Coverage

SEC. 1201. INCREASE IN BENEFIT AND CONTRIBUTION LIMITS.

(a) DEFINED BENEFIT PLANS.—

(1) DOLLAR LIMIT.—

(A) Subparagraph (A) of section 415(b)(1) (relating to limitation for defined benefit plans) is amended by striking "$90,000" and inserting "$160,000".

(B) Subparagraphs (C) and (D) of section 415(b)(2) are each amended by striking "$90,000" each place it appears in the headings and the text and inserting "$160,000".

(C) Paragraph (7) of section 415(b) (relating to benefits under certain collectively bargained plans) is amended by striking "the greater of $68,212 or one-half the amount otherwise applicable for such year under paragraph (1)(A) for '$90,000'" and inserting "one-half the amount otherwise applicable for such year under paragraph (1)(A) for '$160,000'".

(2) LIMIT REDUCED WHEN BENEFIT BEGINS BEFORE AGE 62.—Subparagraph (C) of section 415(b)(2) is amended by striking "the social security retirement age" each place it appears in the heading and text and inserting "age 62".

(3) LIMIT INCREASED WHEN BENEFIT BEGINS AFTER AGE 65.—Subparagraph (D) of section 415(b)(2) is amended by striking "the social security retirement age" each place it appears in the heading and text and inserting "age 65".

(4) COST-OF-LIVING ADJUSTMENTS.—Subsection (d) of section 415 (related to cost-of-living adjustments) is amended—

(A) in paragraph (1)(A) by striking "$90,000" and inserting "$160,000", and

(B) in paragraph (3)(A)—

(i) by striking "$90,000" in the heading and inserting "$160,000", and

(ii) by striking "October 1, 1986" and inserting "July 1, 2000".

(5) CONFORMING AMENDMENT.—Section 415(b)(2) is amended by striking subparagraph (F).

(b) DEFINED CONTRIBUTION PLANS.—

(1) DOLLAR LIMIT.—Subparagraph (A) of section 415(c)(1) (relating to limitation for defined contribution plans) is amended by striking "$30,000" and inserting "$40,000".

(2) COST-OF-LIVING ADJUSTMENTS.—Subsection (d) of section 415 (related to cost-of-living adjustments) is amended—

(A) in paragraph (1)(C) by striking "$30,000" and inserting "$40,000", and

(B) in paragraph (3)(D)—

(i) by striking "$30,000" in the heading and inserting "$40,000", and

(ii) by striking "October 1, 1993" and inserting "July 1, 2000".

(c) QUALIFIED TRUSTS.—

(1) COMPENSATION LIMIT.—Sections 401(a)(17), 404(l), 408(k), and 505(b)(7) are each amended by striking "$150,000" each place it appears and inserting "$200,000".

(2) BASE PERIOD AND ROUNDING OF COST-OF-LIVING ADJUSTMENT.—Subparagraph (B) of section 401(a)(17) is amended—

(A) by striking "October 1, 1993" and inserting "July 1, 2000", and

(B) by striking "$10,000" both places it appears and inserting "$5,000".

(d) ELECTIVE DEFERRALS.—

(1) IN GENERAL.—Paragraph (1) of section 402(g) (relating to limitation on exclusion for elective deferrals) is amended to read as follows:

"(1) IN GENERAL.—

"(A) LIMITATION.—Notwithstanding subsections (e)(3) and (h)(1)(B), the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds the applicable dollar amount.

"(B) APPLICABLE DOLLAR AMOUNT.—For purposes of subparagraph (A), the applicable dollar amount shall be the amount determined in accordance with the following table:

"Taxable year:	Applicable dollar amount:
2001	$11,000
2002	$12,000
2003	$13,000
2004	$14,000
2005 or thereafter	$15,000.".

(2) COST-OF-LIVING ADJUSTMENT.—Paragraph (5) of section 402(g) is amended to read as follows:

"(5) COST-OF-LIVING ADJUSTMENT.—In the case of taxable years beginning after December 31, 2005, the Secretary shall adjust the $15,000 amount under paragraph (1)(B) at the same time and in the same manner as under section 415(d); except that the base period shall be the calendar quarter beginning July 1, 2004, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500.".

(3) CONFORMING AMENDMENTS.—

(A) Section 402(g) (relating to limitation on exclusion for elective deferrals), as amended by paragraphs (1) and (2), is further amended by striking paragraph (4) and redesignating paragraphs (5), (6), (7), (8), and (9) as paragraphs (4), (5), (6), (7), and (8), respectively.

(B) Paragraph (2) of section 457(c) is amended by striking "402(g)(8)(A)(iii)" and inserting "402(g)(7)(A)(iii)".

(C) Clause (iii) of section 501(c)(18)(D) is amended by striking "(other than paragraph (4) thereof)".

(e) DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

(1) IN GENERAL.—Section 457 (relating to deferred compensation plans of State and local governments and tax-exempt organizations) is amended—

(A) in subsections (b)(2)(A) and (c)(1) by striking "$7,500" each place it appears and inserting "the applicable dollar amount", and

(B) in subsection (b)(3)(A) by striking "$15,000" and inserting "twice the dollar amount in effect under subsection (b)(2)(A)".

(2) APPLICABLE DOLLAR AMOUNT; COST-OF-LIVING ADJUSTMENT.—Paragraph (15) of section 457(e) is amended to read as follows:

"(15) APPLICABLE DOLLAR AMOUNT.—

"(A) IN GENERAL.—The applicable dollar amount shall be the amount determined in accordance with the following table:

"Taxable year:	Applicable dollar amount:
2001	$11,000
2002	$12,000
2003	$13,000
2004	$14,000
2005 or thereafter	$15,000.

"(B) COST-OF-LIVING ADJUSTMENTS.—In the case of taxable years beginning after December 31, 2005, the Secretary shall adjust the $15,000 amount specified in the table in subparagraph (A) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2004, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500.".

(f) SIMPLE RETIREMENT ACCOUNTS.—

(1) LIMITATION.—Clause (ii) of section 408(p)(2)(A) (relating to general rule for qualified salary reduction arrangement) is amended by striking "$6,000" and inserting "the applicable dollar amount".

(2) APPLICABLE DOLLAR AMOUNT.—Subparagraph (E) of 408(p)(2) is amended to read as follows:

"(E) APPLICABLE DOLLAR AMOUNT; COST-OF-LIVING ADJUSTMENT.—

"(i) IN GENERAL.—For purposes of subparagraph (A)(ii), the applicable dollar amount shall be the amount determined in accordance with the following table:

"Year:	Applicable dollar amount:
2001	$7,000
2002	$8,000
2003	$9,000
2004 or thereafter	$10,000.

"(ii) COST-OF-LIVING ADJUSTMENT.—In the case of a year beginning after December 31, 2004, the Secretary shall adjust the $10,000 amount under clause (i) at the same time and in the same manner as under section 415(d), except that the base period taken into account shall be the calendar quarter beginning July 1, 2003, and any increase under this subparagraph which is not a multiple of $500 shall be rounded to the next lower multiple of $500.".

(3) CONFORMING AMENDMENTS.—

(A) Clause (I) of section 401(k)(11)(B)(i) is amended by striking "$6,000" and inserting "the amount in effect under section 408(p)(2)(A)(ii)".

(B) Section 401(k)(11) is amended by striking subparagraph (E).

(g) ROUNDING RULE RELATING TO DEFINED BENEFIT PLANS AND DEFINED CONTRIBUTION PLANS.—Paragraph (4) of section 415(d) is amended to read as follows:

"(4) ROUNDING.—

"(A) $160,000 AMOUNT.—Any increase under subparagraph (A) of paragraph (1) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

"(B) $40,000 AMOUNT.—Any increase under subparagraph (C) of paragraph (1) which is not a multiple of $1,000 shall be rounded to the next lowest multiple of $1,000.".

(h) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to years beginning after December 31, 2000.

(2) COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified by the date of enactment of this Act, the amendments made by this section shall not apply to contributions or benefits pursuant to any such agreement for years beginning before the earlier of—

(A) the later of—

(i) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof on or after such date of enactment), or

(ii) January 1, 2001, or

(B) January 1, 2005.

SEC. 1202. PLAN LOANS FOR SUBCHAPTER S OWNERS, PARTNERS, AND SOLE PROPRIETORS.

(a) IN GENERAL.—Subparagraph (B) of section 4975(f)(6) (relating to exemptions not to apply to certain transactions) is amended by adding at the end the following new clause:

"(iii) LOAN EXCEPTION.—For purposes of subparagraph (A)(i), the term 'owner-employee' shall only include a person described in subclause (II) or (III) of clause (i)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to loans made after December 31, 2000.

SEC. 1203. MODIFICATION OF TOP-HEAVY RULES.

(a) SIMPLIFICATION OF DEFINITION OF KEY EMPLOYEE.—

(1) IN GENERAL.—Section 416(i)(1)(A) (defining key employee) is amended—

(A) by striking "or any of the 4 preceding plan years" in the matter preceding clause (i),

(B) by striking clause (i) and inserting the following:

"(i) an officer of the employer having an annual compensation greater than $150,000,",

(C) by striking clause (ii) and redesignating clauses (iii) and (iv) as clauses (ii) and (iii), respectively, and

(D) by striking the second sentence in the matter following clause (iii), as redesignated by subparagraph (C).

(2) CONFORMING AMENDMENT.—Section 416(i)(1)(B)(iii) is amended by striking "and subparagraph (A)(ii)".

(b) MATCHING CONTRIBUTIONS TAKEN INTO ACCOUNT FOR MINIMUM CONTRIBUTION REQUIREMENTS.—Section 416(c)(2)(A) (relating to defined contribution plans) is amended by adding at the end the following: "Employer matching contributions (as defined in section 401(m)(4)(A)) shall be taken into account for purposes of this subparagraph.".

(c) DISTRIBUTIONS DURING LAST YEAR BEFORE DETERMINATION DATE TAKEN INTO ACCOUNT.—

(1) IN GENERAL.—Paragraph (3) of section 416(g) is amended to read as follows:

"(3) DISTRIBUTIONS DURING LAST YEAR BEFORE DETERMINATION DATE TAKEN INTO ACCOUNT.—

"(A) IN GENERAL.—For purposes of determining—

"(i) the present value of the cumulative accrued benefit for any employee, or

"(ii) the amount of the account of any employee,

such present value or amount shall be increased by the aggregate distributions made with respect to such employee under the plan during the 1-year period ending on the determination date. The preceding sentence shall also apply to distributions under a terminated plan which if it had not been terminated would have been required to be included in an aggregation group.

"(B) 5-YEAR PERIOD IN CASE OF IN-SERVICE DISTRIBUTION.—In the case of any distribution made for a reason other than separation from service, death, or disability, subparagraph (A) shall be applied by substituting '5-year period' for '1-year period'.".

(2) BENEFITS NOT TAKEN INTO ACCOUNT.—Subparagraph (E) of section 416(g)(4) is amended—

(A) by striking "LAST 5 YEARS" in the heading and inserting "LAST YEAR BEFORE DETERMINATION DATE", and

(B) by striking "5-year period" and inserting "1-year period".

(d) DEFINITION OF TOP-HEAVY PLANS.—Paragraph (4) of section 416(g) (relating to other special rules for top-heavy plans) is amended by adding at the end the following new subparagraph:

"(H) CASH OR DEFERRED ARRANGEMENTS USING ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—The term 'top-heavy plan' shall not include a plan which consists solely of—

"(i) a cash or deferred arrangement which meets the requirements of section 401(k)(12), and

"(ii) matching contributions with respect to which the requirements of section 401(m)(11) are met.

If, but for this subparagraph, a plan would be treated as a top-heavy plan because it is a member of an aggregation group which is a top-heavy group, contributions under the plan may be taken into account in determining whether any other plan in the group meets the requirements of subsection (c)(2)."

(e) FROZEN PLAN EXEMPT FROM MINIMUM BENEFIT REQUIREMENT.—Subparagraph (C) of section 416(c)(1) (relating to defined benefit plans) is amended—

(A) in clause (i), by striking "clause (ii)" and inserting "clause (ii) or (iii)", and

(B) by adding at the end the following:

"(iii) EXCEPTION FOR FROZEN PLAN.—For purposes of determining an employee's years of service with the employer, any service with the employer shall be disregarded to the extent that such service occurs during a plan year when the plan benefits (within the meaning of section 410(b)) no employee or former employee.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1204. ELECTIVE DEFERRALS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF DEDUCTION LIMITS.

(a) IN GENERAL.—Section 404 (relating to deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan) is amended by adding at the end the following new subsection:

"(n) ELECTIVE DEFERRALS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF DEDUCTION LIMITS.—Elective deferrals (as defined in section 402(g)(3)) shall not be subject to any limitation contained in paragraph (3), (7), or (9) of subsection (a), and such elective deferrals shall not be taken into account in applying any such limitation to any other contributions.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2000.

SEC. 1205. REDUCED PBGC PREMIUM FOR NEW PLANS OF SMALL EMPLOYERS.

(a) IN GENERAL.—Subparagraph (A) of section 4006(a)(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(a)(3)(A)) is amended—

(1) in clause (i), by inserting "other than a new single-employer plan (as defined in subparagraph (F)) maintained by a small employer (as so defined)," after "single-employer plan,",

(2) in clause (iii), by striking the period at the end and inserting ", and", and

(3) by adding at the end the following new clause:

"(iv) in the case of a new single-employer plan (as defined in subparagraph (F)) maintained by a small employer (as so defined) for the plan year, $5 for each individual who is a participant in such plan during the plan year.".

(b) DEFINITION OF NEW SINGLE-EMPLOYER PLAN.—Section 4006(a)(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(a)(3)) is amended by adding at the end the following new subparagraph:

"(F)(i) For purposes of this paragraph, a single-employer plan maintained by a contributing sponsor shall be treated as a new single-employer plan for each of its first 5 plan years if, during the 36-month period ending on the date of the adoption of such plan, the sponsor or any member of such sponsor's controlled group (or any predecessor of either) had not established or maintained a plan to which this title applies with respect to which benefits were accrued for substantially the same employees as are in the new single-employer plan.

"(ii)(I) For purposes of this paragraph, the term 'small employer' means an employer which on the first day of any plan year has, in aggregation with all members of the controlled group of such employer, 100 or fewer employees.

"(II) In the case of a plan maintained by 2 or more contributing sponsors that are not part of the same controlled group, the employees of all contributing sponsors and controlled groups of such sponsors shall be aggregated for purposes of determining whether any contributing sponsor is a small employer.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plans established after December 31, 2000.

SEC. 1206. REDUCTION OF ADDITIONAL PBGC PREMIUM FOR NEW AND SMALL PLANS.

(a) NEW PLANS.—Subparagraph (E) of section 4006(a)(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(a)(3)(E)) is amended by adding at the end the following new clause:

"(v) In the case of a new defined benefit plan, the amount determined under clause (ii) for any plan year shall be an amount equal to the product of the amount determined under clause (ii) and the applicable percentage. For purposes of this clause, the term 'applicable percentage' means—

"(I) 0 percent, for the first plan year.

"(II) 20 percent, for the second plan year.

"(III) 40 percent, for the third plan year.

"(IV) 60 percent, for the fourth plan year.

"(V) 80 percent, for the fifth plan year.

For purposes of this clause, a defined benefit plan (as defined in section 3(35)) maintained by a contributing sponsor shall be treated as a new defined benefit plan for its first 5 plan years if, during the 36-month period ending on the date of the adoption of the plan, the sponsor and each member of any controlled group including the sponsor (or any predecessor of either) did not establish or maintain a plan to which this title applies with respect to which benefits were accrued for substantially the same employees as are in the new plan.".

(b) SMALL PLANS.—Paragraph (3) of section 4006(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(a)) is amended—

(1) in subparagraph (E)(i) by striking "The" and inserting "Except as provided in subparagraph (G), the", and

(2) by inserting after subparagraph (F) the following new subparagraph:

"(G)(i) In the case of an employer who has 25 or fewer employees on the first day of the plan year, the additional premium determined under subparagraph (E) for each participant shall not exceed $5 multiplied by the number of participants in the plan as of the close of the preceding plan year.

"(ii) For purposes of clause (i), whether an employer has 25 or fewer employees on the first day of the plan year is determined taking into consideration all of the employees of all members of the contributing sponsor's controlled group. In the case of a plan maintained by 2 or more contributing sponsors, the employees of all contributing sponsors and their controlled groups shall be aggregated for purposes of determining whether 25-or-fewer-employees limitation has been satisfied.".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendments made by subsection (a) shall apply to plans established after December 31, 2000.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to plan years beginning after December 31, 2000.

SEC. 1207. REPEAL OF COORDINATION REQUIREMENTS FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Subsection (c) of section 457 (relating to deferred compensation plans of State and local governments and tax-exempt organizations), as amended by section 1201(e), is amended to read as follows:

"(c) LIMITATION.—The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed the amount in effect under subsection (b)(2)(A) (as modified by any adjustment provided under subsection (b)(3)).".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 2000.

SEC. 1208. ELIMINATION OF USER FEE FOR REQUESTS TO IRS REGARDING PENSION PLANS.

(a) ELIMINATION OF CERTAIN USER FEES.—The Secretary of the Treasury or the Secretary's delegate shall not require payment of user fees under the program established under section 7527 of the Internal Revenue Code of 1986 for requests to the Internal Revenue Service for determination letters with respect to the qualified status of a pension benefit plan maintained solely by one or more eligible employers or any trust which is part of the plan. The preceding sentence shall not apply to any request made by the sponsor of any prototype or similar plan which the sponsor intends to market to participating employers.

(b) PENSION BENEFIT PLAN.—For purposes of this section, the term "pension benefit plan" means a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan.

(c) ELIGIBLE EMPLOYER.—For purposes of this section, the term "eligible employer" has the same meaning given such term in section 408(p)(2)(C)(i)(I) of the Internal Revenue Code of 1986. The determination of whether an employer is an eligible employer under this section shall be made as of the date of the request described in subsection (a).

(d) EFFECTIVE DATE.—The provisions of this section shall apply with respect to requests made after December 31, 2000.

SEC. 1209. DEDUCTION LIMITS.

(a) IN GENERAL.—Section 404(a) (relating to general rule) is amended by adding at the end the following:

"(12) DEFINITION OF COMPENSATION.—For purposes of paragraphs (3), (7), (8), and (9), the term 'compensation' shall include amounts treated as participant's compensation under subparagraph (C) or (D) of section 415(c)(3).".

(b) CONFORMING AMENDMENT.—Subparagraph (B) of section 404(a)(3) is amended by striking the last sentence thereof.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1210. OPTION TO TREAT ELECTIVE DEFERRALS AS AFTER-TAX CONTRIBUTIONS.

(a) IN GENERAL.—Subpart A of part I of subchapter D of chapter 1 (relating to deferred compensation, etc.) is amended by inserting after section 402 the following new section:

"SEC. 402A. OPTIONAL TREATMENT OF ELECTIVE DEFERRALS AS PLUS CONTRIBUTIONS.

"(a) GENERAL RULE.—If an applicable retirement plan includes a qualified plus contribution program—

"(1) any designated plus contribution made by an employee pursuant to the program shall be treated as an elective deferral for purposes of this chapter, except that such contribution shall not be excludable from gross income, and

"(2) such plan (and any arrangement which is part of such plan) shall not be treated as failing to meet any requirement of this chapter solely by reason of including such program.

"(b) QUALIFIED PLUS CONTRIBUTION PROGRAM.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified plus contribution program' means a program under which an employee may elect to make designated plus contributions in lieu of all or a portion of elective deferrals the employee is otherwise eligible to make under the applicable retirement plan.

"(2) SEPARATE ACCOUNTING REQUIRED.—A program shall not be treated as a qualified plus contribution program unless the applicable retirement plan—

"(A) establishes separate accounts ('designated plus accounts') for the designated plus contributions of each employee and any earnings properly allocable to the contributions, and

"(B) maintains separate recordkeeping with respect to each account.

"(c) DEFINITIONS AND RULES RELATING TO DESIGNATED PLUS CONTRIBUTIONS.—For purposes of this section—

"(1) DESIGNATED PLUS CONTRIBUTION.—The term 'designated plus contribution' means any elective deferral which—

"(A) is excludable from gross income of an employee without regard to this section, and

"(B) the employee designates (at such time and in such manner as the Secretary may prescribe) as not being so excludable.

"(2) DESIGNATION LIMITS.—The amount of elective deferrals which an employee may designate under paragraph (1) shall not exceed the excess (if any) of—

"(A) the maximum amount of elective deferrals excludable from gross income of the employee for the taxable year (without regard to this section), over

"(B) the aggregate amount of elective deferrals of the employee for the taxable year which the employee does not designate under paragraph (1).

"(3) ROLLOVER CONTRIBUTIONS.—

"(A) IN GENERAL.—A rollover contribution of any payment or distribution from a designated plus account which is otherwise allowable under this chapter may be made only if the contribution is to—

"(i) another designated plus account of the individual from whose account the payment or distribution was made, or

"(ii) a Roth IRA of such individual.

"(B) COORDINATION WITH LIMIT.—Any rollover contribution to a designated plus account under subparagraph (A) shall not be taken into account for purposes of paragraph (1).

"(d) DISTRIBUTION RULES.—For purposes of this title—

"(1) EXCLUSION.—Any qualified distribution from a designated plus account shall not be includible in gross income.

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

"(A) IN GENERAL.—The term 'qualified distribution' has the meaning given such term by section 408A(d)(2)(A) (without regard to clause (iv) thereof).

"(B) DISTRIBUTIONS WITHIN NONEXCLUSION PERIOD.—A payment or distribution from a designated plus account shall not be treated as a qualified distribution if such payment or distribution is made within the 5-taxable-year period beginning with the earlier of—

"(i) the 1st taxable year for which the individual made a designated plus contribution to any designated plus account established for such individual under the same applicable retirement plan, or

"(ii) if a rollover contribution was made to such designated plus account from a designated plus account previously established for such individual under another applicable retirement plan, the 1st taxable year for which the individual made a designated plus contribution to such previously established account.

"(C) DISTRIBUTIONS OF EXCESS DEFERRALS AND EARNINGS.—The term 'qualified distribution' shall not include any distribution of any excess deferral under section 402(g)(2) and any income on the excess deferral.

"(3) AGGREGATION RULES.—Section 72 shall be applied separately with respect to distributions and payments from a designated plus account and other distributions and payments from the plan.

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

"(1) APPLICABLE RETIREMENT PLAN.—The term 'applicable retirement plan' means—

"(A) an employees' trust described in section 401(a) which is exempt from tax under section 501(a), and

"(B) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b).

"(2) ELECTIVE DEFERRAL.—The term 'elective deferral' means any elective deferral described in subparagraph (A) or (C) of section 402(g)(3)."

(b) EXCESS DEFERRALS.—Section 402(g) (relating to limitation on exclusion for elective deferrals) is amended—

(1) by adding at the end of paragraph (1) the following new sentence: "The preceding sentence shall not apply to so much of such excess as does not exceed the designated plus contributions of the individual for the taxable year.", and

(2) by inserting "(or would be included but for the last sentence thereof)" after "paragraph (1)" in paragraph (2)(A).

(c) ROLLOVERS.—Subparagraph (B) of section 402(c)(8) is amended by adding at the end the following:

"If any portion of an eligible rollover distribution is attributable to payments or distributions from a designated plus account (as defined in section 402A), an eligible retirement plan with respect to such portion shall include only another designated plus account and a Roth IRA."

(d) REPORTING REQUIREMENTS.—

(1) W–2 INFORMATION.—Section 6051(a)(8) is amended by inserting ", including the amount of designated plus contributions (as defined in section 402A)" before the comma at the end.

(2) INFORMATION.—Section 6047 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) DESIGNATED PLUS CONTRIBUTIONS.—The Secretary shall require the plan administrator of each applicable retirement plan (as defined in section 402A) to make such returns and reports regarding designated plus contributions (as so defined) to the Secretary, participants and beneficiaries of the plan, and such other persons as the Secretary may prescribe."

(e) CONFORMING AMENDMENTS.—

(1) Section 408A(e) is amended by adding after the first sentence the following new sentence: "Such term includes a rollover contribution described in section 402A(c)(3)(A)."

(2) The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by inserting after the item relating to section 402 the following new item:

"Sec. 402A. Optional treatment of elective deferrals as plus contributions."

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1211. INCREASE IN MINIMUM DEFINED BENEFIT LIMIT UNDER SECTION 415.

(a) IN GENERAL.—Paragraph (4) of section 415(b) (relating to total annual benefits not in excess of $10,000) is amended to read as follows:

"(4) TOTAL ANNUAL BENEFITS NOT IN EXCESS OF $40,000.—Notwithstanding the preceding provisions of this subsection, the benefits payable with respect to a participant under any defined benefit plan shall be deemed not to exceed the limitation of this subsection if the retirement benefits payable with respect to such participant under such plan and under all other defined benefit plans of the employer do not exceed $40,000 for the plan year or any prior plan year. The preceding sentence shall be applied by substituting for '$40,000'—

"(A) $20,000 if the plan year begins during 2001, and

"(B) $30,000 if the plan year begins during 2002."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2000.

Subtitle B—Enhancing Fairness for Women

SEC. 1221. ADDITIONAL SALARY REDUCTION CATCH-UP CONTRIBUTIONS.

(a) LIMITATION ON EXCLUSION FOR ELECTIVE DEFERRALS.—

(1) IN GENERAL.—Subsection (g) of section 402 (as amended by section 1201(d)) is further amended by adding at the end the following:

"(9) CATCH-UP CONTRIBUTIONS FOR THOSE APPROACHING RETIREMENT.—

"(A) IN GENERAL.—In the case of an individual who is at least age 50 as of the end of any taxable year, the limitation of paragraph (1) for such year, after the application of paragraph (7), shall be increased by the applicable catch-up amount.

"(B) APPLICABLE CATCH-UP AMOUNT.—For purposes of subparagraph (A), the applicable catch-up amount shall be the amount determined in accordance with the following table:

"Taxable year:	Applicable catch-up amount:
2001	$1,000
2002	$2,000
2003	$3,000
2004	$4,000
2005 or thereafter	$5,000.".

(2) COST-OF-LIVING ADJUSTMENTS.—Paragraph (4) of section 402(g) (relating to cost-of-living adjustment), as amended by section 1201(d), is further amended by inserting "and the $5,000 dollar amount in paragraph (9)" after "paragraph (1)(B)".

(b) SIMPLE RETIREMENT ACCOUNTS.—Paragraph (2) of section 408(p) (relating to qualified salary reduction arrangement) is amended by inserting at the end of the following new subparagraph:

"(F) CATCH-UP CONTRIBUTIONS FOR THOSE APPROACHING RETIREMENT.—In the case of an individual who is at least age 50 as of the end of any taxable year, the limitation of subparagraph (A)(ii) for such year shall be increased by the applicable catch-up amount. For purposes of the preceding sentence, the applicable catch-up amount is the amount in effect under section 402(g)(9) for such taxable year.".

(c) DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—Subsection (e) of section 457 (relating to other definitions and special rules) is amended by adding after paragraph (16) the following new paragraph:

"(17) CATCH-UP AMOUNTS.—In the case of an individual who is at least age 50 as of the end of any taxable year, the limitation of subsection (b)(2)(A) for such year shall be increased by the applicable catch-up amount (as in effect under section 402(g)(9) for such taxable year), except that this paragraph shall not apply to any taxable year to which subsection (b)(3) applies.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1222. EQUITABLE TREATMENT FOR CONTRIBUTIONS OF EMPLOYEES TO DEFINED CONTRIBUTION PLANS.

(a) EQUITABLE TREATMENT.—

(1) IN GENERAL.—Subparagraph (B) of section 415(c)(1) (relating to limitation for defined contribution plans) is amended by striking "25 percent" and inserting "100 percent".

(2) APPLICATION TO SECTION 403(b).—Section 403(b) is amended—

(A) by striking "the exclusion allowance for such taxable year" in paragraph (1) and inserting "the applicable limit under section 415",

(B) by striking paragraph (2), and

(C) by inserting "or any amount received by a former employee after the 5th taxable year following the taxable year in which such employee was terminated" before the period at the end of the second sentence of paragraph (3).

(3) CONFORMING AMENDMENTS.—

(A) Subsection (f) of section 72 is amended by striking "section 403(b)(2)(D)(iii))" and inserting "section 403(b)(2)(D)(iii), as in effect on December 31, 2000)".

(B) Section 404(a)(10)(B) is amended by striking ", the exclusion allowance under section 403(b)(2),".

(C) Section 415(a)(2) is amended by striking ", and the amount of the contribution for such portion shall reduce the exclusion allowance as provided in section 403(b)(2)".

(D) Section 415(c)(3) is amended by adding at the end the following new subparagraph:

"(E) ANNUITY CONTRACTS.—In the case of an annuity contract described in section 403(b), the term 'participant's compensation' means the participant's includible compensation determined under section 403(b)(3).".

(E) Section 415(c) is amended by striking paragraph (4).

(F) Section 415(c)(7) is amended to read as follows:

"(7) CERTAIN CONTRIBUTIONS BY CHURCH PLANS NOT TREATED AS EXCEEDING LIMIT.—

"(A) IN GENERAL.—Notwithstanding any other provision of this subsection, at the election of a participant who is an employee of a church or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), contributions and other additions for an annuity contract or retirement income account described in section 403(b) with respect to such participant, when expressed as an annual addition to such participant's account, shall be treated as not exceeding the limitation of paragraph (1) if such annual addition is not in excess of $10,000.

"(B) $40,000 AGGREGATE LIMITATION.—The total amount of additions with respect to any participant which may be taken into account for purposes of this subparagraph for all years may not exceed $40,000.

"(C) ANNUAL ADDITION.—For purposes of this paragraph, the term 'annual addition' has the meaning given such term by paragraph (2).".

(G) Subparagraph (B) of section 402(g)(7) (as amended by section 1201(d)) is amended by inserting before the period at the end the following: "(as in effect on the date of the enactment of the Financial Freedom Act of 1999)".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 2000.

(b) SPECIAL RULES FOR SECTIONS 403(b) AND 408.—

(1) IN GENERAL.—Subsection (k) of section 415 is amended by adding at the end the following new paragraph:

"(4) SPECIAL RULES FOR SECTIONS 403(b) AND 408.—For purposes of this section, any annuity contract described in section 403(b) for the benefit of a participant shall be treated as a defined contribution plan maintained by each employer with respect to which the participant has the control required under subsection (b) or (c) of section 414 (as modified by subsection (h)). For purposes of this section, any contribution by an employer to a simplified employee pension plan for an individual for a taxable year shall be treated as an employer contribution to a defined contribution plan for such individual for such year.".

(2) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendment made by paragraph (1) shall apply to limitation years beginning after December 31, 1999.

(B) EXCLUSION ALLOWANCE.—Effective for limitation years beginning in 2000, in the case of any annuity contract described in section 403(b) of the Internal Revenue Code of 1986, the amount of the contribution disqualified by reason of section 415(g) of such Code shall reduce the exclusion allowance as provided in section 403(b)(2) of such Code.

(c) DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

(1) IN GENERAL.—Subparagraph (B) of section 457(b)(2) (relating to salary limitation on eligible deferred compensation plans) is amended by striking "33⅓ percent" and inserting "100 percent".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 2000.

SEC. 1223. FASTER VESTING OF CERTAIN EMPLOYER MATCHING CONTRIBUTIONS.

(a) IN GENERAL.—Section 411(a) (relating to minimum vesting standards) is amended—

(1) in paragraph (2), by striking "A plan" and inserting "Except as provided in paragraph (12), a plan", and

(2) by adding at the end the following:

"(12) FASTER VESTING FOR MATCHING CONTRIBUTIONS.—In the case of matching contributions (as defined in section 401(m)(4)(A)), paragraph (2) shall be applied—

"(A) by substituting '3 years' for '5 years' in subparagraph (A), and

"(B) by substituting the following table for the table contained in subparagraph (B):

"Years of service:	The nonforfeitable percentage is:
2	20
3	40
4	60
5	80
6 or more	100.".

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to plan years beginning after December 31, 2000.

(2) COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee rep-

resentatives and 1 or more employers ratified by the date of the enactment of this Act, the amendments made by this section shall not apply to plan years beginning before the earlier of—

(A) the later of—

(i) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof on or after such date of enactment), or

(ii) January 1, 2001, or

(B) January 1, 2005.

(3) SERVICE REQUIRED.—With respect to any plan, the amendments made by this section shall not apply to any employee before the date that such employee has 1 hour of service under such plan in any plan year to which the amendments made by this section apply.

SEC. 1224. SIMPLIFY AND UPDATE THE MINIMUM DISTRIBUTION RULES.

(a) SIMPLIFICATION AND FINALIZATION OF MINIMUM DISTRIBUTION REQUIREMENTS.—

(1) IN GENERAL.—The Secretary of the Treasury shall—

(A) simplify and finalize the regulations relating to minimum distribution requirements under sections 401(a)(9), 408(a)(6) and (b)(3), 403(b)(10), and 457(d)(2) of the Internal Revenue Code of 1986, and

(B) modify such regulations to—

(i) reflect current life expectancy, and

(ii) revise the required distribution methods so that, under reasonable assumptions, the amount of the required minimum distribution does not decrease over a participant's life expectancy.

(2) FRESH START.—Notwithstanding subparagraph (D) of section 401(a)(9) of such Code, during the first year that regulations are in effect under this subsection, required distributions for future years may be redetermined to reflect changes under such regulations. Such redetermination shall include the opportunity to choose a new designated beneficiary and to elect a new method of calculating life expectancy.

(3) EFFECTIVE DATE FOR REGULATIONS.—Regulations referred to in paragraph (1) shall be effective for years beginning after December 31, 2000, and shall apply in such years without regard to whether an individual had previously begun receiving minimum distributions.

(b) REPEAL OF RULE WHERE DISTRIBUTIONS HAD BEGUN BEFORE DEATH OCCURS.—

(1) IN GENERAL.—Subparagraph (B) of section 401(a)(9) is amended by striking clause (i) and redesignating clauses (ii), (iii), and (iv) as clauses (i), (ii), and (iii), respectively.

(2) CONFORMING CHANGES.—

(A) Clause (i) of section 401(a)(9)(B) (as so redesignated) is amended—

(i) by striking "FOR OTHER CASES" in the heading, and

(ii) by striking "the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii)" and inserting "his entire interest has been distributed to him,".

(B) Clause (ii) of section 401(a)(9)(B) (as so redesignated) is amended by striking "clause (ii)" and inserting "clause (i)".

(C) Clause (iii) of section 401(a)(9)(B) (as so redesignated) is amended—

(i) by striking "clause (iii)(I)" and inserting "clause (ii)(I)",

(ii) in subclause (I) by striking "clause (iii)(III)" and inserting "clause (ii)(III)",

(iii) in subclause (I) by striking "the date on which the employee would have attained the age 70½," and inserting "April 1 of the calendar year following the calendar year in which the spouse attains 70½,", and

(iv) in subclause (II) by striking "the distributions to such spouse begin," and inserting "his entire interest has been distributed to him,".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 2000.

(c) REDUCTION IN EXCISE TAX.—

(1) IN GENERAL.—Subsection (a) of section 4974 is amended by striking "50 percent" and inserting "10 percent".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 2000.

SEC. 1225. CLARIFICATION OF TAX TREATMENT OF DIVISION OF SECTION 457 PLAN BENEFITS UPON DIVORCE.

(a) IN GENERAL.—Section 414(p)(11) (relating to application of rules to governmental and church plans) is amended—

(1) by inserting "or an eligible deferred compensation plan (within the meaning of section 457(b))" after "subsection (e))", and

(2) in the heading, by striking "GOVERNMENTAL AND CHURCH PLANS" and inserting "CERTAIN OTHER PLANS".

(b) WAIVER OF CERTAIN DISTRIBUTION REQUIREMENTS.—Paragraph (10) of section 414(p) is amended by striking "and section 409(d)" and inserting "section 409(d), and section 457(d)".

(c) TAX TREATMENT OF PAYMENTS FROM A SECTION 457 PLAN.—Subsection (p) of section 414 is amended by redesignating paragraph (12) as paragraph (13) and inserting after paragraph (11) the following new paragraph:

"(12) TAX TREATMENT OF PAYMENTS FROM A SECTION 457 PLAN.—If a distribution or payment from an eligible deferred compensation plan described in section 457(b) is made pursuant to a qualified domestic relations order, rules similar to the rules of section 402(e)(1)(A) shall apply to such distribution or payment.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers, distributions, and payments made after December 31, 2000.

Subtitle C—Increasing Portability for Participants

SEC. 1231. ROLLOVERS ALLOWED AMONG VARIOUS TYPES OF PLANS.

(a) ROLLOVERS FROM AND TO SECTION 457 PLANS.—

(1) ROLLOVERS FROM SECTION 457 PLANS.—

(A) IN GENERAL.—Section 457(e) (relating to other definitions and special rules) is amended by adding at the end the following:

"(16) ROLLOVER AMOUNTS.—

"(A) GENERAL RULE.—In the case of an eligible deferred compensation plan established and maintained by an employer described in subsection (e)(1)(A), if—

"(i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an eligible rollover distribution (within the meaning of section 402(c)(4) without regard to subparagraph (C) thereof),

"(ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and

"(iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

"(B) CERTAIN RULES MADE APPLICABLE.—The rules of paragraphs (2) through (7) (other than paragraph (4)(C)) and (9) of section 402(c) and section 402(f) shall apply for purposes of subparagraph (A).

"(C) REPORTING.—Rollovers under this paragraph shall be reported to the Secretary in the same manner as rollovers from qualified retirement plans (as defined in section 4974(c)).".

(B) DEFERRAL LIMIT DETERMINED WITHOUT REGARD TO ROLLOVER AMOUNTS.—Section 457(b)(2) (defining eligible deferred compensation plan) is amended by inserting "(other than rollover amounts)" after "taxable year".

(C) DIRECT ROLLOVER.—Paragraph (1) of section 457(d) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by inserting after subparagraph (B) the following:

"(C) in the case of a plan maintained by an employer described in subsection (e)(1)(A), the plan meets requirements similar to the requirements of section 401(a)(31).

Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of transfer.".

(D) WITHHOLDING.—

(i) Paragraph (12) of section 3401(a) is amended by adding at the end the following:

"(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) maintained by an employer described in section 457(e)(1)(A); or".

(ii) Paragraph (3) of section 3405(c) is amended to read as follows:

"(3) ELIGIBLE ROLLOVER DISTRIBUTION.—For purposes of this subsection, the term 'eligible rollover distribution' has the meaning given such term by section 402(f)(2)(A).".

(iii) LIABILITY FOR WITHHOLDING.—Subparagraph (B) of section 3405(d)(2) is amended by striking "or" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", or", and by adding at the end the following:

"(iv) section 457(b).".

(2) ROLLOVERS TO SECTION 457 PLANS.—

(A) IN GENERAL.—Section 402(c)(8)(B) (defining eligible retirement plan) is amended by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", and", and by inserting after clause (iv) the following new clause:

"(v) an eligible deferred compensation plan described in section 457(b) of an employer described in section 457(e)(1)(A).".

(B) SEPARATE ACCOUNTING.—Section 402(c) is amended by adding at the end the following new paragraph:

"(11) SEPARATE ACCOUNTING.—Unless a plan described in clause (v) of paragraph (8)(B) agrees to separately account for amounts rolled into such plan from eligible retirement plans not described in such clause, the plan described in such clause may not accept transfers or rollovers from such retirement plans.".

(C) 10 PERCENT ADDITIONAL TAX.—Subsection (t) of section 72 (relating to 10-percent additional tax on early distributions from qualified retirement plans) is amended by adding at the end the following new paragraph:

"(9) SPECIAL RULE FOR ROLLOVERS TO SECTION 457 PLANS.—For purposes of this subsection, a distribution from an eligible deferred compensation plan (as defined in section 457(b)) of an employer described in section 457(e)(1)(A) shall be treated as a distribution from a qualified retirement plan described in 4974(c)(1) to the extent that such distribution is attributable to an amount transferred to an eligible deferred compensation plan from a qualified retirement plan (as defined in section 4974(c)).".

(b) ALLOWANCE OF ROLLOVERS FROM AND TO 403(b) PLANS.—

(1) ROLLOVERS FROM SECTION 403(b) PLANS.—Section 403(b)(8)(A)(ii) (relating to rollover amounts) is amended by striking "such distribution" and all that follows and inserting "such distribution to an eligible retirement plan described in section 402(c)(8)(B), and".

(2) ROLLOVERS TO SECTION 403(b) PLANS.—Section 402(c)(8)(B) (defining eligible retirement plan), as amended by subsection (a), is amended by striking "and" at the end of clause (iv), by striking the period at the end of clause (v) and inserting ", and", and by inserting after clause (v) the following new clause:

"(vi) an annuity contract described in section 403(b)."

(c) EXPANDED EXPLANATION TO RECIPIENTS OF ROLLOVER DISTRIBUTIONS.—Paragraph (1) of section 402(f) (relating to written explanation to recipients of distributions eligible for rollover treatment) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by adding at the end the following new subparagraph:

"(E) of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making such distribution.".

(d) SPOUSAL ROLLOVERS.—Section 402(c)(9) (relating to rollover where spouse receives distribution after death of employee) is amended by striking "; except that" and all that follows up to the end period.

(e) CONFORMING AMENDMENTS.—

(1) Section 72(o)(4) is amended by striking "and 408(d)(3)" and inserting "403(b)(8), 408(d)(3), and 457(e)(16)".

(2) Section 219(d)(2) is amended by striking "or 408(d)(3)" and inserting "408(d)(3), or 457(e)(16)".

(3) Section 401(a)(31)(B) is amended by striking "and 403(a)(4)" and inserting ", 403(a)(4), 403(b)(8), and 457(e)(16)".

(4) Subparagraph (A) of section 402(f)(2) is amended by striking "or paragraph (4) of section 403(a)" and inserting ", paragraph (4) of section 403(a), subparagraph (A) of section 403(b)(8), or subparagraph (A) of section 457(e)(16)".

(5) Paragraph (1) of section 402(f) is amended by striking "from an eligible retirement plan".

(6) Subparagraphs (A) and (B) of section 402(f)(1) are amended by striking "another eligible retirement plan" and inserting "an eligible retirement plan".

(7) Subparagraph (B) of section 403(b)(8) is amended to read as follows:

"(B) CERTAIN RULES MADE APPLICABLE.—The rules of paragraphs (2) through (7) and (9) of section 402(c) and section 402(f) shall apply for purposes of subparagraph (A), except that section 402(f) shall be applied to the payor in lieu of the plan administrator.".

(8) Section 408(a)(1) is amended by striking "or 403(b)(8)" and inserting ", 403(b)(8), or 457(e)(16)".

(9) Subparagraphs (A) and (B) of section 415(b)(2) are each amended by striking "and 408(d)(3)" and inserting "403(b)(8), 408(d)(3), and 457(e)(16)".

(10) Section 415(c)(2) is amended by striking "and 408(d)(3)" and inserting "408(d)(3), and 457(e)(16)".

(11) Section 4973(b)(1)(A) is amended by striking "or 408(d)(3)" and inserting "408(d)(3), or 457(e)(16)".

(f) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

(2) SPECIAL RULE.—Notwithstanding any other provision of law, subsections (h)(3) and (h)(5) of section 1122 of the Tax Reform Act of 1986 shall not apply to any distribution from an eligible retirement plan (as defined in clause (iii) or (iv) of section 402(c)(8)(B) of the Internal Revenue Code of 1986) on behalf of an individual if there was a rollover to such plan on behalf of such individual which is permitted solely by reason of any amendment made by this section.

SEC. 1232. ROLLOVERS OF IRAS INTO WORKPLACE RETIREMENT PLANS.

(a) IN GENERAL.—Subparagraph (A) of section 408(d)(3) (relating to rollover amounts) is amended by adding "or" at the end of clause (i), by striking clauses (ii) and (iii), and by adding at the end the following:

"(ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to this paragraph).

For purposes of clause (ii), the term 'eligible retirement plan' has the meaning given such term by clauses (iii), (iv), (v), and (vi) of section 402(c)(8)(B).".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 403(b) is amended by striking "section 408(d)(3)(A)(iii)" and inserting "section 408(d)(3)(A)(ii)".

(2) Clause (i) of section 408(d)(3)(D) is amended by striking "(i), (ii), or (iii)" and inserting "(i) or (ii)".

(3) Subparagraph (G) of section 408(d)(3) is amended to read as follows:

"(G) SIMPLE RETIREMENT ACCOUNTS.—In the case of any payment or distribution out of a simple retirement account (as defined in subsection (p)) to which section 72(t)(6) applies, this paragraph shall not apply unless such payment or distribution is paid into another simple retirement account.".

(c) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

(2) SPECIAL RULE.—Notwithstanding any other provision of law, subsections (h)(3) and (h)(5) of section 1122 of the Tax Reform Act of 1986 shall not apply to any distribution from an eligible retirement plan (as defined in clause (iii) or (iv) of section 402(c)(8)(B) of the Internal Revenue Code of 1986) on behalf of an individual if there was a rollover to such plan on behalf of such individual which is permitted solely by reason of the amendments made by this section.

SEC. 1233. ROLLOVERS OF AFTER-TAX CONTRIBUTIONS.

(a) ROLLOVERS FROM EXEMPT TRUSTS.—Paragraph (2) of section 402(c) (relating to maximum amount which may be rolled over) is amended by adding at the end the following: "The preceding sentence shall not apply to such distribution to the extent—

"(A) such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust which is part of a plan which is a defined contribution plan and which agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

"(B) such portion is transferred to an eligible retirement plan described in clause (i) or (ii) of paragraph (8)(B).".

(b) OPTIONAL DIRECT TRANSFER OF ELIGIBLE ROLLOVER DISTRIBUTIONS.—Subparagraph (B) of section 401(a)(31) (relating to limitation) is amended by adding at the end the following: "The preceding sentence shall not apply to such distribution if the plan to which such distribution is transferred—

"(i) agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

"(ii) is an eligible retirement plan described in clause (i) or (ii) of section 402(c)(8)(B).".

(c) RULES FOR APPLYING SECTION 72 TO IRAS.—Paragraph (3) of section 408(d) (relating to special rules for applying section 72) is amended by inserting at the end the following:

"(H) APPLICATION OF SECTION 72.—

"(i) IN GENERAL.—If—

"(I) a distribution is made from an individual retirement plan, and

"(II) a rollover contribution is made to an eligible retirement plan described in section 402(c)(8)(B)(iii), (iv), (v), or (vi) with respect to all or part of such distribution,

then, notwithstanding paragraph (2), the rules of clause (ii) shall apply for purposes of applying section 72.

"(ii) APPLICABLE RULES.—In the case of a distribution described in clause (i)—

"(I) section 72 shall be applied separately to such distribution,

"(II) notwithstanding the pro rata allocation of income on, and investment in the contract, to distributions under section 72, the portion of such distribution rolled over to an eligible retirement plan described in clause (i) shall be treated as from income on the contract (to the extent of the aggregate income on the contract from all individual retirement plans of the distributee), and

"(III) appropriate adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after December 31, 2000.

SEC. 1234. HARDSHIP EXCEPTION TO 60-DAY RULE.

(a) EXEMPT TRUSTS.—Paragraph (3) of section 402(c) (relating to transfer must be made within 60 days of receipt) is amended to read as follows:

"(3) TRANSFER MUST BE MADE WITHIN 60 DAYS OF RECEIPT.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), paragraph (1) shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

"(B) HARDSHIP EXCEPTION.—The Secretary may waive the 60-day requirement under subparagraph (A) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.".

(b) IRAS.—Paragraph (3) of section 408(d) (relating to rollover contributions) is amended by adding after subparagraph (H) the following new subparagraph:

"(I) WAIVER OF 60-DAY REQUIREMENT.—The Secretary may waive the 60-day requirement under subparagraphs (A) and (D) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

SEC. 1235. TREATMENT OF FORMS OF DISTRIBUTION.

(a) PLAN TRANSFERS.—

(1) IN GENERAL.—Paragraph (6) of section 411(d) (relating to accrued benefit not to be decreased by amendment) is amended by adding at the end the following:

"(D) PLAN TRANSFERS.—

"(i) A defined contribution plan (in this subparagraph referred to as the 'transferee plan') shall not be treated as failing to meet the requirements of this subsection merely because the transferee plan does not provide some or all of the forms of distribution previously available under another defined contribution plan (in this subparagraph referred to as the 'transferor plan') to the extent that—

"(I) the forms of distribution previously available under the transferor plan applied to the account of a participant or beneficiary under the transferor plan that was transferred from the transferor plan to the transferee plan pursuant to a direct transfer rather than pursuant to a distribution from the transferor plan;

"(II) the terms of both the transferor plan and the transferee plan authorize the transfer described in subclause (I);

"(III) the transfer described in subclause (I) was made pursuant to a voluntary election by the participant or beneficiary whose account was transferred to the transferee plan;

"(IV) the election described in subclause (III) was made after the participant or beneficiary received a notice describing the consequences of making the election;

"(V) if the transferor plan provides for an annuity as the normal form of distribution under the plan in accordance with section 417, the transfer is made with the consent of the participant's spouse (if any), and such consent meets requirements similar to the requirements imposed by section 417(a)(2); and

"(VI) the transferee plan allows the participant or beneficiary described in subclause (III) to receive any distribution to which the participant or beneficiary is entitled under the transferee plan in the form of a single sum distribution.

"(ii) Clause (i) shall apply to plan mergers and other transactions having the effect of a direct transfer, including consolidations of benefits attributable to different employers within a multiple employer plan.

"(E) ELIMINATION OF FORM OF DISTRIBUTION.—Except to the extent provided in regulations, a defined contribution plan shall not be treated as failing to meet the requirements of this section merely because of the elimination of a form of distribution previously available thereunder. This subparagraph shall not apply to the elimination of a form of distribution with respect to any participant unless—

"(i) a single sum payment is available to such participant at the same time or times as the form of distribution being eliminated; and

"(ii) such single sum payment is based on the same or greater portion of the participant's account as the form of distribution being eliminated.".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 2000.

(b) REGULATIONS.—

(1) IN GENERAL.—The last sentence of paragraph (6)(B) of section 411(d) (relating to accrued benefit not to be decreased by amendment) is amended to read as follows: "The Secretary may by regulations provide that this subparagraph shall not apply to any plan amendment that does not adversely affect the rights of participants in a material manner.".

(2) SECRETARY DIRECTED.—Not later than December 31, 2001, the Secretary of the Treasury is directed to issue final regulations under section 411(d)(6) of the Internal Revenue Code of 1986. Such regulations shall apply to plan years beginning after December 31, 2001, or such earlier date as is specified by the Secretary of the Treasury.

SEC. 1236. RATIONALIZATION OF RESTRICTIONS ON DISTRIBUTIONS.

(a) MODIFICATION OF SAME DESK EXCEPTION.—

(1) SECTION 401(k).—

(A) Section 401(k)(2)(B)(i)(I) (relating to qualified cash or deferred arrangements) is amended by striking "separation from service" and inserting "severance from employment".

(B) Subparagraph (A) of section 401(k)(10) (relating to distributions upon termination of plan or disposition of assets or subsidiary) is amended to read as follows:

"(A) IN GENERAL.—An event described in this subparagraph is the termination of the plan without establishment or maintenance of another defined contribution plan (other than an employee stock ownership plan as defined in section 4975(e)(7)).".

(C) Section 401(k)(10) is amended—

(i) in subparagraph (B)—

(I) by striking "An event" in clause (i) and inserting "A termination", and

(II) by striking "the event" in clause (i) and inserting "the termination",

(ii) by striking subparagraph (C), and

(iii) by striking "OR DISPOSITION OF ASSETS OR SUBSIDIARY" in the heading.

(2) SECTION 403(b).—

(A) Paragraphs (7)(A)(ii) and (11)(A) of section 403(b) are each amended by striking "separates from service" and inserting "has a severance from employment".

(B) The heading for paragraph (11) of section 403(b) is amended by striking "SEPARATION FROM SERVICE" and inserting "SEVERANCE FROM EMPLOYMENT".

(3) SECTION 457.—Clause (ii) of section 457(d)(1)(A) is amended by striking "is separated from service" and inserting "has a severance from employment".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

SEC. 1237. PURCHASE OF SERVICE CREDIT IN GOVERNMENTAL DEFINED BENEFIT PLANS.

(a) 403(b) PLANS.—Subsection (b) of section 403 is amended by adding at the end the following new paragraph:

"(13) TRUSTEE-TO-TRUSTEE TRANSFERS TO PURCHASE PERMISSIVE SERVICE CREDIT.—No amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is—

"(A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or

"(B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.".

(b) 457 PLANS.—

(1) Subsection (e) of section 457 is amended by adding after paragraph (17) the following new paragraph:

"(18) TRUSTEE-TO-TRUSTEE TRANSFERS TO PURCHASE PERMISSIVE SERVICE CREDIT.—No amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is—

"(A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or

"(B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.".

(2) Section 457(b)(2) is amended by striking "(other than rollover amounts)" and inserting "(other than rollover amounts and amounts received in a transfer referred to in subsection (e)(16))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to trustee-to-trustee transfers after December 31, 2000.

SEC. 1238. EMPLOYERS MAY DISREGARD ROLLOVERS FOR PURPOSES OF CASH-OUT AMOUNTS.

(a) IN GENERAL.—Section 411(a)(11) (relating to restrictions on certain mandatory distributions) is amended by adding at the end the following:

"(D) SPECIAL RULE FOR ROLLOVER CONTRIBUTIONS.—A plan shall not fail to meet the requirements of this paragraph if, under the terms of the plan, the present value of the nonforfeitable accrued benefit is determined without regard to that portion of such benefit which is attributable to rollover contributions (and earnings allocable thereto). For purposes of this subparagraph, the term 'rollover contributions' means any rollover contribution under sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3)(A)(ii), and 457(e)(16).".

(b) ELIGIBLE DEFERRED COMPENSATION PLANS.—Clause (i) of section 457(e)(9)(A) is amended by striking "such amount" and inserting "the portion of such amount which is not attributable to rollover contributions (as defined in section 411(a)(11)(D))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

SEC. 1239. MINIMUM DISTRIBUTION AND INCLUSION REQUIREMENTS FOR SECTION 457 PLANS.

(a) MINIMUM DISTRIBUTION REQUIREMENTS.—Paragraph (2) of section 457(d) (relating to distribution requirements) is amended to read as follows:

"(2) MINIMUM DISTRIBUTION REQUIREMENTS.—A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of section 401(a)(9)."

(b) INCLUSION IN GROSS INCOME.—

(1) YEAR OF INCLUSION.—Subsection (a) of section 457 (relating to year of inclusion in gross income) is amended to read as follows:

"(a) YEAR OF INCLUSION IN GROSS INCOME.—

"(1) IN GENERAL.—Any amount of compensation deferred under an eligible deferred compensation plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income—

"(A) is paid to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(A), and

"(B) is paid or otherwise made available to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(B).

"(2) SPECIAL RULE FOR ROLLOVER AMOUNTS.—To the extent provided in section 72(t)(9), section 72(t) shall apply to any amount includible in gross income under this subsection.".

(2) CONFORMING AMENDMENT.—So much of paragraph (9) of section 457(e) as precedes subparagraph (A) is amended to read as follows:

"(9) BENEFITS OF TAX EXEMPT ORGANIZATION PLANS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS, ETC.—In the case of an eligible deferred compensation plan of an employer described in subsection (e)(1)(B)—".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

Subtitle D—Strengthening Pension Security and Enforcement

SEC. 1241. REPEAL OF 150 PERCENT OF CURRENT LIABILITY FUNDING LIMIT.

(a) IN GENERAL.—Section 412(c)(7) (relating to full-funding limitation) is amended—

(1) by striking "the applicable percentage" in subparagraph (A)(i)(I) and inserting "in the case of plan years beginning before January 1, 2004, the applicable percentage", and

(2) by amending subparagraph (F) to read as follows:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in—	The applicable percentage is—
2001	160
2002	165
2003	170.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2000.

SEC. 1242. MAXIMUM CONTRIBUTION DEDUCTION RULES MODIFIED AND APPLIED TO ALL DEFINED BENEFIT PLANS.

(a) IN GENERAL.—Subparagraph (D) of section 404(a)(1) (relating to special rule in case of certain plans) is amended to read as follows:

"(D) SPECIAL RULE IN CASE OF CERTAIN PLANS.—

"(i) IN GENERAL.—In the case of any defined benefit plan, except as provided in regulations, the maximum amount deductible under the limitations of this paragraph shall not be less than the unfunded termination liability (determined as if the proposed termination date referred to in section 4041(b)(2)(A)(i)(II) of the Employee Retirement Income Security Act of 1974 were the last day of the plan year).

"(ii) PLANS WITH LESS THAN 100 PARTICIPANTS.—For purposes of this subparagraph, in the case of a plan which has less than 100 participants for the plan year, termination liability shall not include the liability attributable to benefit increases for highly compensated employees (as defined in section 414(q)) resulting from a plan amendment which is made or becomes effective, whichever is later, within the last 2 years before the termination date.

"(iii) RULE FOR DETERMINING NUMBER OF PARTICIPANTS.—For purposes of determining whether a plan has more than 100 participants, all defined benefit plans maintained by the same employer (or any member of such employer's controlled group (within the meaning of section 412(l)(8)(C))) shall be treated as 1 plan, but only employees of such member or employer shall be taken into account.

"(iv) PLANS ESTABLISHED AND MAINTAIN BY PROFESSIONAL SERVICE EMPLOYERS.—Clause (i) shall not apply to a plan described in section 4021(b)(13) of the Employee Retirement Income Security Act of 1974.".

(b) CONFORMING AMENDMENT.—Paragraph (6) of section 4972(c) is amended to read as follows:

"(6) EXCEPTIONS.—In determining the amount of nondeductible contributions for any taxable year, there shall not be taken into account so much of the contributions to 1 or more defined contribution plans which are not deductible when contributed solely because of section 404(a)(7) as does not exceed the greater of—

"(A) the amount of contributions not in excess of 6 percent of compensation (within the meaning of section 404(a)) paid or accrued (during the taxable year for which the contributions were made) to beneficiaries under the plans, or

"(B) the sum of—

"(i) the amount of contributions described in section 401(m)(4)(A), plus

"(ii) the amount of contributions described in section 402(g)(3)(A).

For purposes of this paragraph, the deductible limits under section 404(a)(7) shall first be applied to amounts contributed to a defined benefit plan and then to amounts described in subparagraph (B).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2000.

SEC. 1243. MISSING PARTICIPANTS.

(a) IN GENERAL.—Section 4050 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1350) is amended by redesignating subsection (c) as subsection (e) and by inserting after subsection (b) the following:

"(c) MULTIEMPLOYER PLANS.—The corporation shall prescribe rules similar to the rules in subsection (a) for multiemployer plans covered by this title that terminate under section 4041A.

"(d) PLANS NOT OTHERWISE SUBJECT TO TITLE.—

"(1) TRANSFER TO CORPORATION.—The plan administrator of a plan described in paragraph (4) may elect to transfer a missing participant's benefits to the corporation upon termination of the plan.

"(2) INFORMATION TO THE CORPORATION.—To the extent provided in regulations, the plan administrator of a plan described in paragraph (4) shall, upon termination of the plan, provide the corporation information with respect to benefits of a missing participant if the plan transfers such benefits—

"(A) to the corporation, or

"(B) to an entity other than the corporation or a plan described in paragraph (4)(B)(ii).

"(3) PAYMENT BY THE CORPORATION.—If benefits of a missing participant were transferred to the corporation under paragraph (1), the corporation shall, upon location of the participant or beneficiary, pay to the participant or beneficiary the amount transferred (or the appropriate survivor benefit) either—

"(A) in a single sum (plus interest), or

"(B) in such other form as is specified in regulations of the corporation.

"(4) PLANS DESCRIBED.—A plan is described in this paragraph if—

"(A) the plan is a pension plan (within the meaning of section 3(2))—

"(i) to which the provisions of this section do not apply (without regard to this subsection), and "(ii) which is not a plan described in paragraphs (2) through (11) of section 4021(b), and

"(B) at the time the assets are to be distributed upon termination, the plan—

"(i) has missing participants, and

"(ii) has not provided for the transfer of assets to pay the benefits of all missing participants to another pension plan (within the meaning of section 3(2)).

"(5) CERTAIN PROVISIONS NOT TO APPLY.—Subsections (a)(1) and (a)(3) shall not apply to a plan described in paragraph (4).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to distributions made after final regulations implementing subsections (c) and (d) of section 4050 of the Employee Retirement Income Security Act of 1974 (as added by subsection (a)), respectively, are prescribed.

SEC. 1244. EXCISE TAX RELIEF FOR SOUND PENSION FUNDING.

(a) IN GENERAL.—Subsection (c) of section 4972 (relating to nondeductible contributions) is amended by adding at the end the following new paragraph:

"(7) DEFINED BENEFIT PLAN EXCEPTION.—In determining the amount of nondeductible contributions for any taxable year, an employer may elect for such year not to take into account any contributions to a defined benefit plan except to the extent that such contributions exceed the full-funding limitation (as defined in section 412(c)(7), determined without regard to subparagraph (A)(i)(I) thereof). For purposes of this paragraph, the deductible limits under section 404(a)(7) shall first be applied to amounts contributed to defined contribution plans and then to amounts described in this paragraph. If an employer makes an election under this paragraph for a taxable year, paragraph (6) shall not apply to such employer for such taxable year.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1245. EXCISE TAX ON FAILURE TO PROVIDE NOTICE BY DEFINED BENEFIT PLANS SIGNIFICANTLY REDUCING FUTURE BENEFIT ACCRUALS.

(a) IN GENERAL.—Chapter 43 of subtitle D (relating to qualified pension, etc., plans) is amended by adding at the end the following new section:

"SEC. 4980F. FAILURE OF APPLICABLE PLANS REDUCING BENEFIT ACCRUALS TO SATISFY NOTICE REQUIREMENTS.

"(a) IMPOSITION OF TAX.—There is hereby imposed a tax on the failure of any applicable pension plan to meet the requirements of subsection (e) with respect to any applicable individual.

"(b) AMOUNT OF TAX.—

"(1) IN GENERAL.—The amount of the tax imposed by subsection (a) on any failure with respect to any applicable individual shall be $100 for each day in the noncompliance period with respect to such failure.

"(2) NONCOMPLIANCE PERIOD.—For purposes of this section, the term 'noncompliance period' means, with respect to any failure, the period beginning on the date the failure first occurs and ending on the date the failure is corrected.

"(c) LIMITATIONS ON AMOUNT OF TAX.—

"(1) OVERALL LIMITATION FOR UNINTENTIONAL FAILURES.—In the case of failures that are due to reasonable cause and not to willful neglect, the tax imposed by subsection (a) for failures during the taxable year of the employer (or, in the case of a multiemployer plan, the taxable year of the trust forming part of the plan) shall not exceed $500,000. For purposes of the preceding sentence, all multiemployer plans of which the same trust forms a part shall be treated as 1 plan. For purposes of this paragraph, if not all persons who are treated as a single employer for purposes of this section have the same taxable year, the taxable years taken into account shall be determined under principles similar to the principles of section 1561.

"(2) WAIVER BY SECRETARY.—In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed by subsection (a) to the extent that the payment of such tax would be excessive relative to the failure involved.

"(d) LIABILITY FOR TAX.—The following shall be liable for the tax imposed by subsection (a):

"(1) In the case of a plan other than a multiemployer plan, the employer.

"(2) In the case of a multiemployer plan, the plan.

"(e) NOTICE REQUIREMENTS FOR PLANS SIGNIFICANTLY REDUCING BENEFIT ACCRUALS.—

"(1) IN GENERAL.—If an applicable pension plan is amended to provide for a significant reduction in the rate of future benefit accrual, the plan administrator shall provide written notice to each applicable individual (and to each employee organization representing applicable individuals).

"(2) NOTICE.—The notice required by paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall provide sufficient information (as determined in accordance with regulations prescribed by the Secretary) to allow applicable individuals to understand the effect of the plan amendment.

"(3) TIMING OF NOTICE.—Except as provided in regulations, the notice required by paragraph (1) shall be provided within a reasonable time before the effective date of the plan amendment.

"(4) DESIGNEES.—Any notice under paragraph (1) may be provided to a person designated, in writing, by the person to which it would otherwise be provided.

"(5) NOTICE BEFORE ADOPTION OF AMENDMENT.—A plan shall not be treated as failing to meet the requirements of paragraph (1) merely because notice is provided before the adoption of the plan amendment if no material modification of the amendment occurs before the amendment is adopted.

"(f) APPLICABLE INDIVIDUAL; APPLICABLE PENSION PLAN.—For purposes of this section—

"(1) APPLICABLE INDIVIDUAL.—The term 'applicable individual' means, with respect to any plan amendment—

"(A) any participant in the plan, and

"(B) any beneficiary who is an alternate payee (within the meaning of section 414(p)(8)) under an applicable qualified domestic relations order (within the meaning of section 414(p)(1)(A)),

who may reasonably be expected to be affected by such plan amendment.

"(2) APPLICABLE PENSION PLAN.—The term 'applicable pension plan' means—

"(A) any defined benefit plan, or

"(B) an individual account plan which is subject to the funding standards of section 412,

which had 100 or more participants who had accrued a benefit, or with respect to whom contributions were made, under the plan (whether or not vested) as of the last day of the plan year preceding the plan year in which the plan amendment becomes effective."

(b) CLERICAL AMENDMENT.—The table of sections for chapter 43 of subtitle D is amended by adding at the end the following new item:

"Sec. 4980F. Failure of applicable plans reducing benefit accruals to satisfy notice requirements."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan amendments taking effect on or after the date of the enactment of this Act.

(2) TRANSITION.—Until such time as the Secretary of the Treasury issues regulations under sections 4980F(e)(2) and (3) of the Internal Revenue Code of 1986 (as added by the amendment made by subsection (a)), a plan shall be treated as meeting the requirements of such section if it makes a good faith effort to comply with such requirements.

(3) SPECIAL RULE.—The period for providing any notice required by the amendments made by this section shall not end before the date which is 3 months after the date of the enactment of this Act.

Subtitle E—Reducing Regulatory Burdens

SEC. 1251. REPEAL OF THE MULTIPLE USE TEST.

(a) IN GENERAL.—Paragraph (9) of section 401(m) is amended to read as follows:

"(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (k), including regulations permitting appropriate aggregation of plans and contributions.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2000.

SEC. 1252. MODIFICATION OF TIMING OF PLAN VALUATIONS.

(a) IN GENERAL.—Section 412(c)(9) (relating to annual valuation) is amended—

(1) by striking "For purposes" and inserting the following:

"(A) IN GENERAL.—For purposes", and

(2) by adding at the end the following:

"(B) ELECTION TO USE PRIOR YEAR VALUATION.—

"(i) IN GENERAL.—Except as provided in clause (ii), if, for any plan year—

"(I) an election is in effect under this subparagraph with respect to a plan, and

"(II) the assets of the plan are not less than 125 percent of the plan's current liability (as defined in paragraph (7)(B)), determined as of the valuation date for the preceding plan year,

then this section shall be applied using the information available as of such valuation date.

"(ii) EXCEPTIONS.—

"(I) ACTUAL VALUATION EVERY 3 YEARS.—Clause (i) shall not apply for more than 2 consecutive plan years and valuation shall be under subparagraph (A) with respect to any plan year to which clause (i) does not apply by reason of this clause.

"(II) REGULATIONS.—Subclause (I) shall not apply to the extent that more frequent valuations are required under the regulations under subparagraph (A).

"(iii) ADJUSTMENTS.—Information under clause (i) shall, in accordance with regulations, be actuarially adjusted to reflect significant differences in participants.

"(iv) ELECTION.—An election under this subparagraph, once made, shall be irrevocable without the consent of the Secretary.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2000.

SEC. 1253. FLEXIBILITY AND NONDISCRIMINATION AND LINE OF BUSINESS RULES.

The Secretary of the Treasury shall, on or before December 31, 2000, modify the existing regulations issued under section 401(a)(4) and section 414(r) of the Internal Revenue Code of 1986 in order to expand (to the extent that the Secretary determines appropriate) the ability of a pension plan to demonstrate compliance with the nondiscrimination and line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

SEC. 1254. SUBSTANTIAL OWNER BENEFITS IN TERMINATED PLANS.

(a) MODIFICATION OF PHASE-IN OF GUARANTEE.—Section 4022(b)(5) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1322(b)(5)) is amended to read as follows:

"(5)(A) For purposes of this paragraph, the term 'majority owner' means an individual who, at any time during the 60-month period ending on the date the determination is being made—

"(i) owns the entire interest in an unincorporated trade or business,

"(ii) in the case of a partnership, is a partner who owns, directly or indirectly, 50 percent or more of either the capital interest or the profits interest in such partnership, or

"(iii) in the case of a corporation, owns, directly or indirectly, 50 percent or more in value of either the voting stock of that corporation or all the stock of that corporation.

For purposes of clause (iii), the constructive ownership rules of section 1563(e) of the Internal Revenue Code of 1986 shall apply (determined without regard to section 1563(e)(3)(C)).

"(B) In the case of a participant who is a majority owner, the amount of benefits guaranteed under this section shall equal the product of—

"(i) a fraction (not to exceed 1) the numerator of which is the number of years from the later of the effective date or the adoption date of the plan to the termination date, and the denominator of which is 10, and

"(ii) the amount of benefits that would be guaranteed under this section if the participant were not a majority owner.".

(b) MODIFICATION OF ALLOCATION OF ASSETS.—

(1) Section 4044(a)(4)(B) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1344(a)(4)(B)) is amended by striking "section 4022(b)(5)" and inserting "section 4022(b)(5)(B)".

(2) Section 4044(b) of such Act (29 U.S.C. 1344(b)) is amended—

(A) by striking "(5)" in paragraph (2) and inserting "(4), (5),", and

(B) by redesignating paragraphs (3) through (6) as paragraphs (4) through (7), respectively, and by inserting after paragraph (2) the following:

"(3) If assets available for allocation under paragraph (4) of subsection (a) are insufficient to satisfy in full the benefits of all individuals who are described in that paragraph, the assets shall be allocated first to benefits described in subparagraph (A) of that paragraph. Any remaining assets shall then be allocated to benefits described in subparagraph (B) of that paragraph. If assets allocated to such subparagraph (B) are insufficient to satisfy in full the benefits described in that subparagraph, the assets shall be allocated pro rata among individuals on the basis of the present value (as of the termination date) of their respective benefits described in that subparagraph.".

(c) CONFORMING AMENDMENTS.—

(1) Section 4021 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1321) is amended—

(A) in subsection (b)(9), by striking "as defined in section 4022(b)(6)", and

(B) by adding at the end the following:

"(d) For purposes of subsection (b)(9), the term 'substantial owner' means an individual who, at any time during the 60-month period ending on the date the determination is being made—

"(1) owns the entire interest in an unincorporated trade or business,

"(2) in the case of a partnership, is a partner who owns, directly or indirectly, more than 10 percent of either the capital interest or the profits interest in such partnership, or

"(3) in the case of a corporation, owns, directly or indirectly, more than 10 percent in value of either the voting stock of that corporation or all the stock of that corporation.

For purposes of paragraph (3), the constructive ownership rules of section 1563(e) of the Internal Revenue Code of 1986 shall apply (determined without regard to section 1563(e)(3)(C)).".

(2) Section 4043(c)(7) of such Act (29 U.S.C. 1343(c)(7)) is amended by striking "section 4022(b)(6)" and inserting "section 4021(d)".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to plan terminations—

(A) under section 4041(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1341(c)) with respect to which notices of intent to terminate are provided under section 4041(a)(2) of such Act (29 U.S.C. 1341(a)(2)) after December 31, 2000, and

(B) under section 4042 of such Act (29 U.S.C. 1342) with respect to which proceedings are instituted by the corporation after such date.

(2) CONFORMING AMENDMENTS.—The amendments made by subsection (c) shall take effect on the date of enactment of this Act.

SEC. 1255. ESOP DIVIDENDS MAY BE REINVESTED WITHOUT LOSS OF DIVIDEND DEDUCTION.

(a) IN GENERAL.—Section 404(k)(2)(A) (defining applicable dividends) is amended by striking "or" at the end of clause (ii), by redesignating clause (iii) as clause (iv), and by inserting after clause (ii) the following new clause:

"(iii) is, at the election of such participants or their beneficiaries—

"(I) payable as provided in clause (i) or (ii), or

"(II) paid to the plan and reinvested in qualifying employer securities, or".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1256. NOTICE AND CONSENT PERIOD REGARDING DISTRIBUTIONS.

(a) EXPANSION OF PERIOD.—

(1) IN GENERAL.—Subparagraph (A) of section 417(a)(6) is amended by striking "90-day" and inserting "180-day".

(2) MODIFICATION OF REGULATIONS.—The Secretary of the Treasury shall modify the regulations under sections 402(f), 411(a)(11), and 417 of the Internal Revenue Code of 1986 to substitute "180 days" for "90 days" each place it appears in Treasury Regulations sections 1.402(f)–1, 1.411(a)–11(c), and 1.417(e)–1(b).

(3) EFFECTIVE DATE.—The amendments made by paragraph (1) and the modifications required by paragraph (2) shall apply to years beginning after December 31, 2000.

(b) CONSENT REGULATION INAPPLICABLE TO CERTAIN DISTRIBUTIONS.—

(1) IN GENERAL.—The Secretary of the Treasury shall modify the regulations under section 411(a)(11) of the Internal Revenue Code of 1986 to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

(2) EFFECTIVE DATE.—The modifications required by paragraph (1) shall apply to years beginning after December 31, 2000.

SEC. 1257. REPEAL OF TRANSITION RULE RELATING TO CERTAIN HIGHLY COMPENSATED EMPLOYEES.

(a) IN GENERAL.—Paragraph (4) of section 1114(c) of the Tax Reform Act of 1986 is hereby repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to plan years beginning after December 31, 2000.

SEC. 1258. EMPLOYEES OF TAX-EXEMPT ENTITIES.

(a) IN GENERAL.—The Secretary of the Treasury shall modify Treasury Regulations section 1.410(b)–6(g) to provide that employees of an organization described in section 403(b)(1)(A)(i) of the Internal Revenue Code of 1986 who are eligible to make contributions under section 403(b) pursuant to a salary reduction agreement may be treated as excludable with respect to a plan under section 401(k), or section 401(m) of such Code that is provided under the same general arrangement as a plan under such section 401(k), if—

(1) no employee of an organization described in section 403(b)(1)(A)(i) of such Code is eligible to participate in such section 401(k) plan or section 401(m) plan, and

(2) 95 percent of the employees who are not employees of an organization described in section 403(b)(1)(A)(i) of such Code are eligible to participate in such section 401(k) plan or section 401(m) plan.

(b) EFFECTIVE DATE.—The modification required by subsection (a) shall apply as of the same date set forth in section 1426(b) of the Small Business Job Protection Act of 1996.

SEC. 1259. CLARIFICATION OF TREATMENT OF EMPLOYER-PROVIDED RETIREMENT ADVICE.

(a) IN GENERAL.—Subsection (a) of section 132 (relating to exclusion from gross income) is amended by striking "or" at the end of paragraph (5), by striking the period at the end of paragraph (6) and inserting ", or", and by adding at the end the following new paragraph:

"(7) qualified retirement planning services.".

(b) QUALIFIED RETIREMENT PLANNING SERVICES DEFINED.—Section 132 is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following:

"(m) QUALIFIED RETIREMENT PLANNING SERVICES.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified retirement planning services' means any retirement planning service provided to an employee and his spouse by an employer maintaining a retirement plan.

"(2) NONDISCRIMINATION RULE.—Subsection (a)(7) shall apply in the case of highly compensated employees only if such services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's pension plan.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1260. PROVISIONS RELATING TO PLAN AMENDMENTS.

(a) IN GENERAL.—If this section applies to any plan or contract amendment—

(1) such plan or contract shall be treated as being operated in accordance with the terms of the plan during the period described in subsection (b)(2)(A), and

(2) such plan shall not fail to meet the requirements of section 411(d)(6) of the Internal Revenue Code of 1986 by reason of such amendment.

(b) AMENDMENTS TO WHICH SECTION APPLIES.—

(1) IN GENERAL.—This section shall apply to any amendment to any plan or annuity contract which is made—

(A) pursuant to any amendment made by this title, or pursuant to any regulation issued under this title, and

(B) on or before the last day of the first plan year beginning on or after January 1, 2003.

In the case of a government plan (as defined in section 414(d) of the Internal Revenue Code of 1986, this paragraph shall be applied by substituting "2005" for "2003".

(2) CONDITIONS.—This section shall not apply to any amendment unless—

(A) during the period—

(i) beginning on the date the legislative or regulatory amendment described in paragraph (1)(A) takes effect (or in the case of a plan or contract amendment not required by such legislative or regulatory amendment, the effective date specified by the plan), and

(ii) ending on the date described in paragraph (1)(B) (or, if earlier, the date the plan or contract amendment is adopted), the plan or contract is operated as if such plan or contract amendment were in effect, and

(B) such plan or contract amendment applies retroactively for such period.

SEC. 1261. MODEL PLANS FOR SMALL BUSINESSES.

(a) IN GENERAL.—Not later than December 31, 2000, the Secretary of the Treasury is directed to issue at least one model defined contribution plan and at least one model defined benefit plan that fit the needs of small businesses and that shall be treated as meeting the requirements of section 401(a) of the Internal Revenue Code of 1986 with respect to the form of the plan. To the extent that the requirements of section 401(a) of such Code are modified after the issuance of such plans, the Secretary of the Treasury shall, in a timely manner, issue model amendments that, if adopted in a timely manner by an employer that has a model plan in effect, shall cause such model plan to be treated as meeting the requirements of section 401(a) of such Code, as modified, with respect to the form of the plan.

(b) PROTOTYPE PLAN ALTERNATIVE.—The Secretary of the Treasury may satisfy the requirements of subsection (a) through the enhancement and simplification of the Secretary's programs for prototype plans in such a manner as to achieve the purposes of subsection (a).

SEC. 1262. SIMPLIFIED ANNUAL FILING REQUIREMENT FOR PLANS WITH FEWER THAN 25 EMPLOYEES.

(a) IN GENERAL.—In the case of a retirement plan which covers less than 25 employees on the 1st day of the plan year and meets the requirements described in subsection (b), the Secretary of the Treasury shall provide for the filing of a simplified annual return that is substantially similar to the annual return required to be filed by a one-participant retirement plan.

(b) REQUIREMENTS.—A plan meets the requirements of this subsection if it—

(1) meets the minimum coverage requirements of section 410(b) of the Internal Revenue Code of 1986 without being combined with any other plan of the business that covers the employees of the business,

(2) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of businesses under common control, and

(3) does not cover a business that leases employees.

SEC. 1263. IMPROVEMENT OF EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM.

The Secretary of the Treasury shall continue to update and improve the Employee Plans Compliance Resolution System (or any successor program) giving special attention to—

(1) increasing the awareness and knowledge of small employers concerning the availability and use of the program,

(2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures,

(3) extending the duration of the self-correction period under the Administrative Policy Regarding Self-Correction for significant compliance failures,

(4) expanding the availability to correct insignificant compliance failures under the Administrative Policy Regarding Self-Correction during audit, and

(5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

TITLE XIII—MISCELLANEOUS PROVISIONS

Subtitle A—Provisions Primarily Affecting Individuals

SEC. 1301. EXCLUSION FOR FOSTER CARE PAYMENTS TO APPLY TO PAYMENTS BY QUALIFIED PLACEMENT AGENCIES.

(a) IN GENERAL.—The matter preceding subparagraph (B) of section 131(b)(1) (defining qualified foster care payment) is amended to read as follows:

"(1) IN GENERAL.—The term 'qualified foster care payment' means any payment made pursuant to a foster care program of a State or political subdivision thereof—

"(A) which is paid by—

"(i) a State or political subdivision thereof, or

"(ii) a qualified foster care placement agency, and".

(b) QUALIFIED FOSTER INDIVIDUALS TO INCLUDE INDIVIDUALS PLACED BY QUALIFIED PLACEMENT AGENCIES.—Subparagraph (B) of section 131(b)(2) (defining qualified foster individual) is amended to read as follows:

"(B) a qualified foster care placement agency."

(c) QUALIFIED FOSTER CARE PLACEMENT AGENCY DEFINED.—Subsection (b) of section 131 is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) QUALIFIED FOSTER CARE PLACEMENT AGENCY.—The term 'qualified foster care placement agency' means any placement agency which is licensed or certified by—

"(A) a State or political subdivision thereof, or

"(B) an entity designated by a State or political subdivision thereof,

for the foster care program of such State or political subdivision to make foster care payments to providers of foster care."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1302. MILEAGE REIMBURSEMENTS TO CHARITABLE VOLUNTEERS EXCLUDED FROM GROSS INCOME.

(A) IN GENERAL.—Part III of subchapter B of chapter 1 is amended by inserting after section 138 the following new section:

"SEC. 138A. MILEAGE REIMBURSEMENTS TO CHARITABLE VOLUNTEERS.

"(a) IN GENERAL.—Gross income of an individual does not include amounts received, from an organization described in section 170(c), as reimbursement of operating expenses with respect to use of a passenger automobile for the benefit of such organization. The preceding sentence shall apply only to the extent that such reimbursement would be deductible under section 274(d) (determined by applying the standard business mileage rate established pursuant to section 274(d)) if the organization were not so described and such individual were an employee of such organization.

"(b) NO DOUBLE BENEFIT.—Subsection (a) shall not apply with respect to any expenses if the individual claims a deduction or credit for such expenses under any other provision of this title.

"(c) EXEMPTION FROM REPORTING REQUIREMENTS.—Section 6041 shall not apply with respect to reimbursements excluded from income under subsection (a)."

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by inserting after the item relating to section 138 the following new items:

"Sec. 138A. Reimbursement for use of passenger automobile for charity."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1303. W–2 TO INCLUDE EMPLOYER SOCIAL SECURITY TAXES.

(a) IN GENERAL.—Subsection (a) of section 6051 (relating to receipts for employees) is amended by striking "and" at the end of paragraph (10), by striking the period at the end of paragraph (11) and inserting a comma, and by inserting after paragraph (11) the following new paragraphs:

"(12) the amount of tax imposed by section 3111(a), and

"(13) the amount of tax imposed by section 3111(b)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to remuneration paid after December 31, 1999.

SEC. 1304. CONSISTENT TREATMENT OF SURVIVOR BENEFITS FOR PUBLIC SAFETY OFFICERS KILLED IN THE LINE OF DUTY.

Subsection (b) of section 1528 of the Taxpayer Relief Act of 1997 (Public Law 105–34) is amended by striking the period and inserting ', and to amounts received in taxable years beginning after December 31, 1999, with respect to individuals dying on or before December 31, 1996."

Subtitle B—Provisions Primarily Affecting Businesses

SEC. 1311. DISTRIBUTIONS FROM PUBLICLY TRADED PARTNERSHIPS TREATED AS QUALIFYING INCOME OF REGULATED INVESTMENT COMPANIES.

(a) IN GENERAL.—Paragraph (2) of section 851(b) (defining regulated investment company) is amended by inserting "income derived from an interest in a publicly traded partnership (as defined in section 7704(b))," after "dividends, interest,".

(b) SOURCE FLOW-THROUGH RULE NOT TO APPLY.—The last sentence of section 851(b) is amended by inserting "(other than a publicly traded partnership (as defined in section 7704(b)))" after "derived from a partnership".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1312. SPECIAL PASSIVE ACTIVITY RULE FOR PUBLICLY TRADED PARTNERSHIPS TO APPLY TO REGULATED INVESTMENT COMPANIES.

(a) IN GENERAL.—Subsection (k) of section 469 (relating to separate application of section in case of publicly traded partnerships) is amended by adding at the end the following new paragraph:

"(4) APPLICATION TO REGULATED INVESTMENT COMPANIES.—For purposes of this section, a regulated investment company (as defined in section 851) holding an interest in a publicly traded partnership shall be treated as a taxpayer described in subsection (a)(2) with respect to items attributable to such interest.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1313. LARGE ELECTRIC TRUCKS, VANS, AND BUSES ELIGIBLE FOR DEDUCTION FOR CLEAN-FUEL VEHICLES IN LIEU OF CREDIT.

(a) IN GENERAL.—Paragraph (1) of section 30(c) (relating to credit for qualified electric vehicles) is amended by adding at the end the following new flush sentence:

"Such term shall not include any vehicle described in subclause (I) or (II) of section 179A(b)(1)(A)(iii)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 1999.

SEC. 1314. MODIFICATIONS TO SPECIAL RULES FOR NUCLEAR DECOMMISSIONING COSTS.

(a) REPEAL OF LIMITATION ON DEPOSITS INTO FUND BASED ON COST OF SERVICE.—Subsection (b) of section 468A is amended to read as follows:

"(b) LIMITATION ON AMOUNTS PAID INTO FUND.—The amount which a taxpayer may pay into the Fund for any taxable year shall not exceed the ruling amount applicable to such taxable year."

(b) CLARIFICATION OF TREATMENT OF FUND TRANSFERS.—Subsection (e) of section 468A is amended by adding at the end the following new paragraph:

"(8) TREATMENT OF FUND TRANSFERS.—If, in connection with the transfer of the taxpayer's interest in a nuclear powerplant, the taxpayer transfers the Fund with respect to such powerplant to the transferee of such interest and the transferee elects to continue the application of this section to such Fund—

"(A) the transfer of such Fund shall not cause such Fund to be disqualified from the application of this section, and

"(B) no amount shall be treated as distributed from such Fund, or be includible in gross income, by reason of such transfer."

(c) TRANSFERS OF BALANCES IN NONQUALIFIED FUNDS.—Section 468A is amended by redesignating subsections (f) and (g) as subsections (g) and (h), respectively, and by inserting after subsection (e) the following new subsection:

"(f) TRANSFERS OF BALANCES IN NONQUALIFIED FUNDS INTO QUALIFIED FUNDS.—

"(1) IN GENERAL.—Notwithstanding subsection (b), any taxpayer maintaining a Fund to which this section applies with respect to a nuclear powerplant may transfer into such Fund amounts held in any nonqualified fund of such taxpayer with respect to such powerplant.

"(2) MAXIMUM AMOUNT PERMITTED TO BE TRANSFERRED.—The amount permitted to be transferred under paragraph (1) shall not exceed the balance in the nonqualified fund as of December 31, 1998.

"(3) DEDUCTION FOR AMOUNTS TRANSFERRED.—

"(A) IN GENERAL.—The deduction allowed by subsection (a) for any transfer permitted by this subsection shall be allowed ratably over the remaining estimated useful life (within the meaning of subsection (d)(2)(A)) of the nuclear powerplant, beginning with the later of the taxable year during which the transfer is made or the taxpayer's first taxable year beginning after December 31, 2001.

"(B) DENIAL OF DEDUCTION FOR PREVIOUSLY DEDUCTED AMOUNTS.—No deduction shall be allowed for any transfer under this subsection of an amount for which a deduction was allowed when such amount was paid into the nonqualified fund. For purposes of the preceding sentence, a ratable portion of each transfer shall be treated as being from previously deducted amounts to the extent thereof.

"(C) TRANSFERS OF QUALIFIED FUNDS.—If—

"(i) any transfer permitted by this subsection is made to any Fund to which this section applies, and

"(ii) such Fund is transferred thereafter,

any deduction under this subsection for taxable years ending after the date that such Fund is transferred shall be allowed to the transferee and not to the transferor. The preceding sentence shall not apply if the transferor is an organization exempt from tax imposed by this chapter.

"(4) NEW RULING AMOUNT REQUIRED.—Paragraph (1) shall not apply to any transfer unless the taxpayer requests from the Secretary a new schedule of ruling amounts in connection with such transfer.

"(5) NONQUALIFIED FUND.—For purposes of this subsection, the term 'nonqualified fund' means, with respect to any nuclear powerplant, any fund in which amounts are irrevocably set aside pursuant to the requirements of any State or Federal agency exclusively for the purpose of funding the decommissioning of such powerplant.

"(6) NO BASIS IN QUALIFIED FUNDS.—Notwithstanding any other provision of law, the basis of any Fund to which this section applies shall not be increased by reason of any transfer permitted by this subsection."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1315. CONSOLIDATION OF LIFE INSURANCE COMPANIES WITH OTHER CORPORATIONS.

(a) IN GENERAL.—Section 1504(b) (defining includible corporation) is amended by striking paragraph (2).

(b) CONFORMING AMENDMENTS.—

(1) Subsection (c) of section 1503 is amended by striking paragraph (2) (relating to losses of recent nonlife affiliates).

(2) Section 1504 is amended by striking subsection (c) and by redesignating subsections (d), (e), and (f) as subsections (c), (d), and (e), respectively.

(3) Section 1503(c)(1) (relating to special rule for application of certain losses against income of insurance companies taxed under section 801) is amended by striking "an election under section 1504(c)(2) is in effect for the taxable year and".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2004.

(d) NO CARRYBACK BEFORE JANUARY 1, 2005.—To the extent that a consolidated net operating loss is allowed or increased by reason of the amendments made by this section, such loss may not be carried back to a taxable year beginning before January 1, 2005.

(e) NONTERMINATION OF GROUP.—No affiliated group shall terminate solely as a result of the amendments made by this section.

(f) WAIVER OF 5-YEAR WAITING PERIOD.—Under regulations prescribed by the Secretary of the Treasury or his delegate, an automatic waiver from the 5-year waiting period for reconsolidation provided in section 1504(a)(3) of such Code shall be granted to any corporation which was previously an includible corporation but was subsequently deemed a nonincludible corporation as a result of becoming a subsidiary of a corporation which was not an includible corporation solely by operation of section 1504(c)(2) of such Code (as in effect on the day before the date of enactment of this Act).

Subtitle C—Provisions Relating to Excise Taxes

SEC. 1321. CONSOLIDATION OF HAZARDOUS SUBSTANCE SUPERFUND AND LEAKING UNDERGROUND STORAGE TANK TRUST FUND.

(a) IN GENERAL.—Subchapter A of chapter 98 (relating to trust fund code) is amended by striking sections 9507 and 9508 and inserting the following new section:

"SEC. 9507. ENVIRONMENTAL REMEDIATION TRUST FUND.

"(a) CREATION OF TRUST FUND.—There is established in the Treasury of the United States a trust fund to be known as the 'Environmental Remediation Trust Fund' consisting of such amounts as may be—

"(1) appropriated to the Environmental Remediation Trust Fund as provided in this section,

"(2) appropriated to the Environmental Remediation Trust Fund pursuant to section 517(b) of the Superfund Revenue Act of 1986, or

"(3) credited to the Environmental Remediation Trust Fund as provided in section 9602(b).

"(b) TRANSFERS TO ENVIRONMENTAL REMEDIATION TRUST FUND.—

"(1) IN GENERAL.—There are hereby appropriated to the Environmental Remediation Trust Fund amounts equivalent to—

"(A) the taxes received in the Treasury under—

"(i) section 59A, 4611, 4661, or 4671 (relating to environmental taxes),

"(ii) section 4041(d) (relating to additional taxes on motor fuels),

"(iii) section 4081 (relating to tax on gasoline, diesel fuel, and kerosene) to the extent attributable to the Environmental Remediation Trust Fund financing rate under such section,

"(iv) section 4091 (relating to tax on aviation fuel) to the extent attributable to the Environmental Remediation Trust Fund financing rate under such section, and

"(v) section 4042 (relating to tax on fuel used in commercial transportation on inland waterways) to the extent attributable to the Environmental Remediation Trust Fund financing rate under such section,

"(B) amounts recovered on behalf of the Environmental Remediation Trust Fund under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (hereinafter in this section referred to as 'CERCLA'),

"(C) all moneys recovered or collected under section 311(b)(6)(B) of the Clean Water Act,

"(D) penalties assessed under title I of CERCLA,

"(E) punitive damages under section 107(c)(3) of CERCLA, and

"(F) amounts received in the Treasury and collected under section 9003(h)(6) of the Solid Waste Disposal Act.

"(2) LIMITATION ON TRANSFERS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no amount may be appropriated or credited to the Environmental Remediation Trust Fund on and after the date of any expenditure from any such Trust Fund which is not permitted by this section. The determination of whether an expenditure is so permitted shall be made without regard to—

"(i) any provision of law which is not contained or referenced in this title or in a revenue Act, and

"(ii) whether such provision of law is a subsequently enacted provision or directly or indirectly seeks to waive the application of this paragraph.

"(B) EXCEPTION FOR PRIOR OBLIGATIONS.—Subparagraph (A) shall not apply to any expenditure to liquidate any contract entered into (or for any amount otherwise obligated) in accordance with the provisions of this section."

"(c) EXPENDITURES FROM ENVIRONMENTAL REMEDIATION TRUST FUND.—

"(1) IN GENERAL.—Amounts in the Environmental Remediation Trust Fund shall be available, as provided in appropriation Acts, only for purposes of making expenditures—

"(A) to carry out the purposes of—

"(i) paragraphs (1), (2), (5), and (6) of section 111(a) of CERCLA as in effect on July 12, 1999,

"(ii) section 111(c) of CERCLA (as so in effect), other than paragraphs (1) and (2) thereof, and

"(iii) section 111(m) of CERCLA (as so in effect), or

"(B) to carry out section 9003(h) of the Solid Waste Disposal Act as in effect on July 12, 1999.

"(2) EXCEPTION FOR CERTAIN TRANSFERS, ETC., OF HAZARDOUS SUBSTANCES.—No amount in the Environmental Remediation Trust Fund or derived from the Environmental Remediation Trust Fund shall be available or used for the transfer or disposal of hazardous waste carried out pursuant to a cooperative agreement between the Administrator of the Environmental Protection Agency and a State if the following conditions apply—

"(A) the transfer or disposal, if made on December 13, 1985, would not comply with a State or local requirement,

"(B) the transfer is to a facility for which a final permit under section 3005(a) of the Solid Waste Disposal Act was issued after January 1, 1983, and before November 1, 1984, and

"(C) the transfer is from a facility identified as the McColl Site in Fullerton, California.

"(3) TRANSFERS FROM TRUST FUND FOR CERTAIN REPAYMENTS AND CREDITS.—

"(A) IN GENERAL.—The Secretary shall pay from time to time from the Environmental Remediation Trust Fund into the general fund of the Treasury amounts equivalent to—

"(i) amounts paid under—

"(I) section 6420 (relating to amounts paid in respect of gasoline used on farms),

"(II) section 6421 (relating to amounts paid in respect of gasoline used for certain nonhighway purposes or by local transit systems), and

"(III) section 6427 (relating to fuels not used for taxable purposes), and

"(ii) credits allowed under section 34,

with respect to the taxes imposed by section 4041(d) or by sections 4081 and 4091 (to the extent attributable to the Leaking Underground Storage Tank Trust Fund financing rate or the Environmental Remediation Trust Fund financing rate under such sections).

"(B) TRANSFERS BASED ON ESTIMATES.—Transfers under subparagraph (A) shall be made on the basis of estimates by the Secretary, and proper adjustments shall be made in amounts subsequently transferred to the extent prior estimates were in excess of or less than the amounts required to be transferred.

"(d) LIABILITY OF UNITED STATES LIMITED TO AMOUNT IN TRUST FUND.—

"(1) GENERAL RULE.—Any claim filed against the Environmental Remediation Trust Fund may be paid only out of the Environmental Remediation Trust Fund.

"(2) COORDINATION WITH OTHER PROVISIONS.—Nothing in CERCLA or the Superfund Amendments and Reauthorization Act of 1986 (or in any amendment made by either of such Acts) shall authorize the payment by the United States Government of any amount with respect to any such claim out of any source other than the Environmental Remediation Trust Fund.

"(3) ORDER IN WHICH UNPAID CLAIMS ARE TO BE PAID.—If at any time the Environmental Remediation Trust Fund has insufficient funds to pay all of the claims payable out of the Environmental Remediation Trust Fund at such time, such claims shall, to the extent permitted under paragraph (1), be paid in full in the order in which they were finally determined."

(b) CONFORMING AMENDMENTS.—

(1) Subsections (c) and (d) of section 4611 are each amended by striking "Hazardous Substance Superfund" each place it appears and inserting "Environmental Remediation Trust Fund".

(2) Subsection (c) of section 4661 is amended by striking "Hazardous Substance Superfund" and inserting "Environmental Remediation Trust Fund".

(3) Sections 4041(d), 4042(b), 4081(a)(2)(B), 4081(d)(3), 4091(b), 4092(b), 6421(f), and 6427(l) are each amended by striking "Leaking Underground Storage Tank" each place it appears (other than the headings) and inserting "Environmental Remediation".

(4) The heading for subsection (d) of section 4041 is amended by striking "LEAKING UNDERGROUND STORAGE TANK" and inserting "ENVIRONMENTAL REMEDIATION".

(5) The headings for subsections (a)(2)(B) and (d)(3) of section 4081 and section 4091(b)(2) are each amended by striking "LEAKING UNDERGROUND STORAGE TANK" and inserting "ENVIRONMENTAL REMEDIATION".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on October 1, 1999.

(d) ENVIRONMENTAL REMEDIATION TRUST FUND TREATED AS CONTINUATION OF OLD TRUST FUNDS.—The Environmental Remediation Trust Fund established by the amendments made by this section shall be treated for all purposes of law as a continuation of both the Hazardous Substance Superfund and the Leaking Underground Storage Tank Trust Fund. Any reference in any law to the Hazardous

Substance Superfund or the Leaking Underground Storage Tank Trust Fund shall be deemed to include (wherever appropriate) a reference to the Environmental Remediation Trust Fund established by such amendments.

SEC. 1322. REPEAL OF CERTAIN MOTOR FUEL EXCISE TAXES ON FUEL USED BY RAILROADS AND ON INLAND WATERWAY TRANSPORTATION.

(a) REPEAL OF LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAXES ON FUEL USED IN TRAINS.—

(1) IN GENERAL.—Paragraph (1) of section 4041(d) is amended by adding at the end the following new sentence: "The preceding sentence shall not apply to any sale for use, or use, of fuel in a diesel-powered train."

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (3) of section 6421(f) is amended by striking "with respect to—" and all that follows through "so much of" and inserting "with respect to so much of".

(B) Paragraph (3) of section 6427(l) is amended by striking "with respect to—" and all that follows through "so much of" and inserting "with respect to so much of".

(b) REPEAL OF 4.3-CENT MOTOR FUEL EXCISE TAXES ON RAILROADS AND INLAND WATERWAY TRANSPORTATION WHICH REMAIN IN GENERAL FUND.—

(1) TAXES ON TRAINS.—

(A) IN GENERAL.—Subparagraph (A) of section 4041(a)(1) is amended by striking "or a diesel-powered train" each place it appears and by striking "or train".

(B) CONFORMING AMENDMENTS.—

(i) Subparagraph (C) of section 4041(a)(1) is amended by striking clause (ii) and by redesignating clause (iii) as clause (ii).

(ii) Subparagraph (C) of section 4041(b)(1) is amended by striking all that follows "section 6421(e)(2)" and inserting a period.

(iii) Paragraph (3) of section 4083(a) is amended by striking "or a diesel-powered train".

(iv) Section 6421(f) is amended by striking paragraph (3).

(v) Section 6427(l) is amended by striking paragraph (3).

(2) FUEL USED ON INLAND WATERWAYS.—

(A) IN GENERAL.—Paragraph (1) of section 4042(b) is amended by adding "and" at the end of subparagraph (A), by striking ", and" at the end of subparagraph (B) and inserting a period, and by striking subparagraph (C).

(B) CONFORMING AMENDMENT.—Paragraph (2) of section 4042(b) is amended by striking subparagraph (C).

(c) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on October 1, 1999 (October 1, 2003, in the case of the amendments made by subsection (b)), but shall not take effect if section 1321 does not take effect.

SEC. 1323. REPEAL OF EXCISE TAX ON FISHING TACKLE BOXES.

(a) IN GENERAL.—Paragraph (6) of section 4162(a) (defining sport fishing equipment) is amended by striking subparagraph (C) and by redesignating subparagraphs (D) through (J) as subparagraphs (C) through (I), respectively.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to articles sold by the manufacturer, producer, or importer more than 30 days after the date of the enactment of this Act.

SEC. 1324. CLARIFICATION OF EXCISE TAX IMPOSED ON ARROW COMPONENTS.

(a) IN GENERAL.—Paragraph (2) of section 4161(b) (relating to bows and arrows, etc.) is amended to read as follows:

"(2) ARROWS.—

"(A) IN GENERAL.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any shaft, point, article used to attach a point to a shaft, nock, or vane of a type used in the manufacture of any arrow which after its assembly—

"(i) measures 18 inches overall or more in length, or

"(ii) measures less than 18 inches overall in length but is suitable for use with a bow described in paragraph (1)(A),

a tax equal to 12.4 percent of the price for which so sold.

"(B) REDUCED RATE ON CERTAIN HUNTING POINTS.—Subparagraph (A) shall be applied by substituting '11 percent' for '12.4 percent' in the case of a point which is designed primarily for use in hunting fish or large animals."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to articles sold by the manufacturer, producer, or importer after the close of the first calendar month ending more than 30 days after the date of the enactment of this Act.

Subtitle D—Improvements in Low-Income Housing Credit

SEC. 1331. INCREASE IN STATE CEILING ON LOW-INCOME HOUSING CREDIT.

(a) INCREASE IN STATE CEILING.—Clause (i) of section 42(h)(3)(C) (relating to State housing credit ceiling) is amended by striking "$1.25" and inserting "the applicable amount under subparagraph (H)".

(b) APPLICABLE AMOUNT; ADJUSTMENT OF STATE CEILING FOR INCREASES IN COST-OF-LIVING.—Paragraph (3) of section 42(h) (relating to housing credit dollar amount for agencies) is amended by adding at the end the following new subparagraphs:

"(H) INITIAL AMOUNT OF STATE CEILING.—For purposes of subparagraph (C)(i), the applicable amount shall be determined under the following table:

"For calendar year	The applicable amount is
2000	$1.35
2001	1.45
2002	1.55
2003	1.65
2004 and thereafter	1.75.

"(I) COST-OF-LIVING ADJUSTMENT.—

"(i) IN GENERAL.—In the case of a calendar year after 2004 the $1.75 amount in subparagraph (H) shall be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting 'calendar year 2003' for 'calendar year 1992' in subparagraph (B) thereof.

"(ii) ROUNDING.—Any increase under clause (i) which is not a multiple of 5 cents shall be rounded to the next lowest multiple of 5 cents.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years after 1999.

SEC. 1332. MODIFICATION OF CRITERIA FOR ALLOCATING HOUSING CREDITS AMONG PROJECTS.

(a) SELECTION CRITERIA.—Subparagraph (C) of section 42(m)(1) (relating to certain selection criteria must be used) is amended—

(1) by inserting ", including whether the project includes the use of existing housing as part of a community revitalization plan" before the comma at the end of clause (iii), and

(2) by striking clauses (v), (vi), and (vii) and inserting the following new clauses:

"(v) tenant populations with special housing needs,

"(vi) public housing waiting lists,

"(vii) tenant populations of individuals with children, and

"(viii) projects intended for eventual tenant ownership."

(b) PREFERENCE FOR COMMUNITY REVITALIZATION PROJECTS LOCATED IN QUALIFIED CENSUS TRACTS.—Clause (ii) of section 42(m)(1)(B) is amended by striking "and" at the end of subclause (I), by adding "and" at the end of subclause (II), and by inserting after subclause (II) the following new subclause:

"(III) projects which are located in qualified census tracts (as defined in subsection (d)(5)(C)) and the development of which contributes to a concerted community revitalization plan,".

SEC. 1333. ADDITIONAL RESPONSIBILITIES OF HOUSING CREDIT AGENCIES.

(a) MARKET STUDY; PUBLIC DISCLOSURE OF RATIONALE FOR NOT FOLLOWING CREDIT ALLOCATION PRIORITIES.—Subparagraph (A) of section 42(m)(1) (relating to responsibilities of housing credit agencies) is amended by striking "and" at the end of clause (i), by striking the period at the end of clause (ii) and inserting a comma, and by adding at the end the following new clauses:

"(iii) a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project is conducted before the credit allocation is made and at the developer's expense by a disinterested party who is approved by such agency, and "(iv) a written explanation is available to the general public for any allocation of a housing credit dollar amount which is not made in accordance with established priorities and selection criteria of the housing credit agency.".

(b) SITE VISITS.—Clause (iii) of section 42(m)(1)(B) (relating to qualified allocation plan) is amended by inserting before the period "and in monitoring for noncompliance with habitability standards through regular site visits".

SEC. 1334. MODIFICATIONS TO RULES RELATING TO BASIS OF BUILDING WHICH IS ELIGIBLE FOR CREDIT.

(a) HOME ASSISTANCE NOT TO DISQUALIFY BUILDING FOR ADDITIONAL CREDIT AVAILABLE TO BUILDINGS IN HIGH COST AREAS.—Clause (i) of section 42(i)(2)(E) (relating to buildings receiving HOME assistance) is amended by striking the last sentence.

(b) ADJUSTED BASIS TO INCLUDE PORTION OF CERTAIN BUILDINGS USED BY LOW-INCOME INDIVIDUALS WHO ARE NOT TENANTS AND BY PROJECT EMPLOYEES.—Paragraph (4) of section 42(d) (relating to special rules relating to determination of adjusted basis) is amended—

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

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

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

"(C) INCLUSION OF BASIS OF PROPERTY USED TO PROVIDE SERVICES FOR CERTAIN NONTENANTS.—

"(i) IN GENERAL.—The adjusted basis of any building located in a qualified census tract (as defined in paragraph (5)(C)) shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation and not otherwise taken into account) used throughout the taxable year in providing any community service facility.

"(ii) LIMITATION.—The increase in the adjusted basis of any building which is taken into account by reason of clause (i) shall not exceed 20 percent of the eligible basis of the qualified low-income housing project of which it is a part. For purposes of the preceding sentence, all community service facilities which are part of the same qualified low-income housing project shall be treated as 1 facility.

"(iii) COMMUNITY SERVICE FACILITY.—For purposes of this subparagraph, the term 'community service facility' means any facility designed to serve primarily individuals whose income is 60 percent or less of area median income (within the meaning of subsection (g)(1)(B)).".

SEC. 1335. OTHER MODIFICATIONS.

(a) ALLOCATION OF CREDIT LIMIT TO CERTAIN BUILDINGS.—

(1) The first sentence of section 42(h)(1)(E)(ii) is amended by striking "(as of" the first place it appears and inserting "(as of the later of the date which is 6 months after the date that the allocation was made or".

(2) The last sentence of section 42(h)(3)(C) is amended by striking "project which" and inserting "project which fails to meet the 10 percent test under paragraph (1)(E)(ii) on a date after the close of the calendar year in which the allocation was made or which".

(b) DETERMINATION OF WHETHER BUILDINGS ARE LOCATED IN HIGH COST AREAS.—The first sentence of section 42(d)(5)(C)(ii)(I) is amended—

(1) by inserting "either" before "in which 50 percent", and

(2) by inserting before the period " or which has a poverty rate of at least 25 percent".

SEC. 1336. CARRYFORWARD RULES.

(a) IN GENERAL.—Clause (ii) of section 42(h)(3)(D) (relating to unused housing credit carryovers allocated among certain states) is amended by striking "the excess" and all that follows and inserting "the excess (if any) of—

"(I) the unused State housing credit ceiling for the year preceding such year, over

"(II) the aggregate housing credit dollar amount allocated for such year.".

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

SEC. 1337. EFFECTIVE DATE.

Except as otherwise provided in this subtitle, the amendments made by this subtitle shall apply to—

(1) housing credit dollar amounts allocated after December 31, 2000, and

(2) buildings placed in service after such date to the extent paragraph (1) of section 42(h) of the Internal Revenue Code of 1986 does not apply to any building by reason of paragraph (4) thereof, but only with respect to bonds issued after such date.

Subtitle E—Entrepreneurial Equity Capital Formation

PART I—TAX-FREE CONVERSIONS OF SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES INTO PASS-THRU ENTITIES

SEC. 1341. MODIFICATIONS TO PROVISIONS RELATING TO REGULATED INVESTMENT COMPANIES.

(a) IN GENERAL.—Section 851 (relating to definition of regulated investment company) is amended by adding at the end the following new subsection:

"(i) SPECIAL RULES FOR SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES.—

"(1) IN GENERAL.—For purposes of determining whether a specialized small business investment company is a regulated investment company for purposes of this subchapter—

"(A) income derived from an investment as a limited partner in a partnership shall be treated as qualifying income under subsection (b)(2) if—

"(i) the company does not participate in the active management of the normal business operations of the partnership, and

"(ii) the company's investment in such partnership is an investment permitted for specialized small business investment companies under the Small Business Investment Act of 1958, and

"(B) the requirements of subsection (b)(3) shall be treated as met if, at the close of each quarter of the taxable year, at least 50 percent of the value of its total assets is represented by—

"(i) assets described in subsection (b)(3)(A)(i), and

"(ii) other investments permitted to be made by a specialized small business investment company under the Small Business Investment Act of 1958.

"(2) COORDINATION OF DISTRIBUTION REQUIREMENTS WITH SBIC REQUIREMENTS.—A specialized small business investment company shall be treated as meeting the requirements of section 852(a)(1) if the deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gain dividends) equals or exceeds the lesser of the amount required under section 852(a)(1) or 100 percent of the maximum amount that the company would be permitted to distribute during such year under the Small Business Investment Act of 1958.

"(3) SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY.—For purposes of this subsection, the term 'specialized small business investment company' has the meaning given to such term by section 1044(c)(3).

"(4) REFERENCES TO 1958 ACT.—For purposes of this subsection, references to the Small Business Investment Act of 1958 shall be treated as references to such Act as in effect on May 13, 1993."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of enactment of this Act.

SEC. 1342. TAX-FREE REORGANIZATION OF SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY AS A PARTNERSHIP.

(a) IN GENERAL.—If, within 180 days after the date of the enactment of this Act, a corporation which is a specialized small business investment company transfers substantially all of its assets to a partnership (including its license to operate as a specialized small business investment company) solely in exchange for partnership interests in such partnership, no gain or loss shall be recognized to the corporation on such a transfer if—

(1) immediately after such exchange, such corporation holds partnership interests in such partnership having a value equal to at least 80 percent of the total value of all partnership interests in such partnership, and

(2) before the 90th day after such exchange, such corporation transfers all partnership interests held by the corporation in such partnership, and all remaining assets of the corporation, to its shareholders in the complete liquidation of such corporation.

(b) NONRECOGNITION OF GAIN OR LOSS TO CORPORATION ON DISTRIBUTION OF PARTNERSHIP INTERESTS.—In the case of any distribution of a partnership interest acquired by the liquidating corporation in an exchange to which subsection (a) applies—

(1) no gain or loss shall be recognized to the liquidating corporation by reason of such distribution, and

(2) such distribution shall not be treated as a sale or exchange for purposes of section 708(b)(1)(B) of the Internal Revenue Code of 1986.

(c) GAIN RECOGNIZED BY SHAREHOLDERS ON RECEIPT OF PROPERTY OTHER THAN PARTNERSHIP INTERESTS.—

(1) IN GENERAL.—No gain or loss shall be recognized to a shareholder of a corporation on the transfer of such shareholder's stock in such corporation to such corporation solely in exchange for a partnership interest in the partnership referred to in subsection (a)(1).

(2) RECEIPT OF PROPERTY.—If paragraph (1) would apply to an exchange but for the fact that there is received, in addition to the partnership interests permitted to be received under paragraph (1), other property or money, then—

(A) gain (if any) to such recipient shall be recognized, but not in excess of—

(i) the amount of money received, plus

(ii) the fair market value of such other property received, and

(B) no loss to such recipient shall be recognized.

(d) BASIS.—The basis of property received in any exchange to which this section applies shall be determined in accordance with rules similar to the rules of section 358 of the Internal Revenue Code of 1986.

(e) ADDITIONAL REQUIREMENTS.—This section shall not apply to any specialized small business investment company unless—

(1) such company elects to be subject to tax on its built-in gains computed in a manner similar to that provided in section 1374 of such Code (without regard to any recognition period (as defined in subsection (d)(7) thereof)), and

(2) such company distributes all of its accumulated earnings and profits (in distributions to which section 301 of such Code applies) before its liquidation under this section.

If, after making an election under paragraph (1), a company ceases to be a specialized small business investment company, such company shall be treated as having disposed of all of its assets for purposes of applying paragraph (1).

(f) SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY.—For purposes of this section, the term "specialized small business investment company" has the meaning given to such term by section 1044(c)(3) of such Code.

PART II—ADDITIONAL INCENTIVES RELATED TO INVESTING IN SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES

SEC. 1346. EXPANSION OF NONRECOGNITION TREATMENT FOR SECURITIES GAIN ROLLED OVER INTO SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES.

(a) EXTENSION OF ROLLOVER PERIOD.—Paragraph (1) of section 1044(a) (relating to nonrecognition of gain) is amended by striking "60-day period" and inserting "180-day period".

(b) INCREASE OF MAXIMUM EXCLUSION.—

(1) IN GENERAL.—Paragraphs (1) and (2) of section 1044(b) (relating to limitations) are amended to read as follows:

"(1) LIMITATION ON INDIVIDUALS.—In the case of an individual, the amount of gain which may be excluded under subsection (a) for any taxable year shall not exceed—

"(A) $750,000, reduced by

"(B) the amount of gain excluded under subsection (a) for all preceding taxable years.

"(2) LIMITATION ON C CORPORATIONS.—In the case of a C corporation, the amount of gain which may be excluded under subsection (a) for any taxable year shall not exceed—

"(A) $2,000,000, reduced by

"(B) the amount of gain excluded under subsection (a) for all preceding taxable years."

(2) CONFORMING AMENDMENT.—Subparagraph (A) of section 1044(b)(3) (relating to special rules for married individuals) is amended to read as follows:

"(A) SEPARATE RETURNS.—In the case of a separate return by a married individual, paragraph (1) shall be applied by substituting '$375,000' for '$750,000'."

(c) EXTENSION TO PREFERRED STOCK.—Paragraph (1) of section 1044(a) is amended by striking "common".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to sales occurring after the date of the enactment of this Act.

SEC. 1347. MODIFICATIONS TO EXCLUSION FOR GAIN FROM QUALIFIED SMALL BUSINESS STOCK.

(a) IN GENERAL.—Section 1202 (relating to 50-percent exclusion for gain from certain small business stock) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) SPECIAL RULES FOR SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES.—

"(1) INCREASE IN EXCLUSION.—In the case of—

"(A) the sale or exchange of stock in a specialized small business investment company, and

"(B) any amount treated under subsection (g) as gain described in subsection (a) by reason of the sale or exchange of stock in a specialized small business investment company,

subsection (a) shall be applied by substituting '60 percent' for '50 percent'.

"(2) WAIVER OF ACTIVE BUSINESS REQUIREMENT.—Notwithstanding any provision of subsection (e), a corporation shall be treated as meeting the active business requirements of such subsection for any period during which such corporation qualifies as a specialized small business investment company.

"(3) SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY.—For purposes of this section, the term 'specialized small business investment company' means any eligible corporation (as defined in subsection (e)(4)) which is licensed to operate under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993)."

(b) CONFORMING AMENDMENT.—Section 1202(c)(2) is amended to read as follows:

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

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales and exchanges occurring after the date of the enactment of this Act.

Subtitle F—Other Provisions

SEC. 1351. INCREASE IN VOLUME CAP ON PRIVATE ACTIVITY BONDS.

(a) IN GENERAL.—Subsection (d) of section 146 (relating to volume cap) is amended by striking paragraph (2), by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively, and by striking paragraph (1) and inserting the following new paragraph:

"(1) IN GENERAL.—The State ceiling applicable to any State for any calendar year shall be the greater of—

"(A) an amount equal to $75 multiplied by the State population, or

"(B) $225,000,000.

Subparagraph (B) shall not apply to any possession of the United States.".

(b) CONFORMING AMENDMENT.—Sections 25(f)(3) and 42(h)(3)(E)(iii) are each amended by striking "section 146(d)(3)(C)" and inserting "section 146(d)(2)(C)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years after 1999.

SEC. 1352. TAX TREATMENT OF ALASKA NATIVE SETTLEMENT TRUSTS.

(a) IN GENERAL.—Subpart A of part I of subchapter J of chapter 1 (relating to general rules for taxation of trusts and estates) is amended by adding at the end the following new section:

"SEC. 646. ELECTING ALASKA NATIVE SETTLEMENT TRUSTS.

"(a) IN GENERAL.—Except as otherwise provided in this section, the provisions of this subchapter and section 1(e) shall apply to all Settlement Trusts.

"(b) BENEFICIARIES OF ELECTING TRUST NOT TAXED ON CONTRIBUTIONS.—

“(1) IN GENERAL.—In the case of a Settlement Trust for which an election under paragraph (2) is in effect for any taxable year, no amount shall be includible in the gross income of a beneficiary of the Settlement Trust by reason of a contribution to the Settlement Trust made during such taxable year.

“(2) ONE-TIME ELECTION.—

“(A) IN GENERAL.—A Settlement Trust may elect to have the provisions of this section apply to the trust and its beneficiaries.

“(B) TIME AND METHOD OF ELECTION.—An election under subparagraph (A) shall be made—

“(i) before the due date (including extensions) for filing the Settlement Trust's return of tax for the 1st taxable year of the Settlement Trust ending after December 31, 1999, and

“(ii) by attaching to such return of tax a statement specifically providing for such election.

“(C) PERIOD ELECTION IN EFFECT.—Except as provided in paragraph (3), an election under subparagraph (A)—

“(i) shall apply to the 1st taxable year described in subparagraph (B)(i) and all subsequent taxable years, and

“(ii) may not be revoked once it is made.

“(c) SPECIAL RULES WHERE TRANSFER RESTRICTIONS MODIFIED.—

“(1) TRANSFER OF BENEFICIAL INTERESTS.—If, at any time, a beneficial interest in a Settlement Trust may be disposed of to a person in a manner which would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(h)) if the interest were Settlement Common Stock—

“(A) no election may be made under subsection (b)(2) with respect to such trust, and

“(B) if such an election is in effect as of such time, such election shall cease to apply for purposes of subsection (b)(1) as of the 1st day of the taxable year following the taxable year in which such disposition is first permitted.

“(2) STOCK IN CORPORATION.—If—

“(A) the Settlement Common Stock in any Native Corporation which transferred assets to a Settlement Trust making an election under subsection (b)(2) may be disposed of to a person in a manner not permitted by section 7(h) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(h)), and

“(B) at any time after such disposition of stock is first permitted, such corporation transfers assets to such trust,

subparagraph (B) of paragraph (1) shall be applied to such trust on and after the date of the transfer in the same manner as if the trust permitted dispositions of beneficial interests in the trust in a manner not permitted by such section 7(h).

“(c) TAX TREATMENT OF DISTRIBUTIONS TO BENEFICIARIES.—

“(1) IN GENERAL.—In the case of a Settlement Trust for which an election under subsection (b)(2) is in effect for any taxable year, any distribution to a beneficiary shall be included in gross income of the beneficiary as ordinary income to the extent such distribution reduces the earnings and profits of any Native Corporation making a contribution to such Trust.

“(2) EARNINGS AND PROFITS.—The earnings and profits of any Native Corporation making a contribution to a Settlement Trust shall not be reduced on account thereof at the time of such contribution, but such earnings and profits shall be reduced (up to the amount of such contribution) as distributions are thereafter made by the Settlement Trust which exceed the sum of—

“(A) such Trust's total undistributed net income for all prior years during which an election under subsection (b)(2) is in effect, and

“(B) such Trust's distributable net income.

“(d) DEFINITIONS.—For purposes of this section—

“(1) NATIVE CORPORATION.—The term ‘Native Corporation’ has the meaning given such term by section 3(m) of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m)).

“(2) SETTLEMENT TRUST.—The term ‘Settlement Trust’ means a trust which constitutes a Settlement Trust under section 39 of the Alaska Native Claims Settlement Act (43 U.S.C. 1629e).”

(b) WITHHOLDING ON DISTRIBUTIONS BY ELECTING ANCSA SETTLEMENT TRUSTS.—Section 3402 is amended by adding at the end the following new subsection:

“(t) TAX WITHHOLDING ON DISTRIBUTIONS BY ELECTING ANCSA SETTLEMENT TRUSTS.—

"(1) IN GENERAL.—Any Settlement Trust (as defined in section 646(d)) for which an election under section 646(b)(2) is in effect (in this subsection referred to as an 'electing trust') and which makes a payment to any beneficiary which is includable in gross income under section 646(c) shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

"(2) EXCEPTION.—The tax imposed by paragraph (1) shall not apply to any payment to the extent that such payment, when annualized, does not exceed an amount equal to the amount in effect under section 6012(a)(1)(A)(i) for taxable years beginning in the calendar year in which the payment is made.

"(3) ANNUALIZED TAX.—For purposes of paragraph (1), the term 'annualized tax' means, with respect to any payment, the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of 31 percent) on an amount of taxable income equal to the excess of—

"(A) the annualized amount of such payment, over

"(B) the amount determined under paragraph (2).

"(4) ANNUALIZATION.—For purposes of this subsection, amounts shall be annualized in the manner prescribed by the Secretary.

"(5) ALTERNATE WITHHOLDING PROCEDURES.—At the election of an electing trust, the tax imposed by this subsection on any payment made by such trust shall be determined in accordance with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

"(6) COORDINATION WITH OTHER SECTIONS.—For purposes of this chapter and so much of subtitle F as relates to this chapter, payments which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee."

(c) REPORTING.—Section 6041 is amended by adding at the end the following new subsection:

"(f) APPLICATION TO ALASKA NATIVE SETTLEMENT TRUSTS.—In the case of any distribution from a Settlement Trust (as defined in section 646(d)) to a beneficiary which is includable in gross income under section 646(c), this section shall apply, except that—

"(1) this section shall apply to such distribution without regard to the amount thereof,

"(2) the Settlement Trust shall include on any return or statement required by this section information as to the character of such distribution (if applicable) and the amount of tax imposed by chapter 1 which has been deducted and withheld from such distribution, and

"(3) the filing of any return or statement required by this section shall satisfy any requirement to file any other form or schedule under this title with respect to distributive share information (including any form or schedule to be included with the trust's tax return)."

(d) CLERICAL AMENDMENT.—The table of sections for subpart A of part I of subchapter J of chapter 1 is amended by adding at the end the following new item:

"Sec. 646. Electing Alaska Native Settlement Trusts."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of Settlement Trusts ending after December 31, 1999, and to contributions to such trusts after such date.

SEC. 1353. INCREASE IN THRESHOLD FOR JOINT COMMITTEE REPORTS ON REFUNDS AND CREDITS.

(a) GENERAL RULE.—Subsections (a) and (b) of section 6405 are each amended by striking "$1,000,000" and inserting "$2,000,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act, except that such amendment shall not apply with respect to any refund or credit with respect to a report that has been made before such date of enactment under section 6405 of the Internal Revenue Code of 1986.

SEC. 1354. CLARIFICATION OF DEPRECIATION STUDY.

Paragraph (1) of section 2022 of the Tax and Trade Relief Extension Act of 1998 (Public Law 105–277; 112 Stat. 2681-903) is amended by inserting after "1986," the following: "including such periods and methods applicable to section 1250 property used in connection with a franchise (within the meaning of section 1253) and owned by the franchisee,".

Subtitle G—Tax Court Provisions

SEC. 1361. TAX COURT FILING FEE IN ALL CASES COMMENCED BY FILING PETITION.

(a) IN GENERAL.—Section 7451 (relating to fee for filing a Tax Court petition) is amended by striking all that follows "petition" and inserting a period.

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 1362. EXPANDED USE OF TAX COURT PRACTICE FEE.

Subsection (b) of section 7475 (relating to use of fees) is amended by inserting before the period at the end "and to provide services to pro se taxpayers".

SEC. 1363. CONFIRMATION OF AUTHORITY OF TAX COURT TO APPLY DOCTRINE OF EQUITABLE RECOUPMENT.

(a) CONFIRMATION OF AUTHORITY OF TAX COURT TO APPLY DOCTRINE OF EQUITABLE RECOUPMENT.—Subsection (b) of section 6214 (relating to jurisdiction over other years and quarters) is amended by adding at the end the following new sentence: "Notwithstanding the preceding sentence, the Tax Court may apply the doctrine of equitable recoupment to the same extent that it is available in civil tax cases before the district courts of the United States and the United States Court of Federal Claims.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to any action or proceeding in the Tax Court with respect to which a decision has not become final (as determined under section 7481 of the Internal Revenue Code of 1986) as of the date of the enactment of this Act.

Subtitle H—Tax-Free Transfer of Bottled Distilled Spirits to Bonded Dealers

SEC. 1371. TAX-FREE TRANSFER OF BOTTLED DISTILLED SPIRITS FROM DISTILLED SPIRITS PLANT TO BONDED DEALER.

(a) DOMESTIC BOTTLED DISTILLED SPIRITS.—

(1) IN GENERAL.—The last sentence of section 5212 is amended by inserting before the period "and shall not apply to bottled distilled spirits transferred from a distilled spirits plant (other than a bonded dealer) to a bonded dealer if the proprietor of such plant notifies (in such form and manner as the Secretary prescribes by regulations) such bonded dealer of the amount of tax determined on the distilled spirits so transferred".

(2) TRANSFER OF LIABILITY CONTINGENT ON FURNISHING OF CERTAIN INFORMATION.—Paragraph (2) of section 5005(c) is amended by adding at the end the following new sentence: "In the case of a transfer of bottled distilled spirits from a distilled spirits plant to a bonded dealer, the preceding provisions of this subsection shall apply only to the extent of the amount specified by the proprietor of such plant in accordance with the last sentence of section 5212."

(b) COMPARABLE TREATMENT FOR IMPORTED BOTTLED DISTILLED SPIRITS.—Subsection (a) of section 5232 is amended to read as follows:

"(a) TRANSFER TO DISTILLED SPIRITS PLANT WITHOUT PAYMENT OF TAX.—

"(1) IN GENERAL.—Distilled spirits imported or brought into the United States in bulk containers may, under such regulations as the Secretary shall prescribe, be withdrawn from customs custody and transferred in such bulk containers or by pipeline to the bonded premises of a distilled spirits plant without payment of the internal revenue tax imposed on such distilled spirits by section 5001.

"(2) IMPORTED BOTTLED DISTILLED SPIRITS.—The restriction under paragraph (1) to transfers in bulk or by pipeline shall not apply to bottled distilled spirits transferred from customs custody to a bonded dealer if the proprietor of the customs bonded warehouse notifies (in such form and manner as the Secretary prescribes by regulations) such bonded dealer of the amount of tax determined on the distilled spirits so transferred.

"(3) TRANSFER OF LIABILITY.—The person operating the bonded premises of the distilled spirits plant to which such spirits are transferred shall become liable for the tax on distilled spirits withdrawn from customs custody under this section upon release of the spirits from customs custody, and the importer, or the person bringing such distilled spirits into the United States, shall thereupon be relieved of his liability for such tax. In the case of a transfer of bottled distilled spirits from a customs bonded warehouse to a bonded dealer, the preceding sentence shall apply only to the extent of the amount specified by the proprietor of such warehouse in accordance with paragraph (2)."

(c) PENALTY FOR FALSE OR ERRONEOUS INFORMATION TO BONDED DEALERS.—

(1) IN GENERAL.—Section 5684 is amended by redesignating subsections (b) and (c) as subsections (c) and (d), respectively, and inserting after subsection (a) the following new subsection:

"(b) FALSE OR ERRONEOUS INFORMATION TO BONDED DEALERS.—Any distilled spirits plant or importer which furnishes false or erroneous information to a bonded dealer relating to the amount of tax determined on a product, as required under sections 5212 and 5232, shall, in addition to any other penalty imposed by this title, be liable for a penalty equal to the greater of $1,000 or 5 times the amount of additional tax due on the product."

(2) CONFORMING AMENDMENT.—Subsection (c) of section 5684, as redesignated by paragraph (1), is amended by striking "subsection (a)" and inserting "subsections (a) and (b)".

SEC. 1372. ESTABLISHMENT OF DISTILLED SPIRITS PLANT.

Section 5171 is amended—

(1) by striking from subsection (a) "or processor" and inserting "processor, or bonded dealer", and

(2) by striking from subsection (b) "or both." and inserting "as a bonded dealer, or as any combination thereof."

SEC. 1373. DISTILLED SPIRITS PLANTS.

Section 5178(a) is amended by adding at the end the following new paragraph:

"(5) BONDED DEALER OPERATIONS.—Any person establishing a distilled spirits plant to conduct operations as a bonded dealer may, as described in the application for registration—

"(A) store distilled spirits in any approved container on the bonded premises of such plant, and

"(B) under such regulations as the Secretary shall prescribe, store taxpaid distilled spirits, beer and wine and such other beverages and items (products) not subject to tax or regulation under this title on such bonded premises."

SEC. 1374. BONDED DEALERS.

(a) IN GENERAL.—Subpart A of part I of subchapter A of chapter 51 (relating to distilled spirits) is amended by adding at the end the following new section:

"SEC. 5011. ELECTION TO BE TREATED AS BONDED DEALER.

"(a) ELECTION.—

"(1) IN GENERAL.—Any wholesale dealer, or any control State entity, may elect to be treated as a bonded dealer if such wholesale dealer or entity sells bottled distilled spirits exclusively to 1 or more of the following: wholesale dealers in liquor, independent retail dealers, or other bonded dealers.

"(2) ELECTION BY CERTAIN ENTITIES NOT PERMITTED.—

"(A) RETAIL DEALERS.—Except in the case of a control State entity, the election under paragraph (1) may not be made by a retail dealer in liquor.

"(B) SMALL DEALERS.—The election under paragraph (1) may not be made by any person who is part of a group treated as a single taxpayer under section 5061(e)(3) if the gross receipts of such group from the sale of distilled spirits during the 12-month period prior to making such election is less than $10,000,000.

"(3) CONTROL STATE ENTITIES PERMITTED TO SELL TO RELATED RETAIL DEALERS.—In the case of a control State entity, paragraph (1) shall be applied by substituting 'retail dealers' for 'independent retail dealers'.

"(b) INDEPENDENT RETAIL DEALER.—For purposes of subsection (a), the term 'independent retail dealer' means, with respect to a bonded dealer, any retail dealer if—

"(1) the bonded dealer does not have a greater than 10 percent ownership interest in, or control of, the retail dealer,

"(2) the retail dealer does not have a greater than 10 percent ownership interest in, or control of, the bonded dealer, and

"(3) no person has a greater than 10 percent ownership interest in, or control of, both the bonded and retail dealer.

For purposes of this subsection, rules similar to the rules of section 318 shall apply.

"(c) INVENTORY OWNED AT TIME OF ELECTION.—Any bottled distilled spirits in the inventory of any person electing under this section to be treated as a bonded dealer shall not be subject to additional Federal excise tax on such spirits as a result of the election being in effect to the extent that the bonded dealer establishes that the

Federal excise tax previously has been determined and paid at the time the election becomes effective.

"(d) REVOCATION OF ELECTION.—The election made under this section may be revoked by the bonded dealer at any time, but once revoked shall not be made again without the consent of the Secretary. When the election is revoked, the bonded dealer shall immediately withdraw the distilled spirits on determination of tax in accordance with a tax payment procedure established by the Secretary.

"(e) APPROVAL OF APPLICATION.—Any application under section 5171(c) submitted by a person electing to be treated as a bonded dealer shall be subject to the same conditions as an application for a basic permit under section 204(a)(2) of title 27 of the United States Code (the Federal Alcohol Administration Act) and shall be accorded notice and hearing as described in section 204(b) of such title 27.

"(f) ADDITIONAL TAX.—

"(1) IN GENERAL.—In addition to any other tax imposed by this chapter, there is hereby imposed on each bonded dealer a tax for each semimonthly period under section 5061(d) for which an election under this section is in effect for such dealer.

"(2) AMOUNT OF TAX.—The tax imposed by this subsection for any semimonthly period shall be equal to 1.5 percent of the liability for tax under sections 5001 and 7652 of such dealer for such semimonthly period.

"(3) PAYMENT OF TAX.—The tax imposed by this subsection shall be paid with the return of tax for such semimonthly period.

"(4) TAXPAYERS NOT PAYING ON SEMIMONTHLY BASIS.—If the taxes referred to in paragraph (2) are not paid on the basis of semimonthly periods, this subsection shall be applied by substituting the time such taxes are required to be paid for such periods.

"(5) TERMINATION.—The tax imposed by this subsection shall not apply to any semimonthly period ending after December 31, 2010."

(b) CONFORMING AMENDMENTS.—

(1) Section 5002(a) is amended by adding the end the following new paragraphs:

"(16) BONDED DEALER.—The term 'bonded dealer' means any person who has elected under section 5011 to be treated as a bonded dealer.

"(17) CONTROL STATE ENTITY.—The term 'control State entity' means a State or a political subdivision of a State in which only the State or a political subdivision thereof is allowed under applicable law to perform distilled spirit operations, or any instrumentality of such a State or political subdivision."

(2) The table of sections of subpart A of part I of subchapter A of chapter 51 and the table of contents of subtitle E are each amended by adding at the appropriate places:

"Sec. 5011. Election to be treated as bonded dealer."

SEC. 1375. TIME FOR COLLECTING TAX ON DISTILLED SPIRITS.

(a) IN GENERAL.—Section 5061(d) is amended by adding at the end the following new paragraph:

"(6) ADVANCED PAYMENT OF DISTILLED SPIRITS TAX BY BONDED DEALERS.—Notwithstanding the preceding provisions of this subsection, in the case of any tax imposed by section 5001, 5011(f), or 7652 with respect to a bonded dealer who has an election under section 5011 in effect on September 20 of any year, any payment which would, but for this paragraph, be due in October or November of that year, shall be made on such September 20. No penalty or interest shall be imposed for the period after such September 20 and before the due date for such payment (determined without regard to this paragraph) to the extent that the tax due exceeds the payment which would have been due in such October and November had the election under section 5011 been in effect."

(b) PAYMENT BY ELECTRONIC FUND TRANSFER.—Section 5061(e)(1) is amended by inserting "and any bonded dealer," after "respectively,".

SEC. 1376. EXEMPTION FROM OCCUPATIONAL TAX NOT APPLICABLE.

Section 5113(a) is amended by adding at the end the following new sentence: "The exemption under this subsection shall not apply to a proprietor of a distilled spirits plant whose premises are used for operations of a bonded dealer."

SEC. 1377. TECHNICAL, CONFORMING, AND CLERICAL AMENDMENTS.

(a) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Section 5003(3) is amended by striking "certain".

(2) Subsection (a) of section 5214 is amended by inserting "(other than a bonded dealer)" after "distilled spirits plant".

(3) Section 5362(b)(5) is amended by adding at the end the following new sentence: "This term shall not apply to premises used for operations as a bonded dealer.".

(4) Section 5551(a) is amended by inserting "bonded dealer," after "processor," each place it appears.

(5) Section 5601(a) (2), (3), (4), (5), and (b) are amended by inserting ", bonded dealer" before "or processor" each place it appears.

(6) Section 5602 is amended—

(A) by inserting ", warehouseman, processor, or bonded dealer" after "distiller", and

(B) by inserting "or possessed" after "distilled".

(7) Sections 5180 and 5681 are repealed.

(b) CLERICAL AMENDMENTS.—

(1) The table of sections for subchapter B of chapter 51 is amended by striking the item relating to section 5180.

(2) The table of sections for part IV of subchapter J of chapter 51 is amended by striking the item relating to section 5681.

SEC. 1378. COOPERATIVE AGREEMENTS.

(a) STUDY.—The Secretary of the Treasury shall study and report to Congress concerning possible administrative efficiencies which could inure to the benefit of the Federal Government of cooperative agreements with States regarding the collection of distilled spirits excise taxes. Such study shall include, but not be limited to, possible benefits of the standardization of forms and collection procedures and shall be submitted 1 year after the date of the enactment of this Act.

(b) COOPERATIVE AGREEMENT.—The Secretary of the Treasury is authorized to enter into such cooperative agreements with States which the Secretary deems will increase the efficient collection of distilled spirits excise taxes.

SEC. 1379. EFFECTIVE DATE.

(a) IN GENERAL.—Except as otherwise provided in this section, the amendments made by this subtitle shall take effect at the beginning of the first calendar quarter that begins after one hundred and twenty days following enactment.

(b) AUTHORITY TO ESTABLISH DISTILLED SPIRITS PLANT.—

(1) IN GENERAL.—The amendments made by section 1372 of this Act shall take effect on the date of enactment of this Act.

(2) DEEMED QUALIFICATION IN CERTAIN CASES.—Each wholesale dealer—

(A) who is required to file an application for registration under section 5171(c) of the Internal Revenue Code of 1986,

(B) whose operations are required to be covered by a basic permit under the Federal Alcohol Administration Act (27 U.S.C. 203 and 204) and who has received such a basic permit as an importer, wholesaler, or both, and

(C) has obtained a bond required under this subchapter,

shall be treated as having such application approved as of the first day of the first calendar quarter that begins at least 9 months after the application is filed until such time as the Secretary or the Secretary's delegate takes final action on such application.

(3) CONTROL STATE ENTITIES.—In the case of a control State entity, paragraph (2) shall be applied without regard to subparagraph (B) thereof.

(c) EQUITABLE TREATMENT OF BONDED DEALERS USING LIFO INVENTORY.—The Secretary of the Treasury or the Secretary's delegate shall provide such rules as may be necessary to assure that taxpayers using the last-in first-out method of inventory valuation do not suffer a recapture of their LIFO reserve by reason of making the election under section 5011 of such Code or by reason of operating a bonded wine cellar as permitted by section 5351 of such Code.

SEC. 1380. STUDY.

Not later than June 1, 2002, the Secretary of the Treasury or the Secretary's delegate shall prepare and submit to the Congress a report—

(1) on the extent to which (if any) there has been a decrease in compliance with the provisions of chapter 51 of the Internal Revenue Code of 1986 by reason of the amendments made by this subtitle, and

(2) on any particular compliance issues in applying the credit allowable by section 5010 of such Code under the amendments made by this subtitle.

TITLE XIV—EXTENSIONS OF EXPIRING PROVISIONS

SEC. 1401. RESEARCH CREDIT.

(a) EXTENSION.—

(1) IN GENERAL.—Paragraph (1) of section 41(h) (relating to termination) is amended—

(A) by striking "June 30, 1999" and inserting "June 30, 2004", and

(B) by striking the material following subparagraph (B).

(2) TECHNICAL AMENDMENT.—Subparagraph (D) of section 45C(b)(1) is amended by striking "June 30, 1999" and inserting "June 30, 2004".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to amounts paid or incurred after June 30, 1999.

(b) INCREASE IN PERCENTAGES UNDER ALTERNATIVE INCREMENTAL CREDIT.—

(1) IN GENERAL.—Subparagraph (A) of section 41(c)(4) is amended—

(A) by striking "1.65 percent" and inserting "2.65 percent",

(B) by striking "2.2 percent" and inserting "3.2 percent", and

(C) by striking "2.75 percent" and inserting "3.75 percent".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after June 30, 1999.

SEC. 1402. SUBPART F EXEMPTION FOR ACTIVE FINANCING INCOME.

(a) IN GENERAL.—Sections 953(e)(10) and 954(h)(9) are each amended—

(1) by striking "the first taxable year" and inserting "taxable years", and

(2) by striking "January 1, 2000" and inserting "January 1, 2005".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1403. TAXABLE INCOME LIMIT ON PERCENTAGE DEPLETION FOR MARGINAL PRODUCTION.

(a) IN GENERAL.—Subparagraph (H) of section 613A(c)(6) is amended by striking "January 1, 2000" and inserting "January 1, 2005".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1404. WORK OPPORTUNITY CREDIT AND WELFARE-TO-WORK CREDIT.

(a) TEMPORARY EXTENSION.—Sections 51(c)(4)(B) and 51A(f) (relating to termination) are each amended by striking "June 30, 1999" and inserting "December 31, 2001".

(b) CLARIFICATION OF FIRST YEAR OF EMPLOYMENT.—Paragraph (2) of section 51(i) is amended by striking "during which he was not a member of a targeted group".

(c) ELECTRONIC FILING OF CERTIFICATION.—Not later than July 1, 2001, the Secretary of the Treasury or the Secretary's delegate shall provide an electronic format by which employers may submit requests to designated local agencies (as defined in section 51(d)(11) of the Internal Revenue Code of 1986) for certifications that individuals are members of targeted groups for purposes of section 51 of such Code.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to individuals who begin work for the employer after June 30, 1999.

TITLE XV—REVENUE OFFSETS

SEC. 1501. RETURNS RELATING TO CANCELLATIONS OF INDEBTEDNESS BY ORGANIZATIONS LENDING MONEY.

(a) IN GENERAL.—Paragraph (2) of section 6050P(c) (relating to definitions and special rules) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by inserting after subparagraph (C) the following new subparagraph:

"(D) any organization a significant trade or business of which is the lending of money."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to discharges of indebtedness after December 31, 1999.

SEC. 1502. EXTENSION OF INTERNAL REVENUE SERVICE USER FEES.

(a) IN GENERAL.—Chapter 77 (relating to miscellaneous provisions) is amended by adding at the end the following new section:

"SEC. 7527. INTERNAL REVENUE SERVICE USER FEES.

"(a) GENERAL RULE.—The Secretary shall establish a program requiring the payment of user fees for—

"(1) requests to the Internal Revenue Service for ruling letters, opinion letters, and determination letters, and

"(2) other similar requests.

"(b) PROGRAM CRITERIA.—

"(1) IN GENERAL.—The fees charged under the program required by subsection (a)—

"(A) shall vary according to categories (or subcategories) established by the Secretary,

"(B) shall be determined after taking into account the average time for (and difficulty of) complying with requests in each category (and subcategory), and

"(C) shall be payable in advance.

"(2) EXEMPTIONS, ETC.—The Secretary shall provide for such exemptions (and reduced fees) under such program as the Secretary determines to be appropriate.

"(3) AVERAGE FEE REQUIREMENT.—The average fee charged under the program required by subsection (a) shall not be less than the amount determined under the following table:

"Category	Average Fee
Employee plan ruling and opinion	$250
Exempt organization ruling	$350
Employee plan determination	$300
Exempt organization determination	$275
Chief counsel ruling	$200.

"(c) TERMINATION.—No fee shall be imposed under this section with respect to requests made after September 30, 2009."

(b) CONFORMING AMENDMENTS.—

(1) The table of sections for chapter 77 is amended by adding at the end the following new item:

"Sec. 7527. Internal Revenue Service user fees."

(2) Section 10511 of the Revenue Act of 1987 is repealed.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to requests made after the date of the enactment of this Act.

SEC. 1503. LIMITATIONS ON WELFARE BENEFIT FUNDS OF 10 OR MORE EMPLOYER PLANS.

(a) BENEFITS TO WHICH EXCEPTION APPLIES.—Section 419A(f)(6)(A) (relating to exception for 10 or more employer plans) is amended to read as follows:

"(A) IN GENERAL.—This subpart shall not apply to a welfare benefit fund which is part of a 10 or more employer plan if the only benefits provided through the fund are 1 or more of the following:

"(i) Medical benefits.

"(ii) Disability benefits.

"(iii) Group term life insurance benefits which do not provide for any cash surrender value or other money that can be paid, assigned, borrowed, or pledged for collateral for a loan.

The preceding sentence shall not apply to any plan which maintains experience-rating arrangements with respect to individual employers."

(b) LIMITATION ON USE OF AMOUNTS FOR OTHER PURPOSES.—Section 4976(b) (defining disqualified benefit) is amended by adding at the end the following new paragraph:

"(5) SPECIAL RULE FOR 10 OR MORE EMPLOYER PLANS EXEMPTED FROM PREFUNDING LIMITS.—For purposes of paragraph (1)(C), if—

"(A) subpart D of part I of subchapter D of chapter 1 does not apply by reason of section 419A(f)(6) to contributions to provide 1 or more welfare benefits through a welfare benefit fund under a 10 or more employer plan, and

"(B) any portion of the welfare benefit fund attributable to such contributions is used for a purpose other than that for which the contributions were made,

then such portion shall be treated as reverting to the benefit of the employers maintaining the fund."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions paid or accrued after June 9, 1999, in taxable years ending after such date.

SEC. 1504. INCREASE IN ELECTIVE WITHHOLDING RATE FOR NONPERIODIC DISTRIBUTIONS FROM DEFERRED COMPENSATION PLANS.

(a) IN GENERAL.—Section 3405(b)(1) (relating to withholding) is amended by striking '10 percent' and inserting '15 percent'.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to distributions after December 31, 1999.

SEC. 1505. CONTROLLED ENTITIES INELIGIBLE FOR REIT STATUS.

(a) IN GENERAL.—Subsection (a) of section 856 (relating to definition of real estate investment trust) is amended by striking "and" at the end of paragraph (6), by redesignating paragraph (7) as paragraph (8), and by inserting after paragraph (6) the following new paragraph:

"(7) which is not a controlled entity (as defined in subsection (l)); and".

(b) CONTROLLED ENTITY.—Section 856 is amended by adding at the end the following new subsection:

"(l) CONTROLLED ENTITY.—

"(1) IN GENERAL.—For purposes of subsection (a)(7), an entity is a controlled entity if, at any time during the taxable year, one person (other than a qualified entity)—

"(A) in the case of a corporation, owns stock—

"(i) possessing at least 50 percent of the total voting power of the stock of such corporation, or

"(ii) having a value equal to at least 50 percent of the total value of the stock of such corporation, or

"(B) in the case of a trust, owns beneficial interests in the trust which would meet the requirements of subparagraph (A) if such interests were stock.

"(2) QUALIFIED ENTITY.—For purposes of paragraph (1), the term 'qualified entity' means—

"(A) any real estate investment trust, and

"(B) any partnership in which one real estate investment trust owns at least 50 percent of the capital and profits interests in the partnership.

"(3) ATTRIBUTION RULES.—For purposes of this paragraphs (1) and (2)—

"(A) IN GENERAL.—Rules similar to the rules of subsections (d)(5) and (h)(3) shall apply.

"(B) STAPLED ENTITIES.—A group of entities which are stapled entities (as defined in section 269B(c)(2)) shall be treated as 1 person.

"(4) EXCEPTION FOR CERTAIN NEW REITS.—

"(A) IN GENERAL.—The term 'controlled entity' shall not include an incubator REIT.

"(B) INCUBATOR REIT.—A corporation shall be treated as an incubator REIT for any taxable year during the eligibility period if it meets all the following requirements for such year:

"(i) The corporation elects to be treated as an incubator REIT.

"(ii) The corporation has only voting common stock outstanding.

"(iii) Not more than 50 percent of the corporation's real estate assets consist of mortgages.

"(iv) From not later than the beginning of the last half of the second taxable year, at least 10 percent of the corporation's capital is provided by lenders or equity investors who are unrelated to the corporation's largest shareholder.

"(v) The directors of the corporation adopt a resolution setting forth an intent to engage in a going public transaction.

No election may be made with respect to any REIT if an election under this subsection was in effect for any predecessor of such REIT.

"(C) ELIGIBILITY PERIOD.—The eligibility period (for which an incubator REIT election can be made) begins with the REIT's second taxable year and ends at the close of the REIT's third taxable year, but, subject to the following rules, it may be extended for an additional 2 taxable years if the REIT so elects:

"(i) A REIT cannot elect to extend the eligibility period unless it agrees that, if it does not engage in a going public transaction by the end of the extended eligibility period, it shall pay Federal income taxes for the 2 years of the extended eligibility period as if it had not made an incubator REIT election and had ceased to qualify as a REIT for those 2 taxable years.

"(ii) In the event the corporation ceases to be treated as a REIT by operation of clause (i), the corporation shall file any appropriate amended returns reflecting the change in status within 3 months of the close of the extended eligibility period. Interest would be payable but, unless there was a finding under subparagraph (D), no substantial underpayment penalties shall be imposed. The corporation shall, at the same time, also notify its shareholders and any other persons whose tax position is, or may reasonably be expected to be, affected by the change in status so they also may file any appropriate amended returns to conform their tax treatment consistent with the corporation's loss of REIT status. The Secretary shall provide appropriate regulations setting forth transferee liability and other provisions to ensure collection of tax and the proper administration of this provision.

"(iii) Clause (i) and (ii) shall not apply if the corporation allows its incubator REIT status to lapse at the end of the initial 2-year eligibility period without engaging in a going public transaction, provided the corporation satisfies the requirements of the closely-held test commencing with its fourth taxable year. In such a case, the corporation's directors may still be liable for the penalties described in subparagraph (D) during the eligibility period.

"(D) SPECIAL PENALTIES.—If the Secretary determines that an incubator REIT election was filed for a principal purpose other than as part of a reasonable plan to undertake a going public transaction, an excise tax of $20,000 would be imposed on each of the corporation's directors for each taxable year for which an election was in effect.

"(E) GOING PUBLIC TRANSACTION.—For purposes of this paragraph, a going public transaction means—

"(i) a public offering of shares of the stock of the incubator REIT;

"(ii) a transaction, or series of transactions, that results in the stock of the incubator REIT being regularly traded on an established securities market and that results in at least 50 percent of such stock being held by shareholders who are unrelated to persons who held such stock before it began to be so regularly traded; or

"(iii) any transaction resulting in ownership of the REIT by 200 or more persons (excluding the largest single shareholder) who in the aggregate own at least 50 percent of the stock of the REIT.

For the purposes of this subparagraph, the rules of paragraph (3) shall apply in determining the ownership of stock.

"(F) DEFINITIONS.—The term 'established securities market' shall have the meaning set forth in the regulations under section 897."

(c) CONFORMING AMENDMENT.—Paragraph (2) of section 856(h) is amended by striking "and (6)" each place it appears and inserting ", (6), and (7)".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years ending after July 12, 1999.

(2) EXCEPTION FOR EXISTING CONTROLLED ENTITIES.—The amendments made by this section shall not apply to any entity which is a controlled entity (as defined in section 856(l) of the Internal Revenue Code of 1986, as added by this section) as of July 12, 1999, which is a real estate investment trust for the taxable year which includes such date, and which has significant business assets or activities as of such date.

SEC. 1506. TREATMENT OF GAIN FROM CONSTRUCTIVE OWNERSHIP TRANSACTIONS.

(a) IN GENERAL.—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by inserting after section 1259 the following new section:

"SEC. 1260. GAINS FROM CONSTRUCTIVE OWNERSHIP TRANSACTIONS.

"(a) IN GENERAL.—If the taxpayer has gain from a constructive ownership transaction with respect to any financial asset and such gain would (without regard to this section) be treated as a long-term capital gain—

"(1) such gain shall be treated as ordinary income to the extent that such gain exceeds the net underlying long-term capital gain, and

"(2) to the extent such gain is treated as a long-term capital gain after the application of paragraph (1), the determination of the capital gain rate (or rates) applicable to such gain under section 1(h) shall be determined on the basis of the respective rate (or rates) that would have been applicable to the net underlying long-term capital gain.

"(b) INTEREST CHARGE ON DEFERRAL OF GAIN RECOGNITION.—

"(1) IN GENERAL.—If any gain is treated as ordinary income for any taxable year by reason of subsection (a)(1), the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under paragraph (2) with respect to each prior taxable year during any portion of which the constructive ownership transaction was open. Any amount payable under this paragraph shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during such taxable year.

"(2) AMOUNT OF INTEREST.—The amount of interest determined under this paragraph with respect to a prior taxable year is the amount of interest which would have been imposed under section 6601 on the underpayment of tax for such year which would have resulted if the gain (which is treated as ordinary income by reason of subsection (a)(1)) had been included in gross income in the taxable years in which it accrued (determined by treating the income as accruing at a constant rate equal to the applicable Federal rate as in effect on the day the transaction closed). The period during which such interest shall accrue shall end on the due date (without extensions) for the return of tax imposed by this chapter for the taxable year in which such transaction closed.

"(3) APPLICABLE FEDERAL RATE.—For purposes of paragraph (2), the applicable Federal rate is the applicable Federal rate determined under 1274(d) (compounded semiannually) which would apply to a debt instrument with a term equal to the period the transaction was open.

"(4) NO CREDITS AGAINST INCREASE IN TAX.—Any increase in tax under paragraph (1) shall not be treated as tax imposed by this chapter for purposes of determining—

"(A) the amount of any credit allowable under this chapter, or

"(B) the amount of the tax imposed by section 55.

"(c) FINANCIAL ASSET.—For purposes of this section—

"(1) IN GENERAL.—The term 'financial asset' means—

"(A) any equity interest in any pass-thru entity, and

"(B) to the extent provided in regulations—

"(i) any debt instrument, and

"(ii) any stock in a corporation which is not a pass-thru entity.

"(2) PASS-THRU ENTITY.—For purposes of paragraph (1), the term 'pass-thru entity' means—

"(A) a regulated investment company,

"(B) a real estate investment trust,

"(C) an S corporation,

"(D) a partnership,

"(E) a trust,

"(F) a common trust fund,

"(G) a passive foreign investment company (as defined in section 1297),

"(H) a foreign personal holding company, and

"(I) a foreign investment company (as defined in section 1246(b)).

"(d) CONSTRUCTIVE OWNERSHIP TRANSACTION.—For purposes of this section—

"(1) IN GENERAL.—The taxpayer shall be treated as having entered into a constructive ownership transaction with respect to any financial asset if the taxpayer—

"(A) holds a long position under a notional principal contract with respect to the financial asset,

"(B) enters into a forward or futures contract to acquire the financial asset,

"(C) is the holder of a call option, and is the grantor of a put option, with respect to the financial asset and such options have substantially equal strike prices and substantially contemporaneous maturity dates, or

"(D) to the extent provided in regulations prescribed by the Secretary, enters into 1 or more other transactions (or acquires 1 or more positions) that have substantially the same effect as a transaction described in any of the preceding subparagraphs.

"(2) EXCEPTION FOR POSITIONS WHICH ARE MARKED TO MARKET.—This section shall not apply to any constructive ownership transaction if all of the positions which are part of such transaction are marked to market under any provision of this title or the regulations thereunder.

"(3) LONG POSITION UNDER NOTIONAL PRINCIPAL CONTRACT.—A person shall be treated as holding a long position under a notional principal contract with respect to any financial asset if such person—

"(A) has the right to be paid (or receive credit for) all or substantially all of the investment yield (including appreciation) on such financial asset for a specified period, and

"(B) is obligated to reimburse (or provide credit for) all or substantially all of any decline in the value of such financial asset.

"(4) FORWARD CONTRACT.—The term 'forward contract' means any contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.

"(e) NET UNDERLYING LONG-TERM CAPITAL GAIN.—For purposes of this section, in the case of any constructive ownership transaction with respect to any financial asset, the term 'net underlying long-term capital gain' means the aggregate net capital gain that the taxpayer would have had if—

"(1) the financial asset had been acquired for fair market value on the date such transaction was opened and sold for fair market value on the date such transaction was closed, and

"(2) only gains and losses that would have resulted from the deemed ownership under paragraph (1) were taken into account.

The amount of the net underlying long-term capital gain with respect to any financial asset shall be treated as zero unless the amount thereof is established by clear and convincing evidence.

"(f) SPECIAL RULE WHERE TAXPAYER TAKES DELIVERY.—Except as provided in regulations prescribed by the Secretary, if a constructive ownership transaction is closed by reason of taking delivery, this section shall be applied as if the taxpayer had sold all the contracts, options, or other positions which are part of such transaction for fair market value on the closing date. The amount of gain recognized under the preceding sentence shall not exceed the amount of gain treated as ordinary income under subsection (a). Proper adjustments shall be made in the amount of any gain or loss subsequently realized for gain recognized and treated as ordinary income under this subsection.

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

"(1) to permit taxpayers to mark to market constructive ownership transactions in lieu of applying this section, and

"(2) to exclude certain forward contracts which do not convey substantially all of the economic return with respect to a financial asset."

(b) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter P of chapter 1 is amended by adding at the end the following new item:

"Sec. 1260. Gains from constructive ownership transactions.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transactions entered into after July 11, 1999.

SEC. 1507. TRANSFER OF EXCESS DEFINED BENEFIT PLAN ASSETS FOR RETIREE HEALTH BENEFITS.

(a) EXTENSION.—Paragraph (5) of section 420(b) (relating to expiration) is amended by striking "in any taxable year beginning after December 31, 2000" and inserting "made after September 30, 2009".

(b) APPLICATION OF MINIMUM COST REQUIREMENTS.—

(1) IN GENERAL.—Paragraph (3) of section 420(c) is amended to read as follows:

"(3) MINIMUM COST REQUIREMENTS.—

"(A) IN GENERAL.—The requirements of this paragraph are met if each group health plan or arrangement under which applicable health benefits are provided provides that the applicable employer cost for each taxable year during the cost maintenance period shall not be less than the higher of the applicable employer costs for each of the 2 taxable years immediately preceding the taxable year of the qualified transfer.

"(B) APPLICABLE EMPLOYER COST.—For purposes of this paragraph, the term 'applicable employer cost' means, with respect to any taxable year, the amount determined by dividing—

"(i) the qualified current retiree health liabilities of the employer for such taxable year determined—

"(I) without regard to any reduction under subsection (e)(1)(B), and

"(II) in the case of a taxable year in which there was no qualified transfer, in the same manner as if there had been such a transfer at the end of the taxable year, by

"(ii) the number of individuals to whom coverage for applicable health benefits was provided during such taxable year.

"(C) ELECTION TO COMPUTE COST SEPARATELY.—An employer may elect to have this paragraph applied separately with respect to individuals eligible for benefits under title XVIII of the Social Security Act at any time during the taxable year and with respect to individuals not so eligible.

"(D) COST MAINTENANCE PERIOD.—For purposes of this paragraph, the term 'cost maintenance period' means the period of 5 taxable years beginning with the taxable year in which the qualified transfer occurs. If a taxable year is in 2 or more overlapping cost maintenance periods, this paragraph shall be applied by taking into account the highest applicable employer cost required to be provided under subparagraph (A) for such taxable year."

(2) CONFORMING AMENDMENTS.—

(A) Clause (iii) of section 420(b)(1)(C) is amended by striking "benefits" and inserting "cost".

(B) Subparagraph (D) of section 420(e)(1) is amended by striking "and shall not be subject to the minimum benefit requirements of subsection (c)(3)" and inserting "or in calculating applicable employer cost under subsection (c)(3)(B)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to qualified transfers occurring after the date of the enactment of this Act.

SEC. 1508. MODIFICATION OF INSTALLMENT METHOD AND REPEAL OF INSTALLMENT METHOD FOR ACCRUAL METHOD TAXPAYERS.

(a) REPEAL OF INSTALLMENT METHOD FOR ACCRUAL BASIS TAXPAYERS.—

(1) IN GENERAL.—Subsection (a) of section 453 (relating to installment method) is amended to read as follows:

"(a) USE OF INSTALLMENT METHOD.—

"(1) IN GENERAL.—Except as otherwise provided in this section, income from an installment sale shall be taken into account for purposes of this title under the installment method.

"(2) ACCRUAL METHOD TAXPAYER.—The installment method shall not apply to income from an installment sale if such income would be reported under an accrual method of accounting without regard to this section. The preceding sentence shall not apply to a disposition described in subparagraph (A) or (B) of subsection (l)(2)."

(2) CONFORMING AMENDMENTS.—Sections 453(d)(1), 453(i)(1), and 453(k) are each amended by striking "(a)" each place it appears and inserting "(a)(1)".

(b) MODIFICATION OF PLEDGE RULES.—Paragraph (4) of section 453A(d) (relating to pledges, etc., of installment obligations) is amended by adding at the end the following: "A payment shall be treated as directly secured by an interest in an installment obligation to the extent an arrangement allows the taxpayer to satisfy all or a portion of the indebtedness with the installment obligation."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales or other dispositions occurring on or after the date of the enactment of this Act.

SEC. 1509. LIMITATION ON USE OF NONACCRUAL EXPERIENCE METHOD OF ACCOUNTING.

(a) IN GENERAL.—Section 448(d)(5) (relating to special rule for services) is amended—

(1) by inserting "in fields described in paragraph (2)(A)" after "services by such person", and

(2) by inserting "CERTAIN PERSONAL" before "SERVICES" in the heading.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer required by the amendments made by this section to change its method of accounting for its first taxable year ending after the date of the enactment of this Act—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account over a period (not greater than 4 taxable years) beginning with such first taxable year.

SEC. 1510. EXCLUSION OF LIKE-KIND EXCHANGE PROPERTY FROM NONRECOGNITION TREATMENT ON THE SALE OF A PRINCIPAL RESIDENCE.

(a) IN GENERAL.—Subsection (d) of section 121 (relating to the exclusion of gain from the sale of a principal residence) is amended by adding at the end the following new paragraph:

"(9) LIKE-KIND EXCHANGES.—Subsection (a) shall not apply to any sale or exchange of a residence if such residence was acquired by the taxpayer during the 5-year period ending on the date of such sale or exchange in an exchange in which any amount of gain was not recognized under section 1031."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to any sale or exchange of a principal residence after the date of the enactment of this Act.

TITLE XVI—TECHNICAL CORRECTIONS

SEC. 1601. AMENDMENTS RELATED TO TAX AND TRADE RELIEF EXTENSION ACT OF 1998.

(a) AMENDMENT RELATED TO SECTION 1004(b) OF THE ACT.—Subsection (d) of section 6104 is amended by adding at the end the following new paragraph:

"(6) APPLICATION TO NONEXEMPT CHARITABLE TRUSTS AND NONEXEMPT PRIVATE FOUNDATIONS.—The organizations referred to in paragraphs (1) and (2) of section 6033(d) shall comply with the requirements of this subsection relating to annual returns filed under section 6033 in the same manner as the organizations referred to in paragraph (1)."

(b) AMENDMENTS RELATED TO SECTION 4003 OF THE ACT.—

(1) Subsection (b) of section 4003 of the Tax and Trade Relief Extension Act of 1998 is amended by inserting "(7)(A)(i)(II)," after "(5)(A)(ii)(I),".

(2) Subparagraph (A) of section 9510(c)(1) is amended by striking "August 5, 1997" and inserting "October 21, 1998".

(c) VACCINE TAX AND TRUST FUND.—Sections 1503 and 1504 of the Vaccine Injury Compensation Program Modification Act (and the amendments made by such sections) are hereby repealed.

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the Tax and Trade Relief Extension Act of 1998 to which they relate.

SEC. 1602. AMENDMENTS RELATED TO INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998.

(a) AMENDMENT RELATED TO 1103 OF THE ACT.—Paragraph (6) of section 6103(k) is amended—

(1) by inserting "and an officer or employee of the Office of Treasury Inspector General for Tax Administration" after "internal revenue officer or employee", and

(2) by striking "INTERNAL REVENUE" in the heading and inserting "CERTAIN".

(b) AMENDMENT RELATED TO SECTION 3509 OF THE ACT.—Subparagraph (A) of section 6110(g)(5) is amended by inserting ", any Chief Counsel advice," after "technical advice memorandum".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the Internal Revenue Service Restructuring and Reform Act of 1998 to which they relate.

SEC. 1603. AMENDMENTS RELATED TO TAXPAYER RELIEF ACT OF 1997.

(a) AMENDMENT RELATED TO SECTION 302 OF THE ACT.—The last sentence of section 3405(e)(1)(B) is amended by inserting "(other than a Roth IRA)" after "individual retirement plan".

(b) AMENDMENTS RELATED TO SECTION 1072 OF THE ACT.—

(1) Clause (ii) of section 415(c)(3)(D) and subparagraph (B) of section 403(b)(3) are each amended by striking "section 125 or" and inserting "section 125, 132(f)(4), or".

(2) Paragraph (2) of section 414(s) is amended by striking "section 125, 402(e)(3)" and inserting "section 125, 132(f)(4), 402(e)(3)".

(c) AMENDMENT RELATED TO SECTION 1454 OF THE ACT.—Subsection (a) of section 7436 is amended by inserting before the period at the end of the first sentence "and the proper amount of employment tax under such determination".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the Taxpayer Relief of 1997 to which they relate.

SEC. 1604. OTHER TECHNICAL CORRECTIONS.

(a) AFFILIATED CORPORATIONS IN CONTEXT OF WORTHLESS SECURITIES.—

(1) Subparagraph (A) of section 165(g)(3) is amended to read as follows:

"(A) the taxpayer owns directly stock in such corporation meeting the requirements of section 1504(a)(2), and".

(2) Paragraph (3) of section 165(g) is amended by striking the last sentence.

(3) The amendments made by this subsection shall apply to taxable years beginning after December 31, 1984.

(b) REFERENCE TO CERTAIN STATE PLANS.—

(1) Subparagraph (B) of section 51(d)(2) is amended—

(A) by striking "plan approved" and inserting "program funded", and

(B) by striking "(relating to assistance for needy families with minor children)".

(2) The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 1201 of the Small Business Job Protection Act of 1996.

(c) AMOUNT OF IRA CONTRIBUTION OF LESSER EARNING SPOUSE.—

(1) Clause (ii) of section 219(c)(1)(B) is amended by striking "and" at the end of subclause (I), by redesignating subclause (II) as subclause (III), and by inserting after subclause (I) the following new subclause:

"(II) the amount of any designated nondeductible contribution (as defined in section 408(o)) on behalf of such spouse for such taxable year, and".

(2) The amendment made by paragraph (1) shall take effect as if included in section 1427 of the Small Business Job Protection Act of 1996.

(d) MODIFIED ENDOWMENT CONTRACTS.—

(1) Paragraph (2) of section 7702A(a) is amended by inserting "or this paragraph" before the period.

(2) Clause (ii) of section 7702A(c)(3)(A) is amended by striking "under the contract" and inserting "under the old contract".

(3) The amendments made by this subsection shall take effect as if included in the amendments made by section 5012 of the Technical and Miscellaneous Revenue Act of 1988.

(e) LUMP-SUM DISTRIBUTIONS.—

(1) Clause (ii) of section 401(k)(10)(B) is amended by adding at the end the following new sentence: "Such term includes a distribution of an annuity contract from—

"(I) a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501(a), or

"(II) an annuity plan described in section 403(a)."

(2) The amendment made by paragraph (1) shall take effect as if included in section 1401 of the Small Business Job Protection Act of 1996.

(f) TENTATIVE CARRYBACK ADJUSTMENTS OF LOSSES FROM SECTION 1256 CONTRACTS.—

(1) Subsection (a) of section 6411 is amended by striking "section 1212(a)(1)" and inserting "subsection (a)(1) or (c) of section 1212".

(2) The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 504 of the Economic Recovery Tax Act of 1981.

SEC. 1605. CLERICAL CHANGES.

(1) Subsection (f) of section 67 is amended by striking "the last sentence" and inserting "the second sentence".

(2) The heading for paragraph (5) of section 408(d) is amended to read as follows:

"(5) DISTRIBUTIONS OF EXCESS CONTRIBUTIONS AFTER DUE DATE FOR TAXABLE YEAR AND CERTAIN EXCESS ROLLOVER CONTRIBUTIONS.—".

(3) The heading for subparagraph (B) of section 529(e)(3) is amended by striking "UNDER GUARANTEED PLANS".

(4)(A) Subsection (e) of section 678 is amended by striking "an electing small business corporation" and inserting "an S corporation".

(B) Clause (v) of section 6103(e)(1)(D) is amended to read as follows:

"(v) if the corporation was an S corporation, any person who was a shareholder during any part of the period covered by such return during which an election under section 1362(a) was in effect, or".

(5) Subparagraph (B) of section 995(b)(3) is amended by striking "the Military Security Act of 1954 (22 U.S.C. 1934)" and inserting "section 38 of the International Security Assistance and Arms Export Control Act of 1976 (22 U.S.C. 2778)".

(6) Subparagraph (B) of section 4946(c)(3) is amended by striking "the lowest rate of compensation prescribed for GS-16 of the General Schedule under section 5332" and inserting "the lowest rate of basic pay for the Senior Executive Service under section 5382".

Amend the title so as to read:

A bill to provide for reconciliation pursuant to sections 105 and 211 of the concurrent resolution on the budget for fiscal year 2000.".

I. INTRODUCTION

A. Purpose and Summary

PURPOSE

The revenue reconciliation provisions included in the Committee bill ("Financial Freedom Act of 1999") (the "bill") provide: (1) 10-percent across-the-board reduction in individual income tax rates, marriage penalty tax relief, and repeal of the individual minimum tax (Title I); (2) reduced taxes on savings and investment income (Title II); (3) reduction in the corporate capital gains tax rate and repeal of the corporate minimum tax (Title III); (4) education savings incentives (Title IV); (5) health care tax relief (Title V); (6) phased-in repeal of estate, gift, and generation-skipping taxes (Title VI); (7) tax relief for distressed communities and industries (Title VII); (8) tax relief for small businesses (Title VIII); (9) international tax relief (Title IX); (10) modifications relating to tax-exempt organizations (Title X); (11) real estate tax relief (Title XI); (12) pension reforms (Title XII); (13) certain miscellaneous revenue provisions (Title XIII); (14) extension of tax provisions expiring in 1999 (Title XIV); (15) certain revenue offsets (Title XV); and (16) technical corrections to recent tax legislation (Title XVI).

The bill provides net tax reductions of $200 billion over fiscal years 1999–2004, and $864 billion over fiscal years 1999–2009. This will provide needed tax relief for individuals, families, small businesses, distressed industries and others, and will give American taxpayers more freedom to improve their financial condition and to help the economy continue to invest and grow into the 21st century.

SUMMARY OF THE BILL

I. Broad-based tax relief provisions

A. Reduction in individual income tax rates

The bill reduces both the regular and the alternative minimum income tax rates by ten percent over a ten year period. The reductions occur in four proportional steps for taxable years beginning in 2001, 2005, 2008, and 2009. The tax rates are rounded up annually to the nearest one-tenth of a percent.

B. Marriage penalty relief provisions

Standard Deduction Tax Relief.—The bill provides for a phased-in increase of the standard deduction for married couples filing jointly, so that it will be twice the standard deduction for a single person. The phase-in occurs ratably for the taxable years 2001 through 2003. The standard deduction for married persons filing separately increases similarly to equal the standard deduction for single persons.

Adjust Student Loan Interest Deduction Income Limits.—The bill increases the income levels at which married taxpayers filing jointly qualify for student loan interest deduction. In taxable years beginning after December 31, 1999, the student loan interest deduction for married taxpayers filing jointly is phased out ratably for modified adjusted gross incomes of $80,000 to $110,000, instead of the present-law phase-out range of $60,000 to $75,000 for joint returns.

Increase Income Limit for Roth IRA Conversions.—The bill increases the adjusted gross income limit on Roth IRA conversions from $100,000 to $160,000 for married couples filing jointly. The provision is effective for taxable years beginning after December 31, 1999.

C. Repeal individual alternative minimum tax

The bill allows an individual to offset the entire regular tax liability, without regard to the minimum tax, for taxable years beginning after December 31, 1998. Further, the bill imposes only 80 percent of the full AMT liability for taxable years after December 31, 2002. That percentage is reduced by 20 percentage points for each of the next three taxable years, and the tax is fully repealed for taxable years beginning after December 31, 2006. Finally, an individual taxpayer is allowed to use the AMT credit to offset 90 percent of his or her regular tax liability for taxable years beginning after December 31, 2006.

II. Savings and investment tax relief provisions

Partial Exclusion for Interest and Dividends.—The bill excludes from income of individuals combined amounts of taxable interest and dividends (other than capital gain dividends from RICs and REITs, dividends from farmers' cooperative associations, and dividends received from an employee stock ownership plan). The maximum exclusion is $100 for taxable years beginning after December 31, 2000 ($200 for married couples filing jointly), and $200 for taxable years beginning after December 31, 2002 ($400 for married couples filing jointly).

Reduce Individual Capital Gains Rates.—The bill reduces the 10- and 20-percent rates on the adjusted net capital gain to 7.5- and 15-percent, respectively. The 25-percent rate on unrecaptured section 1250 gain is reduced to 20 percent. These lower rates apply to both the regular tax and the alternative minimum tax. The bill repeals the special rates on gain from property held more than five years. The provision applies to taxable years ending after June 30, 1999, for property sold or exchanged after June 30, 1999.

Apply Capital Gain Rates to Capital Gains Earned by Designated Settlement Funds.—Present law imposes a tax rate of 39.6 percent on designated settlement funds. For taxable years beginning after December 31, 1999, the bill taxes the net capital gain of such funds in the same manner as in the case of an individual.

Exclusion of Gain on the Sale of a Principal Residence by a Member of the Uniformed Service or the Foreign Service of the United States or Certain Other Individuals Relocated Outside of the United States.—Present law contains a five year test period to determine whether the seller of a principal residence qualifies for exclusion of gain. The bill suspends the five year period for times of compelled service 50 miles away from home, or in government housing, by members of uniformed service or foreign service. The bill also suspends for up to five years, the five-year test period for an individual relocated for a period of more than 90 days outside of the United States by the individual's (or spouse's) employer. This provision does not apply to self-employed individuals. The provisions are effective for sales or exchanges of residences after the dates of enactment.

Clarify the Tax Treatment of Income and Losses on Derivatives.—The bill adds three categories to the list of assets gain or loss on which is treated as ordinary under section 1221. The new categories are: commodities derivatives held by commodities derivatives dealers, hedging transactions, and supplies of a type regularly consumed by the taxpayer in the ordinary course of the taxpayer's trade or business. With respect to hedging transactions, the bill replaces the present-law risk reduction standard with a risk management standard. The provision is effective for transactions entered into on or after the date of enactment.

Treatment of Loss on Stock of Subsidiary.—For taxable years beginning after December 31, 1999, the bill excludes active lending or insurance income from the types of income that disqualify section 165(g)(3) ordinary loss treatment on the sale of worthless stock.

III. Business investment and job creation

Alternative Tax for Corporate Capital Gains.—The bill creates an alternative maximum tax for the net capital gain of a corporation for taxable years beginning after December 31, 1999. The alternative tax would be 34.1 percent for taxable years beginning in 2000, 33.9 percent in 2001, 32.7 percent in 2002, 31.7 percent in 2003, 30.8 percent in 2004, 29.8 percent in 2005, 29.2 percent in 2006, 28.0 percent in 2007, 27.4 percent in 2008, 26.2 percent in 2009, and 25 percent applicable for all taxable years after 2009.

Repeal Corporate Alternative Minimum Tax.—For taxable years beginning after December 31, 2002, the limitation on the amount of AMT credits allowable to a corporation increases by 20 percent of the corporation's tentative minimum tax. This percentage rises to 40-, 60-, and 80-percent, respectively, for 2004, 2005, and 2006. The AMT credit cannot exceed an amount equal to the sum of the regular tax and minimum tax less the other nonrefundable credits. For taxable years beginning after December 31, 2006, the bill repeals the AMT, and a corporation would then be allowed to use the AMT credit to offset 90 percent of its regular tax liability.

Repeal of Limitation of Foreign Tax Credit under Alternative Minimum Tax.—The bill repeals the 90-percent limitation on the utilization of the AMT foreign tax credit for taxable years beginning after December 31, 2001.

IV. Education tax relief provisions

Expand Education Savings Accounts.—The bill changes the name of education IRAs to "Education Savings Accounts," and increases their annual contribution limit from $500 to $2,000 per beneficiary. The bill expands the definition of qualified education expenses to include qualified elementary and secondary expenses, including certain homeschooling expenses. Further, the bill allows contributions to be made on behalf of special needs beneficiaries after they reach age 18. The bill also allows: (1) contributions for a taxable year to be made until April 15th of the following year, (2) coordination of distributions from education savings accounts with the HOPE and Lifetime Learning Credit, and (3) contributions by corporations. The provision generally is effective for taxable years beginning after December 31, 2000.

Allow Tax-Free Distributions from State and Private Education Programs.—The bill expands the definition of "qualified state tuition program" to include certain prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions). The bill also allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program on behalf of the same student as long as the distribution is not used for the same expenses for which a credit was claimed. The bill permits one tax-free rollover in each 1-year period for the benefit of the same beneficiary. The provision permitting the establishment of qualified tuition programs maintained by one or more private educational institutions is effective for taxable years beginning after December 31, 2000. The exclusion from gross income for certain distributions from qualified State tuition programs under section 529 is effective for distributions made in taxable years beginning after December 31, 2000, and is extended to private prepaid tuition programs in taxable years beginning after December 31, 2003. The remaining provisions modifying qualifying tuition plans generally are effective for distributions made after December 31, 2000.

Eliminate Tax on Awards Under National Health Service Corps Scholarship Program, F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program, National Institutes of Health Undergraduate Scholarship Program and Certain State-sponsored Scholarship Programs.—The bill provides that amounts received by an individual under the NHSC Scholarship Program, the Armed Forces Scholarship Program, the NIH Scholarship Program, or any State-sponsored health scholarship program determined by the Secretary of the Treasury to have substantially similar objectives to these programs are eligible for tax-free treatment as qualified scholarships under section 117, without regard to any service obligation by the recipient. The bill is effective for education awards received under the NHSC Scholarship Program, the Armed Forces Scholarship Program, and the NIH Scholarship Program after December 31, 1993. The bill is effective for education awards received under any State-sponsored health scholarship program designated by the Secretary of the Treasury after December 31, 1999.

Liberalize Tax-Exempt Arbitrage Rebate Exceptions for Public School Construction Bonds.—The present-law 24-month expenditure exception to the arbitrage rebate requirement is liberalized for certain public school bonds. Under the bill, no rebate is required with respect to earnings on available construction proceeds of public school bonds if the proceeds are spent within 48 months after the bonds were issued and the certain intermediate spending levels are satisfied. The additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirement is increased from $5 million to $10 million. The liberalized expenditure exception for public school construction bonds is effective for bonds issued after December 31, 1999. The increase in the small governmental unit arbitrage rebate exception is effective for calendar years beginning after December 31, 1999.

Eliminate 60-month Limit on Student Loan Interest Deduction.—Present law allows student loan interest deductions only for the first 60 months of mandatory payments. The bill eliminates the 60 month limit and eliminates the requirement that a payment have been mandatory to qualify for the deduction. The provision is effective for interest paid after December 31, 1999.

V. Health care tax relief provisions

Above-the-Line Deduction for Health Insurance Expenses.—The bill allows an above-the-line deduction for a percentage of health insurance expenses. The amounts of the deduction are: 25 percent in 2001, 40 percent in 2002, 50 percent in 2003 through 2006, 75 percent in 2007, and 100 percent in 2008 and thereafter. The deduction is not available for any month in which the employee is covered by 50-percent employer subsidized, tax-free health insurance. The provision is effective for taxable years beginning after December 31, 2000.

Provisions Relating to Long-Term Care Insurance.—The bill allows an above-the-line deduction for a percentage of qualified long-term care insurance expenses. The deductible percentage is the same as under the above-the-line deduction for health insurance expenses.

Extend Availability of Medical Savings Accounts.—The bill: expands availability of Medical Savings Accounts (MSAs) to all employees covered under a high deductible health insurance plan of their employers, eliminates the cap on the number of taxpayers that can benefit annually from MSA contributions, decreases the lower dollar threshold of a high deductible health insurance plan, increases the amount of annual contributions that could be made to a MSA to 100-percent of the deductible, allows both employees and employers to make contributions to an MSA, and allows MSAs to be offered as part of a cafeteria plan.

Additional Personal Exemption for Caretakers.—The bill provides taxpayers who maintain a household including one or more qualified persons with an additional personal exemption for each qualified person. A qualified person is a parent or ancestor of the taxpayer or the taxpayer's spouse. The provision is effective for taxable years beginning after December 31, 1999.

Expand Human Clinical Trials Expenses Qualifying for the Orphan Drug Tax Credit.—Present law allows a 50-percent credit for human clinical testing expenses after a drug is certified as being a potential treatment for a rare disorder. The bill allows the credit for human testing expenses incurred after the taxpayer applies for orphan drug status. The provision is effective for taxable years beginning after December 31, 1999.

Add Certain Vaccines Against Streptococcus Pneumoniae to the List of Taxable Vaccines.—The bill adds conjugate streptococcus pneumoniae vaccines to the list of taxable vaccines subject to the 75 cent tax to fund the Federal Vaccine Injury Compensation Trust Fund. The provision is effective for vaccines purchased the day after the Centers for Disease Control makes a final recommendation for routine administration of conjugate streptococcus vaccines to children. No floor stocks tax is to be collected for amounts held for sale on that date.

Above-the-Line Deduction for Prescription Drug Insurance Coverage of Medicare Beneficiaries if Certain Medicare and Low-Income Assistance Provisions in Effect.—The bill provides an above-the-line deduction for Medicare beneficiaries for prescription drug insurance. The deduction takes effect when (a) the Federal Government provides assistance for prescription drug coverage for low-income Medicare beneficiaries, (b) all policies supplemental to Medicare provide coverage for costs of prescription drugs, and (c) coverage for outpatient prescription drugs for Medicare beneficiaries is provided only through integrated comprehensive health plans which offer current Medicare covered services and minimum limitations on out-of-pocket spending and such comprehensive plans sponsored by the Health Care Financing Administration compete on the same basis as private plans. The provision is effective for taxable years beginning after the date of enactment.

VI. Death tax relief provisions

Phase in Repeal of Estate, Gift, and Generation-Skipping Taxes.—The bill repeals the estate, gift, and generation-skipping transfer (GST) taxes beginning in 2009, after which a carryover basis regime is to be phased in for large transfers of assets from large estates to individuals other than a decedent's surviving spouse. Beginning in 2001, the unified transfer tax credit is replaced with a comparable unified exemption amount, and the top estate and gift tax rates above 50 percent and the 5-percent phase out surtax are repealed. Beginning in 2002 and through 2004, each of the rates of tax are reduced by 1 percentage point, and in 2005 and through 2008, each of the rates of tax are reduced by 2 percentage points. The top estate, gift, and GST tax rates is to be no higher than the highest future individual income tax rate, and the lower estate and gift tax rates are not to be reduced below the lowest individual income tax rate.

Modify Generation-Skipping Tax Rules.—The bill deems there to have been GST tax exemption allocated to transfers made during life that are "indirect skips," which are transfers to GST trusts that are not direct skips. This provision applies to transfers subject to estate or gift tax made after December 31, 1999, and to estate tax inclusion periods ending after December 31, 1999. The bill also allows the retroactive allocation of GST exemption when there is an unnatural order of death. This rule applies to deaths of non-skip persons occurring after the date of enactment. The bill also allows a trust holding property with an inclusion ratio greater than zero to be severed at any time in a "qualified severance." The severance provisions are effective for severances of trusts occurring after the date of enactment. In addition, the valuation rules are modified such that, for timely and automatic allocations of GST tax exemption, the value of the property for purposes of determining the inclusion ratio is its finally determined gift tax value or estate tax value depending on the circumstances of the transfer. The bill also authorizes and directs the Treasury Secretary to grant extensions of time to make the election to allocate GST tax exemption and to grant exceptions to the time requirement. Finally, the bill provides that substantial compliance with the statutory and regulatory requirements for allocating GST tax exemption suffice to establish that GST tax exemption was allocated to a particular transfer or trust.

VII. Distressed communities and industries provisions

Renewal Community Provisions.—The bill authorizes the Secretary of HUD to designate up to 20 renewal communities that will receive tax benefits for a seven year period beginning January 1, 2001, and ending December 31, 2007. The tax benefits include: a zero percent capital gains tax rate on the sale of qualified community assets held for more than five years; family development accounts for qualified higher educational expenses, qualified first-time homebuyer costs, qualified business capitalization costs, and qualified medical expenses; commercial revitalization deductions for qualified revitalization buildings located in a renewal community; $35,000 in additional section 179 expensing; expensing of environmental remediation costs (for brownfields); and an extension of the work opportunity tax credit to qualified individuals who live in a renewal community.

Provide that Federal Production Payments to Farmers are Taxable in the Year Received.—The bill modifies the constructive receipt rule for purposes of payments made by the Secretary of Agriculture pursuant to The Agriculture Market Transition Act. The existence of any option to accelerate any payment pursuant to the Act is disregarded and the payment is not included in gross income until received. The provision is effective on the date of enactment.

Allow Net Operating Losses from Oil and Gas Properties to be Carried Back for up to Five Years.—The bill provides a special five year carryback period for certain eligible oil and gas losses. The carryforward period remains twenty years. The bill applies to net operating losses arising in taxable years beginning after December 31, 1998.

Deduction for Delay Rental Payments.—The bill allows delay rental payments to be deducted currently. The provision applies to delay rental payments incurred in taxable years beginning after December 31, 2000.

Election to Expense Geological and Geophysical Expenditures.—The bill allows geological and geophysical costs incurred in connection with oil and gas exploration in the United States to be deducted currently. The provision is effective for G&G costs incurred in taxable years beginning after December 31, 2000.

Temporary Suspension of Limitation Based on 65 Percent of Taxable Income.—The bill suspends the limit on percentage depletion deductions to no more than 65 percent of the taxpayer's overall taxable income for taxable years beginning after December 31, 1998, and before January 1, 2005.

Determination of Small Refiner Exception to Oil Depletion Deduction.—The bill changes the refiner limitation on claiming independent producer status from a limit based on actual daily production to a limit based on average daily production for the taxable year: the average daily refinery run for the taxable year may not exceed 50,000 barrels. The provision is effective for taxable years beginning after December 31, 1999.

Increase the Maximum Dollar Amount of Reforestation Expenditures Eligible for Amortization and Credit.—The bill increases the amount of reforestation expenditures eligible for 7-year amortization and the reforestation credit from $10,000 to $25,000 per taxable year (from $5,000 to $12,500 in the case of a separate return by a married individual). For taxable years beginning in 2000 through 2003, there is no limit on the amount eligible for 7-year amortization. The provision is effective for expenditures paid or incurred in taxable years beginning after December 31, 1998.

Capital Gains Treatment Under Section 631(b) to Apply to Outright Sales by Landowners.—The bill provides that the requirement that a taxpayer retain an economic interest in timber in order to treat gains on sales prior to the time the timber is cut as capital gains does not apply in the case of a sale of timber by the owner of the land from which the timber is cut. The provision is effective for sales of timber after the date of enactment.

Minimum Tax Relief for the Steel Industry.—The bill allows minimum tax credits to offset 90 percent of tentative minimum tax in the case of a steel company, in addition to any excess of regular tax over tentative minimum tax. The provision is effective for taxable years beginning after December 31, 1998.

VIII. Small business relief provisions

Accelerate 100-Percent Self-Employed Health Insurance Deduction.—The bill increases the deduction for self-employed health insurance to 100-percent for taxable years beginning after December 31, 1999.

Increase Section 179 Expensing.—The bill increases the maximum section 179 deduction from the present-law $19,000 per year, up to $30,000 per year for taxable years beginning after December 31, 1999.

Repeal of Temporary Federal Unemployment Surtax.—The bill repeals the temporary Federal Unemployment Tax Act after December 31, 2004.

Restore 80-Percent Meals Deduction.—For taxable years beginning after December 31, 2004, the bill increases the business meals deduction from the present-law 50-percent, by five percentage points per taxable year, up to an 80-percent deduction for taxable years beginning after December 31, 2009.

IX. International tax relief provisions

Allocate Interest Expense on a Worldwide Basis.—The bill modifies the present-law interest expense allocation rules (which generally apply for purposes of computing the foreign tax credit limitations) by providing a one-time election under which the taxable income of domestic members of an affiliated group from foreign sources generally would be determined by allocating and apportioning interest expense of the worldwide affiliated group on a worldwide-group basis. The election provides taxpayers with the option either to apply fungibility principles on a worldwide basis or to continue to apply present law. For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group includes any foreign corporations in which more than 50 percent of the total vote or value is owned (directly or indirectly) by U.S. members of the affiliated group. A pro rata portion of such foreign corporation's interest expense and assets is treated as attributable to the affiliated group and taken into account for purposes of determining the allocation and apportionment of interest expense. In addition, regardless of whether a taxpayer elects to continue to be governed by the present-law allocation rules or to apply the new worldwide fungibility principle, the bill provides two annual elections that are exceptions to the general "one-taxpayer" rule: (1) the subsidiary group election under which U.S. members with debt that is not supported by other members of the affiliated group could elect to treat themselves and their subsidiaries as a separate group; and (2) a financial institution group election under which all members that are predominantly engaged in a financial services business could elect to be treated as a separate group. The provision is effective for taxable years beginning after December 31, 2001.

Look-Through Rules to Apply to Dividends from Noncontrolled Section 902 Corporations.—For taxable years beginning after December 31, 2001, the bill applies the look-through approach to all dividends paid by a 10/50 company for foreign tax credit limitation purposes. The bill provides a transition rule under which pre-effective date foreign tax credits associated with a 10/50 company separate limitation category can be carried forward into post-effective date years.

Subpart F Treatment of Pipeline Transportation Income and Income from Transmission of High Voltage Electricity.—The bill exempts income derived from the transmission of high voltage electricity from the definition of foreign base company services income. Further, the bill provides that foreign base company oil related income does not include income from the pipeline transportation of oil or gas within a foreign country. The provision is effective for taxable years of foreign corporations beginning after December 31, 2001, and taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Recharacterization of Overall Domestic Loss.—The bill applies a resourcing rule to U.S.-source income where the taxpayer has suffered a reduction in the amount of its foreign tax credit limitation due to a prior overall domestic loss. The bill applies to losses incurred in taxable years beginning after December 31, 2004.

Treatment of Military Property of Foreign Sales Corporations.—The bill repeals the special Foreign Sales Corporation (FSC) limitation relating to the export of military property, thus providing exports of military property through a FSC with the same treatment currently provided exports of non-military property. The provision is effective for taxable years beginning after December 31, 2001.

Modify Treatment of RIC Dividends Paid to Foreign Persons.—Under the bill, a regulated investment company (RIC) that earns certain interest income or short-term capital gains which are not subject to U.S. tax if earned by a foreign person directly may designate a dividend it pays as derived from such income. Under the provision, a foreign person who is a shareholder in the RIC generally treats such dividends as exempt from gross-basis U.S. tax, just as if the foreign person had realized the interest or short-term capital gains directly. In addition, the estate of a foreign decedent is exempt from U.S. estate tax on a transfer of stock in the RIC in the proportion that the assets held by the RIC are debt obligations, deposits, or other property that would generally be treated as situated outside the United States if held directly by the estate. The provision generally is effective for taxable years beginning after December 31, 2004.

Repeal of Special Rules for Applying Foreign Tax Credit in Case of Foreign Oil and Gas Income.—The bill repeals the special rules of section 907, such that taxes attributable to foreign oil and gas extraction income are no longer subject to a special limitation, and the rules with respect to discriminatory taxes on foreign oil related income no longer apply. The provision is effective for taxable years beginning after December 31, 2004.

Study of Proper Treatment of European Union under Subpart F Same Country Exceptions.—The bill directs the Secretary of the Treasury to conduct a study of the feasibility of treating all countries included in the European Union as one country for purposes of applying same country exceptions under subpart F. The bill requires the study to be completed no later than six months after the date of enactment.

Provide Waiver from Denial of Foreign Tax Credits.—The bill provides that section 901(j) (relating to denial of foreign tax credits, etc.) no longer applies with respect to a foreign country if the President determines that the application of section 901(j) to such foreign country is not in the national interests of the United States. The provision is effective as of the date of enactment.

Prohibit Disclosure of APAs and APA Background Files.—The bill provides that Advance Pricing Agreements (APAs) and related background information are confidential return information not subject to the public inspection requirements of section 6110. The bill also requires the Treasury Department to prepare an extensive annual report regarding APAs. The provision is effective on the date of enactment.

Increase Dollar Limitation on Section 911 Exclusion.—The bill increases the maximum exclusion for foreign earned income in annual increments of $3,000 per year beginning in 2003, until the exclusion amount is $95,000. Beginning in 2008, the maximum exclusion amount of $95,000 is indexed for inflation.

X. Tax-exempt organization provisions

Provide Tax Exemption for Organizations Created by a State to Provide Property and Casualty Insurance Coverage for Property for which Such Coverage is Otherwise Unavailable.—The bill provides tax-exempt status for associations created before January 1, 1999, by State law, and organized and operated exclusively to provide property and casualty insurance for property located within the State if coverage is limited or unavailable at reasonable rates, provided requirements are met. The provision is effective for taxable years beginning after December 31, 1999.

Conform Provisions Relating to Arbitrage Treatment to Reflect Proposed State Constitutional Amendments.—The present law tax exemption for two State universities depends on relevant State law not changing terms in effect as of October 9, 1969. The bill allows the exemption to continue in light of proposed amendments to the State Constitution. The bill applies to bonds issued after the effective date of the State constitutional amendments.

Denial of Charitable Contribution Deduction for Transfers Associated with Split-Dollar Insurance Arrangements.—The bill restates present law to provide that no charitable contribution deduction is allowed for a transfer to or for the use of a charitable organization, if in connection with the transfer the organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or there is an understanding or expectation that any person will directly or indirectly pay any premium on any personal benefit contract with respect to the transferor. The bill also imposes on the charitable organization an excise tax in the amount of the premiums paid. The provision applies generally to transfers, or premiums paid, after February 8, 1999.

Authorize Secretary of Treasury to Grant Waivers from Section 4941 Prohibitions.—The bill requires that the Secretary of the Treasury establish an exemption procedure pursuant to which the Secretary could grant a conditional or unconditional exemption from the self-dealing prohibition of section 4941. The provision is effective for transactions occurring after the date of enactment.

Extend Declaratory Judgment Procedures to Non-501(c)(3) Tax-exempt Organizations.—The bill extends declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) determinations. The provision is effective for pleadings with respect to determinations made after the date of enactment.

Modify Section 512(b)(13).—The bill provides that certain payments made by a controlled entity to a tax-exempt organization count as unrelated business income only to the extent they exceed the amount of the payment that would have been made if the payment had been determined in accordance with the principles of section 482. The provision applies to payments received or accrued in taxable years beginning after December 31, 1999.

XI. Real estate relief provisions

Proposals Relating to REITs.—Under the bill, a Real Estate Investment Trust (REIT) generally can not own more than ten percent of the total value of securities of a single issuer (to supplement the voting power limitation under present law), but does not apply for securities held directly or indirectly by such REIT on July 12, 1999. An exception to the limitations on ownership applies in the case of a wholly owned "taxable REIT subsidiary" that meets certain requirements. The bill also permits a REIT to own and operate a health care facility for at least two years, and treat it as permitted "foreclosure" property, if the facility is acquired by the termination or expiration of a lease of the property. The provisions generally are effective for taxable years beginning after December 31, 2000.

Modify At-Risk Rules for Publicly Traded Nonrecourse Debt.—The bill modifies the rules relating to qualified nonrecourse financing to provide that, in the case of an activity of holding real property, a taxpayer is considered at risk with respect to the taxpayer's share of certain financing that is not borrowed from a person that is regularly engaged in the business of lending money, and that is not secured by real property used in the activity, if the financing is qualified publicly traded debt. The financing may not be borrowed from a related person. The bill is effective for debt instruments issued after December 31, 1999.

Qualified Lessee Construction Allowances Not Limited to Short-Term Leases for Certain Retailers.—The bill eliminates the section 110 requirement that a lease be for a term of 15 years or less in the case of payment (or rent reduction) to a "qualified retail business." Payments by a lessor to such businesses for the purpose of constructing or improving long-term real property are not included in the income of the lessee regardless of the term of the lease, provided the payments are used for such purpose. A qualified retail business is defined as a trade or business of selling tangible personal property to the general public. The bill applies to leases entered into after December 31, 1999. No inference is intended as to the treatment of amounts that are not affected by the bill.

Exclusion From Gross Income For Certain Contributions to the Capital of Certain Retailers.—The bill establishes a safe harbor allowing certain inducements received by retailers in exchange for the retailer's agreement to operate a qualified retail business at particular location for a period of at least 15 years to be treated as nontaxable contributions to capital. The provision is effective for contributions received after December 31, 1999.

XII. Pension reform provisions

A. Expanding coverage

Increase contribution and benefit limits.—Effective in 2001, the bill: increases the $30,000 annual contribution limit for defined contribution plans to $40,000 (indexed in $1,000 increments), increases the $130,000 annual benefit limit under a defined benefit plan to $160,000, lowers the early retirement age to 62 and the normal retirement age to 65 for purposes of applying the limit, and increases the limit on compensation that may be taken into account under a plan to $200,000 (indexed in $5,000 increments). Beginning in 2001, the bill increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs in $1,000 annual increments until the limits reach $15,000 in 2005, with indexing thereafter. Beginning in 2001, the bill increases the maximum annual elective deferrals that can be made to a SIMPLE plan in $1,000 annual increments until the limit reaches $10,000 in 2004, with indexing thereafter. The bill increases the limit on deferrals under a section 457 plan to $11,000 in 2001, and increases in $1,000 annual increments until the limit reaches $15,000 in 2005, with indexing thereafter.

Plan loans for subchapter S shareholders, partners, and sole proprietors.—The bill generally eliminates the special present-law rules relating to plan loans made to an owner-employee. Thus, the general statutory exemption applies to such transactions. Present law applies with respect to IRAs. The provision is effective with respect to transactions entered into after December 31, 2000.

Modification of top-heavy rules.—The bill provides that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan. Matching provided can be taken into account in satisfying the minimum contribution requirements applicable to top-heavy plans. The bill simplifies the definition of key employee and the determination of top-heavy status. The provision is effective for years beginning after December 31, 2000.

Elective deferrals not taken into account for purposes of deduction limits.—Under the bill, elective deferral contributions are not subject to the qualified plan deduction limits, and the application of a deduction limitation to any other employer contribution to qualified retirement plan does not take into account elective deferral contributions. The provision is effective for years beginning after December 31, 2000.

Reduce PBGC premiums for small and new plans.—Under the bill, for the first five plan years of a new single-employer plan of an employer with 100 or fewer employees, the flat-rate Pension Benefit Guaranty Corporation (PBGC) premium is $5 per plan participant. The bill provides that the variable PBGC premium is phased in for "new defined benefit plans" over a six-year period starting with the plan's first plan year. The bill also provides that, in the case of any plan (not just a new plan) of an employer with 25 or fewer employees, the variable-rate premium is no more than $5 multiplied by the number of plan participants. The provisions relating to new plans are effective for plans established after December 31, 2000. The provision reducing the PBGC variable premium for small plans is effective for years beginning after December 31, 2000.

Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations.—For years beginning after December 31, 2000, the bill repeals the rules coordinating the section 457 dollar limit with contributions under other types of plans.

Eliminate IRS user fees for determination letter requests regarding small employer plans.—Under the bill, an employer with no more than 100 employees is not required to pay a user fee for any determination letter with respect to the qualified status of a retirement plan that the employer maintains. The bill is effective for determination letter requests made after December 31, 2000.

Definition of compensation for purposes of deduction limits.—For purposes of the qualified plan deduction limit the compensation otherwise paid or accrued during the employer's taxable year to the beneficiaries under the plan includes elective deferrals under a section 401(k) plan or a section 403(b) annuity, and elective contributions under a section 457 plan. The provision is effective for years beginning after December 31, 2000.

Option to treat elective deferrals as after-tax contributions.—A section 401(k) plan or a section 403(b) annuity is permitted to have all or a portion of the participant's elective deferrals under the plan treated as designated plus contributions (*i.e.,* elective deferrals that the participant designates as not excludable from the participant's gross income). The annual dollar limitation on a participant's designated plus contributions is the section 402(g) annual limitation on elective deferrals, reduced by the participant's elective deferrals that the participant does not designate as designated plus contributions. Designated plus contributions are treated as any other elective deferral for purposes of nonforfeitability requirements, distribution restrictions, and nondiscrimination requirements. A qualified distribution from a participant's designated plus contributions account is not includible in the participant's gross income. A qualified distribution is a distribution made after the end of a specified nonexclusion period that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled. The nonexclusion period is the 5-year-taxable period beginning with the earlier of (1) the first taxable year for which the participant made a designated plus contribution to any designated plus contribution account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated plus contribution account that is the source of the distribution from a designated plus contribution account established for the participant under another plan, the first taxable year for which the participant made a designated plus contribution to the previously established account. A participant is permitted to roll over a distribution from a designated plus contributions account only to another designated plus contributions account or a Roth IRA of the participant. The provision is effective for taxable years beginning after December 31, 2000.

Increase minimum benefit under defined benefit plans.—Beginning in 2001, the minimum annual benefit permitted under a defined benefit plan increases in $10,000 annual increments until the minimum benefit amount reaches $40,000 in 2003. The $40,000 amount is not indexed. In addition, a participant is entitled to the minimum benefit even if the participant had participated in a defined contribution plan of the employer. The provision is effective for years beginning after December 31, 2000.

B. Enhancing fairness for women

Additional salary reduction catch-up contributions.—The bill provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, a section 403(b) annuity, a SIMPLE, or deferrals under a section 457 plan increase for individuals who have attained at least age 50 during the year. The otherwise applicable dollar limit would be increased by $1,000 in each year beginning in 2001 until the amount of the increase is $5,000 in 2005. Thereafter, the $5,000 limit is indexed for inflation in $500 increments. The provision is effective for taxable years beginning after December 31, 2000.

Equitable treatment for contributions of employees to defined contribution plans.—The bill increases the 25 percent of compensation limitation on annual additions under a defined contribution plan to 100 percent of compensation. The bill conforms the limits on contributions to tax-sheltered annuities to the limits applicable to qualified plans. The bill increases the 33⅓ percent of compensation limitation on deferrals under a section 457 plan to 100 percent of compensation. The provision is effective for years beginning after December 31, 2000.

Faster vesting of employer matching contributions.—The bill applies faster vesting schedules to employer matching contributions. Under the bill, employer matching contributions have to vest at least as rapidly as under one of the following two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of employer matching contributions upon the completion of 3 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of employer matching contributions for each year of service beginning with the participant's second year of service and ending with 100 percent after 6 years of service. The provision is effective for years beginning after December 31, 2000.

Simplify and update the minimum distribution rules.—The bill applies the present-law rules applicable if the participant dies before distribution of minimum benefits has begun to all post-death distributions. The bill reduces the excise tax on failures to satisfy the minimum distribution rules to 10 percent of the amount that was required to be distributed but was not distributed. The Treasury is directed to update, simplify, and finalize the regulations relating to the minimum distribution rules. The bill repeals the special minimum distribution rules applicable to section 457 plans. The provision is effective for years beginning after December 31, 2000.

Clarification of tax treatment of division of section 457 plan benefits upon divorce.—The bill applies the taxation rules for qualified plan distributions pursuant to a QDRO to distributions made pursuant to a domestic relations order from a section 457 plan. The provision is effective for transfers, distributions, and payments made after December 31, 2000.

C. Increasing portability for participants

Rollovers of retirement plan and IRA distributions.—The bill provides that eligible rollover distributions from qualified retirement plans, section 403(b) annuities, IRAs and governmental section 457 plans generally can be rolled over to any of such plans or arrangements. The direct rollover and withholding rules are extended to distributions from a section 457 plan. The bill provides that employee after-tax contributions can be rolled over into another qualified plan or a traditional IRA. In the case of a rollover from a qualified plan to another qualified plan, the rollover can be accomplished only through a direct rollover. The bill provides that surviving spouses can roll over distributions to a qualified plan, section 403(b) annuity, or governmental section 457 plan in which the spouse participates. The provision is effective for distributions made after December 31, 2000.

Waiver of 60-day rule.—The bill provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement is against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement. The provision applies to distributions made after December 31, 2000.

Treatment of forms of distribution.—A defined contribution plan to which benefits are transferred is not treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer, (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, (4) if the transferor plan provides for an annuity as the normal form of distribution in accordance with the joint and survivor annuity rules, the participant's spouse (if any) consents to the transfer, and (5) the transferee plan allows the participant or beneficiary to receive distribution of his or her benefit under the transferee plan in the form of a single sum distribution. In addition, except to the extent provided by the Secretary of the Treasury in regulations, a defined contribution plan is not treated as reducing a participant's accrued benefit if (1) a plan amendment eliminates a form of distribution, (2) a single sum distribution is available to the participant at the same time or times as the form of distribution eliminated by the amendment, and (3) the single sum distribution is based on the same or greater portion of the participant's accrued benefit as the eliminated form of distribution. The provision is effective for years beginning after December 31, 2000.

Rationalization of restrictions on distributions.—The bill modifies the distribution restrictions applicable to section 401(k) plans, section 403(b) annuities, and section 457 plans to provide that distribution may occur upon severance from employment rather than separation from service. The provision is effective for distributions made after December 31, 2000.

Purchase of service credit under governmental pension plans.—Under the bill, a participant in a State or local governmental plan is not required to include in gross income a direct trustee-to-trustee transfer to the governmental plan from a section 403(b) plan or a section 457 plan if the transferred amount is used (1) to purchase permissive service credits under the plan, or (2) to repay contributions and earnings with respect to an amount previously refunded under a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State). The provision is effective for transfers made after December 31, 2000.

Employers may disregard rollovers for purposes of cash-out rules.—Under the bill, a plan is permitted to provide that the present value of a participant's nonforfeitable accrued benefit is determined without regard to the portion of such benefit that is attributable to rollover contributions, and any earnings allocable thereto, for purposes of the cash-out rules. The provision is effective for distributions made after December 31, 2000.

Employers may disregard rollovers for purposes of cash-out rules.—A plan is permitted to provide that the present value of a participant's nonforfeitable accrued benefit is determined without regard to the portion of such benefit that is attributable to rollover contributions (and any earnings allocable thereto). The provision is effective for distributions after December 31, 2000.

D. Strengthening pension security and enforcement

Phase in repeal of 150 percent of current liability full funding limit; deduction for contributions to fund termination liability.—The bill gradually increases and then repeals the current liability full funding limit. The current liability full funding limit is 160 percent of current liability for plan years beginning in 2001, 165 percent for plan years beginning in 2002, and 170 percent for plan years beginning in 2003. The current liability full funding limit is repealed for plan years beginning in 2004 and thereafter. Under the bill, the special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans covered by the PBGC. The provision is effective for years beginning after December 31, 2000.

Extension of PBGC missing participants program.—The bill extends the PBGC missing participant program to multi-employer plans and defined contribution plans. The bill is effective for distributions from terminating plans that occur after the PBGC adopts final regulations implementing the provision.

Excise tax relief for sound pension funding.—Under the bill, in determining the amount of nondeductible contributions, the employer can elect not to take into account contributions to a defined benefit pension plan in excess of the current liability full funding limit. The provision is effective for years beginning after December 31, 2000.

Notice of significant reduction in plan benefit accruals.—The bill requires the plan administrator of a defined benefit pension plan with more than 100 participants to provide a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual. The plan administrator is required to provide this notice to each affected participant, each affected alternate payee, and each employee organization representing affected participants. Except to the extent provided by Treasury regulations, the plan administrator is required to provide the notice within a reasonable time before the effective date of the plan amendment. The bill imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. The total excise tax imposed during a taxable year of the employer can not exceed $500,000. In the case of a failure that is due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax is excessive relative to the failure involved. The bill is effective for plan amendments adopted on or after the date of enactment.

E. Reducing regulatory burdens

Repeal of the multiple use test.—The bill repeals the multiple use test, effective for years beginning after December 31, 2000.

Modification of timing of plan valuations.—The bill allows an employer to elect to use the prior year's plan valuation in the case of a defined benefit plan with assets of at least 125 percent of current liability. In any event, a plan valuation is required once every three years. The provision is effective for plan years beginning after December 31, 2000.

Flexibility in nondiscrimination and line of business rules.—The Secretary of the Treasury is directed to modify, on or before December 31, 2000, the existing regulations issued under section 401(a)(4) and section 414(r) in order to expand (to the extent that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the nondiscrimination and line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance. The provision is effective on the date of enactment.

Rules for substantial owner benefits in terminated plans.—The bill increases the PBGC guarantee for certain substantial owners. The bill is effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC after December 31, 2000.

ESOP dividends may be reinvested without loss of dividend deduction.—In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer is entitled to deduct dividends that, at the election of plan participants or their beneficiaries, are paid to the plan and reinvested in qualifying employer securities. The provision is effective for taxable years beginning after December 31, 2000.

Notice and consent period regarding distributions.—Under the bill, a qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than six months before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to six months and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt. The provision is effective for years beginning after December 31, 2000.

Repeal transition rule relating to certain highly compensated employees.—The bill repeals the special definition of highly compensated employee under the Tax Reform Act of 1986. Thus, the present-law definition applies. The provision is effective for plan years beginning after December 31, 2000.

Employees of tax-exempt entities.—The bill directs the Treasury Department to revise its regulations under section 401(b) to provide that if certain requirements are satisfied, employees of a tax-exempt charitable organization who are eligible to make salary reduction contributions under a section 403(b) annuity may be treated as excludable employees for purposes of testing a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan of the employer. The revised regulations are to be effective for years beginning after December 31, 1996.

Treatment of employer-provided retirement advice.—The bill provides that qualified retirement planning services provided to an employee and his or her spouse or dependents are excludable from income and wages. The provision is effective with respect to taxable years beginning after December 31, 2000.

Provisions relating to plan amendments.—Any amendments to a plan or annuity contract required to be made by the bill are not required to be made before the last day of the first plan year beginning on or after January 1, 2003. In the case of a governmental plan, the date for amendments is extended to the first plan year beginning on or after January 1, 2004. The provision is effective on the date of enactment.

Model plans for small businesses.—The Secretary of the Treasury is directed to issue, not later than December 31, 2000, at least one model defined contribution plan document and at least one model defined benefit plan document that fit the needs of small businesses and that would be treated as meeting the requirements of section 401(a) with respect to the form of the plan. The provision is effective on the date of enactment.

Reporting simplification.—The Secretary of the Treasury is directed to provide for the filing of a simplified annual return substantially similar to the Form 5500–EZ by a plan that meets certain requirements. The provision is effective on the date of enactment.

Improvement to employer plans compliance resolution system.—The Secretary of the Treasury is directed to continue to update and improve EPCRS, giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under APRSC for significant compliance failures, (4) expanding the availability to correct insignificant compliance failures under APRSC during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure. The provision is effective on the date of enactment.

XIII. Miscellaneous provisions

Expand the Exclusion from Income for Certain Foster Care Payments.—The bill makes two principal modifications to the exclusion. First, the bill expands the list of persons eligible to make qualified foster care payments. Therefore, the exclusion applies to qualified payments made pursuant to a foster care program of a State or local government which are paid by either: (1) a State or political subdivision of a State; or (2) a qualified foster care placement agency, whether taxable or tax-exempt. Second, the bill expands the list of persons eligible to place foster care individuals.

Specifically, the bill allows placements by either: (1) a State or a political subdivision of a State; or (2) a qualified foster care placement agency. The bill allows State and local governments to employ both tax-exempt and taxable entities to administer their foster care programs more efficiently; however, it does not extend the exclusion to payments outside such foster care programs (*e.g.,* payments to a foster care provider from friends or relatives of foster care individual in its care). The provision is effective for taxable years beginning after December 31, 1999.

Provide Exclusion for Mileage Reimbursements by Charitable Organizations.—Under the bill, reimbursement for the costs of using an automobile in connection with providing donated services from an entity or organization described in section 170(c) is excludable from the gross income of the volunteer, provided that (1) reimbursement does not exceed the rate prescribed for business use, and (2) applicable recordkeeping requirements are satisfied. The provision is effective for taxable years beginning after December 31, 1999.

Expand Employer Reporting on Annual Wage and Tax Statements.—The bill requires the Form W–2 to include a statement of social security and medicare taxes paid by the employer on behalf of each employee. The bill is effective with respect to Form W–2s provided for calendar years beginning after December 31, 1999.

Consistent Treatment of Survivor Benefits for Public Safety Officers Killed in the Line of Duty.—The bill extends the present-law treatment of survivor annuities with respect to public safety officers killed in the line of duty to payments received in taxable years beginning after December 31, 1999, with respect to individuals dying on or before December 31, 1996.

Distributions from Publicly Traded Partnerships Treated as Qualifying Income of Regulated Investment Companies.—The bill provides that permitted income of a RIC includes income derived from an interest in a publicly traded partnership, effective for taxable years beginning after December 31, 2000.

Equalize the Tax Treatment of "Clean Fuel" Vehicles and Oversized Vehicles—The bill provides that an electric truck or van with a gross vehicle weight rating greater than 13 tons or an electric bus which has seating capacity of at least 20 adults is a qualified clean fuel vehicle for which the taxpayer may expense up to $50,000 of cost and that such vehicles are not eligible for the electric vehicle credit. The provision is effective for vehicles placed in service after December 31, 1999.

Nuclear Decommissioning.—The bill repeals the cost of service requirement for deductible contributions to nuclear decommissioning funds. Thus, taxpayers, including unregulated taxpayers, are allowed a deduction for amounts contributed to a qualified nuclear decommissioning fund. As under current law, however, the maximum contribution and deduction for a taxable year can not exceed the IRS ruling amount for that year. The bill also clarifies the Federal income tax treatment of the transfer of qualified nuclear decommissioning funds. No gain or loss is recognized to the transferor or the transferee as a result of the transfer of a qualified fund in connection with the transfer of the power plant with respect to which the fund was established. In such cases, the transferee is considered to “step into the shoes” of the transferor with respect to the qualified nuclear decommissioning fund. The provision is effective for taxable years beginning after December 31, 1999.

Permit Consolidation of Life Insurance and Nonlife Companies.—The bill repeals the two present-law 5-year limitation rules under the election to treat life insurance companies as a member of an affiliated group, and also the rule that a life insurance corporation is not an includible corporation unless the common parent makes an election to treat life insurance companies as includible corporations. The provision is effective for taxable years beginning after December 31, 2004.

Consolidate Code Provisions Governing the Hazardous Substance Superfund and the Leaking Underground Storage Tank Trust Fund.—The Code provisions governing the Superfund and the LUST Trust Fund are consolidated into a single Environmental Remediation Trust Fund (the “Trust Fund”). Amounts in the consolidated Trust Fund are available for expenditure, as provided in appropriations Acts, for the combined purposes of the two present-law Trust Funds, as of July 12, 1999. No future interest accrues on the unobligated balances of the Environmental Trust Fund. The provision is effective on October 1, 1999.

Repeal Certain Excise Taxes on Rail Diesel Fuel and Inland Waterway Barge Fuels.—The 0.1-cent-per-gallon LUST tax on diesel fuel used in trains is repealed. In addition, the 4.3-cents-per-gallon General Fund excise tax rates on diesel fuel used in trains and fuels used in barges operating on the designated inland waterways system is repealed. The repeal of the 0.1-cent-per-gallon LUST tax on diesel fuel used in trains is effective on October 1, 1999. The repeal of the 4.3-cents-per-gallon excise taxes on train diesel and inland waterway barge fuels is effective after September 30, 2003. Repeal of these taxes is contingent upon inclusion in the legislation of a separate section of the bill that would consolidate the Code provisions governing the Hazardous Substance Superfund and the Leaking Underground Storage Tank Trust Fund into an Environmental Remediation Trust Fund.

Repeal Excise Tax on Fishing Tackle Boxes.—The excise tax on fishing tackle boxes is repealed. The provision is effective beginning 30 days after the date of enactment.

Clarification of Excise Tax Imposed on Arrow Components.—The bill conforms the tax to current manufacturing design practice.

Improvements in Low-Income Housing Credit.—The bill increases the credit cap and makes other changes. The provision generally is effective for calendar years beginning after December 31, 2000. The increase and indexing of the credit cap is effective for calendar years after December 31, 1999.

Entrepreneurial Equity Capital Formation.—The bill increases the 50-percent exclusion for gain on the sale of qualifying SSBIC stock to 60 percent and makes certain modifications to the present-law rollover of gain on the proceeds from the sale of publicly traded securities when such proceeds are used to acquire qualifying SSBIC stock.

Accelerate Scheduled Increase in State Volume Limits on Tax-Exempt Private Activity Bonds.—The bill increases the present-law annual State private activity bond volume limits to $75 per resident of each State or $225 million (if greater). The volume limit increases are effective for bonds issued after December 31, 1999.

Tax Treatment of Alaska Native Settlement Trusts.—An Alaska Native Corporation may establish a Trust under section 39 of the Alaska Native Claims Settlement Act and if the Trust makes an election for its first taxable year after the date of enactment, no amount is includible in the gross income of a beneficiary of such Trust by reason of a contribution to the Trust. The provision is effective for taxable years of Settlement Trusts, and contributions to such Trusts, after December 31, 1999.

Increase Joint Committee on Taxation Refund Review Threshold to $2 Million.—The bill increases the threshold above which refunds must be submitted to the Joint Committee on Taxation for review from $1,000,000 to $2,000,000. The provision is effective on the date of enactment.

Tax Court Proposals.—Section 7451 is amended to provide that the Tax Court is authorized to charge a filing fee of up to $60 in all cases commenced by the filing of a petition. The bill further provides that Tax Court fees imposed on practitioners also are available to provide services to pro se taxpayers. These provisions are effective on the date of enactment. Section 6214(b) is amended to provide that the Tax Court may apply the principle of equitable recoupment to the same extent that it may be applied in Federal civil tax cases by the district courts and Court of Federal Claims. This provision is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

XIV. Extension of expiring provisions

Extension of Research and Experimentation Credit and Increase in the Rates for the Alternative Incremental Research Credit.—The research tax credit is extended for five years—i.e., generally, for the period July 1, 1999 through June 30, 2004. In addition, the credit rate applicable under the alternative incremental credit is increased by one percentage point per step, that is, from 1.65 percent to 2.65 percent when a taxpayer's current-year research expenses exceed a base amount of 1 percent but do not exceed a base amount of 1.5 percent; from 2.2 percent to 3.2 percent when a taxpayer's current-year research expenses exceed a base amount of 1.5 percent but do not exceed a base amount of 2 percent; and from 2.75 percent to 3.75 percent when a taxpayer's current-year research expenses exceed a base amount of 2 percent. Extension of the research credit is effective for qualified research expenditures paid or incurred during the period July 1, 1999, through June 30, 2004. The increase in the credit rate under the alternative incremental credit is effective for taxable years beginning after June 30, 1999.

Extend Exceptions under Subpart F for Active Financing Income.—The bill extends for five years the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business. The provision is effective for taxable years of a foreign corporation beginning after December 31, 1999, and before January 1, 2005, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporation end.

Extend Suspension of Income Limitation on Percentage Depletion From Marginal Oil and Gas Wells.—The bill extends the present-law rule suspending the 100-percent-of-net-income limitation with respect to oil and gas production from marginal wells to include taxable years beginning after December 31, 1999, and before January 1, 2005. The provision is effective on the date of enactment.

Extend the Work Opportunity Tax Credit.—The bill extends the WOTC for two years (through June 30, 2001). The bill also includes a direction to the Secretary of the Treasury to expedite procedures to allow taxpayers to satisfy their WOTC filing requirements (*e.g.,* Form 8850) by electronic means. Generally, the provision is effective for wages paid to, or incurred with respect to, qualified individuals who begin work for the employer on or after July 1, 1999, and before July 1, 2001.

Extend the Welfare-To-Work Tax Credit.—The bill extends the welfare-to-work credit for two years, so that the credit is available for eligible individuals who begin work for an employer before July 1, 2001. The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after July 1, 1999, and before July 1, 2001.

XV. Revenue offset provisions

Expand Reporting of Cancellation of Indebtedness Income.—The bill requires that information reporting on discharges of indebtedness also be done by any organization a significant trade or business of which is the lending of money, such as finance companies and credit card companies (whether or not affiliated with financial institutions). The bill is effective with respect to discharges of indebtedness after December 31, 1999.

Extension of IRS User Fees.—The bill extends the statutory authorization for these user fees through September 30, 2009. The bill also moves the statutory authorization for these fees into the Internal Revenue Code. The provision is effective on the date of enactment.

Impose Limitation on Prefunding of Certain Employee Benefits.—Under the bill, the present-law exception to the deduction limit for 10-or-more employer plans is limited to plans that provide only medical benefits, disability benefits and group-term life insurance benefits which do not provide for any cash surrender value or other money that can be paid, assigned, borrowed or pledged for collateral for a loan. In addition, if any portion of a welfare benefit fund attributable to contributions that are deductible pursuant to the 10-or-more employer exception (and earnings thereon) is used for a purpose other than that for which the contributions were made (including cash payments to employees upon termination of the fund), such portion is treated as reverting to the benefit of the employers maintaining the fund and would be subject to an excise tax. The provision is effective with respect to contributions paid or accrued on or after June 9, 1999, in taxable years ending after such date.

Increase Elective Withholding Rate for Nonperiodic Distributions from Deferred Compensation Plans.—Under the bill, the elective withholding rate for nonperiodic distributions from deferred compensation arrangements is increased from 10 percent to 15 percent. The provision is effective for distributions made after December 31, 1999.

Modify Treatment of Closely-Held REITs.—The bill imposes as an additional requirement for REIT qualification that, except for the first taxable year for which an entity elects to be a REIT, no one person (*e.g.,* no one corporation) can own stock of a REIT possessing 50 percent or more of the combined voting power of all classes of voting stock or 50 percent or more of the total value of shares of all classes of stock of the REIT. The provision is effective for entities electing REIT status for taxable years ending after July 12, 1999. Any entity that elects REIT status for a taxable year ending on or before July 12, 1999 and which has significant business assets or activities as of such date is not subject to the provision.

Limit Conversion of Character of Income from Constructive Ownership Transactions.—The bill limits the amount of long-term capital gain a taxpayer can recognize from certain derivative contracts transactions with respect to certain financial assets. The amount of long-term capital gain is limited to the amount of such gain the taxpayer would have had if the taxpayer held the financial asset directly during the term of the derivative contract. Any gain in excess of this amount is treated as ordinary income. An interest charge is imposed on the amount of gain that is treated as ordinary income. This provision applies to transactions entered into on or after July 12, 1999.

Impose Limitation on Prefunding of Certain Employee Benefits.—The present-law provision permitting qualified transfers of excess defined benefit pension plan assets to provide retiree health benefits under a section 401(h) account is extended through September 30, 2009. In addition, the present-law minimum benefit requirement is replaced by the minimum cost requirement that applied to qualified transfers before December 9, 1994, to section 401(h) accounts. The bill generally is effective with respect to qualified transfers of excess defined benefit pension plan assets to section 401(h) accounts after December 31, 2000, and before October 1, 2009. The modification of the minimum benefit requirement is effective with respect to transfers after the date of enactment.

Modify Installment Method and Prohibit its Use by Accrual Method Taxpayers.—The bill generally prohibits the use of the installment method of accounting for dispositions of property that otherwise would be reported for Federal income tax purposes using an accrual method of accounting. The bill does not change present law regarding the availability of the installment method for dispositions of property used or produced in the trade or business of farming. The bill also does not change present law regarding the availability of the installment method for dispositions of timeshares or residential lots if the taxpayer elects to pay interest under section 453(*l*). The bill does not change the ability of a cash method taxpayer to use the installment method. The bill does not change the ability of this individual to use the installment method in reporting the gain on the sale of the stock. The bill also modifies the pledge rule to provide that entering into any arrangement that gives the taxpayer the right to satisfy an obligation with an installment note is treated in the same manner as the direct pledge of the installment note. Under the bill, the taxpayer also is required to treat the proceeds of a loan as payment on the installment note to the extent the taxpayer had the right to "put" or repay the loan by transferring the installment note to the taxpayer's creditor. Other arrangements that have a similar effect would be treated in the same manner. The proposed modification of the pledge rule applies only to installment sales where the pledge rule of present law applies. Accordingly, the bill does not apply to installment method sales made by a dealer in timeshares and residential lots where the taxpayer elects to pay interest under section 453(*l*)(2)(B), to sales of property used or produced in the trade or business of farming, or to dispositions where the sales price does not exceed $150,000, since such sales are not subject to the pledge rule under present law. The provision prohibiting the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting is effective for installment sales entered into on or after the date of enactment. The provision modifying the pledge rules is effective for arrangements entered into on or after the date of enactment.

Exclusion of Like-Kind Exchange Property from Nonrecognition Treatment on the Sale of a Principal Residence.—The bill denies the principal residence exclusion for gain on the sale or exchange of a principal residence if such principal residence was acquired in a like-kind exchange in which any gain was not recognized within the prior five years. The provision is effective for sales or exchanges of principal residences after the date of enactment.

XVI. Tax technical corrections

The bill adopts technical corrections to recent tax legislation.

B. Background and Need for Legislation

Under the Fiscal Year 2000 Budget Resolution (H. Con. Res. 68), as updated to reflect the July 1, 1999 Congressional Budget Office revision in budget surplus projections, the Committee on Ways and Means was instructed to report revenue reconciliation provisions for a net $200 billion of tax reductions for fiscal years 1999–2004, and a net $864 billion of tax reductions for fiscal years 1999–2009.

The revenue reconciliation provisions approved by the Committee reflect the need for tax relief for individuals, families, and small businesses, tax incentives for education savings, tax incentives for distressed communities and industries, health care tax incentives, international tax relief, real estate tax relief, pension reforms, certain miscellaneous provisions, extensions of certain expiring tax provisions, certain revenue offsets, and necessary tax technical corrections.

C. Legislative History

Committee Action

H.R. 2488 (the "Financial Freedom Act of 1999") was introduced by Chairman Archer on July 13, 1999. The Committee on Ways and Means marked up the bill on July 13 and 14, 1999, and approved the provisions, as amended, on July 14, 1999, by a roll call vote of 23 yeas and 13 nays, with a quorum present.

COMMITTEE HEARINGS

The following Committee and Subcommittee hearings related to provisions in the bill have been held during the 106th Congress.

Full Committee hearings

Tax-related hearings were held by the full Committee as follows:

Outlook for the state of the U.S. economy (January 20, 1999).

President's fiscal year 2000 budget (February 4, 1999).

Revenue provisions in President's fiscal year 2000 budget (March 10, 1999).

Reducing the tax burden: Enhancing retirement and health security (June 16, 1999).

Reducing the tax burden: Providing tax relief to strengthen the family and sustain a strong economy (June 23, 1999).

Impact of U.S. tax rules on international competitiveness (June 30, 1999).

Subcommittee hearings

The Oversight Subcommittee held tax-related hearings as follows:

Incentives for domestic oil and gas production and status of the industry (February 25, 1999).

Tax treatment of structured settlements (March 18, 1999).

Pension issues (March 23, 1999).

Impact of complexity in the tax Code on individual taxpayers and small businesses (May 25, 1999).

Current U.S. international tax regime (June 22, 1999).

Work opportunity tax credit (July 1, 1999).

II. EXPLANATION OF THE BILL

TITLE I. BROAD-BASED TAX RELIEF

A. Reduction in Individual Income Tax Rates

(sec. 101 of the bill and secs. 1 and 55 of the Code)

PRESENT LAW

Income tax rate structure

To determine regular income tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. The income bracket amounts are indexed for inflation. Separate rate schedules apply based on an individual's filing status. In order to limit multiple uses of a graduated rate schedule within a family, the net unearned income of a child under age 14 is taxed as if it were the parent's income. For 1999, the individual regular income tax rate schedules are shown below.

TABLE 1.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 1999

If taxable income is:	Then income tax equals:
Single individuals	
$0–25,750	15 percent of taxable income.
$25,750–$62,450	$3,862.50, plus 28% of the amount over $25,750.
$62,450–$130,250	$14,138.50 plus 31% of the amount over $62,450.
$130,250–$283,150	$35,156.50 plus 36% of the amount over $130,250.
Over $283,150	$90,200.50 plus 39.6% of the amount over $283,150.
Heads of households	
$0–$34,550	15 percent of taxable income.
$34,550–$89,150	$5,182.50 plus 28% of the amount over $34,550.
$89,150–$144,400	$20,470.50 plus 31% of the amount over $89,150.
$144,400–$283,150	$37,598 plus 36% of the amount over $144,400.
Over $283,150	$87,548 plus 39.6% of the amount over $283,150.
Married individuals filing joint returns	
$0–$43,050	15 percent of taxable income.
$43,050–$104,050	$6,457.50 plus 28% of the amount over $43,050.
$104,050–$158,550	$23,537.50 plus 31% of the amount over $104,050.
$158,550–$283,150	$40,432.50 plus 36% of the amount over $158,550.
Over $283,150	$85,288.50 plus 39.6% of the amount over $283,150.

Individual alternative minimum tax ("AMT") rate structure

Present law imposes the individual AMT on an individual to the extent the taxpayer's minimum tax liability exceeds his or her regular tax liability. The AMT is imposed upon individuals at rates of (1) 26 percent on the first $175,000 of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent on the amount in excess of $175,000. AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. The exemption amounts are $45,000 in the case of married individuals filing a joint return and surviving spouses; $33,750 in the case of other unmarried individuals; and $22,500 in the case of married individuals filing a separate return. These exemption amounts are phased-out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds a threshold amount. The threshold amounts are $150,000 in the case of married individuals filing a joint return and surviving spouses; $112,500 in the case of other unmarried individuals; and $75,000 in the case of married individuals filing a separate return, estates, and trusts. The exemption amounts, the threshold phase-out amounts, and the $175,000 break-point amount are not indexed for inflation. The lower capital gains rates applicable to the regular tax also apply for purposes of the AMT.

REASONS FOR CHANGE

The Committee believes that the growing budget surplus belongs to the American people and that it should be returned to them. Also, the Committee believes that the American people deserve relief from the excessive and growing tax burden imposed by the tax system. It believes that these rate reductions will provide equitable across-the-board relief to all taxpayers.

EXPLANATION OF PROVISION

Individual regular tax rates

The bill reduces the regular income tax rates by 10 percent over a 10-year period (2000–2009). Specifically, each rate is reduced by 2.5 percent for taxable years beginning in 2001–2004, 5 percent in 2005–2007, 7.5 percent in 2008, and 10 percent in 2009 and thereafter. The tax rates will be rounded up annually to the nearest one-tenth of a percent. The following table shows the regular tax rate structure under the bill.

INDIVIDUAL REGULAR TAX RATES 1999–2000

[In percent]

1999–2000	2001–2004	2005–2007	2008	2009 and thereafter
15	14.7	14.3	13.9	13.5
28	27.3	26.6	25.9	25.2
31	30.3	29.5	28.7	27.9
36	35.1	34.2	33.3	32.4
39.6	38.7	37.7	36.7	35.7

This rate reduction does not apply to the capital gains tax rates. However, a separate provision (described in Part Title II.B., below) will reduce individual capital gains rates.

Individual AMT

The bill reduces the individual AMT tax rates by a total of 2.5 percent for taxable years beginning in 2001–2004, 5 percent in 2005–2007, 7.5 percent in 2008, and 10 percent in 2009 and thereafter. The rates will be rounded up annually to the nearest one-tenth of a percent, like the regular income tax rates. The following table shows the AMT rate structure under the bill including the provision in Title II.C., below, to repeal the individual AMT.

INDIVIDUAL AMT RATES

[In percent]

1999–2000	2001–2004	2005–2007	2008 and thereafter
26	25.4	24.7	0.0
28	27.3	26.6	0.0

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

B. Marriage Penalty Relief Provisions

1. Standard deduction tax relief (sec. 111 of the bill and sec. 63 of the Code)

PRESENT LAW

Marriage penalty

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

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

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

Under present law, the size of the standard deduction and the tax bracket breakpoints follow certain customary ratios across filing statuses. The standard deduction and tax bracket breakpoints for single filers are roughly 60 percent of those for joint filers.[1] With these ratios, unmarried individuals have standard deductions whose sum exceeds the standard deduction they would receive as a married couple filing a joint return. Thus, their taxable income as joint filers may exceed the sum of their taxable incomes as unmarried individuals.

Basic standard deduction

Taxpayers who do not itemize deductions may choose the basic standard deduction (and additional standard deductions, if applicable), which is subtracted (along with the deduction for personal exemptions) from adjusted gross income ("AGI") in arriving at taxable income. The size of the basic standard deduction varies according to filing status and is indexed for inflation. For 1999, the size of the basic standard deduction is as follows:

Filing status	*Basic standard deduction*[2]
Married, joint return	$7,200
Head of household return	6,250
Single return	4,300
Married, separate return	3,600

For 1999, the basic standard deduction for joint returns is 1.674 times the basic standard deduction for single returns.

REASONS FOR CHANGE

The Committee is concerned about the inequity of the marriage penalty created by the present-law income tax. The Committee believes that relief from the marriage penalty is needed because the marriage penalty may undermine respect for the family and may discourage family formation. Any attempt to address the marriage penalty involves the balancing of several competing principles, including equal tax treatment of married couples with equal incomes

[1] This is not true for the 39.6-percent rate. The beginning point of this rate bracket is the same for all taxpayers regardless of filing status.
[2] Joint Committee on Taxation staff projections.

and the determination of equitable relative tax burdens of single individuals and married couples with equal incomes. The Committee believes that an increase in the standard deduction for married couples filing a joint return is a responsible first step towards removing the marriage penalty. It provides tax relief in 2003 to approximately 24 million joint returns, including more than 6 million returns filed by senior citizens.[3] Approximately 3 million returns which currently itemize their deductions will realize the simplification benefits of using the basic standard deduction.[4]

EXPLANATION OF PROVISION

The bill increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual in each taxable year. This increase is phased-in over three years beginning in 2001 by increasing the standard deduction for a married couple filing a joint return to 1.778 times the standard deduction for an unmarried individual in 2001 and to 1.889 times such amount in 2002. Therefore, the provision is fully effective, (i.e., the basic standard deduction for a married couple will be twice the basic standard deduction for an unmarried individual) for taxable years beginning after December 31, 2002. Also, the basic standard deduction for a married taxpayer filing separately will be increased so that it will continue to equal one-half of the basic standard deduction for a married couple filing jointly. The basic standard deduction for a head of household will be unchanged.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

2. Adjust student loan interest deduction income limits (sec. 112 of the bill and sec. 221 of the Code)

PRESENT LAW

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit (sec. 221). The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include nonmandatory payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the

[3] Joint Committee on Taxation staff projections of the number of tax returns affected.
[4] Joint Committee on Taxation staff projections of the number of tax returns affected.

taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The maximum allowable deduction per taxpayer return is $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and thereafter.[5] The deduction is phased out ratably for individual taxpayers with modified adjusted gross income of $40,000–$55,000 and $60,000–$75,000 for joint returns. The income ranges will be indexed for inflation after 2002.

REASONS FOR CHANGE

The Committee is concerned about the inequity of the marriage penalty resulting from the phase-out provisions of the student loan interest deduction. The Committee believes that relief from the marriage penalty is appropriate for individuals with education loan obligations in order to assist in removing tax considerations from decisions regarding marriage.

EXPLANATION OF PROVISION

The bill increases the beginning point of the income phaseout for the student loan interest deduction for taxpayers filing joint returns to twice the beginning point of the income phaseouts applicable to single taxpayers and doubles the phaseout range for joint filers. Thus, beginning in 2000, the deduction is phased out ratably for taxpayers filing joint returns with modified adjusted gross income of $80,000 to $110,000.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

3. Increase income limit for Roth IRA conversions (sec. 113 of the bill and sec. 408A of the Code)

PRESENT LAW

Individuals with adjusted gross income below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that an individual may make to a Roth IRA is the lesser of $2,000 or the individual's compensation for the year. This contribution limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year. With respect to married individuals, a contribution of up to $2,000 for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual Roth IRA contribution is phased out for single individuals with AGI between $95,000 and $110,000,

[5] The maximum allowable deduction for 1998 was $1,000.

and for married individuals filing joint returns with AGI between $150,000 and $160,000.

A taxpayer with AGI of $100,000 or less generally may convert a deductible or nondeductible IRA into a Roth IRA, unless the taxpayer is a married individual filing a separate return. The value of the IRA that is converted is includible in income as if the taxpayer made a withdrawal, except that the 10-percent early withdrawal tax does not apply.

REASONS FOR CHANGE

The present-law income limits for conversions to Roth IRAs create a marriage penalty, because the same income limit applies to single filers and married couples filing a joint return. The Committee believes it appropriate to reduce this marriage penalty by increasing the income limit for married filers to the upper end of the Roth IRA contribution phase-out range for married couples filing joint returns.

EXPLANATION OF PROVISION

The bill increases for married individuals filing joint return the present-law $100,000 AGI limitation on conversion of a deductible or nondeductible IRA into a Roth IRA. The increased AGI limitation matches the upper end of the Roth IRA contribution phase-out range for married individuals filing joint returns. Therefore, married individuals filing joint returns with AGI not exceeding $160,000 are permitted to convert a deductible or nondeductible IRA into a Roth IRA.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

C. Repeal Individual Alternative Minimum Tax

(sec. 121 of the bill and sec. 55 of the Code)

PRESENT LAW

In general

Present law imposes a minimum tax ("AMT") on an individual to the extent the taxpayer's minimum tax liability exceeds his or her regular tax liability. The AMT is imposed on individuals at rates of (1) 26 percent on the first $175,000 of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent on the remaining AMTI. The exemptions amounts are $45,000 in the case of married individuals filing a joint return and surviving spouses; $33,750 in the case of other unmarried individuals; and $22,500 in the case of married individuals filing a separate return. These exemption amounts are phased-out by an amount equal to 25 percent of the amount that the individual's AMTI exceeds a threshold amount. These threshold amounts are $150,000 in the case of married individuals filing a joint return and surviving spouses; $112,500 in the case of other unmarried individuals; and $75,000 in the case of married individuals filing a separate return, estates, and trusts. The exemption amounts, the threshold phase-out amounts, and the $175,000 break-point amount are not indexed for inflation. The lower capital gains rates applicable to the regular tax apply for purposes of the AMT.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Preference items in computing AMTI

The minimum tax preference items are:

(1) The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. This preference does not apply to percentage depletion allowed with respect to oil and gas properties.

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to an independent producer to the extent the preference would not reduce the producer's AMTI by more than 40 percent.

(3) Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986.

(4) Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

(5) Forty-two percent of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter, farm, or passive activities are denied.[6]

Adjustments in computing AMTI

The adjustments that individuals must make in computing AMTI are:

(1) Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence.

(2) Mining exploration and development costs must be capitalized and amortized over a 10-year period.

(3) Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

(4) The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alter-

[6] Given the passage of section 469 by the Tax Reform Act of 1986 (relating to the deductibility of losses from passive activities), these provisions are largely "deadwood."

native depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

(5) Miscellaneous itemized deductions are not allowed.

(6) Itemized deductions for State, local, and foreign real property taxes, State and local personal property taxes, and State, local, and foreign income, war profits, and excess profits taxes are not allowed.

(7) Medical expenses are allowed only to the extent they exceed 10 percent of the taxpayer's adjusted gross income (AGI).

(8) Standard deductions and personal exemptions are not allowed.

(9) The amount allowable as a deduction for circulation expenditures must be capitalized and amortized over a 3-year period.

(10) The amount allowable as a deduction for research and experimental expenditures must be capitalized and amortized over a 10-year period.[7]

(11) The regular tax rules relating to incentive stock options do not apply.

Other rules

The combination of the taxpayer's net operating loss carryover and foreign tax credits cannot reduce the taxpayer's AMT liability by more than 90 percent of the amount determined without these items.

The various nonrefundable credits allowed under the regular tax generally are allowed only to the extent that the individual's regular tax exceeds the tentative minimum tax. The earned income credit and the child credit of those taxpayers with three or more qualified children are refundable credits and may offset the taxpayer's tentative minimum tax. However, a taxpayer must reduce these refundable credits by the amount the taxpayer's tentative minimum tax exceeds his or her regular tax liability.[8]

If an individual is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds his or her tentative minimum tax in such subsequent year. For individuals, the AMT credit is allowed only to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature. Most individual AMT adjustments relate to itemized deductions and personal exemptions and are not timing in nature.

REASONS FOR CHANGE

The Committee is concerned that the individual AMT is a source of great complexity for an increasing number of individual taxpayers. Therefore the bill repeals the individual AMT.

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[7] No adjustment is required if the taxpayer materially participates in the activity that relates to the research and experimental expenditures.

[8] For 1998 only, the nonrefundable personal credits were not limited by the tentative minimum tax, and the refundable child credit was not reduced by the minimum tax.

EXPLANATION OF PROVISION

The bill allows an individual to offset the entire regular tax liability (without regard to the minimum tax) by the personal nonrefundable credits. The bill also repeals the provision reducing the refundable child credit by the AMT.

The bill phase-outs the individual AMT. For taxable years beginning in 2003, only 80 percent of the full AMT liability will be imposed. That percentage will be reduced to 70 percent in 2004, 60 percent in 2005, 50 percent in 2006 and 2007, and the AMT will be fully repealed for taxable years beginning after 2007.

An individual will be allowed to use the AMT credit to offset 90 percent of its regular tax liability (determined after the application of the other nonrefundable credits).

The repeal of the individual AMT will eliminate the present-law marriage penalty in the individual AMT.

EFFECTIVE DATES

The provisions relating to the personal credits are effective for taxable years beginning after December 31, 1998. The phase-out of the AMT will be effective for taxable years beginning after December 31, 2002. The repeal of the AMT and the provision relating to the use of AMT credits apply to taxable years beginning after December 31, 2007.

TITLE II. SAVINGS AND INVESTMENT TAX RELIEF PROVISIONS

A. PARTIAL EXCLUSION FOR INTEREST AND DIVIDENDS

(sec. 201 of the bill and new sec. 116 of the Code)

PRESENT LAW

The Code states that, except as otherwise provided, "gross income means all income from whatever source derived" (sec. 61). Because there is no exclusion for interest and dividends, interest and dividends received by individuals are includible in gross income and subject to tax.

REASONS FOR CHANGE

The Committee believes that an exclusion from income for interest and dividends will provide an incentive for saving and will simplify the tax returns of a number of individuals. Approximately 65 million tax returns for 2003 will reflect tax savings as a result of this provision; out of that number, approximately 30 million tax returns will reflect a total exclusion from tax for all interest and dividends received.[9]

EXPLANATION OF PROVISION

The bill gives individual taxpayers an exclusion from income of interest and dividends (other than capital gain dividends from RICs and REITs, dividends from farmers' cooperative associations,

[9] Joint Committee on Taxation staff projections.

and dividends received from an employee stock ownership plan), received during a taxable year.[10] The maximum exclusion from income is $100 of combined interest and dividends ($200 for married couples filing a joint return) for taxable years beginning after December 31, 2000. The maximum exclusion is $200 of combined interest and dividends ($400 for married couples filing a joint return) for taxable years beginning after December 31, 2002. The amount of the combined interest and dividends excluded under this proposal is in addition to the amount of any interest or dividend which is exempt from tax under any other provision (e.g., interest on certain State and local bonds which is exempt from tax under section 103 of the Code).

In determining eligibility for the earned income credit ("EIC"), any interest or dividends excluded from gross income under this provision are included in modified adjusted gross income for purposes of phase-out rules of the EIC and disqualified income for purposes of the EIC disqualified income test. Similarly, any interest or dividends excluded from gross income under this provision are included in modified adjusted gross income for purposes of the taxation of certain Social Security benefits.

The fact that dividends may be excluded from income pursuant to this provision does not affect the computation of the foreign tax credit.

The exclusion under this provision is in addition to, and is applied after, the exclusion for educational savings bond interest (sec. 135). In applying those provisions of the Code (such as secs. 86, 219, 221, and 469) that determine modified adjusted gross income without regard to section 135, it is intended that the exclusion under this provision be computed without regard to the exclusion under section 135.

In addition, the Committee encourages the IRS to simplify the process of completing tax forms to the greatest extent practicable, including, for example, considering raising the administratively-established dollar thresholds for completing Schedule B or for being able to use the Form 1040EZ.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

B. REDUCE INDIVIDUAL CAPITAL GAINS RATES

(sec. 202 of the bill and secs. 1 and 55 of the Code)

PRESENT LAW

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of capital assets, any gain generally is included in income, and the net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordi-

[10] From 1954 until 1986, the Code (sec. 116) contained an exclusion from income (in varying amounts) for dividends. For 1981 only, that provision was also extended to interest; this proposal is generally parallel to that provision. The exclusion for dividends was repealed by the Tax Reform Act of 1986.

nary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances that would have been available under the straight-line method of depreciation.

The maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. In addition, any adjusted net capital gain which otherwise would be taxed at the lowest individual rate (currently 15 percent) is taxed at a 10–percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax.

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain which the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) ("collectibles gain and loss"), an amount of gain equal to the amount of gain excluded from gross income under section 1202, relating to certain small business stock ("section 1202 gain"),[11] the net short-term capital loss for the taxable year, and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, rather than only to a portion of the depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 applies shall not exceed the net section 1231 gain for the year.

[11] This results in a maximum effective regular tax rate on qualified gain from small business stock of 14 percent.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent.

For taxable years beginning after December 31, 2000, any gain from the sale or exchange of property held more than five years which would otherwise be taxed at the 10-percent rate will instead be taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which begins after December 31, 2000, which would otherwise be taxed at a 20-percent rate will be taxed at an 18-percent rate. A taxpayer holding a capital asset or property used in the trade or business on January 1, 2001, may elect to treat the asset as having been sold in a taxable transaction on that date for an amount equal to its fair market value, and having been reacquired for an amount equal to such value.

REASONS FOR CHANGE

The Committee believes it is important that tax policy be conducive to economic growth. Economic growth cannot occur without savings, investment, and the willingness of individuals to take risks. The greater the pool of savings, the greater the monies available for business investment. It is through such investment that the United States' economy can increase output and productivity. It is through increases in productivity that workers earn higher real wages. Hence, a greater saving rate is necessary for all Americans to benefit from a higher standard of living.

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

EXPLANATION OF PROVISION

The bill reduces the 10- and 20-percent rates on the adjusted net capital gain to 7.5 and 15 percent, respectively. The 25-percent rate on unrecaptured section 1250 gain is reduced to 20 percent. These lower rates apply to both the regular tax and the alternative minimum tax.[12]

The provision repeals the 8- and 18-percent rates on certain gain from property held more than 5 years.

EFFECTIVE DATE

The provision applies to taxable years ending on or after July 1, 1999.

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[12] The provision does not change the regular tax rate for gain from collectibles and small business stock. The provision reduces the maximum effective AMT rate on small business stock to slightly below 15 percent (depending on the amount of individual rate cut for the taxable year).

For taxable years which include July 1, 1999, the lower rates apply to amounts properly taken into account for the portion of the year on or after that date. This generally has the effect of applying the lower rates to capital assets sold or exchanged (and installment payments received) on or after July 1, 1999. In the case of gain taken into account by a pass-through entity, the date taken into account by the entity is the appropriate date for applying this rule.

C. Apply Capital Gain Rates to Capital Gains Earned by Designated Settlement Funds

(sec. 203 of the bill and sec. 468B of the Code)

PRESENT LAW

Under present law, designated settlement funds are taxed at the highest rate of tax imposed on individuals, currently 39.6 percent, on their entire taxable income (sec. 468B).

REASONS FOR CHANGE

The Committee believes that the net capital gain of a designated settlement fund should be taxed at the same rates as the net capital gain of an individual.

EXPLANATION OF PROVISION

Under the bill, the net capital gain of a designated settlement fund will be taxed in the same manner as in the case of an individual, i.e., the lower rates applicable to net capital gain set forth in section 1(h), as amended by the bill, will apply.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 1999.

D. Exclusion of Gain on the Sale of a Principal Residence by a Member of the Uniformed Service or the Foreign Service of the United States or Certain Other Individuals Relocated Outside of the United States

(sec. 204 of the bill and sec. 121 of the Code)

PRESENT LAW

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to: (1) members of the uniformed services or the Foreign Service of the

United States or (2) individuals relocated outside of the United States.

REASONS FOR CHANGE

The Committee believes that members of the uniformed services and the Foreign Service of the United States who would otherwise qualify for the exclusion of the gain on the sale of a principal residence should not be deprived the exclusion because of service to their country. Further, the Committee believes that when an employee is relocated outside of the United States for an extended period of time that such individual and the individual's spouse should not be deprived of the exclusion if the absence from the principal residence does not exceed five years.

EXPLANATION OF PROVISION

Under the bill, the five-year test period for ownership and use is suspended during certain absences due to service in the uniformed services or the Foreign Service of the United States. The uniformed services include: (1) the armed forces (the Army, Navy, Air Force, Marine Corp, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. Specifically, the five-year period ending on the date of the sale or exchange of a principal residence will not include any periods during which the taxpayer or the taxpayer's spouse is on qualified official extended duty as a member of the uniformed services or the Foreign Service of the United States. Qualified official extended duty is any period of extended duty by a member of the uniformed services or the Foreign Service of the United States while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

The bill also suspends for up to five years, the five-year test period for an individual relocated for a period of more than 90 days outside of the United States by the individual's (or spouse's) employer. This provision does not apply to self-employed individuals.

EFFECTIVE DATE

The provision is effective for sales or exchanges of principal residences after the date of enactment.

E. Clarify the Tax Treatment of Income and Losses on Derivatives

(sec. 205 of the bill and sec. 1221 of the Code)

PRESENT LAW

Capital gain treatment applies to gain on the sale or exchange of a capital asset. Capital assets include property other than (1) stock in trade or other types of assets includible in inventory, (2) property used in a trade or business that is real property or property subject to depreciation, (3) accounts or notes receivable acquired in the ordinary course of a trade or business, or (4) certain copyrights (or similar property) and U.S. government publications. Gain or loss on such assets generally is treated as ordinary, rather than capital, gain or loss. Certain other Code sections also treat gains or losses as ordinary. For example, the gains or losses of securities dealers or certain electing commodities dealers or electing traders in securities or commodities that are subject to "mark-to-market" accounting are treated as ordinary (sec. 475).

Under case law in a number of Federal courts prior to 1988, business hedges generally were treated as giving rise to ordinary, rather than capital, income or loss. In 1988, the U.S. Supreme Court rejected this interpretation in *Arkansas Best* v. *Commissioner* which, relying on the statutory definition of a capital asset described above, held that a loss realized on a sale of stock was capital even though the stock was purchased for a business, rather than an investment, purpose.[13]

Treasury regulations (which were finalized in 1994) require ordinary character treatment for most business hedges and provide timing rules requiring that gains or losses on hedging transactions be taken into account in a manner that matches the income or loss from the hedged item or items. The regulations apply to hedges that meet a standard of "risk reduction" with respect to ordinary property held (or to be held) or certain liabilities incurred (or to be incurred) by the taxpayer and that meet certain identification and other requirements (Treas. reg. sec. 1.1221–2).

REASONS FOR CHANGE

Derivative financial instruments entered into by securities dealers generally are required to be marked to market and the resulting gain or loss is automatically treated as ordinary income or loss under section 475. With respect to commodities derivative financial instruments entered into by a commodities derivatives dealer, on the other hand, the character of the gains and losses therefrom may be unclear (absent an election to be treated the same as a dealer in securities under section 475). The Committee is concerned that this uncertainty (i.e., the potential for capital treatment of the commodities derivatives financial instruments) could inhibit commodities derivatives dealers from entering into transactions with respect to commodities derivative financial instruments that qualify as "hedging transactions" within the meaning of the Treasury regulations under section 1221. The Committee believes that commodities derivatives financial instruments are integrally related to the ordinary course of the trade or business of commodities derivatives dealers and, therefore, such assets should be treated as ordinary assets.

The Committee further believes that ordinary character treatment is appropriate for business hedges with respect to ordinary property. The Committee believes that the approach taken in Treasury regulations with respect to the character of hedging transactions generally should be codified. The Treasury regulations model the definition of a hedging transaction after the present-law definition contained in section 1256, which generally requires that

[13] 485 U.S. 212 (1988).

a hedging transaction "reduces" a taxpayer's risk. The Committee believes that a "risk management" standard better describes modern business hedging practices that appropriately should be accorded ordinary character treatment. In fact, Treasury regulations appropriately interpret risk reduction flexibly within the constraints of present law. For example, the regulations recognize that certain transactions that economically convert an interest rate or price from a fixed rate or price to a floating rate or price may qualify as hedging transactions.[14] Similarly, the regulations provide hedging treatment for certain written call options, hedges of aggregate risk, dynamic hedges under which a taxpayer can more frequently manage or adjust its exposure to identified risk, partial hedges, "recycled" hedges (using a position entered into to hedge one asset or liability to hedge another asset or liability), and hedges of aggregate risk.[15] The Committee believes that (depending on the facts) treatment of such transactions as hedging transactions is appropriate and that it also is appropriate to modernize the definition of a hedging transaction by providing risk management as the standard.

The Committee does not intend that speculative transactions or other transactions not entered into in the normal course of a taxpayer's trade or business should qualify for ordinary character treatment, and risk management should not be interpreted so broadly as to cover such transactions. In addition, to minimize whipsaw potential, the Committee believes that it is essential for hedging transactions to be properly identified by the taxpayer when the hedging transaction is entered into.

Finally, because hedging status under present law is dependent upon the ordinary character of the property being hedged, an issue arises with respect to hedges of certain supplies, sales of which could give rise to capital gain, but which are generally consumed in the ordinary course of a taxpayer's trade or business and that would give rise to ordinary deductions. For purposes of defining a hedging transaction, Treasury regulations treat such supplies as ordinary property.[16] The Committee believes that it is appropriate to confirm this treatment by specifying that such supplies are ordinary assets.

EXPLANATION OF PROVISION

The bill adds three categories to the list of assets the gain or loss on which is treated as ordinary (sec. 1221). The new categories are: (1) commodities derivative financial instruments entered into by derivatives dealers; (2) hedging transactions; and (3) supplies of a type regularly consumed by the taxpayer in the ordinary course of a taxpayer's trade or business.

For this purpose, a commodities derivatives dealer is any person that regularly offers to enter into, assume, offset, assign or terminate positions in commodities derivative financial instruments with customers in the ordinary course of a trade or business. A commodities derivative financial instrument means a contract or financial instrument with respect to commodities, the value or settlement

[14] Treas. Reg. sec. 1. 1221–2(c)(1)(ii)(B).
[15] See Treas. Reg. sec. 1.1221–2(c).
[16] Treas. Reg. sec. 1.1221–2(c)(5)(ii).

price of which is calculated by reference to any combination of a fixed rate, price, or amount, or a variable rate, price, or amount, which is based on current, objectively determinable financial or economic information. This includes swaps, caps, floors, options, futures contracts, forward contracts, and similar financial instruments with respect to commodities. It does not include shares of stock in a corporation; a beneficial interest in a partnership or trust; a note, bond, debenture, or other evidence of indebtedness; or a contract to which section 1256 applies.

In defining a hedging transaction, the provision generally codifies the approach taken by the Treasury regulations, but modifies the rules. The "risk reduction" standard of the regulations is broadened to "risk management" with respect to ordinary property held (or to be held) or certain liabilities incurred (or to be incurred). As under the Treasury regulations, the transaction must be identified as a hedge of specified property. It is intended that this be the exclusive means through which the gains or losses with respect to a hedging transaction are treated as ordinary. Authority is provided for Treasury regulations that would address improperly identified or non-identified hedging transactions. The Treasury Secretary is also given authority to apply these rules to related parties.

EFFECTIVE DATE

The provision is effective for any instrument held, acquired or entered into, any transaction entered into, and supplies held or acquired on or after the date of enactment.

F. TREATMENT OF LOSS ON WORTHLESS STOCK OF SUBSIDIARY

(sec. 206 of the bill and sec. 165(g)(3) of the Code)

PRESENT LAW

Under present law, the loss on stock of a subsidiary corporation that becomes worthless is treated as an ordinary loss (rather than a capital loss), unless 10 percent or more of its gross receipts for all taxable years has been, with minor exceptions, from royalties, rents, dividends, interest, annuities, and gains from the sales or exchanges of stocks and securities (sec. 165(g)(3)).

REASONS FOR CHANGE

The Committee believes that the worthless stock of an insurance company or financial institution that is engaged in an active business should be treated the same as the worthless stock of other active businesses.

EXPLANATION OF PROVISION

Under the bill, income from the conduct of an active trade or business of an insurance company or financial institution will not be included as gross receipts from the types of passive income listed above. Thus, a loss recognized with respect to the worthless stock of a subsidiary corporation which is an insurance company or financial institution could be treated as an ordinary loss, rather than as a capital loss.

EFFECTIVE DATE

The provision applies to stock becoming worthless in taxable years beginning after December 31, 1999.

TITLE III. BUSINESS INVESTMENT AND JOB CREATION

A. Alternative Tax for Corporate Capital Gains

(sec. 301 of the bill and sec. 1201 of the Code)

PRESENT LAW

Under present law, the net capital gain of a corporation is taxed at the same rates as ordinary income, and subject to tax at graduated rates up to 35 percent.

REASONS FOR CHANGE

The Committee believes it is important that tax policy be conducive to economic growth. Economic growth cannot occur without savings, investment, and the willingness of business to take risks and exploit new economic opportunities. The greater the pool of savings, the greater the monies available for business investment in equipment and research. It is through such investment in equipment and new products and services that the United States economy can increase output and productivity. It is through increases in productivity that workers earn higher real wages. Hence, a greater saving rate is necessary for all Americans to benefit through a higher standard of living.

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

EXPLANATION OF PROVISION

Under the bill, an alternative tax applies to the net capital gain of a corporation if that tax is lower than the corporation's regular tax. For taxable years beginning in 2000, the rate of the alternative tax is 34.1 percent. The alternative tax rate is reduced for each subsequent year, until a 25-percent rate is reached. The 25-percent rate applies to taxable years beginning after 2009.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 1999.

B. Repeal Corporate Alternative Minimum Tax

(sec. 302(a) of the bill and sec. 55 of the Code)

PRESENT LAW

In general

Present law imposes a minimum tax on a corporation to the extent the corporation's minimum tax liability exceeds its regular tax liability. This alternative minimum tax ("AMT") is imposed on corporations at the rate of 20 percent on the alternative minimum taxable income ("AMTI") in excess of a $40,000 phased-out exemption amount. The exemption amount is phased-out by an amount equal to 25 percent of the amount that the corporation's AMTI exceeds $150,000.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

A corporation with average gross receipts of less than $7.5 million for the prior three taxable years is exempt from the corporate minimum tax. The $7.5 million threshold is reduced to $5 million for the corporation's first 3-taxable year period.

Preference items in computing AMTI

The corporate minimum tax preference items are:

(1) The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. This preference does not apply to percentage depletion allowed with respect to oil and gas properties.

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to an independent producer to the extent the preference would not reduce the producer's AMTI by more than 40 percent.

(3) Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986.

(4) Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

Adjustments in computing AMTI

The adjustments that corporations must make in computing AMTI are:

(1) Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence.

(2) Mining exploration and development costs must be capitalized and amortized over a 10-year period.

(3) Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

(4) The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for

pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

(5) The special rules applicable to Merchant Marine construction funds are not applicable.

(6) The special deduction allowable under section 833(b) for Blue Cross and Blue Shield organizations is not allowed.

(7) The adjusted current earnings adjustment, described below.

Adjusted current earning ("ACE") adjustment

The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings ("ACE") of a corporation exceeds its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction. In determining ACE the following rules apply:

(1) For property placed in service before 1994, depreciation generally is determined using the straight-line method and the class life determined under the alternative depreciation system.

(2) Any amount that is excluded from gross income under the regular tax but is included for purposes of determining earnings and profits is included in determining ACE.

(3) The inside build-up of a life insurance contract is included in ACE (and the related premiums are deductible).

(4) Intangible drilling costs of integrated oil companies must be capitalized and amortized over a 60-month period.

(5) The regular tax rules of section 173 (allowing circulation expenses to be amortized) and section 248 (allowing organizational expenses to be amortized) do not apply.

(6) Inventory must be calculated using the FIFO, rather than LIFO, method.

(7) The installment sales method generally may not be used.

(8) No loss may be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

(9) Depletion (other than for oil and gas) must be calculated using the cost, rather than the percentage, method.

(10) In certain cases, the assets of a corporation that has undergone an ownership change must be stepped-down to their fair market values.

Other rules

The combination of the taxpayer's net operating loss carryover and foreign tax credits cannot reduce the taxpayer's AMT liability by more than 90 percent of the amount determined without these items.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT.

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

REASONS FOR CHANGE

The Committee believes that the corporate AMT inhibits capital formation and business enterprise, and is administratively complex. Therefore, the bill repeals the corporate AMT.

EXPLANATION OF PROVISION

For taxable years beginning in 2003, the limitation on the amount of AMT credits allowable to a corporation will be increased by 20 percent of the corporation's tentative minimum tax. This percentage is raised to 30 and 40 percent, respectively, for 2004 and 2005, and is raised to 50 percent for 2006 and 2007. The AMT credit may not exceed an amount equal to the sum of the regular tax and minimum tax less the other nonrefundable credits.

For taxable years beginning after 2007, the provision repeals the corporate AMT. A corporation then will be allowed to use the AMT credit to offset 90 percent of its regular tax liability (determined after the application of other nonrefundable credits).

EFFECTIVE DATE

The provision allowing the AMT credit to be offset a portion of the minimum tax applies to taxable years beginning after December 31, 2002.

The provision repealing the AMT applies to taxable years beginning after December 31, 2007.

C. REPEAL OF LIMITATION OF FOREIGN TAX CREDIT UNDER ALTERNATIVE MINIMUM TAX

(sec. 302(b) of the bill and sec. 59 of the Code)

PRESENT LAW

Under present law, taxpayers are subject to an alternative minimum tax ("AMT"), which is payable, in addition to all other tax liabilities, to the extent that it exceeds the taxpayer's regular income tax liability. The tax is imposed at a flat rate of 20 percent, in the case of corporate taxpayers, on alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount. The maximum rate for noncorporate taxpayers is 28 percent. AMTI is the taxpayer's taxable income increased for certain tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the exclusion or deferral of income resulting from the regular tax treatment of those items.

Taxpayers are permitted to reduce their AMT liability by an AMT foreign tax credit. The AMT foreign tax credit for a taxable year is determined under principles similar to those used in computing the regular tax foreign tax credit, except that (1) the numerator of the AMT foreign tax credit limitation fraction is foreign source AMTI and (2) the denominator of that fraction is total AMTI.[17] Taxpayers may elect to use as their AMT foreign tax cred-

[17] Similar to the regular tax foreign tax credit, the AMT foreign tax credit is subject to the separate limitation categories set forth in section 904(d). Under the AMT foreign tax credit, however, the determination of whether any income is high taxed for purposes of the high-tax-kick-out rules (sec. 904(d)(2)) is made on the basis of the applicable AMT rate rather than the highest applicable rate of regular tax.

it limitation fraction the ratio of foreign source regular taxable income to total AMTI (sec. 59(a)(4)).

The AMT foreign tax credit for any taxable year generally may not offset a taxpayer's entire pre-credit AMT. Rather, the AMT foreign tax credit is limited to 90 percent of AMT computed without an AMT net operating loss deduction, an AMT energy preference deduction, or an AMT foreign tax credit. For example, assume that a corporation has $10 million of AMTI, has no AMT net operating loss or energy preference deductions, and is subject to the AMT. In the absence of the AMT foreign tax credit, the corporation's tax liability would be $2 million. Accordingly, the AMT foreign tax credit cannot be applied to reduce the taxpayer's tax liability below $200,000. Any unused AMT foreign tax credit may be carried back 2 years and carried forward 5 years for use against AMT in those years under the principles of the foreign tax credit carryback and carryforward rules set forth in section 904(c).

REASONS FOR CHANGE

The purpose of the foreign tax credit generally is to eliminate the possibility of double taxation (once by the foreign jurisdiction and again by the United States) on the foreign source income of a U.S. person. The Committee believes, however, that the 90-percent limitation on the AMT foreign tax credit has the effect of double taxing such income for AMT taxpayers and, thus, finds that the limitation is inconsistent with the purpose of providing a foreign tax credit.

EXPLANATION OF PROVISION

The bill repeals the 90-percent limitation on the utilization of the AMT foreign tax credit.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2001.

TITLE IV. EDUCATION TAX RELIEF PROVISIONS

A. EXPAND EDUCATION SAVINGS ACCOUNTS

(sec. 401 of the bill and secs. 530 and 4973 of the Code)

PRESENT LAW

In general

Section 530 provides tax-exempt status to education individual retirement accounts ("education IRAs"), meaning certain trusts (or custodial accounts) which are created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of a named beneficiary.[18] Contributions to education IRAs may be made only in cash. Annual contributions to education IRAs may not exceed $500 per designated beneficiary (except in cases involving certain tax-free rollovers, as described below), and may not be made after the designated beneficiary

[18] Education IRAs generally are not subject to Federal income tax, but are subject to the unrelated business income tax ("UBIT") imposed by section 511.

reaches age 18.[19] Moreover, an excise tax is imposed if a contribution is made by any person to an education IRA established on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program (defined under sec. 529) on behalf of the same beneficiary.

Phase-out of contribution limit

The $500 annual contribution limit for education IRAs is phased out ratably for contributors with modified adjusted gross income ("AGI") between $95,000 and $110,000 (between $150,000 and $160,000 for joint returns). Individuals with modified AGI above the phase-out range are not allowed to make contributions to an education IRA established on behalf of any individual.

Treatment of distributions

Amounts distributed from an education IRA are excludable from gross income to the extent that the amounts distributed do not exceed qualified higher education expenses of the designated beneficiary incurred during the year the distribution is made (provided that a HOPE credit or Lifetime Learning credit is not claimed with respect to the beneficiary for the same taxable year). Distributions from an education IRA are generally deemed to consist of distributions of principal (which, under all circumstances, are excludable from gross income) and earnings (which may be excludable from gross income) by applying the ratio that the aggregate amount of contributions to the account for the beneficiary bears to the total balance of the account. If the qualified higher education expenses of the student for the year are at least equal to the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the earnings in their entirety are excludable from gross income. If, on the other hand, the qualified higher education expenses of the student for the year are less than the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the qualified higher education expenses are deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings are excludable (i.e., a portion of the earnings based on the ratio that the qualified higher education expenses bear to the total amount of the distribution) and the remaining portion of the earnings is includible in the distributee's gross income.

To the extent that a distribution exceeds qualified higher education expenses of the designated beneficiary, an additional 10-percent tax is imposed on the earnings portion of such excess distribution, unless such distribution is made on account of the death or disability of, or scholarship received by, the designated beneficiary. The additional 10-percent tax also does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the date that a return is required to be filed (including extensions of time) by the beneficiary for the taxable year during which the contribution was

[19] An excise tax may be imposed under present law to the extent that excess contributions above the $500 annual limit are made to an education IRA.

made (or, if the beneficiary is not required to file such a return, April 15th of the year following the taxable year during which the contribution was made).

Present law allows tax-free transfers or rollovers of account balances from one education IRA benefitting one beneficiary to another education IRA benefitting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary. For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws—and any spouse of such persons or of the original beneficiary.

Any balance remaining in an education IRA is deemed to be distributed within 30 days after the date that the named beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

Qualified higher education expenses

The term "qualified higher education expenses" includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. Moreover, the term "qualified higher education expenses" includes certain room and board expenses for any period during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified State tuition program, as defined in section 529, for the benefit of the beneficiary of the education IRA.

Qualified higher education expenses generally include only out-of-pocket expenses. Such qualified higher education expenses do not include expenses covered by educational assistance for the benefit of the beneficiary that is excludable from gross income. Thus, total qualified higher education expenses are reduced by scholarship or fellowship grants excludable from gross income under present- law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127.[20]

Present law also provides that, if any qualified higher education expenses are taken into account in determining the amount of the exclusion for a distribution from an education IRA, then no deduction (e.g., for trade or business expenses deductible under sec. 162), or exclusion (e.g., for expenses paid with interest on education savings bonds excludable under sec. 135), or credit is allowed with respect to such expenses.

[20] No reduction of qualified higher education expenses is required, however, for a gift, bequest, devise, or inheritance.

Eligible educational institution

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

REASONS FOR CHANGE

The Committee believes that the present-law rules and contribution limits governing education IRAs should be expanded to provide a greater incentive for families and other persons to save for educational purposes, including for expenses related to elementary and secondary school education. The Committee also believes that more flexible rules are needed for education IRAs (e.g., accounts established for the benefit of special needs students). The Committee further believes that the benefits of education IRAs should be coordinated with other education tax provisions so as to maximize the potential benefit of all the education tax incentives.

EXPLANATION OF PROVISION

Annual contribution limit

The bill increases the annual education IRA contribution limit to $2,000. Thus, under the bill, aggregate contributions that can be made by all contributors to one (or more) education IRAs established on behalf of any particular beneficiary are limited to $2,000 for each year in years beginning after 2000.

Qualified expenses

The bill expands the definition of qualified education expenses that may be paid with tax-free distributions from an education IRA for distributions made in taxable years beginning after December 31, 2000. Specifically, the definition of qualified education expenses is expanded to include "qualified elementary and secondary education expenses," meaning (1) tuition, fees, academic tutoring,[21] special needs services, books, supplies, and equipment (including computers and related software and services) incurred in connection with the enrollment or attendance of the designated beneficiary as an elementary or secondary student at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12), and (2) room and board, uniforms, transportation, and supplementary items and services (including extended-day programs) required or provided by such a school in connection with such enrollment or attendance of the designated beneficiary.[22] "Qualified elementary and secondary education ex-

[21] For this purpose, the Committee intends that "academic tutoring" means additional, personalized instruction provided in coordination with the student's academic courses.

[22] The Committee intends that contributions made to education IRAs prior to December 31, 2000, (and earnings thereon) may be used for distributions for qualified elementary and secondary education expenses made after January 1, 2001. Thus, it is not necessary for trustees of

penses" also include certain homeschooling education expenses if the requirements of any applicable State or local law are met with respect to such homeschooling.

Under the bill, the definition of "qualified higher education expenses" is modified to mean: (1) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible education institution, and (2) an amount determined by the educational institution for purposes of Federal financial assistance programs as a reasonable allowance for books, supplies, and equipment.[23] The bill also provides that "qualified higher education expenses" does not include expenses for education involving sports, games, or hobbies unless this education is part of the student's degree program or is taken to acquire or improve job skills of the individual. The bill does not change the definition of "qualified higher education expenses" with respect to expenses for room and board.

Special needs beneficiaries

The bill also provides that, although contributions to an education IRA generally may not be made after the designated beneficiary reaches age 18, contributions may continue to be made to an education IRA in the case of a special needs beneficiary (as defined by Treasury Department regulations). In addition, under the bill, in the case of a special needs beneficiary, a deemed distribution of any balance in an education IRA will not occur when the beneficiary reaches age 30.[24]

Contributions by persons other than individuals

The bill clarifies that corporations and other entities (including tax-exempt organizations) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution.[25] As under present law, the eligibility of high-income individuals to make contributions to education IRAs is phased out ratably for individuals with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint returns).

Contributions permitted until April 15

Under the bill, individual contributors to education IRAs are deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law

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education IRAs to keep separate accounts with respect to contributions made prior to January 1, 2001, and earnings thereon.

[23] "Qualified higher education expenses" for purposes of education IRAs are defined by reference to the definition of such expenses for purposes of qualified State tuition programs (sec. 530(b)(2)(A)). Because the bill modifies the definition of "qualified higher education expenses" for purposes of qualified State tuition programs (sec. 529(e)(3)), the definition of "qualified higher education expenses" for education IRAs is also modified.

[24] The Committee intends that the determination of whether a beneficiary has "special needs" will be made for each year that contributions are made to an education IRA after the beneficiary reaches age 18. However, if an individual meets the definition of a "special needs" beneficiary when such individual reaches age 30, then such individual thereafter will be presumed to be a "special needs" beneficiary.

[25] The Committee intends that present-law rules governing the definition of gross income apply for purposes of determining whether a contribution by a corporation or another entity to an education IRA on behalf of a designated beneficiary is includible in the gross income of the beneficiary or another individual (e.g., includible in gross income as compensation to a parent employed by the contributing corporation).

for filing the return for such taxable year (not including extensions), generally April 15.[26] The bill also provides that the additional 10- percent tax does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the first day of the sixth month of the taxable year (generally June 1) following the taxable year during which the contribution was or was deemed made.[27]

Coordination with HOPE and Lifetime Learning credits

For distributions made after December 31, 2000, the bill allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from an education IRA on behalf of the same student as long as the distribution is not used for the same educational expenses for which a credit was claimed.[28]

Coordination with qualified tuition programs

The bill repeals the excise tax on contributions made by any person to an education IRA on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary (sec. 4973(e)(1)(B)).

Change Name to "Education Savings Accounts"

The bill changes the name of education IRAs to "Education Savings Accounts."

EFFECTIVE DATE

The provisions modifying education IRAs generally are effective for taxable years beginning after December 31, 2000. The provision modifying the definition of "qualified higher education expenses"

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[26] The Committee intends that trustees of education IRAs will require documentation from a contributor (whether an individual, corporation, or other entity) indicating the taxable year to which the contribution should be allocated.

[27] Thus, taxpayers will have approximately one and one-half months after the April 15 deadline for making contributions to an education IRA on account of the preceding year to determine whether an excess contribution was made to an education IRA and distribute (or reallocate to the current taxable year) the excess in order to avoid the additional 10–percent tax.

[28] In determining the amount of a distribution that can be excluded from income for a taxable year, a taxpayer's total higher education expenses will be reduced first by the amount of such expenses which were taken into account in determining the amount of any HOPE or Lifetime Learning credit allowed to the taxpayer (or other person) with respect to such expenses. After any reduction for expenses allocable to the credits, taxpayers may determine how to allocate their qualified education expenses among the various remaining education provisions for which they are eligible; however, under no circumstances, can the same expenses be allocated to more than one provision. For example, suppose that in 2002, a college freshman withdraws funds from both an education IRA and a qualified tuition program. If the student is otherwise eligible, he or she may claim a HOPE credit of $1,500 with respect to first $2,000 of tuition expense. To the extent that the student's remaining educational expenses constitute "qualified higher education expenses" and exceed the amounts distributed from both the education IRA and the qualified tuition program, the student may exclude from gross income the earnings portions (and, as always, the principal portions) of both distributions. Alternatively, if after allocating the first $2,000 of tuition expense to the HOPE credit, the student's remaining educational expenses do not exceed his or her total distributions from the education IRA and qualified tuition program, the student will not be able to exclude from gross income the entire earnings portions of both distributions. In addition, the student may be liable for a penalty imposed under the qualified tuition program or for additional tax imposed on the excess amounts distributed from the education IRA, or both. The student may allocate his or her educational expenses between the distributions as the student determines appropriate, but may not use the same expenses for both distributions, nor may he or she "reuse" the expenses taken into account for purposes of computing the HOPE credit claimed.

applies to amounts paid for education furnished after December 31, 1999, the same date that this provision is effective for qualified state tuition plans described in section 529. The provision changing the name of education IRAs to Education Savings Accounts is effective on the date of enactment.

B. Allow Tax-Free Distributions From State and Private Education Programs

(sec. 402 of the bill and sec. 529 of the Code)

PRESENT LAW

Section 529 provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account (a "savings account plan"). The term "qualified higher education expenses" generally has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution,[29] as well as certain room and board expenses for any period during which the student is at least a half-time student.

No amount is included in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) are included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor (e.g., when a parent receives a refund) are included in the contributor's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary.[30]

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.[31] Contributors and beneficiaries are not allowed to directly or indirectly direct the investment of contributions to the program (or earnings thereon). The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary at the commencement of participation in a qualified State tuition program (i.e., when contributions are first

[29] "Eligible educational institutions" are defined the same for purposes of education IRAs (described above) and qualified State tuition programs.

[30] Distributions from qualified State tuition programs are treated as representing a pro-rata share of the principal (i.e., contributions) and accumulated earnings in the account.

[31] Sections 529(c)(2), (c)(4), and (c)(5), and section 530(d)(3) provide special estate and gift tax rules for contributions made to, and distributions made from, qualified State tuition programs and education IRAs.

made to purchase an interest in such a program), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships. A transfer of credits (or other amounts) from one account benefitting one designated beneficiary to another account benefitting a different beneficiary is considered a distribution (as is a change in the designated beneficiary of an interest in a qualified State tuition program), unless the beneficiaries are members of the same family. For this purpose, the term "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws—and any spouse of such persons or of the original beneficiary. Earnings on an account may be refunded to a contributor or beneficiary, but the State or instrumentality must impose a more than de minimis monetary penalty unless the refund is (1) used for qualified higher education expenses of the beneficiary, (2) made on account of the death or disability of the beneficiary, or (3) made on account of a scholarship received by the designated beneficiary to the extent the amount refunded does not exceed the amount of the scholarship used for higher education expenses.

To the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and related expenses (as defined in sec. 25A(f)(1)), the distributee (or another taxpayer claiming the distributee as a dependent) may claim the HOPE credit or Lifetime Learning credit under section 25A with respect to such tuition and related expenses (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning credit are satisfied and the modified AGI phaseout for those credits does not apply).

REASONS FOR CHANGE

The Committee believes that distributions from qualified tuition programs should not be subject to Federal income tax to the extent that such distributions are used to pay for qualified higher education expenses of undergraduate or graduate students who are attending institutions of higher education or certain vocational schools. In addition, the Committee believes that the present-law rules governing qualified tuition programs should be expanded to permit private educational institutions to maintain certain prepaid tuition programs.

EXPLANATION OF PROVISION

Qualified tuition program

The bill expands the definition of "qualified tuition program" to include certain prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under section 529 (other than the present-law State sponsorship rule). In the case of a qualified tuition program maintained by one or more private educational institutions, persons will be able to purchase tuition credits or certificates on behalf of a designated beneficiary, but will not be able to make contributions to savings account plans.

Exclusion from gross income

Under the bill, an exclusion from gross income is provided for distributions made in taxable years beginning after December 31, 2000, from qualified State tuition programs to the extent that the distribution is used to pay for qualified higher education expenses. This exclusion from gross income is extended to distributions from qualified tuition programs established and maintained by an entity other than a State or agency or instrumentality thereof, for distributions made in taxable years after December 31, 2003.

The bill also allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program on behalf of the same student as long as the distribution is not used for the same expenses for which a credit was claimed. [32]

Definition of qualified higher education expenses

Under the bill, the definition of "qualified higher education expenses" is modified to mean: (1) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible education institution, and (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance (but not in excess of the allowance for books and supplies determined by the educational institution for purposes of federal financial assistance programs). The bill also provides that "qualified higher education expenses" will not include expenses for education involving sports, games, or hobbies unless this education is part of the student's degree program or is taken to acquire or improve job skills of the individual. The bill does not change the definition of "qualified higher education expenses" with respect to expenses for room and board.

Rollovers for benefit of same beneficiary

The bill provides that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary will not be considered a distribution for a maximum of one such transfer in each 1–year period.

[32] In determining the amount of a distribution that can be excluded from income for a taxable year, a taxpayer's total higher education expenses will be reduced first by the amount of such expenses which were taken into account in determining the credit allowed to (and elected by) the taxpayer (or other person with respect to such expenses). After any reduction for expenses allocable to the credits, taxpayers may determine how to allocate their qualified education expenses among the various remaining education provisions (including education IRAs and qualified tuition programs) for which they are eligible; however, under no circumstances, can the same expenses be allocated to more than one provision. An example of how a taxpayer may claim a HOPE or Lifetime Learning credit and, in the same year, coordinate exclusions from gross income for distributions from a qualified tuition program and an education IRA is discussed above in connection with the modification of the rules governing education IRAs.

Member of family

The bill further provides that, for purposes of tax-free rollovers and changes of designated beneficiaries, a "member of the family" includes first cousins of such beneficiary.

EFFECTIVE DATE

The provision permitting the establishment of qualified tuition programs maintained by one or more private educational institutions is effective for taxable years beginning after December 31, 2000. The exclusion from gross income for certain distributions from qualified State tuition programs under section 529 is effective for distributions made in taxable years beginning after December 31, 2000. In the case of a qualified tuition program established and maintained by an entity other than a State or agency or instrumentality thereof, the provision allowing an exclusion from gross income for certain distributions is effective for distributions made in taxable years beginning after December 31, 2003. The provision coordinating distributions from qualified tuition programs with the HOPE and Lifetime Learning credits is effective for distributions made after December 31, 2000. The provision modifying the definition of qualified higher education expenses is effective for amounts paid for education furnished after December 31, 1999. The provisions allowing rollovers for the same beneficiary and including first cousins as a member of the family are effective for taxable years beginning after December 31, 2000.

C. ELIMINATE TAX ON AWARDS UNDER NATIONAL HEALTH SERVICE CORPS SCHOLARSHIP PROGRAM, F. EDWARD HEBERT ARMED FORCES HEALTH PROFESSIONS SCHOLARSHIP AND FINANCIAL ASSISTANCE PROGRAM, NATIONAL INSTITUTES OF HEALTH UNDERGRADUATE SCHOLARSHIP PROGRAM, AND CERTAIN STATE-SPONSORED SCHOLARSHIP PROGRAMS

(sec. 403 of the bill and sec. 117 of the Code)

PRESENT LAW

Section 117 excludes from gross income qualified scholarships received by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution. The tax-free treatment provided by section 117 does not extend to scholarship amounts covering regular living expenses, such as room and board. In addition to the exclusion for qualified scholarships, section 117 provides an exclusion from gross income for qualified tuition reductions for certain education provided to employees (and their spouses and dependents) of certain educational organizations.

Section 117(c) specifically provides that the exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction.

The National Health Service Corps Scholarship Program (the "NHSC Scholarship Program"), the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the "Armed Forces Scholarship Program"), and the National Institutes of Health Undergraduate Scholarship Program (the "NIH Scholarship Program") provide education awards to participants on condition that the participants provide certain services. In the case of the NHSC Program, the recipient of the scholarship is obligated to provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health-care professionals. In the case of the Armed Forces Scholarship Program, the recipient of the scholarship is obligated to serve a certain number of years in the military at an armed forces medical facility. The National Institutes of Health Undergraduate Scholarship Program (the "NIH Scholarship Program") awards scholarships to students from disadvantaged backgrounds interested in pursuing a career in biomedical research. In exchange, the recipients must work for the National Institutes of Health after graduation. Several States also provide a limited number of scholarships to students in health professions who are obligated to work in underserved areas for a period of time after graduation. Because the recipients of scholarships in all of these programs are required to perform services in exchange for the education awards, the awards used to pay higher education expenses are taxable income to the recipient.

REASONS FOR CHANGE

To improve health care services in underserved areas, the Committee believes that it is appropriate to provide tax-free treatment for scholarships received by students under the NHSC Scholarship Program, Armed Forces Scholarship Program, NIH Scholarship Program, and State-sponsored programs with similar objectives.

EXPLANATION OF PROVISION

The bill provides that amounts received by an individual under the NHSC Scholarship Program, the Armed Forces Scholarship Program, the NIH Scholarship Program, or any State-sponsored health scholarship program determined by the Secretary of the Treasury to have substantially similar objectives to these programs are eligible for tax-free treatment as qualified scholarships under section 117, without regard to any service obligation by the recipient. As with other qualified scholarships under section 117, the tax-free treatment does not apply to amounts received by students for regular living expenses, including room and board.

EFFECTIVE DATE

The provision is effective for education awards received under the NHSC Scholarship Program, the Armed Forces Scholarship Program, and the NIH Scholarship Program after December 31, 1993. The provision is effective for education awards received under any State-sponsored health scholarship program designated by the Secretary of the Treasury after December 31, 1999.

D. Liberalize Tax-Exempt Bond Arbitrage Rebate Exceptions for Public School Construction Bonds

(sec. 404–405 of the bill and sec. 148 of the Code)

PRESENT LAW

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (sec. 103). Like other activities carried out and paid for by States and local governments, the construction, renovation, and operation of public schools is an activity eligible for financing with the proceeds of tax-exempt bonds.

The Federal income tax does not apply to the income of States and local governments that is derived from the exercise of an essential governmental function. To prevent these tax-exempt entities from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than necessary, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds. In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, profits that are earned during these periods or on such investments must be rebated to the Federal Government.

The Code includes three exceptions applicable to education-related bonds. First, issuers of all types of tax-exempt bonds are not required to rebate arbitrage profits if all of the proceeds of the bonds are spent for the purpose of the borrowing within six months after issuance. In the case of governmental bonds (including bonds to finance public schools) the six-month expenditure exception is treated as satisfied if at least 95 percent of the proceeds is spent within six months and the remaining five percent is spent within 12 months after the bonds are issued.

Second, in the case of bonds to finance certain construction activities, including school construction and renovation, the six-month period is extended to 24 months for construction proceeds. Arbitrage profits earned on construction proceeds are not required to be rebated if all such proceeds (other than certain retainage amounts) are spent by the end of the 24–month period and prescribed intermediate spending percentages are satisfied.

Third, governmental bonds issued by "small" governments are not subject to the rebate requirement. Small governments are defined as general purpose governmental units that issue no more than $5 million of tax-exempt governmental bonds in a calendar year. The $5 million limit is increased to $10 million if at least $5 million of the bonds are used to finance public schools.

REASONS FOR CHANGE

The policy underlying the arbitrage rebate exception for bonds of small governmental units is to reduce complexity for these entities because they may not have in-house financial staff to engage in the expenditure and investment tracking necessary for rebate compliance. The exception further is justified by the limited potential for arbitrage profits at small issuance levels and limitation of the provision to governmental bonds, which typically require voter approval before issuance. The Committee believes that a limited increase of $5 million per year for public school construction bonds will more accurately conform this present-law exception to current school construction costs.

The Committee is aware that a great need exists for construction and renovation of public schools if American educational excellence is to be maintained. The Committee determined that a more liberal spend-down exception for public school construction bonds is appropriate to allow issuers greater flexibility in the timing of bond issuance for this limited purpose to meet actual construction needs.

EXPLANATION OF PROVISION

Liberalize construction bond expenditure rule for governmental bonds for public schools

The present-law 24–month expenditure exception to the arbitrage rebate requirement are liberalized for certain public school bonds. Under the bill, no rebate is required with respect to earnings on available construction proceeds of public school bonds if the proceeds are spent within 48 months after the bonds are issued and the following intermediate spending levels are satisfied:

12 months	At least 10 percent
24 months	At least 30 percent
36 months	At least 60 percent
48 months	100 percent (less present-law retainage amounts which must be spent within 60 months of issuance)

Increase amount of bonds that may be issued by governments qualifying for the "small governmental unit" arbitrage rebate exception

The additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirement is increased from $5 million to $10 million. Thus, these governmental units may issue up to $15 million of governmental bonds in a calendar year, provided that at least $10 million of the bonds are used to finance construction of public schools.

EFFECTIVE DATE

The liberalized expenditure exception for public school construction bonds is effective for bonds issued after December 31, 1999.

The increase in the small governmental unit arbitrage rebate exception is effective for calendar years beginning after December 31, 1999.

E. ELIMINATE 60-MONTH LIMIT ON STUDENT LOAN INTEREST DEDUCTION

(sec. 406 of the bill and sec. 221 of the Code)

PRESENT LAW

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit (sec. 221). The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include nonmandatory payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60–month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The maximum allowable deduction per taxpayer return is $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and thereafter.[33] The deduction is phased out ratably for individual taxpayers with modified adjusted gross income of $40,000–$55,000 and $60,000–-$75,000 for joint returns. The income ranges will be indexed for inflation after 2002.

REASONS FOR CHANGE

The Committee understands that many students incur considerable debt in the course of obtaining undergraduate and graduate education. The Committee believes that it is appropriate to expand the deduction for individuals who have paid interest on qualified education loans by repealing the limitation that the deduction is allowed only with respect to interest paid during the first 60 months in which interest payments are required. In addition, the repeal of the 60-month limitation lessens complexity and administrative burdens for taxpayers, lenders, loan servicing agencies, and the Internal Revenue Service.

EXPLANATION OF PROVISION

The bill repeals both the limit on the number of months during which interest paid on a qualified education loan is deductible and

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[33] The maximum allowable deduction for 1998 was $1,000.

the restriction that nonmandatory payments of interest are not deductible.

EFFECTIVE DATE

The provision is effective for interest paid on qualified education loans after December 31, 1999.

TITLE V. HEALTH CARE TAX RELIEF PROVISIONS

A. Above-the-Line Deduction for Health Insurance Expenses

(sec. 502 of the bill and new sec. 222 of the Code)

PRESENT LAW

Under present law, the tax treatment of health insurance expenses depends on the individual's circumstances. Self-employed individuals may deduct a portion of health insurance expenses for the individual and his or her spouse and dependents. The deductible percentage of health insurance expenses of a self-employed individual is 60 percent in 1999 through 2001; 70 percent in 2002; and 100 percent in 2003 and thereafter. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. The deduction applies to qualified long-term care insurance premiums treated as medical expenses under the itemized deduction for medical expenses, described below.

Employees can exclude from income 100 percent of employer-provided health insurance.

Individuals who itemize deductions may deduct their health insurance expenses only to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213). Subject to certain dollar limitations, premiums for qualified long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses (sec. 213). The amount of qualified long-term care insurance premiums that may be taken into account for 1999 is as follows: $210 in the case of an individual 40 years old or less; $400 in the case of an individual who is more than 40 but not more than 50; $800 in the case of an individual who is more than 50 but not more than 60; $2,120 in the case of an individual who is more than 60 but not more than 70; and $2,660 in the case of an individual who is more than 70. These dollar limits are indexed for inflation.

REASONS FOR CHANGE

The Committee believes that the present-law inequities in tax treatment of health insurance expenses should be reduced. In addition, the Committee believes that individuals who are uninsured should be provided with a tax incentive to purchase health insurance for themselves and their families.

EXPLANATION OF PROVISION

The provision provides an above-the-line deduction for a percentage of the amount paid during the year for insurance which constitutes medical care (as defined under sec. 213, other than long-term care insurance treated as medical care under sec. 213) for the taxpayer and his or her spouse and dependents.[34] The deductible percentage is: 25 percent in 2001; 40 percent in 2002; 50 percent in 2003 through 2006; 75 percent in 2007; and 100 percent in 2008 and thereafter.

The deduction is not available to an individual for any month in which the individual is covered under an employer-sponsored health plan if at least 50 percent of the cost of the coverage is paid or incurred by the employer.[35] For purposes of this rule, any amounts excludable from the gross income of the employee under the exclusion for employer-provided health coverage is treated as paid or incurred by the employer; thus, for example, health insurance purchased by an employee through a cafeteria plan with salary reduction amounts is considered to be paid for by the employer.[36] In determining whether the 50–percent threshold is met, all health plans of the employer in which the employee participates are treated as a single plan. If the employer pays for less than 50 percent of the cost of all health plans in which the individual participates, the deduction is available only with respect to each plan with respect to which the employer subsidy is less than 50 percent. Cost is determined as under the health care continuation rules. The following examples illustrate the application of the 50-percent rule.

Example 1: Employee A participates in an employer-sponsored health plan. The annual cost for single coverage is $3,000, and the annual additional cost for coverage for A's spouse and dependents is $1,000. The employer pays 100 percent of the cost of individual coverage, but does not pay any additional amount for family coverage. A chooses family coverage. The total amount the employer pays for the insurance is $3,000, which is 75 percent of the total cost of the coverage ($4,000). Thus, the deduction is not available.

Example 2: Employee B participates in two employer-sponsored health plans. One plan provides major medical coverage. The cost of this plan is $2,000 per year. The employer pays for half the cost of this plan ($1,000). The second plan provides only dental coverage. The cost of the dental plan is $300 per year, which is paid by the employee. The total cost of the health plans in which B participates is $2,300. The employer pays for less than 50 percent of this total cost. B may deduct the cost of the dental coverage; but not B's share of the premium for the major medical plan, because the employer pays for at least 50 percent of the cost of that plan.

Example 3: Employee C participates in an employer-sponsored health plan. The cost of the plan is $4,000. Employee C pays $1,000 of the cost of the plan by salary reduction through a cafeteria plan. The $1,000 salary reduction contribution is an employer payment.

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[34] The deduction only applies to health insurance that constitutes medical care; it does not apply to medical expenses. The deduction applies to self-insured arrangements (provided such arrangements constitute insurance, e.g., there is appropriate risk-shifting) and coverage under employer plans treated as insurance under section 104. Another provision of the bill provides a similar deduction for qualified long-term care insurance expenses.

[35] This rule is applied separately with respect to qualified long-term care insurance.

[36] Excludable employer contributions to a health flexible spending arrangement or medical savings account (including salary reduction contributions) are also considered amounts paid by the employer for health insurance that constitutes medical care. Salary reduction contributions are not considered to be amounts paid by the employee.

Thus, the employer pays only one-fourth of the cost of the coverage. C may deduct the $3,000 C pays for the plan on an after-tax basis.

The deduction is not available to individuals enrolled in Medicare, Medicaid, the Federal Employees Health Benefit Program ("FEHBP"),[37] Champus, VA, Indian Health Service, or Children's Health Insurance programs. Thus, for example, the deduction is not available with respect to Medigap coverage, because such coverage is provided to individuals enrolled in Medicare.

The provision authorizes the Secretary to prescribe rules necessary to carry out the provision, including appropriate reporting requirements for employers.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

B. PROVISIONS RELATING TO LONG-TERM CARE INSURANCE

(secs. 501 and 502 of the bill, new sec. 222 of the Code and secs. 106 and 125 of the Code)

PRESENT LAW

Tax treatment of health insurance and long-term care insurance

Under present law, the tax treatment of health insurance expenses depends on the individual's circumstances. Self-employed individuals may deduct a portion of health insurance expenses for the individual and his or her spouse and dependents. The deductible percentage of health insurance expenses of a self-employed individual is 60 percent in 1999 through 2001; 70 percent in 2002; and 100 percent in 2003 and thereafter. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. The deduction applies to qualified long-term care insurance premiums treated as medical expenses under the itemized deduction for medical expenses, described below.

Employees can exclude from income 100 percent of employer-provided health insurance or qualified long-term care insurance.

Individuals who itemize deductions may deduct their health insurance expenses only to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213). Subject to certain dollar limitations, premiums for qualified long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses (sec. 213). The amount of qualified long-term care insurance premiums that may be taken into account for 1999 is as follows: $210 in the case of an individual 40 years old or less; $400 in the case of an individual who is more than 40 but not more than 50; $800 in the case of an individual who is more than 50 but not more than 60; $2,120 in the case of an individual who is more than 60 but not more than

[37] This rule does not prevent individuals covered by the FEHBP from deducting premiums for health care continuation coverage, provided the requirements for the deduction are otherwise met.

70; and $2,660 in the case of an individual who is more than 70. These dollar limits are indexed for inflation.

Cafeteria plans

Under present law, compensation generally is includible in gross income when actually or constructively received. An amount is constructively received by an individual if it is made available to the individual or the individual has an election to receive such amount. Under one exception to the general principle of constructive receipt, amounts are not included in the gross income of a participant in a cafeteria plan described in section 125 of the Code solely because the participant may elect among cash and certain employer-provided qualified benefits under the plan. This constructive receipt exception is not available if the individual is permitted to revoke a benefit election during a period of coverage in the absence of a change in family status or certain other events.

In general, qualified benefits are certain specified benefits that are excludable from an employee's gross income by reason of a specific provision of the Code. Thus, employer-provided accident or health coverage, group-term life insurance coverage (whether or not subject to tax by reason of being in excess of the dollar limit on the exclusion for such insurance), and benefits under dependent care assistance programs may be provided through a cafeteria plan. The cafeteria plan exception from the principle of constructive receipt generally also applies for employment tax (FICA and FUTA) purposes.[38]

Long-term care insurance cannot be provided under a cafeteria plan.

Flexible spending arrangements

A flexible spending arrangement ("FSA") is a reimbursement account or other arrangement under which an employer pays or reimburses employees for medical expenses or certain other nontaxable employer-provided benefits, such as dependent care. An FSA may be part of a cafeteria plan and may be funded through salary reduction. FSAs may also be provided by an employer outside a cafeteria plan. FSAs are commonly used, for example, to reimburse employees for medical expenses not covered by insurance. Qualified long-term care services cannot be provided through an FSA.

REASONS FOR CHANGE

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") included provisions providing favorable tax treatment for qualified long-term care insurance. The Congress enacted those provisions in order to provide an incentive for individuals to take financial responsibility for their long-term care needs. The Committee believes that further incentives are appropriate for individuals to purchase their own qualified long-term care insurance. The Committee also wishes to facilitate the purchase of qualified long-term care insurance through the workplace.

[38] Elective contributions under a qualified cash or deferred arrangement that is part of a cafeteria plan are subject to employment taxes.

EXPLANATION OF PROVISION

Deduction for qualified long-term care insurance expenses

The provision provides an above-the-line deduction for a percentage of the amount paid during the year for long-term care insurance which constitutes medical care (as defined under sec. 213) for the taxpayer and his or her spouse and dependents.[39] The deductible percentage is: 25 percent in 2001; 40 percent in 2002; 50 percent in 2003 through 2006; 75 percent in 2007; and 100 percent in 2008 and thereafter.

The deduction is not available to an individual for any month in which the individual is covered under an employer-sponsored health plan if at least 50 percent of the cost of the coverage is paid or incurred by the employer.[40] For purposes of this rule, any amounts excludable from the gross income of the employee with respect to qualified long-term care insurance are treated as paid or incurred by the employer. In determining whether the 50–percent threshold is met, all plans of the employer providing long-term care in which the employee participates are treated as a single plan. If the employer pays less than 50 percent of the cost of all long-term care plans in which the individual participates, the deduction is available only with respect to each plan with respect to which the employer pays for less than 50 percent of the cost. Cost is determined as under the health care continuation rules.

The provision authorizes the Secretary to prescribe rules necessary to carry out the provision, including appropriate reporting requirements for employers.

The provision provides that qualified long-term care insurance is a qualified benefit under a cafeteria plan. The provision also provides that qualified long-term care services can be provided under an FSA.[41]

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

C. Extend Availability of Medical Savings Accounts

(sec. 503 of the bill and sec. 220 of the Code)

PRESENT LAW

In general

Within limits, contributions to a medical savings account ("MSA")[42] are deductible in determining AGI if made by an eligible

[39] The deduction would only apply to insurance that constitutes medical care; it would not apply to long-term care insurance expenses. The deduction would apply to self-insured arrangements (provided such arrangements constitute insurance, e.g., there is appropriate risk-shifting) and coverage under employer plans treated as insurance under section 104. Another provision of the bill provides a similar deduction for health insurance expenses.

[40] This rule is applied separately with respect to health insurance.

[41] Excludable employer contributions to a flexible spending arrangement or a cafeteria plan for qualified long-term care insurance or services are considered an amount paid by the employer for long-term care insurance.

[42] In general, an MSA is a trust or custodial account created exclusively for the benefit of the account holder and is subject to rules similar to those applicable to individual retirement ar-

Continued

individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an eligible individual. Earnings on amounts in an MSA are not currently taxable. Distributions from an MSA for medical expenses are not taxable. Distributions not used for medical expenses are taxable. In addition, distributions not used for medical expenses are subject to an additional 15-percent tax unless the distribution is made after age 65, death, or disability.

Eligible individuals

MSAs are available to employees covered under an employer-sponsored high deductible plan of a small employer and self-employed individuals regardless of the size of the entity for which the individual performs services.[43] An employer is a small employer if it employed, on average, no more than 50 employees on business days during either the preceding or the second preceding year.

In order for an employee of a small employer to be eligible to make MSA contributions (or to have employer contributions made on his or her behalf), the employee must be covered under an employer-sponsored high deductible health plan (see the definition below) and must not be covered under any other health plan (other than a plan that provides certain permitted coverage, described below). In the case of an employee, contributions can be made to an MSA either by the individual or by the individual's employer. However, an individual is not eligible to make contributions to an MSA for a year if any employer contributions are made to an MSA on behalf of the individual for the year. Similarly, if the individual's spouse is covered under the high deductible plan covering such individual and the spouse's employer makes a contribution to an MSA for the spouse, the individual may not make MSA contributions for the year.

Similarly, in order to be eligible to make contributions to an MSA, a self-employed individual must be covered under a high deductible health plan and no other health plan (other than a plan that provides certain permitted coverage, described below). A self-employed individual is not an eligible individual (by reason of being self-employed) if the high deductible plan under which the individual is covered is established or maintained by an employer of the individual (or the individual's spouse).

An individual with other coverage in addition to a high deductible plan is still eligible for an MSA if such other coverage is certain permitted insurance or is coverage (whether provided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care. Permitted insurance is: (1) Medicare supplemental insurance; (2) insurance if substantially all of the coverage provided under such insurance relates to (a) liabilities incurred under worker's compensation law, (b) tort liabilities, (c) liabilities relating to ownership or use of property (e.g., auto insurance), or (d) such other similar liabilities as the Secretary may pre-

rangements. The trustee of an MSA can be a bank, insurance company, or other person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with applicable requirements.

[43] Self-employed individuals include more than 2-percent shareholders of S corporations who are treated as partners for purposes of fringe benefit rules pursuant to section 1372.

scribe by regulations; (3) insurance for a specified disease or illness; and (4) insurance that provides a fixed payment for hospitalization.

If a small employer with an MSA plan ceases to become a small employer (i.e., exceeds the 50-employee limit), then the employer (and its employees) can continue to establish and make contributions to MSAs (including contributions for new employees and employees that did not previously have an MSA) until the year following the first year in which the employer has more than 200 employees. After that, those employees who had an MSA (to which individual or employer contributions were made in any year) can continue to make contributions (or have contributions made on their behalf) even if the employer has more than 200 employees.

Tax treatment of and limits on contributions

Individual contributions to an MSA are deductible (within limits) in determining adjusted gross income (i.e., "above the line"). In addition, employer contributions are excludable from gross income and wages for employment tax purposes (within the same limits), except that this exclusion does not apply to contributions made through a cafeteria plan. No deduction is allowed to any individual for MSA contributions if such individual is a dependent on another taxpayer's tax return.

In the case of a self-employed individual, the deduction cannot exceed the individual's earned income from the trade or business with respect to which the high deductible plan is established. In the case of an employee, the deduction cannot exceed the individual's compensation attributable to the employer sponsoring the high deductible plan in which the individual is enrolled.

The maximum annual contribution that can be made to an MSA for a year is 65 percent of the deductible under the high deductible plan in the case of individual coverage and 75 percent of the deductible in the case of family coverage.

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

If an employer provides high deductible health plan coverage coupled with an MSA to employees and makes employer contributions to the MSAs during a calendar year, the employer must make available a comparable contribution on behalf of all employees with comparable coverage during the same coverage period in the calendar year. Contributions are considered comparable if they are either of the same dollar amount or the same percentage of the deductible under the high deductible plan. The comparability rule does not restrict contributions that can be made to an MSA by a self- employed individual.

If employer contributions do not comply with the comparability rule during a calendar year, then the employer is subject to an excise tax equal to 35 percent of the aggregate amount contributed by the employer to MSAs of the employer for the year. In the case of a failure to comply with the comparability rule which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed to the extent that the payment of the tax is excessive relative to the failure involved.

Definition of high deductible plan

A high deductible plan is a health plan with an annual deductible of at least $1,550 and no more than $2,300 in the case of individual coverage and at least $3,050 and no more than $4,600 in the case of family coverage. In addition, the maximum out-of-pocket expenses with respect to allowed costs (including the deductible) must be no more than $3,050 in the case of individual coverage and no more than $5,600 in the case of family coverage.[44] A plan does not fail to qualify as a high deductible plan merely because it does not have a deductible for preventive care as required by State law. A plan does not qualify as a high deductible health plan if substantially all of the coverage under the plan is for permitted coverage (as described above). In the case of a self-insured plan, the plan must in fact be insurance (e.g., there must be appropriate risk shifting) and not merely a reimbursement arrangement.

Tax treatment of MSAs

Earnings on amounts in an MSA are not currently includible in income.

Taxation of distributions

Distributions from an MSA for the medical expenses of the individual and his or her spouse or dependents generally are excludable from income.[45] However, in any year for which a contribution is made to an MSA, withdrawals from an MSA maintained by that individual generally are excludable from income only if the individual for whom the expenses were incurred was covered under a high deductible plan for the month in which the expenses were incurred.[46] This rule is designed to ensure that MSAs are in fact used in conjunction with a high deductible plan, and that they are not primarily used by other individuals who have health plans that are not high deductible plans.

For this purpose, medical expenses are defined as under the itemized deduction for medical expenses, except that medical expenses do not include expenses for insurance other than long-term care insurance, premiums for health care continuation coverage, and premiums for health care coverage while an individual is receiving unemployment compensation under Federal or State law.

Distributions that are not used for medical expenses are includible in income. Such distributions are also subject to an additional 15-percent tax unless made after age 65, death, or disability.

Cap on taxpayers utilizing MSAs

The number of taxpayers benefiting annually from an MSA contribution is limited to a threshold level (generally 750,000 taxpayers). If it is determined in a year that the threshold level has been exceeded (called a "cut-off" year) then, in general, for succeeding years during the 4-year pilot period 1997–2000, only those indi-

[44] These dollar amounts are for 1999. These amounts are indexed for inflation in $50 increments.

[45] This exclusion does not apply to expenses that are reimbursed by insurance or otherwise.

[46] The exclusion still applies to expenses for continuation coverage or coverage while the individual is receiving unemployment compensation, even if for an individual who is not an eligible individual.

viduals who (1) made an MSA contribution or had an employer MSA contribution for the year or a preceding year (i.e., are active MSA participants) or (2) are employed by a participating employer, is eligible for an MSA contribution. In determining whether the threshold for any year has been exceeded, MSAs of individuals who were not covered under a health insurance plan for the six month period ending on the date on which coverage under a high deductible plan commences would not be taken into account.[47] However, if the threshold level is exceeded in a year, previously uninsured individuals are subject to the same restriction on contributions in succeeding years as other individuals. That is, they would not be eligible for an MSA contribution for a year following a cut-off year unless they are an active MSA participant (i.e., had an MSA contribution for the year or a preceding year) or are employed by a participating employer.

The number of MSAs established has not exceeded the threshold level.

End of MSA pilot program

After December 31, 2000, no new contributions may be made to MSAs except by or on behalf of individuals who previously had MSA contributions and employees who are employed by a participating employer. An employer is a participating employer if (1) the employer made any MSA contributions for any year to an MSA on behalf of employees or (2) at least 20 percent of the employees covered under a high deductible plan made MSA contributions of at least $100 in the year 2000.

Self-employed individuals who made contributions to an MSA during the period 1997–2000 also may continue to make contributions after 2000.

REASONS FOR CHANGE

In enacting the MSA pilot program, the Congress wanted to provide additional health care options for individuals. The Congress believed that MSAs would give individuals more control over their health care dollars and provide an incentive for Americans to be more cost conscious purchasers of medical services by making available an alternative to low deductible health plans. MSA participation has been less than originally hoped for. The Committee believes that one of the reasons for the relatively low participation level is the restrictions imposed on MSAs. The Committee believes that these restrictions should be eliminated or modified in order to make MSAs more attractive.

EXPLANATION OF PROVISION

Eligible individuals and cap on MSAs

The provision expands availability of MSAs to include all employees covered under a high deductible plan of an employer. Self-employed individuals continue to be eligible to contribute to an MSA.

The provision also eliminates the cap on the number of taxpayers that can benefit annually from MSA contributions.

[47] Permitted coverage, as described above, does not constitute coverage under a health insurance plan for this purpose.

Definition of high deductible plan and limits on contributions

The provision modifies the definition of a high deductible plan by decreasing the lower threshold for the annual deductible. Thus, under the provision, a high deductible plan means a plan with an annual deductible of at least $1,000 and not more than $2,300 (indexed) in the case of individual coverage and at least $2,000 and not more than $4,600 (indexed) in the case of family coverage. The limits on out-of-pocket expenses is the same as under present law.

The provision increases the amount of deductible (or excludable) contributions to an MSA to 100 percent of the deductible under the high deductible plan. The provision also allows an individual to make deductible contributions to an MSA even if the individual's employer also made contributions. The provision provides that MSAs may be offered as part of a cafeteria plan. The total contributions to MSAs on behalf of an individual for a year may not exceed 100 percent of the deductible under the high deductible plan.

End of MSA pilot program

The provision makes MSAs permanent.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

D. Additional Personal Exemption for Caretakers

(sec. 504 of the bill and sec. 151 of the Code)

PRESENT LAW

Generally, present law does not provide for an additional personal exemption based solely on the custodial care of parents or grandparents. However, taxpayers with dependent parents generally are able to claim a personal exemption for each of these dependents, if they satisfy five tests: (1) a member of household or relationship test; (2) a citizen test; (3) a joint return test; (4) a gross income test; and (5) a support test. The taxpayer is also required to list each dependent's tax identification number (the TIN") on the tax return.

The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is $2,750 for 1999, and is adjusted annually for inflation. The total amount of the personal exemptions is phased out for taxpayers with AGI in excess of $126,600 for single taxpayers, $158,300 for heads of household, and $189,950 for married couples filing joint returns. For 1999, the point at which a taxpayer's personal exemptions are completely phased-out is $249,100 for single taxpayers, $280,800 for heads of households, and $312,450 for married couples filing joint returns.

REASONS FOR CHANGE

Present law provides favorable tax treatment for long-term care insurance and services, but does not provide similar tax relief for in-home care. The Committee understands that in-house care may be preferable in some cases, and that individuals who care for family members with special needs incur additional expenses. Thus, the Committee believes tax relief for in-home care is appropriate.

EXPLANATION OF PROVISION

The bill provides taxpayers who maintain a household including one or more "qualified persons" with an additional personal exemption in computing income tax liability for each qualified person.

To be a "qualified person," an individual has to satisfy: (1) a relationship test, (2) a residency test, (3) a disability test, and (4) an identification test. The individual satisfies the relationship test if the individual was the father or mother of: (a) the taxpayer, (b) the taxpayer's spouse, or (c) a former spouse of the taxpayer. A stepfather, stepmother, and ancestors of the father or mother are treated as a father or mother for these purposes.

An individual satisfies the residency test if the individual had the same principal place of abode as the taxpayer for the taxpayer's entire taxable year.

An individual satisfies the disability test if the individual is certified before the due date of the return for the taxable year (without extensions) by a licensed physician as being unable for a period of at least 180 consecutive days to perform at least 2 activities of daily living ("ADLs") without substantial assistance from another individual, due to a loss of functional capacity. As with the present-law rules relating to long-term care, ADLs are: (1) eating; (2) toileting; (3) transferring; (4) bathing; (5) dressing; and (6) continence. Substantial assistance includes hands-on assistance (that is, the physical assistance of another person without which the individual is unable to perform the ADL) and stand-by assistance (that is, the presence of another person within arm's reach of the individual that is necessary to prevent, by physical intervention, injury to the individual when performing the ADL).

As an alternative to the 2–ADL test described above, an individual is considered to be disabled if he or she is certified by a licensed physician as (a) requiring substantial supervision for at least 6 months to be protected from threats to health and safety due to severe cognitive impairment and (b) being unable for at least 6 months to perform at least one or more ADLs or to engage in age appropriate activities as determined under regulations prescribed by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services.

An individual satisfies the identification test if the individual's name and taxpayer identification number ("TIN") is included on the taxpayer's return for the taxable year.

The bill provides that a taxpayer is treated as maintaining a household for any period only if over one-half of the cost of maintaining a household for such period is furnished by such taxpayer or, if such taxpayer is married, by such taxpayer and the taxpayer's spouse. The bill also provides that taxpayers who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from their respective spouse for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the qualified person for the entire taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Finally, the bill provides that a taxpayer legally separated from the taxpayer's spouse under a decree of divorce or of separate maintenance will not be considered married for purposes of this provision.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

E. EXPAND HUMAN CLINICAL TRIALS EXPENSES QUALIFYING FOR THE ORPHAN DRUG TAX CREDIT

(sec. 505 of the bill and sec. 45C of the Code)

PRESENT LAW

Taxpayers may claim a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions, generally those that afflict less than 200,000 persons in the United States. Qualifying expenses are those paid or incurred by the taxpayer after the date on which the drug is designated as a potential treatment for a rare disease or disorder by the Food and Drug Administration ("FDA") in accordance with the section 526 of the Federal Food, Drug, and Cosmetic Act.

REASONS FOR CHANGE

The Committee understands that approval for human clinical testing and designation as a potential treatment for a rare disease or disorder require separate reviews within the FDA. As a result, in some cases, a taxpayer may be permitted to begin human clinical testing prior to a drug being designated as a potential treatment for a rare disease or disorder. If the taxpayer delays human clinical testing in order to obtain the benefits of the orphan drug tax credit, which currently may be claimed only for expenses incurred after the drug is designated as a potential treatment for a rare disease or disorder, valuable time will have been lost and Congress's original intent in enacting the orphan drug tax credit will have been partially thwarted. Because taxpayers generally seek designation of a potential drug as a treatment for a rare disease or disorder at the time they seek approval to clinically test such drugs, the Committee believes it is appropriate to make such expenses related to human clinical testing that the taxpayer incurs prior to FDA designation eligible for the orphan drug tax credit to help speed cures to such insidious diseases.

EXPLANATION OF PROVISION

The bill expands qualifying expenses to include those expenses related to human clinical testing incurred after the date on which the taxpayer files an application with the FDA for designation of the drug under section 526 of the Federal Food, Drug, and Cosmetic Act as a potential treatment for a rare disease or disorder. As under present law, the credit may only be claimed for such expenses related to drugs designated as a potential treatment for a rare disease or disorder by the FDA in accordance with section 526 of such Act.

EFFECTIVE DATE

The provision would be effective for expenditures paid or incurred after December 31, 1999.

F. ADD CERTAIN VACCINES AGAINST STREPTOCOCCUS PNEUMONIAE TO THE LIST OF TAXABLE VACCINES

(sec. 506 of the bill and sec. 4132 of the Code)

PRESENT LAW

A manufacturer's excise tax is imposed at the rate of 75 cents per dose (sec. 4131) on the following vaccines recommended for routine administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, varicella (chicken pox), and rotavirus gastroenteritis. The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund ("Vaccine Trust Fund") to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. This program provides a substitute Federal, "no fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers and physicians. All persons immunized after September 30, 1988, with covered vaccines must pursue compensation under this Federal program before bringing civil tort actions under State law.

REASONS FOR CHANGE

Streptococcus pneumoniae (often referred to as pneumococcus) is a bacteria that can cause bacterial meningitis, a brain or spinal cord infection, bacteremia, a bloodstream infection, and otitis media (ear infection). The Committee understands that each year in the United States, pneumococcal disease accounts for an estimated 3,000 cases of bacterial meningitis, 50,000 cases of bacteremia, 500,000 cases of pneumonia, and 7 million cases of otitis media among all age groups. The Committee understands that, while there currently is a vaccine effective in preventing pneumococcal diseases in adults, that vaccine, a polysaccaride vaccine, does not induce an adequate immune response in young children and therefore does not protect children against these diseases. The Committee further understands that the Food and Drug Administration's (the "FDA") is expected to approve a new, sugar protein conjugate vaccine against the disease and the Centers for Disease

Control is expected to recommend this conjugate vaccine for routine inoculation of children. The Committee believes American children will benefit from wide use of this new vaccine. The Committee believes that, by including the new vaccine with those presently covered by the Vaccine Trust Fund, greater application of the vaccine will be promoted. The Committee, therefore, believes it is appropriate to add the conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines.

The Committee is aware that the Vaccine Trust Fund has a current cash-flow surplus in excess of $1.3 billion dollars.[48] However, without more detailed information on the operation of the Vaccine Injury Compensation Program and likely future claims it is not possible to assess whether this current surplus is a prudent use of taxpayers' dollars. Therefore, the Committee finds it appropriate to direct the Comptroller General of the United States to report on the operation and management of expenditures from the Vaccine Trust Fund and to advise the Committee on the adequacy of the Vaccine Trust Fund to meet future claims under the Federal Vaccine Injury Compensation Program.

EXPLANATION OF PROVISION

The bill adds any conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines.

In addition, the bill directs the General Accounting Office ("GAO") to report to the House Committee on Ways and Means and the Senate Committee on Finance on the operation and management of expenditures from the Vaccine Trust Fund and to advise the Committees on the adequacy of the Vaccine Trust Fund to meet future claims under the Federal Vaccine Injury Compensation Program.

Within its report, to the greatest extent possible, the Committee would like to see a thorough statistical report of the number of claims submitted annually, the number of claims settled annually, and the value of settlements. The Committee would like to learn about the statistical distribution of settlements, including the mean and median values of settlements, and the extent to which the value of settlements varies with an injury attributed to an identifiable vaccine. The Committee also would like to learn about the settlement process, including a statistical distribution of the amount of time required from the initial filing of a claim to a final resolution.

The Code provides that certain administrative expenses may be charged to the Vaccine Trust Fund. The Committee intends that the GAO report include an analysis of the overhead and administrative expenses charged to the Vaccine Trust Fund.

The GAO is directed to report its findings to the House Committee on Ways and Means and the Senate Committee on Finance not later than December 31, 1999.

[48] Joint Committee on Taxation, Schedule of Present Federal Excise Taxes (as of January 1, 1999) (JCS–2–99), March 29, 1999, p. 48.

EFFECTIVE DATE

The provision is effective for vaccine purchases beginning on the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated streptococcus pneumonia vaccines to children. No floor stocks tax is to be collected for amounts held for sale on that date. For sales on or before the date on which the Centers for Disease Control make final recommendation for routine administration of conjugate streptococcus pneumonia vaccines to children for which delivery is made after such date, the delivery date is deemed to be the sale date.

G. Above-the-line Deduction for Prescription Drug Insurance Coverage of Medicare Beneficiaries If Certain Provisions Are in Effect

(sec. 507 of the bill and sec. 213 of the Code)

PRESENT LAW

Individuals who itemize deductions may deduct their health insurance expenses, including the cost of prescription drugs, to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213).

REASONS FOR CHANGE

The Committee believes it appropriate to provide more favorable tax treatment for prescription drug insurance for Medicare beneficiaries when certain Medicare changes are enacted.

EXPLANATION OF PROVISION

The provision provides an above-the-line deduction for Medicare beneficiaries for prescription drug insurance. The deduction will take effect when (a) the Federal Government provides assistance for prescription drug coverage for low-income Medicare beneficiaries, (b) all policies supplemental to Medicare provide coverage for costs of prescription drugs, and (c) coverage for outpatient prescription drugs for Medicare beneficiaries is provided only through integrated comprehensive health plans which offer current Medicare covered services and maximum limitations on out-of-pocket spending and such comprehensive plans sponsored by the Health Care Financing Administration compete on the same basis as private plans.

EFFECTIVE DATE

The provision is effective for taxable years beginning after the date of enactment.

VI. DEATH TAX RELIEF PROVISIONS

A. Phase in Repeal of Estate, Gift, and Generation-Skipping Taxes

(secs. 601–603, 611, and 621 of the bill and secs. 2001–2704 of the Code)

PRESENT LAW

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. The gift tax and the estate tax are unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death. The unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million. In addition, a 5-percent surtax is imposed on cumulative taxable transfers between $10 million and the amount necessary to phase out the benefits of the graduated rates.

A unified credit is available with respect to taxable transfers by gift and at death. The unified credit amount effectively exempts from tax a total of $650,000 in 1999, $675,000 in 2000 and 2001, $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1 million in 2006 and thereafter.

A generation-skipping transfer ("GST") tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations, and taxable distributions. The GST tax is imposed at a flat rate of 55 percent (i.e., the top estate and gift tax rate) on cumulative generation-skipping transfers in excess of $1 million (indexed beginning in 1999).

The basis of property acquired or passing from a decedent generally is its fair market value on the date of the decedent's death (or, if the alternative valuation date is elected, the earlier of six months after death or the date the property is sold or distributed by the estate). This step up (or step down) in basis eliminates the recognition of any income on the appreciation of the property that occurred prior to the decedent's death, and it has the effect of eliminating any tax benefit from any unrealized loss. The basis of property acquired by gift generally is the same as it was in the hands of the donor. However, if the donor's basis was greater than the fair market value of the property at the time of gift, then, for purposes of determining loss on the disposition of the property, the basis is its fair market value at the time of gift.

REASONS FOR CHANGE

The Committee finds that the estate, gift, and generation-skipping taxes are unduly burdensome on all taxpayers, including decedents' estates, decedents' heirs, and businesses. The Committee further believes it is inappropriate to impose a tax by reason of the death of a taxpayer.

EXPLANATION OF PROVISION

Beginning in 2009, the estate, gift, and GST taxes are repealed, after which a carryover basis regime takes effect for transfers of property at death. Transfers to surviving spouses at death will continue to receive a step up in basis. Assets from estates with a total value of $2 million or less also will receive a step up in basis; however, the carryover basis regime is phased in for estates valued in excess of $1.3 million and not over $2 million.

Beginning in 2001, (1) the unified credit is replaced with a unified exemption, (2) the 5 percent surtax (which phases out the graduated rates) and the rates in excess of 50 percent are repealed, and (3) the estate, gift, and GST tax rates will be reduced each year until they are repealed in 2009.

Phaseout and repeal of estate, gift, and GST taxes

Beginning in 2001, the top estate and gift tax rates above 50 percent are repealed, as is the 5- percent surtax, which phases out the graduated rates. Beginning in 2002 and through 2004, each of the rates of tax are reduced by 1 percentage point annually. Beginning in 2005 and through 2008, each of the rates of tax are reduced by 2 percentage points annually. The highest estate and gift tax rate in effect for a given year will be the GST tax rate for that year. The reduction in estate and gift tax rates is coordinated with the income tax rates such that the highest estate and gift tax rate (and, thus, the GST tax rate) is not reduced below the top individual tax rate under the broad-based income tax relief provision. The lower estate and gift tax rates will not be reduced below the lowest individual tax rate under the broad-based income tax relief provision. Beginning in 2002 and through 2008, the State death tax credit rates will be reduced in proportion to the reduction in the estate and gift tax rates.

Beginning in 2009, the estate, gift, and GST taxes are repealed.

Replace unified credit with unified exemption

Beginning in 2001, the unified credit is replaced with a unified exemption amount. The unified exemption amount is determined for the following calendar years: in 2001, $675,000; in 2002 and 2003, $700,000; in 2004, $850,000; in 2005, $950,000; and in 2006 and thereafter, $1,000,000. For decedents who are not residents and not citizens of the United States, the exemption is the greater of (1) $60,000 or (2) that portion of $175,000 which the value of that part of the decent's gross estate which at the time of his death is situated in the United States bears to the value of the decedent's entire gross estate wherever situated.

Carryover basis

Beginning in 2009, after the estate, gift, and GST taxes have been repealed, a carryover basis regime will take effect. Recipients of property transferred during the transferor's life or at the decedent transferor's death will receive the transferor's basis in the property. However, if such basis is greater than the fair market value of the property at the time of the transfer from the estate, then, for purposes of determining loss on the disposition of the property, the basis is its fair market value at the time of transfer.

Transfers to surviving spouses at death will continue to receive step up in basis. Assets from estates with a total value of $2 million or less also will receive a step up in basis; however, the step up in basis will be phased out for estates valued in excess of $1.3 million and not over $2 million. For transfers from these estates, the amount of the step up from basis to fair market value of each appreciated asset will be reduced, proportionately, by the amount which bears the same ratio to such step up as the excess over $1.3 million but not over $2 million bears to $700,000.

EFFECTIVE DATE

The unified credit is replaced with a unified exemption, the 5-percent surtax is repealed, and the rates in excess of 50 percent are repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2000.

The reduction of the estate and gift tax rates and of the State death tax credit occurs in 2002 through 2008.

The estate, gift, and GST taxes will be repealed and the carryover basis regime takes effect for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2008.

B. Modify Generation-Skipping Tax Rules

1. Deemed allocation of the generation-skipping transfer ("GST") tax exemption to lifetime transfers to trusts that are not direct skips (sec. 631 of the bill and sec. 2632 of the Code)

PRESENT LAW

A GST tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999) is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property.

A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person. A skip person may be a natural person or certain trusts. All persons assigned to the second or more remote generation below the transferor are skip persons (e.g., grandchildren and great-grandchildren). Trusts are skip persons if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip).

The tax rate on generation-skipping transfers is a flat rate of tax equal to the maximum estate and gift tax rate in effect at the time of the transfer (55 percent under present law) multiplied by the "inclusion ratio." The inclusion ratio with respect to any property transferred in a generation-skipping transfer indicates the amount of "GST exemption" allocated to a trust. The allocation of GST exemption reduces the 55-percent tax rate on a generation-skipping transfer.

If an individual makes a direct skip during his or her lifetime, any unused GST exemption is automatically allocated to a direct skip to the extent necessary to make the inclusion ratio for such property equal to zero. An individual may elect out of the automatic allocation for lifetime direct skips.

For lifetime transfers made to a trust that are not direct skips, the transferor must allocate GST exemption—the allocation is not automatic. If GST exemption is allocated on a timely-filed gift tax return, then the portion of the trust which is exempt from GST tax is based on the value of the property at the time of the transfer. If, however, the allocation is not made on a timely-filed gift tax return, then the portion of the trust which is exempt from GST tax is based on the value of the property at the time the allocation of GST exemption was made.

Treas. Reg. 26.2632–1(d) further provides that any unused GST exemption, which has not been allocated to transfers made during an individual's life, is automatically allocated on the due date for filing the decedent's estate tax return. Unused GST exemption is allocated pro rata on the basis of the value of the property as finally determined for estate tax purposes, first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata, on the basis of the estate tax value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

REASONS FOR CHANGE

Under present law, GST tax exemption is automatically allocated to transfers that are direct skips; however, GST tax exemption is not automatically allocated to transfers to trusts that are not direct skips ("indirect skips"). The Committee recognizes that there are situations where a taxpayer would desire allocation of GST tax exemption, yet the taxpayer had missed allocating GST tax exemption to an indirect skip, e.g., because the taxpayer or the taxpayer's advisor inadvertently omitted making the election on a timely-filed gift tax return or the taxpayer submitted a defective election. Thus, the Committee believes that automatic allocation is appropriate for transfers to a trust from which GSTs are likely to occur.

EXPLANATION OF PROVISION

Under the bill, GST tax exemption is automatically allocated to transfers made during life that are "indirect skips." An indirect skip is any transfer of property (that is not a direct skip) subject to the gift tax that is made to a GST trust.

A GST trust is defined as a trust that could have a generation-skipping transfer with respect to the transferor (e.g., a taxable termination or taxable distribution), unless:

—the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons (a) before the date that the individual attains age 46, (b) on or before 1 or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or (c) upon the occurrence of an event that, in accordance with regulations prescribed by the Treasury Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

—the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

—the trust instrument provides that, if 1 or more individuals who are non-skip persons die on or before a date or event described in clause (1) or (2), more than 25 percent of the trust corpus either must be distributed to the estate or estates of 1 or more of such individuals or is subject to a general power of appointment exercisable by 1 or more of such individuals;

—the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

—the trust is a charitable lead annuity trust or a charitable remainder annuity trust or a charitable unitrust; or

—the trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

If any individual makes an indirect skip during the individual's lifetime, then any unused portion of such individual's GST exemption is allocated to the property transferred to the extent necessary to produce the lowest possible inclusion ratio for such property.

An individual may elect not to have the automatic allocation rules apply to an indirect skip, and such elections will be deemed timely if filed on a timely-filed gift tax return for the calendar year in which the transfer was made or deemed to have been made or on such later date or dates as may be prescribed by the Treasury Secretary. An individual may elect not to have the automatic allocation rules apply to any or all transfers made by such individual to a particular trust and may elect to treat any trust as a GST trust with respect to any or all transfers made by the individual to such trust, and such election may be made on a timely-filed gift tax return for the calendar year for which the election is to become effective.

EFFECTIVE DATE

The provision applies to transfers subject to estate or gift tax made after December 31, 1999, and to estate tax inclusion periods ending after December 31, 1999.

2. Retroactive allocation of the GST tax exemption (sec. 631 of the bill and sec. 2632 of the Code)

PRESENT LAW

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip). If a transferor allocates GST tax exemption to a trust prior to the taxable termination or taxable distribution, GST tax may be avoided.

A transferor likely will not allocate GST tax exemption to a trust that the transferor expects will benefit only non-skip persons. However, if a taxable termination occurs because, for example, the transferor's child unexpectedly dies such that the trust terminates in favor of the transferor's grandchild, and GST tax exemption had not been allocated to the trust, then GST tax would be due even if the transferor had unused GST tax exemption.

REASONS FOR CHANGE

The Committee recognizes that when a transferor does not expect the second generation (e.g., the transferor's child) to die before the termination of a trust, the transferor likely will not allocate GST tax exemption to the transfer to the trust. If a transferor knew, however, that the transferor's child might predecease the transferor and that there could be a taxable termination as a result thereof, the transferor likely would have allocated GST tax exemption at the time of the transfer to the trust. The Committee believes it is appropriate to provide that when there is an unnatural order of death (e.g., when the second generation dies before the first generation transferor), the transferor may allocate GST tax exemption retroactively to the date of the respective transfer to trust.

EXPLANATION OF PROVISION

Under the bill, GST tax exemption may be allocated retroactively when there is an unnatural order of death. If a lineal descendant of the transferor predeceases the transferor, then the transferor may allocate any unused GST exemption to any previous transfer or transfers to the trust on a chronological basis. The provision allows a transferor to retroactively allocate GST exemption to a trust where a beneficiary (a) is a non-skip person, (b) is a lineal descendant of the transferor's grandparent or a grandparent of the transferor's spouse, (c) is a generation younger than the generation of the transferor, and (d) dies before the transferor. Exemption is allocated under this rule retroactively, and the applicable fraction and inclusion ratio would be determined based on the value of the property on the date that the property was transferred to trust.

EFFECTIVE DATE

The provision applies to deaths of non-skip persons occurring after the date of enactment.

3. Severing of trusts holding property having an inclusion ratio of greater than zero (sec. 632 of the bill and sec. 2642 of the Code)

PRESENT LAW

A generation-skipping transfer tax ("GST tax") generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999) is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property.

If the value of transferred property exceeds the amount of the GST exemption allocated to that property, then the GST tax generally is determined by multiplying a flat tax rate equal to the highest estate tax rate (which is currently 55 percent) by the "inclusion ratio" and the value of the taxable property at the time of the taxable event. The "inclusion ratio" is the number one minus the "applicable fraction." The applicable fraction is a fraction calculated by dividing the amount of the GST exemption allocated to the property by the value of the property.

Under Treas. Reg. 26.2654–1(b), a trust may be severed into two or more trusts (e.g., one with an inclusion ratio of zero and one with an inclusion ratio of one) only if (1) the trust is severed according to a direction in the governing instrument or (2) the trust is severed pursuant to the trustee's discretionary powers, but only if certain other conditions are satisfied (e.g., the severance occurs or a reformation proceeding begins before the estate tax return is due). Under current Treasury regulations, however, a trustee cannot establish inclusion ratios of zero and one by severing a trust that is subject to the GST tax after the trust has been created.

REASONS FOR CHANGE

If a trust has an inclusion ratio between zero and one, every distribution from the trust is subject to tax at a reduced rate. Complexity in this regard can be reduced if a GST trust is treated as two separate trusts for GST tax purposes—one with an inclusion ratio of zero and one with an inclusion ratio of one. This result can be achieved by drafting complex documents in order to meet the specific requirements of severance. The Committee believes it is appropriate to make the rules regarding severance less burdensome and less complex.

EXPLANATION OF PROVISION

Under the bill, a trust may be severed in a "qualified severance." A qualified severance is defined as the division of a single trust and the creation of two or more trusts if (1) the single trust was divided on a fractional basis, and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust. If a trust has an inclusion ratio of greater than zero and less than one, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of one. Under the provision, a trustee may elect to sever a trust in a qualified severance at any time.

EFFECTIVE DATE

The provision is effective for severances of trusts occurring after the date of enactment.

4. Modification of certain valuation rules (sec. 633 of the bill and sec. 2642 of the Code)

PRESENT LAW

Under present law, the inclusion ratio is determined using gift tax values for allocations of GST tax exemption made on timely filed gift tax returns. The inclusion ratio generally is determined using estate tax values for allocations of GST tax exemption made to transfers at death. Treas. Reg. 26.2642–5(b) provides that, with respect to taxable terminations and taxable distributions, the inclusion ratio becomes final on the later of the period of assessment with respect to the first transfer using the inclusion ratio or the period for assessing the estate tax with respect to the transferor's estate.

REASONS FOR CHANGE

The Committee believes it is appropriate to clarify the valuation rules relating to timely and automatic allocations of GST tax exemption.

EXPLANATION OF PROVISION

Under the bill, in connection with timely and automatic allocations of GST tax exemption, the value of the property for purposes of determining the inclusion ratio shall be its finally determined gift tax value or estate tax value depending on the circumstances of the transfer. In the case of a GST tax exemption allocation deemed to be made at the conclusion of an estate tax inclusion period, the value for purposes of determining the inclusion ratio shall be its value at that time.

EFFECTIVE DATE

The provision is effective as though included in the amendments made by section 1431 of the Tax Reform Act of 1986.

5. Relief from late elections (sec. 634 of the bill and sec. 2642 of the Code)

PRESENT LAW

Under present law, an election to allocate GST tax exemption to a specific transfer may be made at any time up to the time for filing the transferor's estate tax return. If an allocation is made on a gift tax return filed timely with respect to the transfer to trust, then the value on the date of transfer to the trust is used for determining GST tax exemption allocation. However, if the allocation relating to a specific transfer is not made on a timely-filed gift tax return, then the value on the date of allocation must be used. There is no statutory provision allowing relief for an inadvertent failure to make an election on a timely-filed gift tax return to allocate GST tax exemption.

REASONS FOR CHANGE

The Committee believes it is appropriate for the Treasury Secretary to grant extensions of time to make an election to allocate GST tax exemption and to grant exceptions to the statutory time requirement in appropriate circumstances, e.g., when the taxpayer intended to allocate GST tax exemption and the failure to timely allocate GST tax exemption was inadvertent.

EXPLANATION OF PROVISION

Under the bill, the Treasury Secretary is authorized and directed to grant extensions of time to make the election to allocate GST tax exemption and to grant exceptions to the time requirement. If such relief is granted, then the value on the date of transfer to trust would be used for determining GST tax exemption allocation.

In determining whether to grant relief for late elections, the Treasury Secretary is directed to consider all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems relevant. For purposes of determining whether to grant relief, the time for making the allocation (or election) is treated as if not expressly prescribed by statute.

EFFECTIVE DATE

The provision to provide relief from late elections applies to requests pending on, or filed after, the date of enactment.

6. Substantial compliance (sec. 634 of the bill and sec. 2642 of the Code)

PRESENT LAW

Under present law, there is no statutory rule which provides that substantial compliance with the statutory and regulatory requirements for allocating GST tax exemption will suffice to establish that GST tax exemption was allocated to a particular transfer or trust.

REASONS FOR CHANGE

The Committee recognizes that the rules and regulations regarding the allocation of GST tax exemption are complex. Thus, it is often difficult for taxpayers to comply with the technical requirements for making a proper election to allocate GST tax exemption. The Committee therefore believes it is appropriate to provide that GST tax exemption will be allocated when a taxpayer substantially complies with the rules and regulations for allocating GST tax exemption.

EXPLANATION OF PROVISION

Under the bill, substantial compliance with the statutory and regulatory requirements for allocating GST tax exemption will suffice to establish that GST tax exemption was allocated to a particular transfer or a particular trust. If a taxpayer demonstrates substantial compliance, then so much of the transferor's unused GST tax exemption will be allocated to the extent it produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances will be considered, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems appropriate.

EFFECTIVE DATE

The substantial compliance provisions are effective on the date of enactment and apply to allocations made prior to such date for purposes of determining the tax consequences of generation-skipping transfers with respect to which the period of time for filing claims for refund has not expired.[49]

TITLE VII. DISTRESSED COMMUNITIES AND INDUSTRIES PROVISIONS

A. RENEWAL COMMUNITY PROVISIONS

(secs. 701–706 of the bill and secs. 51, 198, 4973, 4975, 6047, 6104, 6693, and new secs. 1400E–L of the Code)

PRESENT LAW

Pursuant to the Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993"), the Secretaries of the Department of Housing and Urban Development (HUD) and the Department of Agriculture designated a total of nine empowerment zones and 95 enterprise communities on December 21, 1994. As required by law, six empowerment zones are located in urban areas and three empowerment zones are located in rural areas.[50] Of the enterprise communities,

[49] No inference is intended with respect to the application of a rule of substantial compliance prior to enactment of this provision.

[50] The six designated urban empowerment zones are located in New York City, Chicago, Atlanta, Detroit, Baltimore, and Philadelphia-Camden (New Jersey). The three designated rural

Continued

65 are located in urban areas and 30 are located in rural areas (sec. 1391). Designated empowerment zones and enterprise communities were required to satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations (sec. 1392).

The following tax incentives are available for certain businesses located in empowerment zones: (1) a 20-percent wage credit for the first $15,000 of wages paid to a zone resident who works in the zone; (2) an additional $20,000 of section 179 expensing for "qualified zone property" placed in service by an "enterprise zone business" (accordingly, certain businesses operating in empowerment zones are allowed up to $39,000 of expensing for 1999); (3) special tax-exempt financing for certain zone facilities; and (4) the so-called "brownfields" tax incentive, which allows taxpayers to expense (rather than capitalize) certain environmental remediation expenditures.[51]

The 95 enterprise communities are eligible for the special tax-exempt financing benefits and "brownfields" tax incentive, but not the other tax incentives (i.e., the wage credit and additional sec. 179 expensing) available in the empowerment zones. In addition to these tax incentives, OBRA 1993 provided that Federal grants would be made to designated empowerment zones and enterprise communities. The tax incentives (other than the "brownfields" incentive) for empowerment zones and enterprise communities generally will be available during the period that the designation remains in effect (i.e., a 10–year period).

Pursuant to the Tax Relief Act of 1997 ("1997 Act"), the Secretary of HUD designated two additional empowerment zones located in urban areas (thereby increasing to eight the total number of empowerment zones located in urban areas) with respect to which the same tax incentives generally apply (i.e., the wage credit, additional expensing under section 179, special tax-exempt financing, and "brownfields" incentive) as are available within the empowerment zones authorized by OBRA 1993.[52] The two additional empowerment zones are subject to the same eligibility criteria under present-law section 1392 that apply to the original six urban

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empowerment zones are located in Kentucky Highlands (Clinton, Jackson, and Wayne counties, Kentucky), Mid-Delta Mississippi (Bolivar, Holmes, Humphreys, and Leflore counties, Mississippi), and Rio Grande Valley Texas (Cameron, Hidalgo, Starr, and Willacy counties, Texas).

[51] The environmental remediation expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site, generally meaning any property that (1) is held for use in a trade or business, for the production of income, or as inventory; (2) is certified by the appropriate State environmental agency to be located within a targeted area; and (3) contains (or potentially contains) a hazardous substance. Targeted areas include: (1) empowerment zones and enterprise communities as designated under OBRA 1993 and the 1997 Act (including any supplemental empowerment zone designated on December 21, 1994); (2) sites announced before February 1997, as being subject to one of the 76 Environmental Protection Agency (EPA) Brownfields Pilots; (3) any population census tract with a poverty rate of 20 percent or more; and (4) certain industrial and commercial areas that are adjacent to tracts described in (3) above. The "brownfields" provision (enacted in the 1997 Act) applies to eligible expenditures incurred in taxable years ending after date of enactment and before January 1, 2001.

[52] The two additional empowerment zones are located in Cleveland and Los Angeles. The wage credit available in the two new urban empowerment zones is modified slightly to provide that the credit rate will be 20 percent for calendar years 2000–2004, 15–percent for calendar year 2005, 10 percent for calendar year 2006, and five percent for calendar year 2007. No wage credit will be available in the two new urban empowerment zones after 2007.

empowerment zones.[53] However, a special rule provides that the designations of these two additional empowerment zones will not take effect until January 1, 2000 (and generally will remain in effect for 10 years).

The 1997 Act also authorizes the Secretaries of HUD and Agriculture to designate an additional 20 empowerment zones (no more than 15 in urban areas and no more than five in rural areas).[54] With respect to these additional empowerment zones, the present-law eligibility criteria are expanded slightly in comparison to the eligibility criteria provided for by OBRA 1993. First, the general square mileage limitations (i.e., 20 square miles for urban areas and 1,000 square miles for rural areas) are expanded to allow the empowerment zones to include an additional 2,000 acres. This additional acreage, which could be developed for commercial or industrial purposes, is not subject to the poverty rate criteria and may be divided among up to three noncontiguous parcels. In addition, the general requirement that at least half of the nominated area consists of census tracts with poverty rates of 35 percent or more does not apply to the 20 additional empowerment zones. However, under present-law section 1392(a)(4), at least 90 percent of the census tracts within a nominated area must have a poverty rate of 25 percent or more, and the remaining census tracts must have a poverty rate of 20 percent or more.[55] For this purpose, census tracts with populations under 2,000 are treated as satisfying the 25–percent poverty rate criteria if (1) at least 75 percent of the tract was zoned for commercial or industrial use, and (2) the tract is contiguous to one or more other tracts that actually have a poverty rate of 25 percent or more.

Within the 20 additional empowerment zones, qualified "enterprise zone businesses" are eligible to receive up to $20,000 of additional section 179 expensing[56] and to utilize special tax-exempt financing benefits. The "brownfields" tax incentive (described above) also is available within all designated empowerment zones. However, businesses within the 20 additional empowerment zones are *not* eligible to receive the present-law wage credit available within the 11 other designated empowerment zones (*i.e.*, the wage credit is available only within the nine zones designated under OBRA 1993 and the two urban zones designated under the 1997 Act that are eligible for the same tax incentives as are available in the nine zones designated under OBRA 1993). The 20 additional empowerment zones generally will remain in effect for 10 years (*i.e.*, from 1999 through 2008).[57]

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[53] In order to permit designation of these two additional empowerment zones, the 1997 Act increased the aggregate population cap applicable to urban empowerment zones from 750,000 to a cap of one million aggregate population for the eight urban empowerment zones.

[54] The additional 20 empowerment zones were designated by the Secretaries of HUD and Agriculture on December 31, 1998.

[55] In lieu of the poverty criteria, outmigration may be taken into account in designating one rural empowerment zone.

[56] However, the additional section 179 expensing is not available within the additional 2,000 acres allowed to be included under the 1997 Act within an empowerment zone.

[57] In addition, the 1997 Act also provides for special tax incentives (some of which are modeled after the empowerment zone tax incentives, but which also include a zero percent capital gains rate for certain qualified assets) for the District of Columbia.

REASONS FOR CHANGE

The Committee believes that the tax incentives available in empowerment zones and enterprise communities are inadequate to address the problems of distressed rural and urban areas. Revitalization of economically distressed areas through expanded business and employment opportunities and increased savings incentives should help address both economic and social problems in such areas.

EXPLANATION OF PROVISION

The provision authorizes the designation of 20 "renewal communities" within which special tax incentives would be available. The following is a description of the designation process and the tax incentives that would be available within the renewal communities.

Designation process

Designation of 20 renewal communities.—Under the bill, the Secretary of HUD is authorized to designate up to 20 "renewal communities" from areas nominated by States and local governments. At least four of the designated communities must be in rural areas (defined as areas which are (1) within local government jurisdictions with a population less than 50,000, (2) outside of a metropolitan statistical area, or (3) determined by HUD to be a rural area). The Secretary of HUD would be required to publish (within four months after enactment) regulations describing the selection process; all designations of renewal communities would have to be made within 24 months after such regulations are published. The designation of an area as a renewal community terminates after December 31, 2007.[58]

Old empowerment zones and enterprise communities could seek additional designation as renewal communities.—The bill allows the previously designated empowerment zones and enterprise communities to apply for designation as renewal communities. Priority is given in the designation of the first ten renewal communities to nominated areas that are designated as empowerment zones or enterprise communities under present law and that otherwise meet the requirements for designation as a renewal community. If a previously designated empowerment zone or enterprise community is selected as one of the 20 renewal communities, then the area's designation as an empowerment zone or enterprise community remains in effect and the same area would also be designated as a renewal community. For such an area obtaining dual-designation status, the special tax incentives available for empowerment zones (or enterprise communities, as the case may be) and for renewal communities would be available.

Eligibility criteria.—To be designated as a renewal community, a nominated area must meet all of the following criteria: (1) each census tract has a poverty rate of at least 20 percent; (2) in the case of an urban area, at least 70 percent of the households have incomes below 80 percent of the median income of households with-

[58] The designation would terminate earlier than December 31, 2007, if (1) an earlier termination date is designated by the State or local government in their designation, or (2) the Secretary of HUD revokes the designation as of an earlier date.

in the local government jurisdiction; (3) the unemployment rate is at least 1.5 times the national unemployment rate; and (4) the area is one of pervasive poverty, unemployment, and general distress.

Except with respect to the designation of the first ten renewal communities when priority would be given to existing empowerment zones and enterprise communities (as described above), those areas with the highest average ranking of eligibility factors (1), (2), and (3) above would be designated as renewal communities. The Secretary of HUD shall take into account in selecting areas for designation the extent to which such areas have a high incidence of crime, as well as whether the area has census tracts identified in the May 12, 1998, report of the Government Accounting Office regarding the identification of economically distressed areas.

There are no geographic size or maximum population limitations placed on the designated renewal communities. The provision merely requires that the boundary of a designated community be "continuous" and that the designated community have a minimum population of 4,000 if the community is located within a metropolitan statistical area (at least 1,000 in all other cases, or the community must be entirely within an Indian reservation).

Required State and local government course of action.—In order for an area to be designated as a renewal community, State and local governments are required to submit a written course of action that promises within the nominated area at least five of the following: (1) a reduction of tax rates or fees; (2) an increase in the level of efficiency of local services; (3) crime reduction strategies; (4) actions to remove or streamline governmental requirements; (5) involvement by private entities and community groups, such as to provide jobs and job training and financial assistance; (6) State or local income tax benefits for fees paid for services performed by a nongovernmental entity that were formerly performed by a government entity; and (7) the gift (or sale at below fair market value) of surplus realty by the State or local government to community organizations or private companies.

In addition, the bill requires that the nominating State and local governments promise to promote economic growth in the nominated area by repealing or not enforcing (1) licensing requirements for occupations that do not ordinarily require a professional degree, (2) zoning restrictions on home-based businesses which do not create a public nuisance, (3) permit requirements for street vendors who do not create a public nuisance, (4) zoning or other restrictions that impede the formation of schools or child care centers, and (5) franchises or other restrictions on competition for businesses providing public services, including but not limited to taxicabs, jitneys, cable television, or trash hauling, unless such regulations are necessary for and well-tailored to the protection of health and safety.

Tax incentives for renewal communities

The following tax incentives generally would be available during the seven-year period beginning January 1, 2001, and ending December 31, 2007.

100-percent capital gain exclusion.—The bill provides for a 100 percent capital gains exclusion for capital gain from the sale of any qualified community asset acquired after December 31, 2000, and before January 1, 2008, and held for more than five years. A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock purchased for cash in a "renewal community business"); (2) a qualified community partnership interest (meaning a partnership interest acquired for cash in a renewal community business); and (3) qualified community business property (meaning tangible real and personal property used in a renewal community business if acquired (or substantially improved) by the taxpayer after December 31, 2000). A "renewal community business" is similar to the present-law definition of an enterprise zone business[59] except that 80 percent of the gross income must be derived from the conduct of a qualified business within a renewal community. Property continues to be a "qualified community asset" if sold (or otherwise transferred) to a subsequent purchaser, provided that the property continues to represent an interest in (or is tangible property used in) a renewal community business. The termination of an area's status as a renewal community does not affect whether property is a qualified community asset. Any gain attributable to the period before January 1, 2001, and after December 31, 2007, is not eligible for the 100-percent capital gains exclusion.

Family development accounts.—The bill allow individuals to claim an above-the-line deduction for certain amounts paid in cash to a family development account ("FDA") established for the benefit of a "qualified individual," meaning an individual who both resides in a renewal community throughout the taxable year and was allowed to claim the earned income credit (EIC) during the preceding taxable year. A qualified individual may claim a deduction of up to $2,000 per year for amounts he or she contributes to his or her own FDA. Any other person may contribute amounts to one or more FDAs established for the benefit of a qualified individual and deduct up to $1,000 per qualified individual. Contributions to an FDA made on or before April 15th of the current taxable year could be treated as made during the preceding taxable year. The bill permits (but does not require) individuals to direct that the IRS directly deposit their EIC refunds into an FDA on behalf of such individual.

The bill provides that up to five of the renewal communities may be designated by the Secretary of HUD as "FDA matching dem-

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[59] An "enterprise zone business" is defined as a corporation or partnership (or proprietorship) if for the taxable year: (1) the sole trade or business of the corporation or partnership is the active conduct of a qualified business within an empowerment zone or enterprise community; (2) at least 50 percent of the total gross income is derived from the active conduct of a "qualified business" within a zone or community; (3) a substantial portion of the business' tangible property is used within a zone or community; (4) a substantial portion of the business' intangible property is used in the active conduct of such business; (5) a substantial portion of the services performed by employees are performed within a zone or community; (6) at least 35 percent of the employees are residents of the zone or community; and (7) less than five percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to (a) certain financial property, or (b) collectibles not held primarily for sale to customers in the ordinary course of an active trade or business (sec. 1397B).

A "qualified business" is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license. In addition, the leasing of real property that is located within the empowerment zone or community to others is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property to others is not a qualified business unless at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone or enterprise community (sec. 1397B(d)).

onstration areas," with respect to which HUD will, at the request of a qualified individual, match amounts contributed to FDAs, up to $1,000 per individual per taxable year (with a $2,000 lifetime cap). At least two of the FDA matching demonstration areas must be rural areas. The Secretary of HUD may designate renewal communities as FDA matching demonstration areas only during the 24-month period after such Secretary prescribes regulations regarding such areas. The matching grant amounts made under this demonstration program are excluded from the gross income of the account holder, and no deduction is allowed for matching grant amounts. The Secretary of the Treasury is required to provide notice to residents of FDA matching demonstration areas of the availability of matching contributions.

An FDA is exempt from taxation (other than the unrelated business income tax imposed by present-law section 511). A distribution from an FDA is not included in the gross income of the distributee if it is a "qualified family development distribution." A qualified family development distribution is defined as a distribution from an FDA that is used exclusively to pay for (1) qualified higher educational expenses, (2) qualified first-time homebuyer expenses, (3) qualified business capitalization costs [60], or (4) qualified medical expenses. Such qualified expenses must be incurred on behalf of the FDA account holder, or the spouse or dependent of the account holder.

Distributions from an FDA that are not qualified family development distributions are included in gross income and subject to either a 100-percent additional tax (in the case of a distribution attributable to a demonstration matching contribution) or a 10-percent additional tax (in the case of a distribution that is not attributable to a demonstration matching contribution). The 100-percent and 10-percent additional taxes do not apply to distributions that are made on or after the account holder attains age 59½, dies, or becomes disabled. Any distribution from an FDA that is not a qualified family development distribution is deemed to have been made from demonstration matching contributions (and, therefore, subject to a 100-percent additional tax) until all such demonstration matching contributions have been withdrawn. The purpose of this rule is to encourage account holders to use the amounts contributed to the FDA for qualified family development distributions or to save such amounts for retirement.

The bill permits tax-free rollovers of amounts in an FDA into another such account established for the benefit of an individual who (1) both resides in a renewal community throughout the taxable year and was allowed to claim the earned income credit during the preceding taxable year, and (2) either is the account holder or is a spouse or dependent of the account holder.

Commercial revitalization deduction.—The bill allows each State to allocate an amount of "commercial revitalization deductions" with respect to qualified revitalization expenditures incurred in connection with a qualified revitalization building. The commercial revitalization deduction is equal to (a) 50 percent of qualified revi-

[60] As is the case for enterprise zone businesses, a qualified business capitalization cost would not include expenditures incurred for the capitalization of any trade or business described in section 144(c)(6)(B) (e.g., a country club, hot tub facility, or liquor store).

talization expenditures for the taxable year in which a qualified revitalization building is placed in service or, at the election of the taxpayer, (b) a ten-percent deduction for qualified revitalization expenditures per year for a 10-year period beginning with the year in which the building is placed in service. A "qualified revitalization expenditure" means the cost (up to $10 million) of constructing or substantially rehabilitating a building used for commercial purposes in a designated renewal community, including certain land acquisition costs. A commercial revitalization deduction would be in lieu of any depreciation deduction otherwise allowable on account of such expenditure.

Each State would be allowed to allocate no more than $6 million worth of commercial revitalization deductions to each renewal community located within the State for each calendar year after 2000 and before 2008. The appropriate State agency would make the allocations pursuant to a qualified allocation plan. The qualified allocation plan would (1) set forth the selection criteria to be used to determine priorities as appropriate to local conditions; (2) consider how the building project would contribute to the renewal community and its residents, and (3) provide a procedure that the agency would follow to monitor compliance.

A qualified revitalization building must be located in a renewal community and placed in service after December 31, 2000, and before January 1, 2008.

Additional section 179 expensing.—A renewal community business is allowed an additional $35,000 of section 179 expensing for qualified renewal property placed in service after December 31, 2000, and before January 1, 2008. If a renewal community business is located in an area that is designated as both an empowerment zone and a renewal community, such business could be allowed an additional $55,000 of section 179 expensing (i.e., $20,000 of additional expensing because the area is designated an empowerment zone plus $35,000 of additional expensing because the area is designated a renewal community). The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified renewal property placed in service during the year by the taxpayer exceeds $200,000. The term "qualified renewal property" is similar to the definition of "qualified zone property" under section 1397C.

Expensing of environmental remediation costs ("brownfields").—Under the bill, a renewal community is treated as a "targeted area" under section 198 which permits expensing of certain environmental remediation costs. Thus, taxpayers can elect to treat certain environmental remediation expenditures that otherwise would be capitalized as deductible in the year paid or incurred. The expenditure must be incurred in connection with the abatement or control of environmental contaminants, as required by Federal and State law, at a trade or business site located within a designated renewal community. This provision applies to expenditures incurred after December 31, 2000, and before January 1, 2008.

Extension of work opportunity tax credit ("WOTC").—The provision makes two changes to the WOTC. Beginning in 2001, the provision expands the high-risk youth and qualified summer youth categories in the present-law WOTC to include qualified individuals who live in a renewal community.

Second, in the event that the WOTC program were to expire, the bill permits employers engaged in a trade or business in a renewal community to claim a tax credit with respect to individuals hired from one or more targeted groups that live and perform substantially all of their work in a renewal community. The tax credit equals 15 percent of the qualified first-year wages and 30 percent of the qualified second-year wages through December 31, 2007.[61] No more than $10,000 of wages may be taken into account in each year. Thus, the maximum credit for a qualifying individual is $1,500 with respect to qualified first-year wages and $3,000 with respect to qualified second-year wages. Qualified wages generally consist of wages paid or incurred during the period for which the WOTC is being calculated.

Targeted groups eligible for the tax credit include: (1) certain individuals certified by the designated local agency as being a member of a family receiving assistance under a IV-A program for any nine months during the 18-month period ending on the hiring date; (2) certain ex-felons having a hiring date within one year of release from prison or date of conviction; (3) individuals who are at least 18 but not 25 years of age and have a principal place of abode within an empowerment zone, enterprise community, or renewal community; (4) individuals who are at least 18 but not 25 years of age who are certified as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least six months ending on the hiring date; (5) individuals who have a physical or mental disability that constitutes a substantial handicap to employment and who have been referred to the employer while receiving, or after completing, vocational rehabilitation services; (6) individuals who are 16 or 17 years of age, perform services during any 90-day period between May 1 and September 15, and have a principal place of abode within an empowerment zone, enterprise community, or renewal community; (7) certain veterans who receive food stamps; and (8) recipients of certain ("SSI") Supplemental Security Income benefits.

HUD reports.—The bill provides that, not later than the close of the fourth calendar year after the year the Secretary of HUD first designates an area as a renewal community and every four years thereafter, the Secretary of HUD must report to Congress on the effects of such designation in stimulating the creation of new jobs, particularly for disadvantaged workers and long-term unemployed individuals, and promoting the revitalization of economically distressed areas.

EFFECTIVE DATE

Although renewal communities would be designated within 24 months after publication of regulations by HUD, the tax benefits available in renewal communities are effective for the 7-year period beginning January 1, 2001, and ending December 31, 2007.

[61] The Work Opportunity Tax Credit expired on July 1, 1999. A different section of the bill extends the Work Opportunity Tax Credit through December 31, 2001.

B. Provide That Federal Production Payments to Farmers Are Taxable in the Year Received

(sec. 711 of the bill)

PRESENT LAW

A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless such amount properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment.

The Federal Agriculture Improvement and Reform Act of 1996 (the "FAIR Act") provides for production flexibility contracts between certain eligible owners and producers and the Secretary of Agriculture. These contracts generally cover crop years from 1996 through 2002. Annual payments are made under such contracts at specific times during the Federal government's fiscal year. Section 112(d)(2) of the FAIR Act provides that one-half of each annual payment is to be made on either December 15 or January 15 of the fiscal year, at the option of the recipient.[62] The remaining one-half of the annual payment must be made no later than September 30 of the fiscal year. The Emergency Farm Financial Relief Act of 1998 added section 112(d)(3) to the FAIR Act which provides that all payments for fiscal year 1999 are to be paid at such time or times during fiscal year 1999 as the recipient may specify. Thus, the one-half of the annual amount that would otherwise be required to be paid no later than September 30, 1999 can be specified for payment in calendar year 1998.

These options potentially would have resulted in the constructive receipt (and thus inclusion in income) of the payments to which they relate at the time they could have been exercised, whether or not they were in fact exercised. However, section 2012 of the Tax and Trade Relief Extension Act of 1998 provided that the time a production flexibility contract payment under the FAIR Act properly is includible in income is to be determined without regard to either option, effective for production flexibility contract payments made under the FAIR Act in taxable years ending after December 31, 1995.

REASONS FOR CHANGE

The Committee does not believe that farmers should be required to accelerate the recognition of income on production flexibility contract payments solely because Congress creates an option for the accelerated receipt of such payments.

EXPLANATION OF PROVISION

Any option to accelerate the receipt of any payment under a production flexibility contract which is payable under the FAIR Act, as in effect on the date of enactment of the provision, is to be dis-

[62] This rule applies to fiscal years after 1996. For fiscal year 1996, this payment was to be made not later than 30 days after the production flexibility contract was entered into.

regarded in determining the taxable year in which such payment is properly included in gross income. Options to accelerate payments that are enacted in the future are covered by this rule, providing the payment to which they relate is mandated by the FAIR Act as in effect on the date of enactment of this Act.

The provision does not delay the inclusion of any amount in gross income beyond the taxable period in which the amount is received.

EFFECTIVE DATE

The provision is effective on the date of enactment.

C. Allow Net Operating Losses from Oil and Gas Properties To Be Carried Back for Up to Five Years

(sec. 721 of the bill and sec. 172 of the Code)

PRESENT LAW

A net operating loss ("NOL") generally is the amount by which business deductions of a taxpayer exceed business gross income. In general, an NOL may be carried back two years and carried forward 20 years to offset taxable income in such years.[63] A carryback of an NOL results in the refund of Federal income tax for the carryback year. A carryforward of an NOL reduces Federal income tax for the carryforward year. Special NOL carryback rules apply to (1) casualty and theft losses of individual taxpayers, (2) Presidentially declared disasters for taxpayers engaged in a farming business or a small business, (3) real estate investment trusts, (4) specified liability losses, (5) excess interest losses, and (6) farm losses.

REASONS FOR CHANGE

The Committee notes that oil is, and will continue to be, vital to the American economy. The Committee observes that low oil prices have created substantial economic hardship in the oil industry and particularly in those communities where the majority of jobs are related to providing this vital commodity to the nation. Skilled workers and industry know-how will be critical to the exploration for and production of oil and gas in the future. The Committee, therefore, is concerned that the current economic hardship in the industry could lead to business failures and job losses. The Committee understands that many of these businesses are cash starved. The Committee also observes that, while current operations are unprofitable, many of these businesses have been taxpayers in the past. The Committee finds it appropriate to provide current net operating losses in the oil and gas industry to be carried back to earlier, more profitable, years, as this will improve the current cash position of many such businesses and help them weather this current economic storm.

[63] A taxpayer could elect to forgo the carryback of an NOL.

EXPLANATION OF PROVISION

The bill provides a special five-year carryback for certain eligible oil and gas losses. The carryforward period remains 20 years. An "eligible oil and gas loss" is defined as the lesser of (1) the amount which would be the taxpayer's NOL for the taxable year if only income and deductions attributable to operating mineral interests in oil and gas wells were taken into account, or (2) the amount of such net operating loss for such taxable year. In calculating the amount of a taxpayer's NOL carrybacks, the portion of the NOL that is attributable to an eligible oil and gas loss is treated as a separate NOL and taken into account after the remaining portion of the NOL for the taxable year.

EFFECTIVE DATE

The provision applies to NOLs arising in taxable years beginning after December 31, 1998.

D. Deduction for Delay Rental Payments

(sec. 722 of the bill and sec. 263A of the Code)

PRESENT LAW

Present law generally requires costs associated with inventory and property held for resale to be capitalized rather than currently deducted as they are incurred. (sec. 263). Oil and gas producers typically contract for mineral production in exchange for royalty payments. If mineral production is delayed, these contracts provide for "delay rental payments" as a condition of their extension. The Treasury Department has taken the position that the uniform capitalization rules of section 263A require delay rental payments to be capitalized.

REASONS FOR CHANGE

The Committee believes that, in essence, a delay rental payment is a substitute, both in the eyes of the payor and the payee, for a royalty payment that would have been made had the property been brought into production. The Committee notes that a royalty payment is deductible currently and, therefore, believes that delay rental payments also should be deductible currently.

EXPLANATION OF PROVISION

The bill allows delay rental payments to be deducted currently.

EFFECTIVE DATE

The provision applies to delay rental payments incurred in taxable years beginning after December 31, 2000.

No inference is intended from the prospective effective date of this provision as to the proper treatment of pre-effective date delay rental payments.

E. Election To Expense Geological and Geophysical Expenditures

(sec. 723 of the bill and sec. 263 of the Code)

PRESENT LAW

In general

Under present law, current deductions are not allowed for any amount paid for new buildings or for permanent improvements or betterments made to increase the value of any property or estate (sec. 263(a)). Treasury Department regulations define capital amounts to include amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer or (2) to adapt property to a new or different use.[64]

The proper income tax treatment of geological and geophysical costs ("G&G costs") associated with oil and gas production has been the subject of a number of court decisions and administrative rulings. G&G costs are incurred by the taxpayer for the purpose of obtaining and accumulating data that will serve as a basis for the acquisition and retention of oil or gas properties by taxpayers exploring for the minerals. Courts have ruled that such costs are capital in nature and are not deductible as ordinary and necessary business expenses.[65] Accordingly, the costs attributable to such exploration are allocable to the cost of the property acquired or retained.[66] The term "property" includes an economic interest in a tract or parcel of land notwithstanding that a mineral deposit has not been established or proven at the time the costs are incurred.

Revenue Ruling 77–188

In Revenue Ruling 77–188[67] (hereinafter referred to as the "1977 ruling"), the Internal Revenue Service ("IRS") provided guidance regarding the proper tax treatment of G&G costs. The ruling describes a typical geological and geophysical exploration program as containing the following elements:

—It is customary in the search for mineral producing properties for a taxpayer to conduct an exploration program in one or more identifiable project areas. Each project area encompasses a territory that the taxpayer determines can be explored advantageously in a single integrated operation. This determination is made after analyzing certain variables such as the size and topography of the project area to be explored, the existing information available with respect to the project area and nearby areas, and the quantity of equipment, the number of personnel, and the amount of money available to conduct a reasonable exploration program over the project area.

—The taxpayer selects a specific project area from which geological and geophysical data are desired and conducts a reconnaissance-type survey utilizing various geological and geophysical ex-

[64] Treas. Reg. sec. 1.263(a)–(1)(b).
[65] See, e.g., Schermerhorn Oil Corporation, 46 B.T.A. 151 (1942).
[66] By contrast, section 617 of the Code permits a taxpayer to elect to deduct certain expenditures incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (but not oil and gas). These deductions are subject to recapture if the mine with respect to which the expenditures were incurred reaches the producing stage.
[67] 1977–1 C.B. 76.

ploration techniques that are designed to yield data that will afford a basis for identifying specific geological features with sufficient mineral potential to merit further exploration.

—Each separable, noncontiguous portion of the original project area in which such a specific geological feature is identified is a separate "area of interest." The original project area is subdivided into as many small projects as there are areas of interest located and identified within the original project area. If the circumstances permit a detailed exploratory survey to be conducted without an initial reconnaissance-type survey, the project area and the area of interest will be coextensive.

—The taxpayer seeks to further define the geological features identified by the prior reconnaissance-type surveys by additional, more detailed, exploratory surveys conducted with respect to each area of interest. For this purpose, the taxpayer engages in more intensive geological and geophysical exploration employing methods that are designed to yield sufficiently accurate sub-surface data to afford a basis for a decision to acquire or retain properties within or adjacent to a particular area of interest or to abandon the entire area of interest as unworthy of development by mine or well.

The 1977 ruling provides that if, on the basis of data obtained from the preliminary geological and geophysical exploration operations, only one area of interest is located and identified within the original project area, then the entire expenditure for those exploratory operations is to be allocated to that one area of interest and thus capitalized into the depletable basis of that area of interest. On the other hand, if two or more areas of interest are located and identified within the original project area, the entire expenditure for the exploratory operations is to be allocated equally among the various areas of interest.

The 1977 ruling further provides that if, on the basis of data obtained from a detailed survey that does not relate exclusively to any particular property within a particular area of interest, an oil or gas property is acquired or retained within or adjacent to that area of interest, the entire G&G exploration expenditures, including those incurred prior to the identification of the particular area of interest but allocated thereto, are to be allocated to the property as a capital cost under section 263(a).

If, however, from the data obtained by the exploratory operations no areas of interest are located and identified by the taxpayer within the original project area, then the 1977 ruling states that the entire amount of the G&G costs related to the exploration is deductible as a loss under section 165 for the taxable year in which that particular project area is abandoned as a potential source of mineral production.

REASONS FOR CHANGE

The Committee believes that substantial simplification for taxpayers and significant gains in taxpayer compliance and reductions in administrative cost can be obtained by establishing the simple rule that all geological and geophysical costs can be deducted currently, regardless of the taxpayer's determination of the suitability of the site or sites examined for future production.

EXPLANATION OF PROVISION

The bill allows geological and geophysical costs incurred in connection with oil and gas exploration in the United States to be deducted currently.

EFFECTIVE DATE

The provision is effective for G&G costs incurred in taxable years beginning after December 31, 2000.

F. Temporary Suspension of Limitation Based on 65 Percent of Taxable Income

(sec. 724 of the bill and sec. 613 of the Code)

PRESENT LAW

In general

Depletion, like depreciation, is a form of capital cost recovery. In both cases, the taxpayer is allowed a deduction in recognition of the fact that an asset—in the case of depletion for oil or gas interests, the mineral reserve itself—is being expended in order to produce income. Certain costs incurred prior to drilling an oil or gas property are recovered through the depletion deduction. These include costs of acquiring the lease or other interest in the property and geological and geophysical costs (in advance of actual drilling). Depletion is available to any person having an economic interest in a producing property.

Two methods of depletion currently are allowable under the Code: (1) the cost depletion method, and (2) the percentage depletion method (secs. 611–613). Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the depletable property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining as of the end of taxable year plus the number of units sold during the taxable year. Thus, the amount recovered under cost depletion may never exceed the taxpayer's basis in the property.

Under the percentage depletion method, generally, 15 percent of the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year (sec. 613A(c)). The amount deducted generally may not exceed 100 percent of the net income from that property in any year (the "net-income limitation") (sec. 613(a)).[68] Additionally, the percentage depletion deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income (determined before such deduction and adjusted for certain loss carrybacks and trust distributions) (sec. 613A(d)(1)).[69] Because percentage depletion, unlike cost depletion, is computed without regard to the taxpayer's basis in the de-

[68] The Taxpayer Relief Act of 1997 suspended the 100-percent net-income limitation for production from marginal wells for taxable years beginning after December, 31, 1997, and before January 1, 2000. This suspension is extended for an additional period, through December 31, 2004, in another section of the bill.

[69] Amounts disallowed as a result of this rule may be carried forward and deducted in subsequent taxable years, subject to the 65-percent taxable income limitation for those years. Amounts in excess of the 100-percent-of-income-from-the-property limit may not be carried forward. In neither case can unused amounts be carried back to reduce prior-years' tax liability.

pletable property, cumulative depletion deductions may be greater than the amount expended by the taxpayer to acquire or develop the property.

A taxpayer is required to determine the depletion deduction for each oil or gas property under both the percentage depletion method (if the taxpayer is entitled to use this method) and the cost depletion method. If the cost depletion deduction is larger, the taxpayer must utilize that method for the taxable year in question (sec. 613(a)).

Limitation of oil and gas percentage depletion to independent producers and royalty owners

Generally, only independent producers and royalty owners (as contrasted to integrated oil companies) are allowed to claim percentage depletion. Percentage depletion for eligible taxpayers is allowed only with respect to up to 1,000 barrels of average daily production of domestic crude oil or an equivalent amount of domestic natural gas (sec. 613A(c)). For producers of both oil and natural gas, this limitation applies on a combined basis.

In addition to the independent producer and royalty owner exception, certain sales of natural gas under a fixed contract in effect on February 1, 1975, and certain natural gas from geopressured brine,[70] are eligible for percentage depletion, at rates of 22 percent and 10 percent, respectively. These exceptions apply without regard to the 1,000-barrel-per-day limitation and regardless of whether the producer is an independent producer or an integrated oil company.

REASONS FOR CHANGE

The Committee notes that oil is, and will continue to be, vital to the American economy. The Committee observes that low oil prices have created substantial economic hardship in the oil industry and particularly in those communities where the majority of jobs are related to providing this vital commodity to the nation. Skilled workers and industry know-how will be critical to the exploration for and production of oil and gas in the future. The Committee, therefore, is concerned that the current economic hardship in the industry could lead to business failures and job losses. The Committee understands that many of these businesses are cash starved. In light of this situation, the Committee finds it appropriate to suspend the 65-percent of taxable income limitation related to percentage depletion deductions.

EXPLANATION OF PROVISION

The limit on percentage depletion deductions to no more than 65 percent of the taxpayer's overall taxable income is suspended for taxable years beginning after December 31, 1998, and before January 1, 2005.

EFFECTIVE DATE

The provision is effective on the date of enactment.

[70] This exception is limited to wells the drilling of which began between September 30, 1978, and January 1, 1984.

G. Determination of Small Refiner Exception to Oil Depletion Deduction

(sec. 725 of the bill and sec. 613A of the Code)

PRESENT LAW

Present law classifies oil and gas producers as independent producers or integrated companies. The Code provides numerous different, and typically more generous, tax rules for operations by independent producers. One such rule allows independent producers to claim percentage depletion deductions rather than deducting the costs of their asset, a producing well, based on actual production from the well (i.e., cost depletion).

A producer is an independent producer only if its refining and retail operations are relatively small. For example, an independent producer may not have refining operations the runs from which exceed 50,000 barrels on any day in the taxable year during which independent producer status is claimed.

REASONS FOR CHANGE

The Committee observes that the present law limitation serves to define those oil and gas producers who are not integrated into the refining side of the oil business to a large degree. The Committee notes that the operation of a refinery, while highly technical is not so precise that a refinery can be efficiently run at a level up to but just below the present-law 50,000 barrel limitation on each an every day. The Committee believes that the goal of present law, to identify producers without significant refining capacity, can be achieved while permitting more flexibility to refinery operations.

EXPLANATION OF PROVISION

The provision changes the refinery limitation on claiming independent producer status from a limit based on actual daily production to a limit based on average daily production for the taxable year: the average daily refinery run for the taxable year may not exceed 50,000 barrels. For this purpose, the taxpayer shall calculate average daily production by dividing total production for the taxable year by the total number of days in the taxable year.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

H. Increase the Maximum Dollar Amount of Reforestation Expenditures Eligible for Amortization and Credit

(sec. 731 of the bill and secs. 48 and 194 of the Code)

PRESENT LAW

Amortization of reforestation costs (sec. 194)

A taxpayer may elect to amortize up to $10,000 ($5,000 in the case of a separate return by a married individual) of qualifying reforestation expenditures incurred during the taxable year with respect to qualifying timber property. Amortization is taken over 84 months (7 years) and is subject to a mandatory half-year convention.[71] In the case of an individual, the amortization deduction is allowed in determining adjusted gross income (an above-the-line deduction) rather than as an itemized deduction. The amount eligible for amortization has not been increased since the election was added to the Code in 1980.[72]

Qualifying reforestation expenditures are the direct costs a taxpayer incurs in connection with the forestation or reforestation of a site by planting or seeding, and include costs for the preparation of the site, the cost of the seed or seedlings, and the cost of the labor and tools (including depreciation of long lived assets such as tractors and other machines) used in the reforestation activity. Qualifying reforestation expenditures do not include expenditures that would otherwise be deductible and do not include costs for which the taxpayer has been reimbursed under a governmental cost sharing program, unless the amount of the reimbursement is also included in the taxpayer's gross income.

Qualifying timber property includes any woodlot or other site that is located in the United States that will contain trees in significant commercial quantities and that is held by the taxpayer for the planting, cultivating, caring for, and cutting of trees for sale or use in the commercial production of timber products. The regulations require that the site consist of at least one acre that is devoted to such activities.[73] A taxpayer may hold qualifying timber property in fee or by lease. Where the property is held by one person for life with the remainder to another person, the life tenant is considered the owner of the property for this purpose.

Reforestation amortization is subject to recapture as ordinary income on sale of qualifying timber property within 10 years of the year in which the qualifying reforestation expenditures were incurred.[74]

Reforestation tax credit (sec. 48(b))

A tax credit is allowed equal to 10 percent of the reforestation expenditures incurred during the year that are properly elected to be amortized. An amount allowed as a credit is subject to recapture if the qualifying timber property to which the expenditure relates is disposed of within 5 years.

REASONS FOR CHANGE

The Committee believes that it is appropriate to increase the amount eligible for amortization and the credit to reflect the increased costs of reforestation. In light of the current financial difficulties in the timber industry, the Committee also believes that it is appropriate to temporarily allow amortization of reforestation expenditures without limit.

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[71] Under the half-year convention, all reforestation expenditures are considered to be incurred on the first day of the first month of the second half of the taxable year. Thus, an amortization deduction equal to 6/84 of the expenditures for the year is allowed in the first and eighth years and an amortization deduction equal to 1/7 (12/84) of such expenditures is allowed in the second through seventh years.

[72] Sec. 301(a) of the Multiemployer Pension Plan Amendments Act of 1980.

[73] Treas. Reg. sec. 1.194–3(a).

[74] Sec. 1245(b)(7); Treas. Reg. sec. 1.194–1(c).

EXPLANATION OF PROVISION

The provision increases the amount of reforestation expenditures eligible for 7-year amortization and the reforestation credit from $10,000 to $25,000 per taxable year (from $5,000 to $12,500 in the case of a separate return by a married individual).

For taxable years beginning in 2000 through 2003, the provision removes the limitation on the amount eligible for 7-year amortization.

EFFECTIVE DATE

The provision is effective for expenditures paid or incurred in taxable years beginning after December 31, 1998. Expenditures paid or incurred prior to the effective date would continue to be recovered under the rules of present law. For taxable years beginning in 1999 and after 2003, the amount of reforestation expenditures eligible for 7-year amortization and for the credit is limited to $25,000. For taxable years beginning in 2000 through 2003, the amount of reforestation expenditures eligible for the credit is limited to $25,000 and no limit would apply to the amount eligible for 7-year amortization.

I. Capital Gains Treatment Under Section 631(b) To Apply to Outright Sales by Landowners

(sec. 732 of the bill and sec. 631 of the Code)

PRESENT LAW

Gain on the cutting and sale of timber generally is eligible for capital gains treatment, provided the growing timber has been held for more than one year. If the taxpayer sells the timber at the time it is cut, the capital gain is measured as the difference between the sales price of the timber less cost of sales and any unrecovered costs of growing the timber.

If the taxpayer sells the timber prior to its being cut, a special rule allows the taxpayer to treat the sale as a capital gain, provided the taxpayer retains an economic interest in the timber and holds the timber for more than one year prior to the date of disposal. The date of disposal is deemed to be the date the timber is cut, unless the taxpayer receives payment for the timber prior to the date it is cut and elects to treat the date of payment as the date of disposal.

REASONS FOR CHANGE

The Committee believes that, in the case of a landowner, gains from the sale of growing timber generally should be eligible for capital gains treatment without regard to whether the timber is cut at the time of sale. The Committee is concerned that present law requires landowners to engage in unnecessarily complex transactions in order to satisfy the present law requirement that the taxpayer retain an economic interest in the timber.

EXPLANATION OF PROVISION

In the case of a sale of timber by the owner of the land from which the timber is cut, the requirement that a taxpayer retain an economic interest in the timber in order to treat gains on sales prior to the time the timber is cut as capital gains does not apply. Outright sales of timber by the landowner will qualify for capital gains treatment in the same manner as sales with a retained economic interest qualify under present law. The provision does not modify the rule that deems the date of cutting to be the date of disposition. Thus, unless the taxpayer receives payment prior to the date of cutting and elects to treat that date as the date of disposition, the date of sale will be the date of cutting whether or not an economic interest is retained.

EFFECTIVE DATE

The provision is effective for sales of timber after the date of enactment. A sale will not be considered to occur after the date of enactment if the taxpayer conveys its interest in the timber on or before the date of enactment, even if the deemed date of disposition is after the date of enactment.

J. Minimum Tax Relief for the Steel Industry

(sec. 741 of the bill and sec. 53 of the Code)

PRESENT LAW

A corporate taxpayer receives a minimum tax credit for any year in which it pays alternative minimum tax. The alternative minimum tax is the excess of tentative minimum tax over regular tax [75] and generally represents the additional tax a corporate taxpayer is required to pay in any year as a result of the alternative minimum tax system. The minimum tax credit may be used in future years to the extent regular tax exceeds tentative minimum tax. The minimum tax credit may not be used to reduce liability below tentative minimum tax. The credit may be carried forward indefinitely.

For example, a corporate taxpayer has $1,000 of minimum tax credits available in a year in which its regular tax is $200 and its tentative minimum tax is $100. The taxpayer may use $100 of its minimum tax credits (the excess of regular tax over tentative minimum tax) to reduce its current liability to $100. The taxpayer would then have $900 of minimum tax credits available in the following year.

If instead the corporate taxpayer had regular tax of $100 and tentative minimum tax of $200, it would not be allowed to use any of its minimum tax credits because there is no excess of regular tax over tentative minimum tax. The taxpayer would have a current liability of $200 ($100 of regular tax and $100 of alternative minimum tax) and would generate an additional $100 of minimum tax credits, giving it minimum tax credits of $1100 available for the following year.

[75] For this purpose, tentative minimum tax is determined net of alternative minimum tax foreign tax credits and regular tax is determined net of regular tax foreign tax credits.

REASONS FOR CHANGE

The Committee notes that the business of manufacturing steel within the United States has been damaged by worldwide overcapacity and depressed prices for steel and steel products. The Committee is concerned that this has created substantial economic hardship in the steel industry and in those communities that rely on jobs related to the industry, and believes that this economic hardship threatens the well being of the current and retired employees of the companies comprising the steel industry.

The Committee believes that the companies in the steel industry have been disadvantaged by their exposure to the alternative minimum tax, and that it is appropriate to accelerate the rate at which the alternative minimum tax they paid as a result of being a steel company is returned through the allowance of the minimum tax credit. The Committee intends that this accelerated return of previously paid alternative minimum tax be available to redress the disadvantages faced by the steel industry. The Committee does not intend for this provision to serve as an incentive to other companies to acquire steel companies for the purpose of accessing this tax treatment.

EXPLANATION OF PROVISION

The provision allows minimum tax credits to offset 90 percent of tentative minimum tax [76] in the case of a steel company, in addition to any excess of regular tax over tentative minimum tax. The benefit of the provision is limited to amounts that are attributable to the trade or business of manufacturing steel within the United States for sale to customers. The rules regarding the determination of minimum tax credits are not changed. The Secretary is authorized to issue regulations to insure that the benefit of the provision is limited to steel companies.

For example, under the provision, a company that has exclusively engaged in the trade or business of manufacturing steel within the United States for sale to customers has $1,000 of minimum tax credits available in a year in which its regular tax is $200 and its tentative minimum tax is $100. The taxpayer may use minimum tax credits of $100 (the excess of its regular tax over its tentative minimum tax) plus $90 (90 percent of its tentative minimum tax), for a total of $190, to reduce its current liability to $10. The taxpayer would then have $810 of minimum tax credits available in the following year.

If instead the steel company had regular tax of $100 and tentative minimum tax of $200, it would be allowed to use $180 (90 percent of its tentative minimum tax) of its minimum tax credits to reduce its current liability to $20. The net effect on its minimum tax credits would be a reduction of $80 [77], giving it minimum tax credits of $920 available for the following year.

[76] Determined net of the alternative minimum tax foreign tax credit.

[77] The determination of minimum tax credits available in the following year is a multiple step process, involving an increase in the stock of minimum tax credits by the amount that tentative minimum tax exceeds regular tax ($100), combined with a reduction by the amount used ($180), for a net reduction of $80.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1998.

TITLE VIII. SMALL BUSINESS TAX RELIEF PROVISIONS

A. Accelerate 100–Percent Self-Employed Health Insurance Deduction

(sec. 801 of the bill and sec. 162(l) of the Code)

PRESENT LAW

Under present law, the tax treatment of health insurance expenses depends on the individual's circumstances. Self-employed individuals may deduct a portion of health insurance expenses for the individual and his or her spouse and dependents. The deductible percentage of health insurance expenses of a self-employed individual is 60 percent in 1999 through 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse.

Employees can exclude from income 100 percent of employer-provided health insurance.

Individuals who itemize deductions may deduct their health insurance expenses only to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213). Subject to certain dollar limitations, premiums for qualified long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses (sec. 213). The amount of qualified long-term care insurance premiums that may be taken into account for 1999 are as follows: $210 in the case of an individual 40 years old or less; $400 in the case of an individual who is over 40 but not more than 50; $800 in the case of an individual who is more than 50 but not more than 60; $2,120 in the case of an individual who is more than 60 but not more than 70; and $2,660 in the case of an individual who is more than 70. These dollar limits are indexed for inflation.

The self-employed health deduction also applies to qualified long-term care insurance premiums treated as medical care for purposes of the itemized deduction for medical expenses.

REASONS FOR CHANGE

The Committee believes it appropriate to eliminate the disparate treatment of employer-provided health care and health insurance expenses of self-employed individuals as soon as possible.

EXPLANATION OF PROVISION

Beginning in 2000, the provision increases the deduction for health insurance expenses (and qualified long-term care insurance expenses) of self-employed individuals to 100 percent.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

B. Increase Section 179 Expensing

(sec. 802 of the bill and sec. 179 of the Code)

PRESENT LAW

Present law provides that, in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $19,000 (for taxable years beginning in 1999) of the cost of qualifying property placed in service for the taxable year (sec. 179). In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $19,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

The $19,000 amount is increased to $25,000 for taxable years beginning in 2003 and thereafter. The increase is phased in as follows: for taxable years beginning in 2000, the amount is $20,000; for taxable years beginning in 2001 or 2002, the amount is $24,000; and for taxable years beginning in 2003 and thereafter, the amount is $25,000.

REASONS FOR CHANGE

The Committee believes that section 179 expensing provides two important benefits for small business. First, it lowers the cost of capital for tangible property used in a trade or business. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. In order to increase the value of these benefits, the Committee bill increases the amount allowed to be expensed under section 179 to $30,000.

EXPLANATION OF PROVISION

The provision provides that the maximum dollar amount that may be deducted under section 179 is increased to $30,000 for taxable years beginning in 2000 and thereafter, without the present-law phase-in rule.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

C. Repeal of Temporary Federal Unemployment Surtax

(sec. 803 of the bill and sec. 3301 of the Code)

PRESENT LAW

The Federal Unemployment Tax Act ("FUTA") imposes a 6.2-percent gross tax rate on the first $7,000 paid annually by covered employers to each employee. Employers in States with programs approved by the Federal Government and with no delinquent Federal loans may credit 5.4-percentage points against the 6.2-percent tax rate, making the minimum, net Federal unemployment tax rate 0.8 percent. Since all States have approved programs, 0.8 percent is the Federal tax rate that generally applies. This Federal revenue finances administration of the unemployment system, half of the Federal-State extended benefits program, and a Federal account for State loans. The States use the revenue turned back to them by the 5.4-percent credit to finance their regular State programs and half of the Federal-State extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8-percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax subsequently has been extended through 2007.

REASONS FOR CHANGE

Because current projections indicate that the overall funding levels in the unemployment trust funds can be maintained at adequate levels without the 0.2-percent surtax, the Committee believes that the surtax should be repealed. Also, the Committee believes that the repeal will reduce the tax burden on businesses subject to the surtax.

EXPLANATION OF PROVISION

The bill repeals the temporary FUTA surtax after December 31, 2004.

EFFECTIVE DATE

The provision is effective for labor performed on or after January 1, 2005.

D. Restore 80-Percent Meals Deduction

(sec. 804 of the bill and sec. 274(n) of the Code)

PRESENT LAW

Ordinary and necessary business expenses, as well as expenses incurred for the production of income, are generally deductible, subject to a number of restrictions and limitations. Generally, the amount allowable as a deduction for business meal and entertainment expenses is limited to 50 percent of the otherwise deductible amount. Exceptions to this 50 percent rule are provided for food and beverages provided to crew members of certain vessels and offshore oil or gas platforms or drilling rigs, as well as to individuals subject to the hours of service limitations of the Department of Transportation.

REASONS FOR CHANGE

The Committee believes that these expenses generally serve legitimate business purposes, which is more appropriately reflected by increasing the deductible portion of business meal expenses from 50 percent to 80 percent.

EXPLANATION OF PROVISION

The provision phases in an increase from 50 percent to 80 percent in the deductible percentage of business meal (food and beverage) expenses.[78] The increase in the deductible percentage is phased in according to the following schedule:

Taxable years beginning in—	*Deductible percentage*
2005	55
2006	60
2007	65
2008	70
2009	75
2010 and thereafter	80

EFFECTIVE DATE

The provision is effective for taxable years beginning after 1999.

TITLE IX. INTERNATIONAL TAX RELIEF PROVISIONS

A. Allocate Interest Expense on Worldwide Basis

(sec. 901 of the bill and sec. 864 of the Code)

PRESENT LAW

In general

In order to compute the foreign tax credit limitation, a taxpayer must determine the amount of taxable income from foreign sources. Thus, the taxpayer must allocate and apportion deductions between items of U.S.-source gross income, on the one hand, and items of foreign-source gross income, on the other. Generally, it is left to the Treasury to provide detailed rules for the allocation and apportionment of expenses.

In the case of interest expense, regulations generally are based on the approach that money is fungible and that interest expense is properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring an obligation on which interest is paid. (Exceptions to the fungibility concept are recognized or required, however, in particular cases, some of which are described below.) The Code provides that for interest allocation purposes all members of an affiliated group of corporations generally are to be treated as a single corporation (the so-called "one-taxpayer rule"), and that allocation must be made on the basis of assets rather than gross income.

[78] The present-law 50 percent limitation continues to apply to entertainment expenses.

Affiliated group

In general

The term "affiliated group" in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns. However, some groups of corporations are eligible to file consolidated returns yet are not treated as affiliated for interest allocation purposes, and other groups of corporations are treated as affiliated for interest allocation purposes even though they are not eligible to file consolidated returns. Thus, under the one-taxpayer rule, the factors affecting the allocation of interest expense of one corporation may affect the sourcing of taxable income of another, related corporation even if the two corporations do not elect to file, or are ineligible to file, consolidated returns. (See, e.g., Treas. Reg. sec. 1.861–11T(g).)

Definition of affiliated group—consolidated return rules

For consolidation purposes, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if the common parent owns directly at least 80 percent of the total voting power of all classes of stock and at least 80 percent of the total value of all outstanding stock of at least one other includible corporation. In addition, for each such other includible corporation (except the common parent), stock possessing at least 80 percent of the total voting power of all classes of its stock and at least 80 percent of the total value of all of its outstanding stock must be directly owned by one or more other includible corporations.

Generally the term "includible corporation" means any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation.

Definition of affiliated group—special interest allocation rules

Subject to exceptions, the consolidated return and interest allocation definitions of affiliation generally are consistent with each other. For example, both definitions exclude all foreign corporations from the affiliated group. Thus, while debt generally is considered fungible among the assets of a group of domestic affiliated corporations, the same rule does not apply as between the domestic and foreign members of a group with the same degree of common control as the domestic affiliated group. Moreover, Congress in 1986 expressly considered and rejected a rule that would have accomplished a result more consistent with worldwide fungibility by taking foreign members' indebtedness into account when allocating the interest expense of the domestic members (H. Rept. 99–841, II–605 (1986)). In practice, the limit in the degree of fungibility recognized by present law can reduce the foreign tax credit limitations that otherwise would apply if the principle of fungibility were extended to foreign and domestic members of a commonly controlled group.

The statutory definition of affiliation for purposes of group-wide allocation of interest expenses expressly provides for two exceptions from the definition of affiliation for consolidation purposes, one of which contracts the affiliated group and the other of which expands it.

Banks, savings institutions and other financial affiliates

Under the first-mentioned exception, the affiliated group for interest allocation purposes generally excludes what are referred to in the regulations as "financial corporations" (Treas. Reg. sec. 1.861–11T(d)(4)). These include any corporation, otherwise a member of the affiliated group for consolidation purposes, that is a financial institution (described in section 581 or section 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by State or Federal law to be operated separately from any other entity which is not a financial institution (sec. 864(e)(5)(C)). The category of financial corporations also includes, to the extent provided in regulations, bank holding companies, subsidiaries of banks and bank holding companies, and savings institutions predominantly engaged in the active conduct of a banking, financing, or similar business (sec. 864(e)(5)(D)).

A financial corporation is not treated as a member of the regular affiliated group for purposes of applying the one-taxpayer rule to other nonfinancial members of that group. Instead, all such financial corporations that would be so affiliated are treated as a separate single corporation for interest allocation purposes.

Section 936 corporations

Under the second exception referred to above, the affiliated group for interest allocation purposes includes any corporation that has elected the application of the possession tax credit for the taxable year, if the corporation would be excluded solely for this reason from the affiliated group as defined for consolidation purposes (sec. 864(e)(5)(A)).

REASONS FOR CHANGE

The present-law rules with respect to the allocation and apportionment of interest expense, although largely left to Treasury regulations, are generally based on the principle that money is fungible and that interest expense is properly attributable to all business activities and property of the taxpayer, regardless of the specific purpose for which the debt is incurred. The present-law rules, however, disregard the interest expense of foreign affiliates. Accordingly, the interest expense incurred by the domestic members of an affiliated group is treated as funding all the activities and assets of such group, including the assets and activities of the group's foreign affiliates, notwithstanding that the foreign affiliate may have directly incurred debt itself to fund its own assets and activities.

The Committee believes that ignoring the interest expense of foreign affiliates in the interest expense allocation and apportionment formula can result in a disproportionate amount of U.S. interest expense being allocated to foreign-source income, which in turn could result in an inappropriate reduction in the group's foreign tax credit limitation. To the extent that the interest expense allocation rules are intended to apply the principle of fungibility, the Committee believes that the rules should take into account the interest expense incurred by and assets owned by foreign affiliates. While foreign affiliates' borrowings are not related to the amount of the U.S. group's interest deduction, the Committee believes that those borrowings may nonetheless bear on the proper allocation of the U.S. group's interest expense for foreign tax credit purposes.

In the domestic context, the Committee believes that corporations which satisfy the standards of affiliation for consolidated return purposes are sufficiently economically interrelated that treatment as a single corporation for interest expense allocation purposes provides an accurate measurement of their economic income, even if such corporations do not choose to consolidate. For purposes of expanding the group to include foreign corporations, however, the Committee believes that it is appropriate to apply the standards for treatment as a controlled foreign corporation (without regard to the constructive ownership rules). Because the controlled foreign corporation ownership requirements are significantly lower than the ownership requirements for consolidation, however, the Committee believes that inclusion of only a pro rata portion of the interest expense (and assets) of a foreign affiliate should be taken into account for purposes of applying the interest expense allocation rules, rather than inclusion of the foreign affiliate's entire interest expense.

In addition, the Committee believes that in certain cases it is appropriate to permit the affiliated group to apply the interest expense allocation and apportionment rules separately with respect to certain subgroups of the affiliated group. For example, where a subsidiary corporation borrows solely on its own credit, its interest expense may support only its own assets and perhaps the assets of its lower-tier subsidiaries. The Committee believes that separate-group allocation is appropriate in circumstances in which the subsidiary corporation is using borrowed funds solely for its own purposes and not for purposes of other members of the group outside of the subsidiary group. When excessive funds are distributed outside of the subsidiary group to other members of the affiliated group, however, the rationale no longer applies. Similarly, if there is a guarantee of debt by a related party or the debt is otherwise supported by an affiliate outside of the subsidiary group, the Committee believes that the taxpayer should not be able to assert that the debt is the independent debt of the borrower for this purpose.

Present law treats certain banks and bank holding companies as a separate subgroup of the affiliated group to which the interest expense allocation rules apply separately. This separation recognizes that financial institutions may have debt structures that are very different from the other members of an affiliated group. The Committee believes that the same rationale applies to any corporations predominantly engaged in banking, insurance, financing, and similar businesses and not merely those entities regulated as U.S. banks. The Committee therefore believes that affiliated groups should be permitted to apply the interest expense allocation rules separately with respect to a subgroup consisting of all corporations predominantly engaged in such financial services businesses.

EXPLANATION OF PROVISION

In general

The bill modifies the present-law interest expense allocation rules (which generally apply for purposes of computing the foreign tax credit limitations) by providing a one-time election under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally would be determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis. The election provides taxpayers with the option either to apply fungibility principles on a worldwide basis or to continue to apply present law. For purposes of the new elective rules based on worldwide fungibility, the affiliated group is expanded to include any foreign corporations in which more than 50 percent of the total vote or value is owned (directly or indirectly) by domestic members of the affiliated group (through application of the controlled foreign corporation standards). A pro rata portion of such foreign corporation's interest expense and assets is treated as attributable to the affiliated group and taken into account for purposes of determining the allocation and apportionment of interest expense. In addition, regardless of whether a taxpayer elects to continue to be governed by the present-law allocation rules or to apply the new worldwide fungibility principle, the provision provides two annual elections that are exceptions to the general "one-taxpayer" rule: (1) a "subsidiary group" election under which domestic members with debt that is not supported by other members of the affiliated group can elect to treat themselves and their subsidiaries as a separate group; and (2) a "financial institution group" election under which all members that are predominantly engaged in a financial services business can elect to be treated as a separate group.

Worldwide affiliated group election

Under the bill, the common parent of an affiliated group can make a one-time election to apply the present-law interest expense allocation and apportionment rules under section 864(e) by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group on a worldwide-group basis. If an affiliated group makes this election, subject to certain modifications and exceptions discussed below, the taxable income of the domestic members of the worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the interest expense of those domestic members to foreign-source income in an amount equal to the worldwide affiliated group's worldwide interest expense multiplied by a ratio of the foreign assets of the worldwide affiliated group over the total assets of the worldwide affiliated group.

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group (as that term is defined under present law for interest expense allocation purposes)[79] as well as any foreign corporations with respect to which domestic members of the affiliated group own stock meeting the ownership requirements for treatment as a controlled foreign corporation under section 957(a) (without regard to the constructive ownership rules of section 958(b)). Hence, if more than 50 percent of the total combined voting power or the total value of the stock of a foreign corporation is owned (directly or indirectly) by domestic members of the affiliated group that are U.S. shareholders (i.e., that own 10 percent or more of the total combined voting power of the stock of such foreign corporation), then such foreign corporation is included in an electing worldwide affiliated group.

With respect to foreign corporations included in a worldwide affiliated group, the bill provides that only a pro rata portion of such foreign corporation's interest expense and assets is treated as attributable to the worldwide affiliated group and taken into account for purposes of determining the allocation and apportionment of interest expense. The pro rata portion is determined by the ratio of the value of the stock of the foreign corporation owned by domestic members of the worldwide affiliated group (regardless of whether the foreign corporation qualifies as more than 50-percent owned because of either vote or value) to the total value of the stock of such foreign corporation. As a result, a situation could arise in which a foreign corporation is a member of a worldwide affiliated group because a domestic member (or members) of the affiliated group owns more than 50 percent of the combined voting power of the foreign corporation's stock but owns, for example, only 40 percent of the value of the foreign corporation's stock. In such a case only 40 percent of the foreign corporation's interest expense and assets would be taken into account in applying the interest expense allocation and apportionment rules on a worldwide basis.

In short, the taxable income from sources outside the United States of electing domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group under present-law section 864(e)(5)(A) as modified to include insurance companies) and a pro rata portion of the interest expense and assets of greater than 50-percent owned foreign subsidiaries were attributable to a single corporation.

Although a pro rata portion of the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return. After calculating the interest expense allocation based on the worldwide affiliated group, the interest expense of the domestic members preliminarily allocable to foreign-source income is re-

[79] The bill expands the present-law definition of an affiliated group for interest expense allocation purposes to include certain insurance companies that are generally excluded from an affiliated group under section 1504(b)(2) (without regard to whether such companies are covered by an election under section 1504(c)(2)). As is the case under present law, the affiliated group includes section 936 corporations.

duced (but not below zero) by the applicable pro rata portion of the interest expense incurred by a foreign member of the group to the extent that such interest would be allocated to foreign sources if the provision's principles were applied separately to the foreign members of the group.

The general rules under present law continue to apply to the electing worldwide affiliated group as if it were an affiliated group as defined under present law for interest expense allocation purposes. Thus, among other things, the allocation and apportionment of interest expense continues to be made on the basis of assets (rather than gross income), modified in the case of foreign members to include a pro rata share of the foreign member's assets. In addition, as is the case under present law, certain basis adjustments are made with respect to the stock of nonaffiliated 10-percent owned corporations. To the extent that foreign members are included in the worldwide affiliated group, these basis adjustments are not applicable.

The worldwide affiliated group election is to be made by the common parent of the affiliated group. It must be made for the first taxable year beginning after December 31, 2001 (the effective date), in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election applies to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election was made and all subsequent taxable years.

Annual elections

Regardless of whether a taxpayer elects to continue to be governed by the present-law allocation rules or to apply the new worldwide fungibility principle, the bill provides two annual elections that are exceptions to the "one-taxpayer" rule described above: (1) the "subsidiary group" election, and (2) a "financial institution group" election.

Subsidiary group election

Under the subsidiary group election, at the annual election of the common parent of the affiliated group, certain interest expense attributable to qualified indebtedness incurred by a domestic member of the affiliated group (other than the common parent) is allocated and apportioned by treating the borrower and its direct and indirect subsidiaries as a separate group (in which the borrower would be treated as the common parent). The regime that was elected by the entire affiliated group (i.e., present law or the worldwide fungibility principles of the bill) applies to all the qualified indebtedness of the members of that separate electing subsidiary group. For this purpose, qualified indebtedness generally means any borrowing from unrelated parties that is not guaranteed or in any other way supported by any corporation within the same affiliated group (other than a member of the subsidiary group) of the borrower.

If the common parent of the affiliated group makes the election with respect to a domestic member of an affiliated group, the subsidiary group election applies to all direct and indirect subsidiaries of that member. No member of an electing subsidiary group can be treated as a member of another electing subsidiary group. Therefore, a separate subsidiary group election could not be made with respect to lower-tier subsidiaries in an electing subsidiary group. It is intended that Treasury regulations similar to present-law regulations that apply with respect to a bank subgroup would provide that the subsidiary group's stock be ignored for purposes of applying the interest expense allocation and apportionment rules to the rest of the affiliated group.[80]

If the subsidiary group election is made, the bill also provides that an "equalization" rule applies under which interest expense (if any) incurred by domestic members of the affiliated group with respect to indebtedness that is not qualified indebtedness of an electing subsidiary group is allocated first to foreign-source income to the extent necessary to achieve (if possible) the allocation and apportionment of interest expense to foreign-source income that would have resulted had the subsidiary group election not been made. Under this rule, the interest expense of the domestic members of the affiliated group (other than subsidiary group interest expense) is allocated to foreign-source income to the extent such expense does not exceed the excess (if any) of (1) the total interest expense of the affiliated group (including that of the subsidiary group) that would have been allocated to foreign sources had no subsidiary group election been made over (2) the subsidiary group interest expense that is allocated to foreign sources through application of the subsidiary group election.

In addition, the bill provides anti-abuse rules under which certain transfers from one member of a subsidiary group to a member of the affiliated group outside of the subsidiary group are treated as reducing the amount of qualified indebtedness. In this regard, if a member of an electing subsidiary group makes dividend or other distributions in a taxable year to a member of the affiliated group (other than a member of the electing subsidiary group) that exceed the greater of (1) its average annual dividend (expressed as a percentage of current earnings and profits) during the five preceding taxable years or (2) 25 percent of its average annual earnings and profits for such five preceding taxable years, or otherwise deals with any person in a manner not clearly reflecting income (as determined under principles similar to section 482), an amount of its qualified indebtedness equal to such excess is recharacterized as nonqualified indebtedness.

Financial institution group election

The bill provides a financial institution group election that expands and replaces the bank group rules of present law (sec. 864(e)(5)(B)-(D)). At the annual election of the common parent of the affiliated group, the interest expense allocation and apportionment rules that apply to the affiliated group as a whole (i.e., present law or the worldwide approach), can be applied separately to a subgroup of the affiliated group consisting of corporations that are predominantly engaged in a banking, insurance, financing, or similar business (as well as certain bank holding companies). For

[80] See Temp. Treas. Reg. sec. 1.861–11T(d)(4).

this purpose, a corporation is predominantly engaged in such a business if at least 80 percent of its gross income is "financial services income" as described in section 904(d)(2)(C)(ii) and the regulations thereunder.[81] The financial institution group rules, if elected, apply to all members of the affiliated group that are considered to be predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, or otherwise considered to be a bank holding company. In addition, if a financial institution group election has been made, a member of the affiliated group that is part of the financial institution group could not also be a member of a separate subsidiary group at the same time. It is intended that Treasury regulations, similar to those that apply to the present-law bank group, would continue to apply to treat the financial institution group as a segregated group from the rest of the affiliated group.[82] Thus, the measurement of assets of the affiliated group would exclude the stock of members included in the financial institution group and, similarly, the financial institution group would not take into account the stock of any lower-tier corporation that is a member of the affiliated group but not a member of the financial institution group. In addition, the bill provides that anti-abuse rules similar to those that apply in connection with the subsidiary group election apply to the financial institution group.

REGULATORY AUTHORITY

The bill grants the Treasury Secretary authority to prescribe rules to carry out the purposes of the provision, including rules (1) to address changes in members of an affiliated group (including acquisitions or other business combinations of affiliated groups in which one group has made an election to apply the worldwide approach and the other group applies present law); (2) to prevent assets and interest expense from being taken into account more than once; and (3) to provide for direct allocation of interest expense in circumstances where such allocation would be appropriate to carry out the purposes of the provision.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2001.

B. LOOK-THROUGH RULES TO APPLY TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS

(sec. 902 of the bill and sec. 904 of the Code)

PRESENT LAW

U.S. persons may credit foreign taxes against U.S. tax on foreign-source income. The amount of foreign tax credits that may be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. Separate limitations are applied to specific categories of income.

[81] See Treas. Reg. sec. 1.904–4(e)(2).
[82] Temp. Treas. Reg. sec. 1.861–11T(d)(4).

Special foreign tax credit limitations apply in the case of dividends received from a foreign corporation in which the taxpayer owns at least 10 percent of the stock by vote and which is not a controlled foreign corporation (a so-called "10/50 company").[83] Dividends paid by a 10/50 company in taxable years beginning before January 1, 2003, are subject to a separate foreign tax credit limitation for each 10/50 company. Dividends paid by a 10/50 company that is not a passive foreign investment company in taxable years beginning after December 31, 2002, out of earnings and profits accumulated in taxable years beginning before January 1, 2003, are subject to a single foreign tax credit limitation for all 10/50 companies (other than passive foreign investment companies). Dividends paid by a 10/50 company that is a passive foreign investment company out of earnings and profits accumulated in taxable years beginning before January 1, 2003, continue to be subject to a separate foreign tax credit limitation for each such 10/50 company. Dividends paid by a 10/50 company in taxable years beginning after December 31, 2002, out of earnings and profits accumulated in taxable years after December 31, 2002, are treated as income in a foreign tax credit limitation category in proportion to the ratio of the earnings and profits attributable to income in such foreign tax credit limitation category to the total earnings and profits (a so-called "look-through" approach). For these purposes, distributions are treated as made from the most recently accumulated earnings and profits. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earnings and profits for periods prior to the taxpayer's acquisition of such stock.

REASONS FOR CHANGE

In the Taxpayer Relief Act of 1997, the Congress provided for a look-through regime to apply in characterizing dividends from 10/50 companies for foreign tax credit limitation purposes. The present-law rules that subject the dividends received from each 10/50 company to a separate foreign tax credit limitation impose a substantial record-keeping burden on companies and have the additional negative effect of discouraging minority-position joint ventures abroad.[84]

The Committee believes that the present-law rules for dividends from 10/50 companies will result in additional complexity and compliance burdens. For instance, dividends paid by a 10/50 company in taxable years beginning after December 31, 2002, will be subject to the concurrent application of both the single-basket approach (for pre-2003 earnings and profits) and the look-through approach (for post-2002 earnings and profits).

The Committee believes that joint ventures can be an efficient way for U.S. businesses to exploit their know-how and technology in foreign markets. To the extent that the present-law limitation is discouraging such joint ventures or altering the structure of new ventures, the ability of U.S. businesses to succeed abroad could be

[83] A controlled foreign corporation in which the taxpayer owns at least 10 percent of the stock by vote is treated as a 10/50 company with respect to any distribution out of earnings and profits for periods when it was not a controlled foreign corporation.

[84] Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997 (JCS–23–97), December 17, 1997, p. 302.

diminished. The Committee believes that it is important to accelerate and simplify the look-through approach enacted in 1997.

EXPLANATION OF PROVISION

The bill simplifies the application of the foreign tax credit limitation by applying the look-through approach to all dividends paid by a 10/50 company, regardless of the year in which the earnings and profits out of which the dividend is paid were accumulated. The bill eliminates the single-basket limitation approach for dividends from such companies for foreign tax credit limitation purposes.

The bill provides a transition rule under which pre-effective date foreign tax credits associated with a 10/50 company separate limitation category can be carried forward into post-effective date years. Under the bill, look-through principles similar to those applicable to post-effective date dividends from a 10/50 company apply to determine the appropriate foreign tax credit limitation category or categories with respect to the foreign tax credit carryforward.

The bill also provides a default rule in cases in which taxpayers are unable to obtain the necessary information to apply the look-through rules with respect to dividends from a 10/50 company (or in which the income is not treated as falling within one of certain enumerated limitation categories). In such cases, the bill treats the dividend (or a portion thereof) from such 10/50 company as a dividend that is not subject to the look-through rules.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2001.

C. Subpart F Treatment of Pipeline Transportation Income and Income From Transmission of High Voltage Electricity

(secs. 903 and 904 of the bill and sec. 954 of the Code)

PRESENT LAW

Under the subpart F rules, U.S. 10-percent shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on their shares of certain income earned by the foreign corporation, whether or not such income is distributed to the shareholders (referred to as "subpart F income"). Subpart F income includes foreign base company income, which in turn includes five categories of income: foreign personal holding company income, foreign base company sales income, foreign base company services income, foreign base company shipping income, and foreign base company oil related income (sec. 954(a)).

Foreign base company services income includes income from services performed (1) for or on behalf of a related party and (2) outside the country of the CFC's incorporation (sec. 954(e)). Treasury regulations provide that the services of the foreign corporation will be treated as performed for or on behalf of the related party if, for example, a party related to the foreign corporation furnishes substantial assistance to the foreign corporation in connection with the provision of services (Treas. Reg. sec. 1.954–4(b)(1)(iv)).

Foreign base company oil related income is income derived outside the United States from the processing of minerals extracted from oil or gas wells into their primary products; the transportation, distribution, or sale of such minerals or primary products; the disposition of assets used by the taxpayer in a trade or business involving the foregoing; or the performance of any related services. However, foreign base company oil related income does not include income derived from a source within a foreign country in connection with: (1) oil or gas which was extracted from a well located in such foreign country or, (2), oil, gas, or a primary product of oil or gas which is sold by the CFC or a related person for use or consumption within such foreign country or is loaded in such country as fuel on a vessel or aircraft. An exclusion also is provided for income of a CFC that is a small producer (i.e., a corporation whose average daily oil and natural gas production, including production by related corporations, is less than 1,000 barrels).

REASONS FOR CHANGE

The subpart F rules generally apply to provide current U.S. taxation of income that can be described as "mobile," that is, income for which the taxpayer might easily be able to arrange that it be sourced to a low-tax foreign jurisdiction. The Committee understands that, until recently, many countries did not permit foreign corporations to own energy facilities such as oil and gas pipelines, electric generating stations, and high voltage electricity transmission lines. The Committee observes that with the advent of deregulation policies abroad, many U.S. corporations are actively considering the construction and operation of oil and gas pipelines and high voltage electricity transmission systems in foreign markets. The Committee understands that such projects involve substantial amounts of fixed capital investment, the income from which does not represent the type of "mobile" income to which the subpart F rules should apply.

EXPLANATION OF PROVISION

The bill exempts income derived in connection with the performance of services which are directly related to the transmission of high voltage electricity from the definition of foreign base company services income. Thus, the income of a CFC that owns a high voltage transmission line for the purpose of providing electricity generated by a related party to a third party outside the CFC's country of incorporation does not constitute foreign base company services income. No inference is intended as to the treatment of such income under present law.

The bill also provides an additional exception to the definition of foreign base company oil related income. Under the bill, foreign base company oil related income does not include income derived from a source within a foreign country in connection with the pipeline transportation of oil or gas within such foreign country. Thus, the exception applies whether or not the CFC that owns the pipeline also owns any interest in the oil or gas transported. In addition, the exception applies to income earned from the transportation of oil or gas by pipeline in a country in which the oil or gas was neither extracted nor consumed within such foreign country.

EFFECTIVE DATE

The provision is effective for taxable years of CFCs beginning after December 31, 2001, and taxable years of U.S. shareholders with or within which such taxable years of CFCs end.

D. Recharacterization of Overall Domestic Loss

(sec. 905 of the bill and sec. 904 of the Code)

PRESENT LAW

A premise of the foreign tax credit is that it should not reduce a taxpayer's U.S. tax on its U.S.-source income; rather, it should only reduce U.S. tax on foreign-source income. An overall foreign tax credit limitation prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. The overall limitation is calculated by prorating a taxpayer's pre-credit U.S. tax on its worldwide income between its U.S.-source and foreign-source taxable income. The ratio (not exceeding 100 percent) of the taxpayer's foreign-source taxable income to worldwide taxable income is multiplied by its pre-credit U.S. tax to establish the amount of U.S. tax allocable to the taxpayer's foreign-source income and, thus, the upper limit on the foreign tax credit for the year. If the taxpayer's foreign-source taxable income exceeds worldwide taxable income (because of a domestic source loss), then the full amount of pre-credit U.S. tax may be offset by the foreign tax credit.

If a taxpayer's losses from foreign sources exceed its foreign-source income, the excess ("overall foreign loss" or "OFL") may offset U.S.-source income. Such an offset reduces the effective rate of U.S. tax on U.S.-source income. To eliminate a double benefit (that is, the reduction of U.S. tax previously noted and, later, full allowance of a foreign tax credit with respect to foreign-source income), an OFL recapture rule applies. Under this rule, a portion of foreign-source taxable income earned after an OFL year is recharacterized as U.S.-source taxable income for foreign tax credit purposes (and for purposes of the possessions tax credit) (sec. 904(f)(1)). Foreign-source taxable income up to the amount of the unrecaptured OFL may be so treated. In general, no more than 50 percent of the foreign-source taxable income earned in any particular taxable year is recharacterized as U.S.-source taxable income, unless a taxpayer elects a higher percentage.[85] The effect of the recapture is to reduce the foreign tax credit limitation in one or more years following an OFL year and, therefore, the amount of U.S. tax that can be offset by foreign tax credits in the later year or years.

An overall U.S.-source loss reduces pre-credit U.S. tax on worldwide income to an amount less than the hypothetical tax that would apply to the taxpayer's foreign-source income if viewed in isolation. The existence of foreign-source taxable income in the year

[85] If a taxpayer with an OFL disposes of property that was used predominantly outside the United States in a trade or business, the taxpayer generally is deemed to have received and recognized foreign-source taxable income as the result of a disposition in an amount at least equal to the lesser of the gain actually realized on the disposition or the remaining amount of the unrecaptured OFL. Furthermore, the annual 50-percent limit on the resourcing of foreign-source income does not apply to that amount of foreign-source income realized by reason of the disposition.

of the U.S. loss reduces or eliminates any net operating loss carryover that the U.S. loss would otherwise have generated absent the foreign income. In addition, as the pre-credit U.S. tax on worldwide income is reduced, so is the foreign tax credit limitation. As a result, some foreign tax credits in the year of the U.S. loss must be credited, if at all, in a carryover year. Tax on domestic-source taxable income in a subsequent year may be offset by a net operating loss carryforward (if any), but not by a foreign tax credit carryforward. There is presently no mechanism for resourcing such subsequent U.S.-source income as foreign-source income.

REASONS FOR CHANGE

The Committee believes that it is appropriate to provide more parity between the treatment of U.S. and foreign losses for foreign tax credit limitation purposes. Accordingly, the Committee believes that rules similar to the resourcing rules that currently apply to OFLs should apply in the case of overall domestic losses.

EXPLANATION OF PROVISION

The bill applies a resourcing rule to U.S.-source income where the taxpayer has suffered a reduction in the amount of its foreign tax credit limitation due to a prior overall domestic loss. Under the bill, in the case of a taxpayer that has incurred an overall domestic loss, the portion of the taxpayer's U.S.-source taxable income for each succeeding taxable year that is equal to the lesser of (1) the amount of the unrecharacterized overall domestic loss, or (2) 50 percent of the taxpayer's U.S.-source taxable income for such succeeding taxable year is recharacterized as foreign-source taxable income.

The bill defines an overall domestic loss for this purpose as any domestic loss to the extent it offsets foreign-source taxable income for the current taxable year or for any preceding taxable year by reason of a loss carryback. For this purpose, a domestic loss means the amount by which the U.S.-source gross income for the taxable year is exceeded by the sum of the deductions properly apportioned or allocated thereto, determined without regard to any loss carried back from a subsequent taxable year. Under the bill, an overall domestic loss does not include any loss for any taxable year unless the taxpayer elected the use of the foreign tax credit for such taxable year.

Any U.S.-source income resourced under the bill is allocated among the various foreign tax credit separate limitation categories in the same proportion that those categories were reduced by the prior overall domestic loss.

It is anticipated that situations could arise in which a taxpayer would generate an overall domestic loss in a year following a year in which it had an overall foreign loss, or vice versa. In such a case, it would be necessary for ordering and other coordination rules to be developed for purposes of computing the foreign tax credit limitation in subsequent taxable years. The bill grants the Treasury Secretary authority to prescribe such regulations as may be necessary to coordinate the operation of the OFL recapture rules with the operation of the overall domestic loss recharacterization rules that would be added by the bill.

EFFECTIVE DATE

The provision applies to losses incurred in taxable years beginning after December 31, 2004.

E. TREATMENT OF MILITARY PROPERTY OF FOREIGN SALES CORPORATIONS

(sec. 906 of the bill and sec. 923 of the Code)

PRESENT LAW

A portion of the foreign trade income of an eligible foreign sales corporation ("FSC") is exempt from federal income tax. Foreign trade income is defined as the gross income of a FSC that is attributable to foreign trading gross receipts. In general, the term "foreign trading gross receipts" means the gross receipts of a FSC from the sale or lease of export property, services related and subsidiary to the sale or lease of export property, engineering or architectural services for construction projects located outside the United States, and certain managerial services for an unrelated FSC or DISC.

Section 923(a)(5) contains a special limitation relating to the export of military property. Under regulations prescribed by the Treasury Secretary, the portion of a FSC's foreign trading gross receipts from the disposition of, or services relating to, military property that may be treated as exempt foreign trade income is limited to 50 percent of the amount that would otherwise be so treated. For this purpose, the term "military property" means any property that is an arm, ammunition, or implement of war designated in the munitions list published pursuant to federal law.[86] Under this provision, the export of military property through a FSC is accorded one-half the tax benefit that is accorded to exports of non-military property.

REASONS FOR CHANGE

The Committee finds the present-law rule limiting the tax benefit available for the export of property through a FSC to one half of that otherwise available in the case of the export of military property to be an inappropriate limitation. The Committee believes that exporters of military property should be treated no differently under the FSC rules than exporters of other products.

EXPLANATION OF PROVISION

The bill repeals the special FSC limitation relating to the export of military property, thus providing exports of military property through a FSC with the same treatment currently provided exports of non-military property.

[86] Section 923(a)(5) defines "military property" by reference to section 995(b)(3)(B), which contains a technical error. Section 995(b)(3)(B) references the Military Security Act of 1954. The proper reference should have been to the Mutual Security Act of 1954, which subsequently was superceded by the International Security Assistance and Arms Export Control Act of 1976. Current Treasury regulations provide the correct reference for purposes of defining "military property."

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2001.

F. MODIFY TREATMENT OF RIC DIVIDENDS PAID TO FOREIGN PERSONS

(sec. 907 of the bill and secs. 871, 881, 897, 1441, 1442, and 2105 of the Code)

PRESENT LAW

Regulated investment companies

A regulated investment company ("RIC") is a domestic corporation that, at all times during the taxable year, is registered under the Investment Company Act of 1940 as a management company or as a unit investment trust, or has elected to be treated as a business development company under that Act (sec. 851(a)).

In addition, to qualify as a RIC, a corporation must elect such status and must satisfy certain tests (sec. 851(b)). These tests include a requirement that the corporation derive at least 90 percent of its gross income from dividends, interest, payments with respect to certain securities loans, and gains on the sale or other disposition of stock or securities or foreign currencies, or other income derived with respect to its business of investment in such stock, securities, or currencies.

Generally, a RIC pays no income tax because it is permitted to deduct dividends paid to its shareholders in computing its taxable income. The amount of any distribution generally is not considered as a dividend for purposes of computing the dividends paid deduction unless the distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class (sec. 562(c)). For distributions by RICs to shareholders who made initial investments of at least $10,000,000, however, the distribution is not treated as non-pro rata or preferential solely by reason of an increase in the distribution due to reductions in administrative expenses of the company.

A RIC generally may pass through to its shareholders the character of its long-term capital gains. It does this by designating a dividend it pays as a capital gain dividend to the extent that the RIC has net capital gain (i.e., net long-term capital gain over net short-term capital loss). These capital gain dividends are treated as long-term capital gains by the shareholders. A RIC generally also can pass through to its shareholders the character of tax-exempt interest from State and municipal bonds, but only if, at the close of each quarter of its taxable year, at least 50 percent of the value of the total assets of the RIC consists of these obligations. In this case, the RIC generally may designate a dividend it pays as an exempt-interest dividend to the extent that the RIC has tax-exempt interest income. These exempt-interest dividends are treated as interest excludable from gross income by the shareholders.

U.S. source investment income of foreign persons

In general

The United States generally imposes a flat 30-percent tax, collected by withholding, on the gross amount of U.S.-source investment income payments, such as interest, dividends, rents, royalties, or similar types of income, to nonresident alien individuals and foreign corporations ("foreign persons") (secs. 871(a), 881, 1441, and 1442). Under treaties, the United States may reduce or eliminate such taxes. Even taking into account U.S. treaties, however, the tax on a dividend generally is not entirely eliminated. Instead, U.S.-source portfolio investment dividends received by foreign persons generally are subject to U.S. withholding tax at a rate of at least 15 percent.

Interest

Although payments of U.S.-source interest that is not effectively connected with a U.S. trade or business generally are subject to the 30-percent withholding tax, there are significant exceptions to that rule. For example, interest from certain deposits with banks and other financial institutions is exempt from tax (secs. 871(i)(2)(A) and 881(d)). Original issue discount on obligations maturing in 183 days or less from the date of original issue (without regard to the period held by the taxpayer) is also exempt from tax (sec. 871(g)). An additional exception is provided for certain interest paid on portfolio obligations (secs. 871(h) and 881(c)). "Portfolio interest" generally is defined as any U.S.-source interest (including original issue discount), not effectively connected with the conduct of a U.S. trade or business, (1) on an obligation that satisfies certain registration requirements or specified exceptions thereto (i.e., the obligation is "foreign targeted"), and (2) that is not received by a 10-percent shareholder (secs. 871(h)(3) and 881(c)(3)). With respect to a registered obligation, a statement that the beneficial owner is not a U.S. person is required (secs. 871(h)(2), (5) and 881(c)(2)). This exception is not available for any interest received either by a bank on a loan extended in the ordinary course of its business (except in the case of interest paid on an obligation of the United States), or by a controlled foreign corporation from a related person (sec. 881(c)(3)). Moreover, this exception is not available for certain contingent interest payments (secs. 871(h)(4) and 881(c)(4)). The payment of interest must not be to any person within a foreign country (and must not be a payment addressed to, or for the account of, persons within a foreign country) with respect to which the Treasury Secretary has determined that exchange of information is inadequate to prevent evasion of U.S. income tax by U.S. persons (secs. 871(h)(6), and 881(c)(6)).

Capital gains

Foreign persons generally are not subject to U.S. tax on gain realized on the disposition of stock or securities issued by a U.S. person (other than a "U.S. real property holding corporation," as described below), unless the gain is effectively connected with the conduct of a trade or business in the United States. This exemption does not apply, however, to the extent that the foreign person is a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year (sec. 871(a)(2)). A RIC may elect not to withhold on a distribution to a foreign person representing a capital gain dividend. (Treas. Reg. sec. 1.1441–3(c)(2)(D)).

Under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), as amended, gain or loss of a foreign person from the disposition of a U.S. real property interest is subject to net basis tax as if the taxpayer were engaged in a trade or business within the United States and the gain or loss were effectively connected with such trade or business (sec. 897). In addition to an interest in real property located in the United States or the Virgin Islands, U.S. real property interests include (among other things) any interest in a domestic corporation unless the taxpayer establishes that the corporation was not, during a 5-year period ending on the date of the disposition of the interest, a U.S. real property holding corporation (which is defined generally to mean a corporation the fair market value of whose U.S. real property interests equals or exceeds 50 percent of the sum of the fair market values of its real property interests and any other of its assets used or held for use in a trade or business).

Under the FIRPTA provisions, a distribution by a real estate investment trust ("REIT") to a foreign person is, to the extent attributable to gain from sales or exchanges by the REIT of U.S. real property interests, treated as gain recognized by the foreign person from the sale or exchange of a U.S. real property interest (sec. 897(h)). Under Treasury regulations, a REIT generally is required to withhold tax upon such a distribution to a foreign person, at a rate of 35 percent times the maximum amount of that distribution that could be designated by the REIT as a capital gain dividend (Treas. Reg. sec. 1.1445–8(a)(2), (b)(1), and (c)(2)).

In view of the nature of a REIT, an interest in a REIT may in some cases be considered to be a U.S. real property interest. An interest in a domestically-controlled REIT, however, is not considered a U.S. real property interest (sec. 897(h)(2)). Nonetheless, the foreign ownership percentage of taxable appreciation in the value of a U.S. real property interest distributed by a domestically-controlled REIT is subject to tax in the hands of the REIT (sec. 897(h)(3)).

Estate taxation

Decedents who were citizens or residents of the United States are generally subject to Federal estate tax on all property, wherever situated. Nonresidents who are not U.S. citizens, however, are subject to estate tax only on their property which is within the United States. Property within the United States generally includes debt obligations of U.S. persons, including the Federal government and State and local governments (sec. 2104(c)), but does not include either bank deposits or portfolio obligations, the interest on which would be exempt from U.S. income tax under section 871 (sec. 2105(b)). Stock owned and held by a nonresident who is not a U.S. citizen is treated as property within the United States only if the stock was issued by a domestic corporation (sec. 2104(a); Treas. Reg. sec. 20.2104–1(a)(5)).

Treaties may reduce U.S. taxation on transfers by estates of nonresident decedents who are not U.S. citizens. Under recent treaties, for example, U.S. tax may generally be eliminated except insofar as the property transferred includes U.S. real property or business property of a U.S. permanent establishment.

REASONS FOR CHANGE

Under present law, a disparity is created between foreign persons who directly invest in certain interest bearing and other securities and a foreign person who invests in such securities indirectly through U.S. mutual funds. In general, certain amounts received by the direct foreign investor (or a foreign investor through a foreign fund) may be exempt from the U.S. gross-basis withholding tax, whereas distributions from a RIC generally are treated as dividends subject to the withholding tax, notwithstanding that the distributions may be attributable to amounts that could otherwise qualify for an exemption from withholding tax. The Committee believes that such disparate treatment should be eliminated.

The Committee therefore believes that, to the extent that a RIC distributes to a foreign person a dividend attributable to amounts that would have been exempt from U.S. withholding tax had the foreign person received it directly (such as portfolio interest and capital gains, including short-term capital gains), such dividend should be exempt from the U.S. gross-basis withholding tax. Similarly, the Committee believes that comparable treatment should be afforded for estate tax purposes to foreign persons who invest in certain assets through a RIC to the extent that such assets would not be subject to the estate tax if held directly.

EXPLANATION OF PROVISION

In general

Under the provision, a RIC that earns certain interest income that would not be subject to U.S. tax if earned by a foreign person directly may, to the extent of such income, designate a dividend it pays as derived from such interest income. A foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, just as if the foreign person had earned the interest directly. Similarly, a RIC that earns an excess of net short-term capital gains over net long-term capital losses, which excess would not be subject to U.S. tax if earned by a foreign person directly, generally may, to the extent of such excess, designate a dividend it pays as derived from such excess. A foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, just as if the foreign person had realized the amount directly. The estate of a foreign decedent is exempt from U.S. estate tax on a transfer of stock in the RIC in the proportion that the assets held by the RIC are debt obligations, deposits, or other property that would generally be treated as situated outside the United States if held directly by the estate.

Interest-related dividends

Under the provision, a RIC can, under certain circumstances, designate all or a portion of a dividend as an "interest-related dividend," by written notice mailed to its shareholders not later than 60 days after the close of its taxable year. An interest-related dividend received by a foreign person generally is exempt from U.S. gross-basis tax under sections 871(a), 881, 1441 and 1442.

This exemption does not apply, however, to a dividend on shares of RIC stock in a case where the withholding agent does not receive a statement, similar to that required under the portfolio interest rules, that the beneficial owner of the shares is not a U.S. person. The exemption does not apply to a dividend paid to any person within a foreign country (or dividends addressed to, or for the account of, persons within such foreign country) with respect to which the Treasury Secretary has determined, under the portfolio interest rules, that exchange of information is inadequate to prevent evasion of U.S. income tax by U.S. persons.

In addition, the exemption generally does not apply to dividends paid to a controlled foreign corporation to the extent that such dividends are attributable to income received by the RIC on a debt obligation of a person with respect to which the recipient of the dividend (i.e., the controlled foreign corporation) is a related person. Nor does the exemption generally apply to dividends to the extent such dividends are attributable to income (other than short-term original discount, bank deposit interest, and certain foreign-source interest income) received by the RIC on indebtedness issued by the RIC-dividend recipient or by any corporation or partnership with respect to which the recipient of the RIC dividend is a 10-percent shareholder. In these two cases, however, the RIC remains exempt from its withholding obligation unless the RIC knows that the dividend recipient is such a controlled foreign corporation or 10-percent shareholder. To the extent that an interest-related dividend received by a controlled foreign corporation is attributable to interest income of the RIC that would be portfolio interest if received by a foreign corporation, the dividend is treated as portfolio interest for purposes of the de minimis rules, the high-tax exception, and the same country exceptions of subpart F (see sec. 881(c)(5)(A)).

The aggregate amount designated as interest-related dividends for the RIC's taxable year (including dividends so designated that are paid after the close of the taxable year but treated as paid during that year as described in section 855) generally is limited to the qualified net interest income of the RIC for the taxable year. The qualified net interest income of the RIC equals the excess of (1) the amount of qualified interest income of the RIC over (2) the amount of direct and indirect expenses of the RIC properly allocable to such interest income.

Qualified interest income of the RIC is the sum of (1) its U.S.-source income with respect to (a) bank deposit interest; (b) short term original issue discount that is currently exempt from the gross-basis tax under section 871; (c) any interest (including amounts recognized as ordinary income in respect of original issue discount, market discount, or acquisition discount under the provisions of sections 1271–1288, and such other amounts as regulations may provide) on an obligation which is in registered form, unless it is earned on an obligation issued by a corporation or partnership in which the RIC is a 10-percent shareholder or is contingent interest not treated as portfolio interest under section 871(h)(4); and (d) any interest-related dividend from another RIC; and (2) its foreign-source interest income unless such interest is subject to a tax imposed by a foreign jurisdiction that is reduced or eliminated by a treaty with the United States.

Where the amount designated as an interest-related dividend is greater than the qualified net interest income described above, then the portion of the distribution so designated which constitutes an interest-related dividend will be only that proportion of the amount so designated as the amount of the qualified net interest income bears to the amount so designated.

Short-term capital gain dividends

Under the provision, a RIC can also, under certain circumstances, designate all or a portion of a dividend as a "short-term capital gain dividend," by written notice mailed to its shareholders not later than 60 days after the close of its taxable year. For purposes of the U.S. gross-basis tax, a short-term capital gain dividend received by a foreign person generally would be exempt from U.S. gross-basis tax under sections 871(a), 881, 1441 and 1442. This exemption does not apply to the extent that the foreign person is a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year. In this case, however, the RIC remains exempt from its withholding obligation unless the RIC knows that the dividend recipient has been present in the United States for such period.

The aggregate amount qualified to be designated as short-term capital gain dividends for the RIC's taxable year (including dividends so designated that are paid after the close of the taxable year but treated as paid during that year as described in section 855) is the excess of the RIC's net short-term capital gains over net long-term capital losses. The net short-term capital gains include short-term capital gain dividends from another RIC. As is provided under present law for purposes of computing the amount of a capital gain dividend, the amount is determined (except in the case where an election under section 4982(e)(4) applies) without regard to any net capital loss or net short-term capital loss attributable to transactions after October 31 of the year. Instead, that loss is treated as arising on the first day of the next taxable year. To the extent provided in regulations, this rule also would apply for purposes of computing the taxable income of the RIC.

In computing the amount of short-term capital gain dividends for the year, no reduction is made for the amount of expenses of the RIC allocable to such net gains. In addition, where the amount designated as short-term capital gain dividends is greater than the amount of qualified short-term capital gain, then the portion of the distribution so designated which constitutes a short-term capital gain dividend will be only that proportion of the amount so designated as the amount of the excess bears to the amount so designated.

As is true under present law for distributions from REITs, the bill provides that any distribution by a RIC to a foreign person shall, to the extent attributable to gain from the sale or exchange by the RIC of an asset that is considered a U.S. real property interest, be treated as gain recognized by the foreign person from the sale or exchange of a U.S. real property interest. The provision also extends the special rules applicable to domestically-controlled REITs to domestically-controlled RICs.

Estate tax treatment

Under the provision, a portion of the stock in a RIC held by the estate of a nonresident decedent who is not a U.S. citizen is treated as property without the United States. The portion so treated is based on the proportion of the assets held by the RIC at the end of the quarter immediately preceding the decedent's death (or such other time as the Secretary may designate in regulations) that are "qualifying assets." Qualifying assets for this purpose are bank deposits of the type that are exempt from gross-basis income tax, portfolio debt obligations, certain original issue discount obligations, debt obligations of a domestic corporation that are treated as giving rise to foreign source income, and other property not within the United States.

EFFECTIVE DATE

The provision generally applies to dividends with respect to taxable years of RICs beginning after December 31, 2004. With respect to the treatment of a RIC for estate tax purposes, the provision applies to estates of decedents dying after December 31, 2004. With respect to the treatment of RICs under section 897 (dealing with U.S. real property interests), the provision is effective on January 1, 2005.

G. Repeal of Special Rules for Applying Foreign Tax Credit in Case of Foreign Oil and Gas Income

(sec. 908 of the bill and sec. 907 of the Code)

PRESENT LAW

U.S. persons are subject to U.S. income tax on their worldwide income. A credit against U.S. tax on foreign-source income is allowed for foreign taxes paid or accrued (or deemed paid) (secs. 901, 902).

The amount of foreign tax credits that a taxpayer may claim in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income (sec. 904). The foreign tax credit limitation is calculated on an overall basis and separately for specific categories of income. The amount of creditable taxes paid or accrued (or deemed paid) in any taxable year that exceeds the respective foreign tax credit limitations is permitted to be carried back two years and carried forward five years (sec. 904(c)).

Special rules apply with respect to the foreign tax credit in the case of foreign oil and gas income (sec. 907). Under a special limitation, taxes on foreign oil and gas extraction income are creditable only to the extent that they do not exceed a specified amount (e.g., 35 percent of such income in the case of a corporation) (sec. 907(a)). For this purpose, foreign oil and gas extraction income is income derived from foreign sources from the extraction of minerals from oil or gas wells or the sale or exchange of assets used by the taxpayer in such extraction. A taxpayer must have excess limitation under the special rules applicable to foreign extraction taxes and excess limitation under the general foreign tax credit provisions in order to utilize excess foreign oil and gas extraction taxes in a carryback or carryforward year. A recapture rule applicable to foreign oil and gas extraction losses treats income that otherwise would be foreign oil and gas extraction income as foreign-source income that is not considered oil and gas extraction income; the taxes on such income retain their character as foreign oil and gas extraction taxes and continue to be subject to the special limitation imposed on such taxes.

In the case of taxes paid or accrued to any foreign country with respect to foreign oil related income, discriminatory foreign taxes are not treated as creditable foreign taxes (sec. 907(b)). Foreign taxes are discriminatory for this purpose to the extent that the Treasury Secretary determines that the foreign law imposing the tax is structured, or in facts operates, so that the amount of tax imposed with respect to foreign oil related income will be materially greater, over a reasonable period of time, than the amount imposed on non-oil related and non-extraction income. Foreign oil related income is income derived from foreign sources from the processing of minerals extracted from oil or gas wells into their primary products; the transportation, distribution, or sale of such minerals or primary products; the disposition of assets used by the taxpayer in one of the foregoing businesses; or the performance of any related service. To the extent that such taxes are treated as not creditable, the amount is treated as a deduction under foreign law (i.e., the amount is treated as a deductible business expense for purposes of computing an appropriate level of foreign income tax and for U.S. tax purposes).

REASONS FOR CHANGE

The purpose of the foreign tax credit is to eliminate double taxation of the same income by both the United States and a foreign jurisdiction. Certain safeguards apply to prevent taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. In the case of foreign oil and gas income, however, in addition to safeguards of general application, special limitations apply. The Committee understands that these additional limitations involve substantial compliance burdens for U.S.-based companies. In addition, the interaction of these special limitations with the other foreign tax credit limitations of general application may result in double taxation of the same income. The Committee believes that it is appropriate to repeal these special limitation rules.

EXPLANATION OF PROVISION

The bill repeals the special rules of section 907 for applying the foreign tax credit in the case of foreign oil and gas income. Thus, taxes attributable to foreign oil and gas extraction income are no longer subject to a special limitation, but rather are subject to the general limitation rules of section 904. Additionally, the special rules of section 907 with respect to discriminatory taxes on foreign oil related income no longer apply. It is intended that rules with respect to the creditability of foreign taxes and dual capacity taxpayers under section 901 and the regulations thereunder will continue to apply.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2004.

H. STUDY OF PROPER TREATMENT OF EUROPEAN UNION UNDER SUBPART F SAME COUNTRY EXCEPTIONS

(sec. 909 of the bill)

PRESENT LAW

In general, U.S. 10-percent shareholders of a controlled foreign corporation ("CFC") are required to include in income for U.S. tax purposes currently certain income of the CFC (referred to as "subpart F income"), without regard to whether the income is distributed to the shareholders (sec. 951(a)(1)(A)). In effect, the Code treats the U.S. 10-percent shareholders of a CFC as having received a current distribution of their pro rata shares of the CFC's subpart F income. For this purpose, a U.S. 10-percent shareholder is a U.S. person that owns 10 percent or more of the corporation's stock (measured by vote) (sec. 951(b)). In general, a foreign corporation is a CFC if U.S. 10-percent shareholders own more than 50 percent of such corporation's stock (measured by vote or by value) (sec. 957).

Subpart F income typically is passive income or income that is relatively movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income (defined in sec. 954), insurance income (defined in sec. 953), and certain income relating to international boycotts and other violations of public policy (defined in sec. 952(a)(3)-(5)). Subpart F income does not include income of the CFC that is effectively connected with the conduct of a trade or business within the United States (on which income the CFC is subject to current U.S. tax) (sec. 952(b)).

Income of a CFC may be excepted from the subpart F provisions under various same country exceptions. For example, a major category of foreign base company income is foreign personal holding company income, which generally includes, among other things, certain dividends, interest, rents and royalties (sec. 954(c)). Same country exceptions from treatment as foreign personal holding company income generally are provided for dividends and interest received by the CFC from a related person that (1) is a corporation organized under the laws of the same foreign country in which the CFC is created or organized and (2) has a substantial part of its assets used in a trade or business located in such same foreign country. Similarly, same country exceptions from foreign personal holding income generally are provided for rents and royalties received by the CFC from a related corporation for the use of property within the country in which the CFC is created or organized (sec. 954(c)(3)).

EXPLANATION OF PROVISION

The bill directs the Treasury Secretary to conduct a study of the feasibility of treating all countries included in the European Union as one country for purposes of applying same country exceptions under subpart F. The bill requires the results of the study to be reported to the House Committee on Ways and Means and the Senate Committee on Finance, along with any legislative recommendations, no later than 6 months after the date of enactment.

I. Provide Waiver From Denial of Foreign Tax Credits

(sec. 910 of the bill and sec. 901(j) of the Code)

PRESENT LAW

In general, U.S. persons may credit foreign taxes against U.S. tax on foreign-source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. Separate limitations are applied to specific categories of income.

Pursuant to special rules applicable to taxes paid to certain foreign countries, no foreign tax credit is allowed for income, war profits, or excess profits taxed paid, accrued, or deemed paid to a country which satisfies specified criteria, to the extent that the taxes are with respect to income attributable to a period during which such criteria were satisfied (sec. 901(j)). Section 901(j) applies with respect to any foreign country: (1) the government of which the United States does not recognize, unless such government is otherwise eligible to purchase defense articles or services under the Arms Export Control Act, (2) with respect to which the United States has severed diplomatic relations, (3) with respect to which the United States has not severed diplomatic relations but does not conduct such relations, or (4) which the Secretary of State has, pursuant to section 6(j) of the Export Administration Act of 1979, as amended, designated as a foreign country which repeatedly provides support for acts of international terrorisms (a "section 901(j) foreign country"). The denial of credits applies to any foreign country during the period beginning on the later of January 1, 1987, or six months after such country becomes a section 901(j) country, and ending on the date the Secretary of State certifies to the Secretary of the Treasury that such country is no longer a section 901(j) country.

Taxes treated as noncreditable under section 901(j) generally are permitted to be deducted notwithstanding the fact that the taxpayer elects use of the foreign tax credit for the taxable year with respect to other taxes. In addition, income for which foreign tax credits are denied generally cannot be sheltered from U.S. tax by other creditable foreign taxes.

Under the rules of subpart F, U.S. 10-percent shareholders of a controlled foreign corporation ("CFC") are required to include in income currently certain types of income of the CFC, whether or not such income is actually distributed currently to the shareholders (referred to as "subpart F income"). Subpart F income includes income derived from any foreign country during a period in which the taxes imposed by that country are denied eligibility for the foreign tax credit under section 901(j) (sec. 952(a)(5)).

REASONS FOR CHANGE

The Committee has observed that the automatic denial of foreign tax credits under section 901(j) with respect to a foreign country may in certain cases conflict with other policy interests of the United States. The Committee believes that it is appropriate to provide a mechanism for the waiver of the denial of foreign tax credits in certain cases.

EXPLANATION OF PROVISION

The bill provides that section 901(j) no longer applies with respect to a foreign country if the President determines that the application of section 901(j) to such foreign country is not in the national interests of the United States.

EFFECTIVE DATE

The provision is effective as of the date of enactment.

J. Prohibit Disclosure of APAs and APA Background Files

(sec. 911 of the bill and secs. 6103 and 6110 of the Code)

PRESENT LAW

Section 6103

Under section 6103, returns and return information are confidential and cannot be disclosed unless authorized by the Internal Revenue Code.

The Code defines return information broadly. Return information includes:

—a taxpayer's identity, the nature, source or amount of income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments;

—whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing; or

—any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.[87]

Section 6110 and the Freedom of Information Act

With certain exceptions, section 6110 makes the text of any written determination the IRS issues available for public inspection. A written determination is any ruling, determination letter, technical

[87] Sec. 6103(b)(2)(A).

advice memorandum, or Chief Counsel advice. Once the IRS makes the written determination publicly available, the background file documents associated with such written determination are available for public inspection upon written request. The Code defines "background file documents" as any written material submitted in support of the request. Background file documents also include any communications between the IRS and persons outside the IRS concerning such written determination that occur before the IRS issues the determination.

Before making them available for public inspection, section 6110 requires the IRS to delete specific categories of sensitive information from the written determination and background file documents.[88] It also provides judicial and administrative procedures to resolve disputes over the scope of the information the IRS will disclose. In addition, Congress has also wholly exempted certain matters from section 6110's public disclosure requirements.[89] Any part of a written determination or background file that is not disclosed under section 6110 constitutes "return information."[90]

The Freedom of Information Act (FOIA) lists categories of information that a federal agency must make available for public inspection.[91] It establishes a presumption that agency records are accessible to the public. The FOIA, however, also provides nine exemptions from public disclosure. One of those exemptions is for matters specifically exempted from disclosure by a statute other than the FOIA if the exempting statute meets certain requirements.[92] Section 6103 qualifies as an exempting statute under this FOIA provision. Thus, returns and return information that section 6103 deems confidential are exempt from disclosure under the FOIA.

Section 6110 is the exclusive means for the public to view IRS written determinations.[93] If section 6110 covers the written determination, then the public cannot use the FOIA to obtain that determination.

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[88] Sec. 6110(c) provides for the deletion of identifying information, trade secrets, confidential commercial and financial information and other material.

[89] Sec. 6110(l).

[90] Sec. 6103(b)(2)(B) ("The term 'return information' means . . . any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110").

[91] Unless published promptly and offered for sale, an agency must provide for public inspection and copying: (1) final opinions as well as orders made in the adjudication of cases; (2) statements of policy and interpretations not published in the Federal Register; (3) administrative staff manuals and instructions to staff that affect a member of the public; and (4) agency records which have been or the agency expects to be, the subject of repetitive FOIA requests. 5 U.S.C. sec. 552(a)(2). An agency must also publish in the Federal Register: the organizational structure of the agency and procedures for obtaining information under the FOIA; statements describing the functions of the agency and all formal and informal procedures; rules of procedure, descriptions of forms and statements describing all papers, reports and examinations; rules of general applicability and statements of general policy; and amendments, revisions and repeals of the foregoing. 5 U.S.C. sec. 552(a)(1). All other agency records can be sought by FOIA request; however, some records may be exempt from disclosure.

[92] Exemption 3 of the FOIA provides that an agency is not required to disclose matters that are: (3) specifically exempted from disclosure by statute (other than section 552b of this title) provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld; . . . 5 U.S.C. § 552(b)(3).

[93] Sec. 6110(m).

Advance pricing agreements

The Advanced Pricing Agreement ("APA") program is an alternative dispute resolution program conducted by the IRS, which resolves international transfer pricing issues prior to the filing of the corporate tax return. Specifically, an APA is an advance agreement establishing an approved transfer pricing methodology entered into among the taxpayer, the IRS, and a foreign tax authority. The IRS and the foreign tax authority generally agree to accept the results of such approved methodology. Alternatively, an APA also may be negotiated between just the taxpayer and the IRS; such an APA establishes an approved transfer pricing methodology for U.S. tax purposes. The APA program focuses on identifying the appropriate transfer pricing methodology; it does not determine a taxpayer's tax liability. Taxpayers voluntarily participate in the program.

To resolve the transfer pricing issues, the taxpayer submits detailed and confidential financial information, business plans and projections to the IRS for consideration. Resolution involves an extensive analysis of the taxpayer's functions and risks. Since its inception in 1991, the APA program has resolved more than 180 APAs, and approximately 195 APA requests are pending.

Currently pending in the U.S. District Court for the District of Columbia are three consolidated lawsuits asserting that APAs are subject to public disclosure under either section 6110 or the FOIA.[94] Prior to this litigation and since the inception of the APA program, the IRS held the position that APAs were confidential return information protected from disclosure by section 6103.[95] On January 11, 1999, the IRS conceded that APAs are "rulings" and therefore are "written determinations" for purposes of section 6110.[96] Although the court has not yet issued a ruling in the case, the IRS announced its plan to publicly release both existing and future APAs. The IRS then transmitted existing APAs to the respective taxpayers with proposed deletions. It has received comments from some of the affected taxpayers. Where appropriate, foreign tax authorities have also received copies of the relevant APAs for comment on the proposed deletions. No APAs have yet been released to the public.

Some taxpayers assert that the IRS erred in adopting the position that APAs are subject to section 6110 public disclosure. Several have sought to participate as amici in the lawsuit to block the release of APAs. They are concerned that release under section 6110 could expose them to expensive litigation to defend the deletion of the confidential information from their APAs. They are also concerned that the section 6110 procedures are insufficient to protect the confidentiality of their trade secrets and other financial and commercial information.

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[94] *BNA* v. *IRS,* Nos. 96–376, 96–2820, and 96–1473 (D.D.C.). The Bureau of National Affairs, Inc. (BNA) publishes matters of interest for use by its subscribers. BNA contends that APAs are not return information as they are prospective in application. Thus at the time they are entered into they do not relate to "the determination of the existence, or possible existence, of liability or amount thereof . . ."

[95] The IRS contended that information received or generated as part of the APA process pertains to a taxpayer's liability and therefore was return information as defined in sec. 6103(b)(2)(A). Thus, the information was subject to section 6103's restrictions on the dissemination of returns and return information. Rev. Proc. 91–22, sec. 11, 1991–1 C.B. 526, 534 and Rev. Proc. 96–53, sec. 12, 1996–2 C.B. 375, 386.

[96] IR 1999–05.

REASONS FOR CHANGE

The APA program has been a successful mechanism for resolving transfer pricing issues, not only for future years, but, in some instances, for prior open years as well (rollbacks). It reduces protracted disputes and costly litigation between taxpayers and the government. The program involves not only taxpayers and the IRS, but also foreign taxing authorities.

As part of the program, the taxpayer voluntarily provides substantial, sensitive information to the IRS. The proprietary information necessary to support a claim of comparability may be among a company's most closely guarded trade secrets. Similarly, information regarding production costs and customer pricing may also be extremely sensitive information.

From the program's inception, the IRS has assured taxpayers and foreign governments that the information received or generated in the APA process would be protected as confidential return information. Such assurances were based on published IRS materials.

The APA process is based on taxpayers' cooperation and voluntary disclosure to the IRS of sensitive information. The continued confidentiality of this information is vital to the APA program. Otherwise, the Committee believes that some taxpayers may refuse to participate in this successful program, causing a decline in its usefulness.

Congress must balance the need for confidentiality with the general public's need for practical tax guidance. Some members of the public have expressed concern that the APA program has led to the development of a body of "secret law," known only to a few members of the tax profession. In addition, some members of the public contend that taxpayers have received APAs permitting the use of transfer pricing methodologies not contemplated in the section 482 regulations. They also contend that APAs have provided interpretations of law not available to taxpayers that do not participate in the APA process. Such concerns could undermine the public's confidence in the IRS's ability to fairly enforce the transfer pricing rules. Thus, the provision requires the Department of the Treasury to prepare and publish an annual report regarding APAs, which will provide extensive information regarding the program, while clarifying that existing and future APAs and related background information continue to be confidential return information.

EXPLANATION OF PROVISION

The provision amends section 6103 to provide that APAs and related background information are confidential return information under section 6103. Related background information is meant to include: the request for an APA, any material submitted in support of the request, and any communication (written or otherwise) prepared or received by the Secretary in connection with an APA, regardless of when such communication is prepared or received. Protection is not limited to agreements actually executed; it includes material received and generated in the APA process that does not result in an executed agreement.

Further, APAs and related background information are not "written determinations" as that term is defined in section 6110. Therefore, the public inspection requirements of section 6110 do not apply to APAs and related background information. A document's incorporation in a background file, however, is not intended to be grounds for not disclosing an otherwise disclosable document from a source other than a background file.

The provision statutorily requires that the Treasury Department prepare and publish an annual report on the status of APAs. The annual report is to contain the following information:

—Information about the structure, composition and, operation of the APA program office;

—A copy of each current model APA;

—Statistics regarding the amount of time to complete new and renewal APAs;

—The number of APA applications filed during such year;

—The number of APAs executed to date and for the year;

—The number of APA renewals issued to date and for the year;

—The number of pending APA requests;

—The number of pending APA renewals;

—The number of APAs executed and pending (including renewals and renewal requests) that are unilateral, bilateral and multilateral, respectively;

—The number of APAs revoked or canceled, and the number of withdrawals from the APA program, to date and for the year;

—The number of finalized new APAs and renewals by industry;[97] and

General descriptions of:

—The nature of the relationships between the related organizations, trades, or businesses covered by APAs;

—The related organizations, trades, or businesses whose prices or results are tested to determine compliance with the transfer pricing methodology prescribed in the APA;

—The covered transactions and the functions performed and risks assumed by the related organizations, trades or businesses involved;

—Methodologies used to evaluate tested parties and transactions and the circumstances leading to the use of those methodologies;

—Critical assumptions;

—Sources of comparables;

—Comparable selection criteria and the rationale used in determining such criteria;

—The nature of adjustments to comparables and/or tested parties;

—The nature of any range agreed to, including information such as whether no range was used and why, whether an inter-quartile range was used, or whether there was a statistical narrowing of the comparables;

—Adjustment mechanisms provided to rectify results that fall outside of the agreed upon APA range;

[97] This information was previously released in IRS Publication 3218, "IRS Report on Application and Administration of I.R.C. Section 482."

—The various term lengths for APAs, including rollback years, and the number of APAs with each such term length;

—The nature of documentation required; and

—Approaches for sharing of currency or other risks.

The first report is to cover the period January 1, 1991, through the calendar year including the date of enactment. The Treasury Department cannot include any information in the report which would have been deleted under section 6110(c) if the report were a written determination as defined in section 6110. Additionally, the report cannot include any information which can be associated with or otherwise identify, directly or indirectly, a particular taxpayer. For purposes of section 6103, the report requirement is treated as part of Title 26.

The IRS user fee otherwise required to be paid for an APA is increased by $500. The Secretary has the authority to make appropriate reductions in such fee for small businesses.

While the provision statutorily requires an annual report, it is not intended to discourage the Treasury Department from issuing other forms of guidance, such as regulations or revenue rulings, consistent with the confidentiality provisions of the Code.

EFFECTIVE DATE

The provision is effective on the date of enactment; accordingly, no APAs or related background file documents can be released to the public after the date of enactment. It requires the Treasury Department to publish the first annual report no later than March 30, 2000.

K. INCREASE DOLLAR LIMITATION ON SECTION 911 EXCLUSION

(sec. 912 of the bill and sec. 911 of the Code)

PRESENT LAW

U.S. citizens generally are subject to U.S. income tax on their worldwide income. A U.S. citizen who earns income in a foreign country also may be taxed on such income by that foreign country. A credit against the U.S. income tax imposed on foreign-source income is allowed for foreign taxes paid on such income.

U.S. citizens living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign housing costs. In order to qualify for these exclusions, a U.S. citizen must be either (1) a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year, or (2) present in a foreign country or countries for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country.

The exclusion for foreign earned income generally applies to income earned from sources outside the United States as compensation for personal services actually rendered by the taxpayer. The maximum exclusion for foreign earned income for taxable years before 1998 is $70,000. Beginning in 1998, the maximum exclusion is increased in increments of $2,000 per year until the exclusion amount is $80,000 (i.e., in the year 2002). The maximum exclusion is $74,000 for 1999. The exclusion is indexed for inflation beginning in 2008 (for inflation after 2006).

The exclusion for housing costs applies to reasonable expenses, other than deductible interest and taxes, paid or incurred by or on behalf of the taxpayer for housing for the taxpayer and his or her spouse and dependents in a foreign country. The exclusion amount for housing costs for a taxable year is equal to the excess of such housing costs for the taxable year over an amount computed pursuant to a specified formula.

The combined earned income exclusion and housing cost exclusion may not exceed the taxpayer's total foreign earned income. The taxpayer's foreign tax credit is reduced by the amount of the credit that is attributable to excluded income.

REASONS FOR CHANGE

The Committee recognizes that for U.S. businesses to be effective competitors overseas it is necessary to dispatch U.S. citizens or residents to sites of foreign operations. Being stationed abroad typically imposes additional financial burdens on the employee and his or her family. These burdens may arise from maintaining two homes (one in the United States and one abroad), additional personal travel to maintain family ties, or the added expenses of living in a foreign location that has a high cost of living. Businesses often remunerate their employees for these additional burdens by paying higher wages. Because the increased remuneration is offset by larger burdens, the remuneration does not truly reflect an increase in economic well being. The Committee, therefore, believes that the exclusion of section 911 is a simple way to prevent taxpayers from facing an increased tax burden when there has been no increase in economic well being by accepting an overseas assignment.

The Committee notes that in 1997 the Congress increased the then prevailing $70,000 exclusion, but the increase enacted was modest in light of the fact that the $70,000 exclusion had remained unchanged for the previous ten years, while the extra costs from working abroad had increased with worldwide inflation. The Committee, therefore, believes that it is appropriate to further increase the exclusion permitted under section 911. In addition, as a rough measure for the increased burden that may be expected to arise from future inflation, the Committee believes that it is appropriate to index the level of the increased section 911 exclusion amount to future changes in the domestic cost of living.

EXPLANATION OF PROVISION

The bill increases the maximum exclusion for foreign earned income in annual increments of $3,000 per year beginning in 2003, until the exclusion amount is $95,000 (i.e., in the year 2007). Thus, for the years 2003 through 2007, the maximum exclusion gradually increases from $83,000 to $95,000. Beginning in 2008, the maximum exclusion amount of $95,000 is indexed for inflation.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

TITLE X. TAX-EXEMPT ORGANIZATION PROVISIONS

A. Provide Tax Exemption for Organizations Created by a State To Provide Property and Casualty Insurance Coverage for Property for Which Such Coverage Is Otherwise Unavailable

(sec. 1001 of the bill and sec. 501(c)(28) of the Code)

PRESENT LAW

A life insurance company is subject to tax on its life insurance company taxable income, which is its life insurance income reduced by life insurance deductions (sec. 801). Similarly, a property and casualty insurance company is subject to tax on its taxable income, which is determined as the sum of its underwriting income and investment income (as well as gains and other income items) (sec. 831). Present law provides that the term "corporation" includes an insurance company (sec. 7701(a)(3)).

In general, the Internal Revenue Service ("IRS") takes the position that organizations that provide insurance for their members or other individuals are not considered to be engaged in a tax-exempt activity. The IRS maintains that such insurance activity is either (1) a regular business of a kind ordinarily carried on for profit, or (2) an economy or convenience in the conduct of members' businesses because it relieves the members from obtaining insurance on an individual basis.

Certain insurance risk pools have qualified for tax exemption under Code section 501(c)(6). In general, these organizations (1) assign any insurance policies and administrative functions to their member organizations (although they may reimburse their members for amounts paid and expenses); (2) serve an important common business interest of their members; and (3) must be membership organizations financed, at least in part, by membership dues.

State insurance risk pools may also qualify for tax exempt status under section 501(c)(4) as a social welfare organization or under section 115 as serving an essential governmental function of a State. In seeking qualification under section 501(c)(4), insurance organizations generally are constrained by the restrictions on the provision of "commercial-type insurance" contained in section 501(m). Section 115 generally provides that gross income does not include income derived from the exercise of any essential governmental function or accruing to a State or any political subdivision thereof.

Certain specific provisions provide tax-exempt status to organizations meeting statutory requirements.

Health coverage for high-risk individuals

Section 501(c)(26) provides tax-exempt status to any membership organization that is established by a State exclusively to provide coverage for medical care on a nonprofit basis to certain high-risk individuals, provided certain criteria are satisfied. The organization may provide coverage for medical care either by issuing insurance itself or by entering into an arrangement with a health maintenance organization ("HMO").

High-risk individuals eligible to receive medical care coverage from the organization must be residents of the State who, due to a pre-existing medical condition, are unable to obtain health coverage for such condition through insurance or an HMO, or are able to acquire such coverage only at a rate that is substantially higher than the rate charged for such coverage by the organization. The State must determine the composition of membership in the organization. For example, a State could mandate that all organizations that are subject to insurance regulation by the State must be members of the organization.

The provision further requires the State or members of the organization to fund the liabilities of the organization to the extent that premiums charged to eligible individuals are insufficient to cover such liabilities. Finally, no part of the net earnings of the organization can inure to the benefit of any private shareholder or individual.

Workers' compensation reinsurance organizations

Section 501(c)(27)(A) provides tax-exempt status to any membership organization that is established by a State before June 1, 1996, exclusively to reimburse its members for workers' compensation insurance losses, and that satisfies certain other conditions. A State must require that the membership of the organization consist of all persons who issue insurance covering workers' compensation losses in such State, and all persons and governmental entities who self-insure against such losses. In addition, the organization must operate as a nonprofit organization by returning surplus income to members or to workers' compensation policyholders on a periodic basis and by reducing initial premiums in anticipation of investment income.

State workmen's compensation act companies

Section 501(c)(27)(B) provides tax-exempt status for any organization that is created by State law, and organized and operated exclusively to provide workmen's compensation insurance and related coverage that is incidental to workmen's compensation insurance, and that meets certain additional requirements. The workmen's compensation insurance must be required by State law, or be insurance with respect to which State law provides significant disincentives if it is not purchased by an employer (such as loss of exclusive remedy or forfeiture of affirmative defenses such as contributory negligence). The organization must provide workmen's compensation to any employer in the State (for employees in the State or temporarily assigned out-of-State) seeking such insurance and meeting other reasonable requirements. The State must either extend its full faith and credit to the initial debt of the organization or provide the initial operating capital of such organization. For this purpose, the initial operating capital can be provided by providing the proceeds of bonds issued by a State authority; the bonds may be repaid through exercise of the State's taxing authority, for example. For periods after the date of enactment, either the assets of the organization must revert to the State upon dissolution, or State law must not permit the dissolution of the organization absent an act of the State legislature. Should dissolution of the organization become permissible under applicable State law, then the requirement that the assets of the organization revert to the State upon dissolution applies. Finally, the majority of the board of directors (or comparable oversight body) of the organization must be appointed by an official of the executive branch of the State or by the State legislature, or by both.

REASONS FOR CHANGE

The Committee understands that certain types of insurance to support governmental programs to prepare for or mitigate the effects of natural catastrophic events (such as hurricanes) may be limited or unavailable at reasonable rates in the authorized insurance market in some States. The Committee believes it is appropriate to provide tax-exempt status to certain types of associations that provide property and casualty insurance for property located within a State if the State has determined that coverage in the authorized insurance market is in fact limited or unavailable at reasonable rates.

EXPLANATION OF PROVISION

The provision provides tax-exempt status for any association created before January 1, 1999, by State law and organized and operated exclusively to provide property and casualty insurance coverage for property located within the State for which the State has determined that coverage in the authorized insurance market is limited or unavailable at reasonable rates, provided certain requirements are met.

Under the provision, no part of the net earnings of the association may inure to the benefit of any private shareholder or individual. Except as provided in the case of dissolution, no part of the assets of the association may be used for, or diverted to, any purpose other than: (1) to satisfy, in whole or in part, the liability of the association for, or with respect to, claims made on policies written by the association; (2) to invest in investments authorized by applicable law; (3) to pay reasonable and necessary administration expenses in connection with the establishment and operation of the association and the processing of claims against the association (4) to make remittances pursuant to State law to be used by the State to provide for the payment of claims on policies written by the association, purchase reinsurance covering losses under such policies, or to support governmental programs to prepare for or mitigate the effects of natural catastrophic events. The provision requires that the State law governing the association permit the association to levy assessments on insurance companies authorized to sell property and casualty insurance in the State, or on property and casualty insurance policyholders with insurable interests in property located in the State to fund deficits of the association, including the creation of reserves. The provision requires that the plan of operation of the association be subject to approval by the chief executive officer or other official of the State, by the State legislature, or both. In addition, the provision requires that the assets of the association revert upon dissolution to the State, the State's designee, or an entity designated by the State law governing the association, or that State law not permit the dissolution of the association.

The provision provides a special rule in the case of any entity or fund created before January 1, 1999, pursuant to State law and organized and operated exclusively to receive, hold, and invest remittances from an association exempt from tax under the provision, to make disbursements to pay claims on insurance contracts issued by the association, and to make disbursements to support governmental programs to prepare for or mitigate the effects of natural catastrophic events. The special rule provides that the entity or fund may elect to be disregarded as a separate entity and be treated as part of the association exempt from tax under the provision, from which it receives such remittances. The election is required to be made no later than 30 days following the date on which the association is determined to be exempt from tax under the provision, and would be effective as of the effective date of that determination.

An organization described in the provision is treated as having unrelated business taxable income ("UBIT") in the amount of its taxable income (computed as if the organization were not exempt from tax under the proposal), if at the end of the immediately preceding taxable year, the organization's net equity exceeded 15 percent of the total coverage in force under insurance contracts issued by the organization and outstanding at the end of that preceding year.

Under the provision, no income or gain is recognized solely as a result of the change in status to that of an association exempt from tax under the provision.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999. No inference is intended as to the tax status under present law of associations described in the provision.

B. CONFORM PROVISIONS RELATING TO ARBITRAGE TREATMENT TO REFLECT PROPOSED STATE CONSTITUTIONAL AMENDMENTS

(sec. 1002 of the bill)

PRESENT LAW

In general, present-law tax-exempt bond arbitrage restrictions provide that interest on a State or local government bond is not eligible for tax-exemption if the proceeds are invested, directly or indirectly, in materially higher yielding investments or if the debt service on the bond is secured by or paid from (directly or indirectly) such investments. An exception, enacted in 1984, provides that the pledge of income from investments in a Fund established under a provision of a State constitution adopted in 1876 as security for a limited amount of tax-exempt bonds will not cause interest on those bonds to be taxable. The terms of this exception are limited to State constitutional or statutory restrictions in effect as of October 9, 1969.

The Fund consists of certain State lands that were set aside for the benefit of higher education, the income from mineral rights to these lands, and certain other earnings on Fund assets. The State constitution directs that monies held in the Fund are to be invested in interest-bearing obligations and other securities. The constitution does not permit the expenditure or mortgage of the Fund for any purpose. Income from the Fund is apportioned between two university systems operated by the State. Tax-exempt bonds issued by the two university systems are secured by and payable from the income of the Fund. These bonds are used to finance buildings and other permanent improvements for the universities.

The General Assembly of the State has approved proposed constitutional amendments regarding the manner in which amounts in the Fund are paid for the benefit of the two university systems. These proposed amendments are to be voted on by the State's citizens in November 1999. If approved, the amendments will in substance eliminate the benefits of the 1984 exception from the tax-exempt bond arbitrage restrictions for future debt.

REASONS FOR CHANGE

The Committee understands that the proposed State constitutional amendments will have the effect of permitting the Fund to make annual distributions in a manner similar to standard university endowment funds, rather than the present practice which ties distributions to annual income performance which can create a quite variable pattern of distributions. The Committee does not believe that the Fund should lose the benefits of the 1984 exception from the tax-exempt bond arbitrage restrictions by adopting a sounder, more modern approach to the management of Fund distributions.

EXPLANATION OF PROVISION

The 1984 exception is conformed to the proposed State constitutional amendments to permit its continued applicability to bonds of the two university systems. Limitations on the aggregate amount of bonds which may benefit from the exception are not modified.

EFFECTIVE DATE

The provision applies to bonds issued after December 31, 1999.

C. DENIAL OF CHARITABLE CONTRIBUTION DEDUCTION FOR TRANSFERS ASSOCIATED WITH SPLIT-DOLLAR INSURANCE ARRANGEMENTS

(sec. 1003 of the bill and new sec. 501(c)(28) of the Code)

PRESENT LAW

Under present law, in computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct charitable contributions paid during the taxable year. The amount of the deduction allowable for a taxable year with respect to any charitable contribution depends on the type of property contributed, the type of organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)). A charitable contribution is defined to mean a contribution or gift to or for the use of a charitable organization or certain other entities (sec. 170(c)). The term "contribution or gift" is not defined by statute, but generally is interpreted to mean a voluntary transfer of money or other property without receipt of adequate consideration and with donative intent. If a taxpayer receives or expects to receive a quid pro quo in exchange for a transfer to charity, the taxpayer may be able to deduct the excess of the amount transferred over the fair market value of any benefit received in return, provided the excess payment is made with the intention of making a gift.[98]

In general, no charitable contribution deduction is allowed for a transfer to charity of less than the taxpayer's entire interest (i.e., a partial interest) in any property (sec. 170(f)(3)). In addition, no deduction is allowed for any contribution of $250 or more unless the taxpayer obtains a contemporaneous written acknowledgment from the donee organization that includes a description and good faith estimate of the value of any goods or services provided by the donee organization to the taxpayer in consideration, whole or part, for the taxpayer's contribution (sec. 170(f)(8)).

REASONS FOR CHANGE

The Committee is concerned about an abusive scheme[99] referred to as charitable split-dollar life insurance, and the provision is designed to stop the spread of this scheme. Under this scheme, taxpayers typically transfer money to a charity, which the charity then uses to pay premiums for cash value life insurance on the transferor or another person. The beneficiaries under the life insurance contract typically include members of the transferor's family (either directly or through a family trust or family partnership). Having passed the money through a charity, the transferor claims a charitable contribution deduction for money that is actually being used to benefit the transferor and his or her family. If the transferor or the transferor's family paid the premium directly, the payment would not be deductible. Although the charity eventually may get some of the benefit under the life insurance contract, it does not have unfettered use of the transferred funds.

The Committee is concerned that this type of transaction represents an abuse of the charitable contribution deduction. The Committee is also concerned that the charity often gets relatively little benefit from this type of scheme, and serves merely as a conduit or accommodation party, which the Committee does not view as appropriate for an organization with tax-exempt status. In substance, the charity receives a transfer of a partial interest in an insurance policy, for which no charitable contribution deduction is allowed. While there is no basis under present law for allowing a charitable contribution deduction in these circumstances, the Committee intends that the provision stop the marketing of these transactions immediately.

Therefore, the provision clarifies present law by specifically denying a charitable contribution deduction for a transfer to a charity

[98] *United States* v. *American Bar Endowment,* 477 U.S. 105 (1986). Treas. Reg. sec. 1.170A–1(h).

[99] "A Popular Tax Shelter for 'Angry Affluent' Prompts Ire of Others," Wall Street Journal, Jan. 22, 1999, p. A1; "U.S. Treasury Officials Investigating Charitable Split-Dollar Insurance Plan," Wall Street Journal, Jan. 29, 1999, p. B5; "Brilliant Deduction?," The Chronicle of Philanthropy, Aug. 13, 1998, p. 24; "Charitable Reverse Split-Dollar: Bonanza or Booby Trap," Journal of Gift Planning, 2nd quarter 1998.

if the charity directly or indirectly pays or paid any premium on a life insurance, annuity or endowment contract in connection with the transfer, and any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other noncharitable person chosen by the transferor. In addition, the provision clarifies present law by specifically denying the deduction for a charitable contribution if, in connection with a transfer to the charity, there is an understanding or expectation that any person will directly or indirectly pay any premium on any such contract.

The provision provides that certain persons are not treated as indirect beneficiaries, in certain cases in which a charitable organization purchases an annuity contract to fund an obligation to pay a charitable gift annuity. The provision also provides that a person is not treated as an indirect beneficiary solely by reason of being a noncharitable recipient of an annuity or unitrust amount paid by a charitable remainder trust that holds a life insurance, annuity or endowment contract. The rationale for these rules is that the amount of the charitable contribution deduction is limited under present law to the value of the charitable organization's interest. Congress has previously enacted rules designed to prevent a charitable contribution deduction for the value of any personal benefit to the donor in these circumstances, and the Committee expects that the personal benefit to the donor is appropriately valued.

Further, the provision imposes an excise tax on the charity, equal to the amount of the premiums paid by the charity. Finally, the provision requires a charity to report annually to the Internal Revenue Service the amount of premiums subject to this excise tax and information about the beneficiaries under the contract.

EXPLANATION OF PROVISION

Deduction denial

The provision [100] restates present law to provide that no charitable contribution deduction is allowed for purposes of Federal tax, for a transfer to or for the use of an organization described in section 170(c) of the Internal Revenue Code, if in connection with the transfer (1) the organization directly or indirectly pays, or has previously paid, any premium on any "personal benefit contract" with respect to the transferor, or (2) there is an understanding or expectation that any person will directly or indirectly pay any premium on any "personal benefit contract" with respect to the transferor. It is intended that an organization be considered as indirectly paying premiums if, for example, another person pays premiums on its behalf.

A personal benefit contract with respect to the transferor is any life insurance, annuity, or endowment contract, if any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other person (other than a section 170(c) organization) designated by the transferor. For example, such a beneficiary would include a trust having a direct or indirect beneficiary who is the transferor or any member of the transferor's

[100] The provision is similar to H.R. 630, introduced by Mr. Archer for himself and for Mr. Rangel (106th Cong., 1st Sess.).

family, and would include an entity that is controlled by the transferor or any member of the transferor's family. It is intended that a beneficiary under the contract include any beneficiary under any side agreement relating to the contract. If a transferor contributes a life insurance contract to a section 170(c) organization and designates one or more section 170(c) organizations as the sole beneficiaries under the contract, generally, it is not intended that the deduction denial rule under the provision apply. If, however, there is an outstanding loan under the contract upon the transfer of the contract, then the transferor is considered as a beneficiary. The fact that a contract also has other direct or indirect beneficiaries (persons who are not the transferor or a family member, or designated by the transferor) does not prevent it from being a personal benefit contract. The provision is not intended to affect situations in which an organization pays premiums under a legitimate fringe benefit plan for employees.

It is intended that a person be considered as an indirect beneficiary under a contract if, for example, the person receives or will receive any economic benefit as a result of amounts paid under or with respect to the contract. For this purpose, as described below, an indirect beneficiary is not intended to include a person that benefits exclusively under a bona fide charitable gift annuity (within the meaning of sec. 501(m)).

In the case of a charitable gift annuity, if the charitable organization purchases an annuity contract issued by an insurance company to fund its obligation to pay the charitable gift annuity, a person receiving payments under the charitable gift annuity is not treated as an indirect beneficiary, provided certain requirements are met. The requirements are that (1) the charitable organization possess all of the incidents of ownership (within the meaning of Treas. Reg. sec. 20.2042–1(c)) under the annuity contract purchased by the charitable organization; (2) the charitable organization be entitled to all the payments under the contract; and (3) the timing and amount of payments under the contract be substantially the same as the timing and amount of payments to each person under the organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

Under the provision, an individual's family consists of the individual's grandparents, the grandparents of the individual's spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.

In the case of a charitable gift annuity obligation that is issued under the laws of a State that requires, in order for the charitable gift annuity to be exempt from insurance regulation by that State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in that State, then the foregoing requirements (1) and (2) are treated as if they are met, provided that certain additional requirements are met. The additional requirements are that the State law requirement was in effect on February 8, 1999, each beneficiary under the charitable gift annuity is a bona fide resident of the State at the time the charitable gift annuity was issued, the only persons entitled to payments under the annuity contract issued by the insurance company are persons entitled to payments under the charitable gift annuity when it was issued, and (as required by clause (iii) of subparagraph (D) of the provision) the timing and amount of payments under the annuity contract to each person are substantially the same as the timing and amount of payments to the person under the charitable organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

In the case of a charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)) that holds a life insurance, endowment or annuity contract issued by an insurance company, a person is not treated as an indirect beneficiary under the contract held by the trust, solely by reason of being a recipient of an annuity or unitrust amount paid by the trust, provided that the trust possesses all of the incidents of ownership under the contract and is entitled to all the payments under such contract. No inference is intended as to the applicability of other provisions of the Code with respect to the acquisition by the trust of a life insurance, endowment or annuity contract, or the appropriateness of such an investment by a charitable remainder trust.

Nothing in the provision is intended to suggest that a life insurance, endowment, or annuity contract would be a personal benefit contract, solely because an individual who is a recipient of an annuity or unitrust amount paid by a charitable remainder annuity trust or charitable remainder unitrust uses such a payment to purchase a life insurance, endowment or annuity contract, and a beneficiary under the contract is the recipient, a member of his or her family, or another person he or she designates.

Excise tax

The provision imposes on any organization described in section 170(c) of the Code an excise tax, equal to the amount of the premiums paid by the organization on any life insurance, annuity, or endowment contract, if the premiums are paid in connection with a transfer for which a deduction is not allowable under the deduction denial rule of the provision (without regard to when the transfer to the charitable organization was made). The excise tax does not apply if all of the direct and indirect beneficiaries under the contract (including any related side agreement) are organizations described in section 170(c). Under the provision, payments are treated as made by the organization, if they are made by any other person pursuant to an understanding or expectation of payment. The excise tax is to be applied taking into account rules ordinarily applicable to excise taxes in chapter 41 or 42 of the Code (e.g., statute of limitation rules).

Reporting

The provision requires that the charitable organization annually report the amount of premiums that is paid during the year and that is subject to the excise tax imposed under the provision, and the name and taxpayer identification number of each beneficiary under the life insurance, annuity or endowment contract to which the premiums relate, as well as other information required by the Secretary of the Treasury. For this purpose, it is intended that a beneficiary include any beneficiary under any side agreement to which the section 170(c) organization is a party (or of which it is otherwise aware). Penalties applicable to returns required under Code section 6033 apply to returns under this reporting requirement. Returns required under this provision are to be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

Regulations

The provision provides for the promulgation of regulations necessary or appropriate to carry out the purposes of the provisions, including regulations to prevent the avoidance of the purposes of the provision. For example, it is intended that regulations prevent avoidance of the purposes of the provision by inappropriate or improper reliance on the limited exceptions provided for certain beneficiaries under *bona fide* charitable gift annuities and for certain noncharitable recipients of an annuity or unitrust amount paid by a charitable remainder trust.

EFFECTIVE DATE

The deduction denial provision applies to transfers after February 8, 1999 (as provided in H.R. 630). The excise tax provision applies to premiums paid after the date of enactment. The reporting provision applies to premiums paid after February 8, 1999 (determined as if the excise tax imposed under the provision applied to premiums paid after that date).

No inference is intended that a charitable contribution deduction is allowed under present law with respect to a charitable split-dollar insurance arrangement. The provision does not change the rules with respect to fraud or criminal or civil penalties under present law; thus, actions constituting fraud or that are subject to penalties under present law would still constitute fraud or be subject to the penalties after enactment of the provision.

D. AUTHORIZE SECRETARY OF TREASURY TO GRANT WAIVERS FROM SECTION 4941 PROHIBITIONS

(sec. 1004 of the bill and sec. 4941 of the Code)

PRESENT LAW

In order to prohibit transactions between tax-exempt private foundations and certain related persons, present law provides for the imposition of excise taxes when "disqualified persons" engage in acts of "self-dealing" with a private foundation (sec. 4941). Disqualified persons include foundation managers (directors, trustees, and officers of the foundation), substantial contributors to the foundation, certain family members of these persons, and certain entities related to these persons. Disqualified persons also include government officials at certain levels.

Acts of self-dealing include any direct or indirect: (1) sale, exchange, or leasing of property between a private foundation and a disqualified person, (2) lending of money or extensions of credit between a private foundation and a disqualified person,[101] (3) furnishing of goods, services, or facilities between a private foundation and a disqualified person,[102] (4) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person,[103] (5) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation, and (6) agreement by a private foundation to make any payment of money or other property to a government official. There is no exception from the prohibition on acts of self-dealing for inadvertent violations, and even transactions which arguably may benefit the private foundation may be subject to tax as an act of self-dealing. Thus, for example, a disqualified person may not rent space to a private foundation at a rate that is below the market.

Self-dealing excise taxes are imposed on a disqualified person who has engaged in a self-dealing transaction, and on any foundation manager who knowingly participates in the transaction.[104] At the first level of tax, a disqualified person is subject to an initial tax at a rate of 5 percent and a foundation manager at a rate of 2.5 percent (up to a maximum of $10,000) of the "amount involved" in the act of self-dealing. Where the self-dealing transaction involves the use of money (e.g., a loan) or other property, the "amount involved" generally is the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the property received.[105] Section 4941 also imposes a second level of taxes at higher rates where an act of self-dealing has occurred and the transaction is not corrected within a specified period of time. At the second level, a disqualified person is subject to a tax of 200 percent and a foundation manager is subject to a tax of 50 percent (up to a maximum of $10,000) of the amount involved.

REASONS FOR CHANGE

The Committee believes that there may be certain transactions for which exemption from the self-dealing prohibition is appropriate and in the best interests of the private foundation, as long as such transactions are reviewed carefully pursuant to procedures established by the Secretary of the Treasury.

EXPLANATION OF PROVISION

The bill requires the Secretary of the Treasury to establish an exemption procedure pursuant to which the Secretary can grant a

[101] The lending of money to private foundation on an interest-free basis where the loan proceeds are to be used exclusively for charitable purposes is not an act of self-dealing.

[102] A disqualified person may, however, furnish goods, services, or facilities to a private foundation at no charge. In addition, it is not an act of self-dealing for a private foundation to furnish goods, services, or facilities to a disqualified person on a basis no more favorable than available to the general public.

[103] Payment by a private foundation of compensation to a disqualified person (other than a government official) for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation is not an act of self-dealing.

[104] Except in the case of a government official, the excise tax is imposed on a disqualified person even though the person had no knowledge at the time of the act that it constituted self-dealing. In the case of a government official, however, the tax may be imposed only if the official participated in an act of self-dealing knowing that it was such an act.

[105] For example, if a disqualified person leases office space from a private foundation, the amount involved is the greater of the amount of rent received by the foundation from the disqualified person or the fair rental value of the building for the period the building is used by the disqualified person.

conditional or unconditional exemption from the self-dealing prohibition of section 4941. The Secretary is permitted to grant an exemption for any disqualified person or transaction, or class of disqualified persons or transactions, if such exemption is: (1) administratively feasible, (2) in the interests of the private foundation, and (3) protective of the rights of the private foundation. The bill requires that, prior to granting such an exemption, the Secretary must: (1) require that adequate notice be given to interested persons, (2) publish notice in the Federal Register of the pendency of a request for an exemption, and (3) afford interested persons an opportunity to present their views.

EFFECTIVE DATE

The provision is effective for transactions occurring after the date of enactment.

E. EXTEND DECLARATORY JUDGMENT PROCEDURES TO NON-501(C)(3) TAX-EXEMPT ORGANIZATIONS

(sec. 1005 of the bill and sec. 7428 of the Code)

PRESENT LAW

In order for an organization to be granted tax exemption as a charitable entity described in section 501(c)(3), it generally must file an application for recognition of exemption with the IRS and receive a favorable determination of its status. Similarly, for most organizations, a charitable organization's eligibility to receive tax-deductible contributions is dependent upon its receipt of a favorable determination from the IRS. In general, a section 501(c)(3) organization can rely on a determination letter or ruling from the IRS regarding its tax-exempt status, unless there is a material change in its character, purposes, or methods of operation. In cases where an organization violates one or more of the requirements for tax exemption under section 501(c)(3), the IRS is authorized to revoke an organization's tax exemption, notwithstanding an earlier favorable determination.

In situations where the IRS denies an organization's application for recognition of exemption under section 501(c)(3) or fails to act on such application, or where the IRS informs a section 501(c)(3) organization that it is considering revoking or adversely modifying its tax-exempt status, present law authorizes the organization to seek a declaratory judgment regarding its tax status (sec. 7428). Section 7428 provides a remedy in the case of a dispute involving a determination by the IRS with respect to: (1) the initial qualification or continuing qualification of an organization as a charitable organization for tax exemption purposes or for charitable contribution deduction purposes; (2) the initial classification or continuing classification of an organization as a private foundation; (3) the initial classification or continuing classification of an organization as a private operating foundation; or (4) the failure of the IRS to make a determination with respect to (1), (2), or (3). A "determination" in this context generally means a final decision by the IRS affecting the tax qualification of a charitable organization, although it also can include a proposed revocation of an organization's tax-exempt status or public charity classification. Section 7428 vests jurisdiction over controversies involving such a determination in the U.S. District Court for the District of Columbia, the U.S. Court of Federal Claims, and the U.S. Tax Court.

Prior to utilizing the declaratory judgment procedure, an organization must have exhausted all administrative remedies available to it within the IRS. For the first 270 days after a request for a determination is made, an organization is deemed to not have exhausted its administrative remedies. Provided that no determination is made during the 270-day period, the organization may initiate an action for declaratory judgment after the period has elapsed. If, however, the IRS makes an adverse determination during the 270-day period, an organization may initiate a declaratory judgment immediately. The 270-day period does not begin with respect to applications for recognition of tax-exempt status until the date a substantially completed application is submitted.

In contrast to the rules governing charities, it is a disputed issue as to whether non-charities (i.e., organizations not described in section 501(c)(3), including trade associations, social welfare organizations, social clubs, labor and agricultural organizations, and fraternal organizations) are required to file an application with the IRS to obtain a determination of their tax-exempt status. If an organization voluntarily files an application for recognition of exemption and receives a favorable determination from the IRS, the determination of tax-exempt status is usually effective as of the date of formation of the organization if its purposes and activities during the period prior to the date of the determination letter were consistent with the requirements for exemption. However, if the organization files an application for recognition of exemption and later receives an adverse determination from the IRS, the IRS may assert that the organization is subject to tax on some or all of its income for open taxable years. In addition, as with charitable organizations, the IRS may revoke or modify an earlier favorable determination regarding an organization's tax-exempt status.

Under present law, a non-charity (i.e., an organization not described in section 501(c)(3)) may not seek a declaratory judgment with respect to an IRS determination regarding its tax-exempt status. The only remedies available to such an organization are to petition the U.S. Tax Court for relief following the issuance of a notice of deficiency or to pay any tax owed and sue for refund in federal district court or the U.S. Court of Federal Claims.

REASONS FOR CHANGE

The Committee believes that it is important to provide certainty for organizations that have sought a determination of their tax-exempt status and believes that it is necessary to provide a remedy for such organizations in cases where a determination by the Internal Revenue Service is delayed for a significant period of time.

EXPLANATION OF PROVISION

The bill extends declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) determinations. Jurisdiction over controversies involving such determinations is limited to the United States Tax Court.[106]

EFFECTIVE DATE

The provision is effective for pleadings with respect to determinations made after the date of enactment.

F. Modify Section 512(b)(13)

(sec. 1006 of the bill and section 512(b)(13) of the Code)

PRESENT LAW

In general, interest, rents, royalties and annuities are excluded from the unrelated business income ("UBI") of tax-exempt organizations. However, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as UBI if such income is received from a taxable or tax-exempt subsidiary that is 50 percent controlled by the parent tax-exempt organization. In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, control means ownership of more than 50 percent of the profits, capital or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

Under present law, interest, rent, annuity, or royalty payments made by a controlled entity to a tax-exempt organization are includable in the latter organization's UBI and are subject to the unrelated business income tax to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity.

The Taxpayer Relief Act of 1997 (the "1997 Act") made several modifications, as described above, to the control requirement of section 512(b)(13). In order to provide transitional relief, the changes made by the 1997 Act do not apply to any payment received or accrued during the first two taxable years beginning on or after the date of enactment of the 1997 Act (August 5, 1997) if such payment is received or accrued pursuant to a binding written contract in effect on June 8, 1997, and at all times thereafter before such payment (but not pursuant to any contract provision that permits optional accelerated payments).

REASONS FOR CHANGE

The Committee believes that the present-law rule of section 512(b)(13) produces results that are arbitrary in certain cases and that it is appropriate to use a fair market value standard to determine the pricing structure for rents, royalties, interest, and annuities paid by subsidiaries to their tax-exempt parent organizations.

[106] This limitation currently applies to declaratory judgments relating to tax qualification for certain employee retirement plans (sec. 7476).

EXPLANATION OF PROVISION

The bill provides that the general rule of section 512(b)(13), which includes interest, rent, annuity, or royalty payments made by a controlled entity to a tax-exempt organization in the latter organization's UBI, applies only to the portion of payments received in a taxable year that exceed the amount of the specified payment which would have been paid if such payment had been determined under the principles of section 482. Thus, if a payment of rent by a controlled subsidiary to its tax-exempt parent organization exceeds fair market value, the excess amount of such payment over fair market value (as determined in accordance with section 482) is included in the parent organizations's UBI. In addition, the bill imposes a 20 percent penalty on the excess amount of any such payment.

The bill provides relief for payments under contracts which, on the date of enactment of the proposal, are still subject to the binding contract transition rule of the 1997 Act, but for which the transition rule would expire prior to the effective date of the proposal, by extending the transition rule until December 31, 1999.

EFFECTIVE DATE

The provision providing an exception from the general rule of section 512(b)(13) for interest, rent, annuity, or royalty payments from controlled subsidiaries that do not exceed fair market value generally applies to payments received or accrued in taxable years beginning after December 31, 1999.

TITLE XI. REAL ESTATE RELIEF PROVISIONS

A. Provisions Relating to REITs

(secs 1101–1106, 1111, 1121, 1131, 1141 and 1151 of the bill and secs. 852, 856 and 857 of the Code)

PRESENT LAW

Real estate investment trust ("REITs") are treated, in substance, as pass-through entities under present law. Pass-through status is achieved by allowing the REIT a deduction for dividends paid to its shareholders. REITs are restricted to investing in passive investments, primarily in real estate and securities. Specifically, a REIT is required to receive at least 95 percent of its income from real property rents and from securities. Amounts received as impermissible "tenant services income" are not treated as rents from real property. In general, such amounts are for services rendered to tenants that are not "customarily furnished" in connection with the rental of real property. Special rules permit amounts to be received from certain "foreclosure property," treated as such for 3 years after the property is acquired by the REIT in foreclosure after a default (or imminent default) on a lease of such property or on indebtedness which such property secured.

A REIT is not treated as providing services that produce impermissible tenant services income if such services are provided by an independent contractor from whom the REIT does not derive or receive any income. An independent contractor is defined as a person who does not own, directly or indirectly, more than 35 percent of the shares of the REIT. Also, no more than 35 percent of the total shares of stock of an independent contractor (or of the interests in assets or net profits, if not a corporation) can be owned directly or indirectly by persons owning 35 percent or more of the interests in the REIT.

A REIT is limited in the amount that it can own in other corporations. Specifically, a REIT cannot own securities (other than Government securities and certain real estate assets) in an amount greater than 25 percent of the value of REIT assets. In addition, it cannot own securities of any one issuer representing more than 5 percent of the total value of REIT assets or more than 10 percent of the voting securities of any corporate issuer. Under an exception to this rule, a REIT can own 100 percent of the stock of a corporation, but in that case the income and assets of such corporation are treated as income and assets of the REIT. Securities for purposes of these rules are defined by reference to the Investment Company Act of 1940.[1]

A REIT is generally required to distribute 95 percent of its income before the end of its taxable year, as deductible dividends paid to shareholders. This rule is similar to a rule for regulated investment companies ("RICs") that requires distribution of 90 percent of income. Both REITS and RICs can make certain "deficiency dividends" after the close of the taxable year, and have these treated as made before the end of the year. The regulations applicable to REITS state that a distribution will be treated as a "deficiency dividend" and thus as made before the end of the prior taxable year, only to the extent the earnings and profits for that year exceed the amount of distributions actually made during the taxable year.

A REIT that has been or has combined with a C corporation will be disqualified if, as of the end of its taxable year, it has accumulated earnings and profits from a non-REIT year. A similar rule applies to regulated investment companies ("RICs"). In the case of a REIT, any distribution made in order to comply with this requirement is treated a being first from pre-REIT accumulated earnings and profits. RICs do not have a similar ordering rule.

In the case of a RIC, under an elective provision entitled "procedures similar to deficiency dividend procedures", any distribution made within a specified period after determination that the investment company did not qualify as a RIC for the taxable year will, "for purposes of applying [the earnings and profits rule that forbids a RIC to have non-RIC earnings and profits] to subsequent taxable years", be treated as applying to the RIC for the non-RIC year. The REIT rules do not specify any particular separate treatment of distributions made after the end of the taxable year for purposes of the earnings and profits rule. Treasury regulations under the REIT provisions state that "distribution procedures similar to those . . . for regulated investment companies apply to non-REIT earnings and profits of a real estate investment trust."

[1] 15 U.S.C. 80a–1 and following.

REASONS FOR CHANGE

The Committee believes that a 10-percent value, as well as a 10-percent vote test, is appropriate to test the permitted relationship of a REIT to the entities in which it invests. The committee is concerned that a REIT may invest in an entity in which it owns virtually all the value (e.g., through preferred stock) while owning a small amount of the vote. The remainder of the voting power might be held by persons related to the REIT such as its officers, directors, or employees. The REIT might effectively be the beneficiary of virtually all the earnings of the entity, through its preferred stock ownership. Also, the REIT might hold significant debt in the entity. If the entity is a corporation, this might significantly reduce the corporate tax that the corporation might pay. If the entity is a partnership engaged in activities that would generate nonqualified income for the REIT if done directly, the REIT might use a significant debt investment in the partnership to reduce the amount of nonqualified income it would report from the partnership while still receiving a significant income stream through the debt.

The Committee believes, however, that certain types of activities that are related to the REIT's real estate investments should be permitted to be performed under the control of the REIT, through the establishment of a "taxable REIT subsidiary". One such type of activity is the provision of certain tenant services that might not be considered customary simply because they are relatively new or "cutting-edge" services that the REIT wishes to have provided in order to retain the competitive value of its properties. The Committee believes it will be simplifying for the REIT to be able to use the taxable REIT subsidiary, so that any uncertainty whether a particular service will be considered "customary" would not affect the REIT's qualification as a REIT. Another type of activity is the performance of real estate management and operation, generally for third parties. A REIT may have developed expertise in such activities with respect to its own properties. which expertise could efficiently be made available to third parties.

The Committee believes it is desirable to obtain information regarding the extent of use of the new taxable REIT subsidiaries and the amount of corporate Federal income tax that such subsidiaries are paying.

The Committee also believes that a number of other simplifying changes are desirable, including allowing limited operation of health care facilities after a lease terminates; simplifying the determination whether an entity is an independent contractor; and modifying and conforming certain RIC and REIT distribution rules.

EXPLANATION OF PROVISION

Taxable REIT subsidiaries

Under the provision, a REIT generally may not own more than 10 percent of the total value of securities of a single issuer, in addition to the present-law rule limiting the REIT's ownership to no more than 10 percent of the outstanding voting securities of a single issuer.

For purposes of the new 10 percent value test, securities generally are defined to exclude safe harbor debt owned by a REIT (as defined for purposes of section 1361(c)(5)(B)(i) and (ii)) if the REIT (and any taxable REIT subsidiary of such REIT) owns no other securities of the issuer. In the case of a REIT that owns securities of a partnership, safe harbor debt is excluded from the definition of securities only if the REIT owns at least 20 percent or more of the profits interest in the partnership. The purpose of the partnership rule requiring a 20–percent profits interest is to assure that if the partnership produces income that would be disqualified income to the REIT, the REIT will be treated as receiving a significant portion of that income directly, even though it may also derive qualified interest income through its safe harbor debt interest.

An exception to the limitations on ownership of securities of a single issuer applies in the case of a "taxable REIT subsidiary" that meets certain requirements. For a subsidiary to qualify as a taxable REIT subsidiary, both the REIT and the subsidiary corporation must join in an election. In addition, any corporation (other than a REIT) of which a taxable REIT subsidiary owns, directly or indirectly, more than 35 percent of the vote or value is automatically treated as a taxable REIT subsidiary. Securities (as defined in the Investment Company Act of 1940) of taxable REIT subsidiaries (plus other assets that are not real estate assets, cash, cash items, or Government securities) may not exceed 25 percent of the total value of a REIT's assets.

Under the provision, a taxable REIT subsidiary is able to engage in certain business activities that under present law could disqualify the REIT because, but for the provision, the taxable REIT subsidiary's activities and relationship with the REIT could prevent certain income from qualifying as rents from real property. Specifically, the subsidiary may provide services to tenants of REIT property (even if such services were not considered services customarily furnished in connection with the rental of real property), and manage or operate properties generally, without causing amounts received or accrued directly or indirectly by REIT for such activities to fail to be treated as rents from real property.

However, the subsidiary may not directly or indirectly operate or manage a lodging or healthcare facility. Nevertheless, it could lease a qualified lodging facility (e.g., a hotel) from the REIT (provided no gambling revenues were derived by the hotel or on its premises); and the rents paid would be treated as rents from real property so long as the lodging facility was operated by an independent contractor for a fee. The subsidiary may bear all expenses of operating the facility and receive all the net revenues, minus the independent contractor's fee.

For purposes of the rule that an independent contractor may operate a qualified lodging facility, an independent contractor qualifies so long as, at the time it enters into the management agreement with the taxable REIT subsidiary, it is actively engaged in the trade or business of operating qualified lodging facilities for any person who is not related to the REIT or the taxable REIT subsidiary. The REIT may receive income from such an independent contractor with respect to certain pre-existing leases.

Also, the subsidiary generally may not provide to any person rights to any brand name under which hotels or healthcare facilities are operated. An exception applies to rights provided to an independent contractor to operate or manage a lodging facility, if the rights are held by the subsidiary as licensee or franchisee, and the lodging facility is owned by the subsidiary or leased to it by the REIT.

Interest paid by a taxable REIT subsidiary to the related REIT is subject to the earnings stripping rules of section 163(j). Thus, the taxable REIT subsidiary may not deduct interest in any year that would exceed 50 percent of the subsidiary's adjusted gross income.

If any amount of interest, rent, or other deductions of the taxable REIT subsidiary for amounts paid to the REIT is determined to be other than at arm's length ("redetermined" items), an excise tax of 100 percent is imposed on the portion that was excessive. "Safe harbors" are provided for certain rental payments where the amounts are de minimis, there is specified evidence that charges to unrelated parties are substantially comparable, certain charges for services from the taxable REIT subsidiary are separately stated, or the subsidiary's gross income from the service is not less than 150 percent of the subsidiary's direct cost in furnishing the service.

In determining whether rents are arm's length rents, the fact that such rents do not meet the requirements of the specified safe harbors is not taken into account. In addition, rent received by a REIT does not fail to qualify as rents from real property by reason of the fact that all or any portion of such rent is redetermined for purposes of the excise tax.

The Commissioner of Internal Revenue is to conduct a study to determine how many taxable REIT subsidiaries are in existence and the aggregate amount of taxes paid by such subsidiaries. The Commissioner is required to submit a report to the Congress describing the results of the study.

Health care REITS

The provison permits a REIT to own and operate a health care facility for two years, and treat it as permitted "foreclosure" property, if the facility is acquired by the termination or expiration of a lease of the property. Extensions of the 2-year period may be granted.

Conformity with regulated investment company rules

The provision conforms the REIT distribution requirements to the rules for regulated investment companies. Specifically, a REIT is required to distribute only 90 percent, rather than 95 percent, of its income.

Definition of independent contractor

If any class of stock of the REIT or of the person being tested as an independent contractor is regularly traded on an established securities market, only persons who directly or indirectly own 5 percent or more of such class of stock are counted as owning such stock for purposes of determining whether the 35 percent ownership limitations have been exceeded (but all of the outstanding stock is included in the denominator for purposes of this computation) .

Modification of earnings and profits rules for RICs and REITS

The provision modifies the present-law rule allowing a RIC to make a distribution after a determination that it had failed RIC status, and thus meet the requirement of no non-RIC earnings and profits in subsequent years. Under the provision, when the reason for the determination is that the RIC had non-RIC earnings and profits in the initial year, RIC qualification is permitted in the initial year to which such determination applied, in addition to subsequent years.

The provision modifies the present-law RIC earnings and profits rules to provide an ordering rule similar to the REIT rule, treating a distribution to meet the requirements of no non-RIC earnings and profits as coming first from the earliest earnings and profits accumulated in any year for which the RIC was not qualified as a RIC.

The rule regarding ordering of REIT distributions to cure a failure to distribute non-REIT earnings and profits is included as part of the REIT deficiency dividend procedure, thereby providing that all REIT distributions (including those made after the end of a taxable year under a deficiency dividend procedure) will be deemed to come from accumulated earnings and profits first if made for the purpose of curing such failure.

EFFECTIVE DATE

The provision is generally effective for taxable years beginning after December 31, 2000. The provision with respect to modification of earnings and profits rules is effective for distributions after December 31, 2000.

In the case of the provisions relating to permitted ownership of securities of an issuer, special transition rules apply. The new rules forbidding a REIT to own more than 10 percent of the value of securities of a single issuer do not apply to a REIT with respect to securities held directly or indirectly by such REIT on July 12, 1999, or acquired pursuant to the terms of a written binding contract in effect on that date and at all times thereafter until the acquisition. Also, securities received in a tax-free exchange or reorganization, with respect to or in exchange for such grandfathered securities are grandfathered. This transition rule ceases to apply to securities of a corporation as of the first day after July 12, 1999 on which such corporation engages in a substantial new line of business, or acquires any substantial asset, other than pursuant to a binding contract in effect on such date and at all times thereafter, or in a reorganization or transaction in which gain or loss is not recognized by reason of section 1031 or 1033 of the Code. If a corporation makes an election to become a taxable REIT subsidiary, effective before January 1, 2004 and at a time when the REIT's ownership is grandfathered under these rules, the election is treated as a reorganization under section 368(a)(1)(A) of the Code.

B. Modify At-Risk Rules for Publicly Traded Nonrecourse Debt

(sec. 1161 of the bill and sec. 465(b)(6) of the Code)

PRESENT LAW

Present law provides an at-risk limitation on losses from business and income-producing activities, applicable to individuals and certain closely held corporations (sec. 465). Under the at-risk rules, a taxpayer generally is not considered at risk with respect to borrowed amounts if the taxpayer is not personally liable for repayment of the debt (e.g., nonrecourse loans), and in certain other circumstances.

In the case of the activity of holding real property, however, an exception is provided for qualified nonrecourse financing that is secured by real property used in the activity (sec. 465(b)(6)). The qualified nonrecourse financing rules require, among other things, that the financing be borrowed by the taxpayer from a qualified person or from certain governmental entities. For this purpose, a qualified person is one that is actively and regularly engaged in the business of lending money (and that is not a related person with respect to the taxpayer, is not a person from whom the taxpayer acquired the property or a related person, and is not a person that receives a fee with respect to the taxpayer's investment or a related person (sec. 49(a)(1)(D)(iv)). A related person is one with certain types of relationships to the taxpayer defined by statute (sec. 465(b)(3)(C)). The qualified nonrecourse financing rules also require that the financing be secured by real property used in the activity (sec. 465(b)(6)(A)).

REASONS FOR CHANGE

The Committee understands that the rule requiring that the financing be borrowed from a person that is actively and regularly engaged in the business of lending money hinders the use of publicly traded debt in real estate financing to which the at-risk rules apply, because absent restrictions on sale of the debt, the holders of publicly traded debt could be persons other than those who are actively and regularly engaged in the business of lending money (even though such persons are not related persons). In addition, the Committee understands that publicly traded debt may often be debt that is not mortgage debt and is not otherwise secured by real property used in the real estate activity. Nevertheless, the Committee is aware that seller financing and related-party financing can give rise to deduction shifting and overvaluation problems that the at-risk rules are designed to address. Thus, the Committee bill provides that qualified nonrecourse financing in the case of the activity of holding real property can include certain publicly traded debt that is not borrowed from a person who is actively and regularly engaged in the business of lending money, and that is not secured by property used in the real estate activity, so long as the present-law prohibitions against seller financing and related party financing continue to apply. In addition, to address concerns about shifting deductions among taxpayers through the use of relatively risky debt with a relatively high yield, which may tend to resemble an equity investment, the yield on the publicly traded debt under the provision is limited in the same manner as the yield under high-yield debt obligations under present law.

EXPLANATION OF PROVISION

The provision modifies the rules relating to qualified nonrecourse financing to provide that, in the case of an activity of holding real property, a taxpayer is considered at risk with respect to the taxpayer's share of certain financing that is not borrowed from a person that is regularly engaged in the business of lending money, and that is not secured by real property used in the activity, if the financing is qualified publicly traded debt.

The financing may not be borrowed from a person that is a related person with respect to the taxpayer, that is a person from whom the taxpayer acquired the property or a related person, or that is a person that receives a fee with respect to the taxpayer's investment or a related person.

Qualified publicly traded debt generally means any debt instrument that is readily tradable on an established securities market. However, qualified publicly traded debt does not include any debt instrument, the yield to maturity on which equals or exceeds the applicable Federal rate of interest for the calendar month in which it is issued, plus 5 percentage points. The applicable Federal rate is the rate determined under section 1274(d) with respect to the term of the debt instrument. Under the provision, it is intended that "readily tradable on an established securities market" have the same meaning as under section 453(f)(5).

EFFECTIVE DATE

The provision is effective for debt instruments issued after December 31, 1999.

C. Qualified Lessee Construction Allowances Not Limited to Short-term Leases for Certain Retailers

(sec. 1171 of the bill and sec. 110 of the Code)

PRESENT LAW

Section 110 provides that the gross income of a lessee does not include amounts received in cash (or treated as a rent reduction) from a lessor under a short-term lease of retail space for the purpose of the lessee's construction or improvement of qualified long-term real property for use in the lessee's trade or business at the retail space subject to the short-term lease. The exclusion only applies to the extent the allowance does not exceed the amount expended by the lessee on the construction or improvement of qualified long-term real property. For this purpose, "qualified long-term real property" means nonresidential real property that is part of, or otherwise present at, retail space used by the lessee and that reverts to the lessor at the termination of the lease. A "short-term lease" means a lease or other agreement for the occupancy or use of retail space for a term of 15 years or less (as determined pursuant to sec. 168(i)(3)). "Retail space" means real property leased, occupied, or otherwise used by the lessee in its trade or business of selling tangible personal property or services to the general public.

The lessor must treat the amounts expended on the construction allowance as nonresidential real property owned by the lessor. The Secretary is granted the authority to require reporting to ensure that both the lessor and lessee treat such amounts as nonresidential real property owned by the lessor.[2]

REASONS FOR CHANGE

The Committee is concerned that the present law limitation of section 110 to situations involving a short-term lease does not adequately reflect transactions between developers and retailers. The Committee believes that section 110 should be available in a transaction between a developer and a retailer without regard to the term of the lease.

EXPLANATION OF PROVISION

The provision eliminates the section 110 requirement that the lease be for a term of 15 years or less in the case of payment (or rent reduction) to a "qualified retail business." Payments by a lessor to such businesses for the purpose of constructing or improving long-term real property would not be included in the income of the lessee regardless of the term of the lease, provided the payments are used for such purpose.

For this purpose, a qualified retail business would be defined as a trade or business of selling tangible personal property to the general public. A trade or business will not fail to be considered a qualified retail business by reason of sales of services to the general public if such sales are incidental to the sale of tangible personal property (such as tailoring services provided incidental to the sale of a suit or dress) or are de minimis in amount. For this purpose, services would be considered de minimis in amount if they represent 10% or less of the gross receipts of the business at the retail space subject to the lease.

The provision does not eliminate the short-term lease requirement in all situations that are otherwise eligible for section 110 under present law. Section 110 presently applies (assuming the other standards are met) if the retail space of the lessee will be used in the trade or business of selling tangible personal property or services to the public. If the lessee will earn more than 10% of the gross receipts of the space from the sale of services (other than from services that are incidental to the sale of tangible personal property), section 110 will continue to be available only if the lease is for a term of 15 years or less.

EFFECTIVE DATE

The provision applies to leases entered into after December 31, 1999. No inference is intended as to the treatment of amounts that are not affected by the provision.

[2] Section 110 provides for regulations to be issued establishing the time and manner information must be provided the Secretary concerning amounts received (or treated as a rent reduction), amounts expended on qualified long-term real property, and such other information as the Secretary deems necessary to carry out the provision. These regulations have not yet been issued.

D. Exclusion From Gross Income for Certain Contributions to the Capital of Certain Retailers

(sec. 1172 of the bill and sec. 118 of the Code)

PRESENT LAW

Section 118 provides that gross income does not include any contribution to the capital of a corporation. The test for determining whether a particular payment is a contribution to capital is the intent or motive of the transferor. The contribution (1) must become a part of the recipient's capital structure; (2) may not be compensation for a "specific, quantifiable service"; (3) must be bargained for; (4) must result in a benefit to the recipient; and (5) ordinarily will contribute to the production of additional income. *United States* v. *Chicago, Burlington & Quincy R.R.*, 412 U.S. 401, 411, 93 S. Ct. 2169, 2175, 37 L. Ed. 2d 30 (1973).

Two appellate courts have applied section 118(a) to inducements paid by developers to retailers in exchange for the agreement of the retailers to "anchor" future shopping centers. *Federated Department Stores* v. *Commissioner* 51 TC 500 (1968), aff'd 426 F. 2d 417 (6th Cir., 1970), *May Department Stores Co.* v. *Commissioner*, 33 TCM 1128 (1974), aff'd 519 F. 2d 1154 (8th Cir., 1975). In both cases, the courts held that the benefits anticipated by the developer were speculative and intangible, and thus could not be considered in payment for any particular service.

The recipient taxpayer is allowed no basis in any property it receives as a contribution to capital, or an property it acquires within 12 months with the proceeds of a contribution to capital (sec. 362).

REASONS FOR CHANGE

The Committee agrees with the courts that inducements paid by developers to retailers in exchange for the agreement of the retailers to anchor future shopping centers may constitute nontaxable contributions to capital. The Committee believes that it is appropriate that a safeharbor be created to cover common situations that are expected to qualify as nontaxable contributions to capital under present law without requiring the taxpayer to prove the intent of the other party to the transaction. The Committee believes that the benefits of the safeharbor should be limited to amounts that would typically be treated as nontaxable contributions to capital under present law and that the safeharbor should not apply to any amount that may be falsely classified as a contribution in an attempt to abuse the provision.

EXPLANATION OF PROVISION

The provision establishes a safe harbor allowing certain inducements received by retailers to be treated as nontaxable contributions to capital. In order to qualify for the safe harbor, the inducement must be in exchange for the retailer's agreement to operate a qualified retail business at particular location for a period of at least 15 years. The retailer must, immediately after the receipt of the contribution, own the land and structures to be used by the taxpayer in carrying on the qualified retail business at the agreed location and must satisfy an expenditure rule.

The safe harbor does not apply if the contributor owns a beneficial interest in property located on the premises of the qualified retail business, other than de minimis amounts of property associated with the operation of adjacent property. For example, a developer may be the owner of the pipes and related equipment making up the water system of a shopping mall. Ownership of such property on premises owned by the retailer is expected to be considered de minimis and would not prevent the application of the safeharbor. On the other hand, ownership of more than a de minimis amount of assets or the ownership of assets disqualifies the inducement from safeharbor treatment. For example, if a developer owns and leases to a retailer the retailer's point of sale equipment, any inducement paid by the developer to the retailer will not qualify under the safeharbor as a nontaxable contribution to capital.[3] The rule applies to property owned by the developer on the premises of the retailer. The premises of the retailer is the area in which the retailer holds out personal property for sale to the general public. The premises of the retailer do not include adjacent space, such as a parking facility under the store which is owned and operated by the developer whose use is not limited to customers of the taxpayer. The rule also does not prevent the developer paying the inducement from owning a beneficial interest in the retailers, or joining in a joint venture with the retailer unless the joint venture involves ownership of property on the premises of the retailer that would prevent the use of the safeharbor if owned directly by the developer.

The expenditure rule requires that, prior to the end of the second taxable year after the year in the contribution was received, the retailer spend an amount equal to the amount of the contribution for the acquisition of land or structure, or for the acquisition or construction of other property to be used in the qualified retail business at the agreed location. Accurate records would be required to be kept that establish the satisfaction of the expenditure rule. It is not intended that the retailer be required to trace specific expenditures to the inducement.

A qualified retail business is defined as a trade or business of selling tangible personal property to the general public. A trade or business will not fail to be considered a qualified retail business by reason of sales of services to the general public if such sales are incidental to the sale of tangible personal property (such as tailoring services provided incidental to the sale of a suit or dress) or are de minimis in amount. For this purpose, services are considered de minimis in amount if they represent 10 percent or less of the gross receipts of the business at the retail space subject to the lease.

Anti-abuse rules are provided to prevent the use of the safeharbor for amounts that are not intended by the parties as contributions to capital. The Secretary is authorized to allocate income and deductions, or to reduce the amount of any contribution to capital under the safeharbor, in cases in which it is established that above market rates have been paid from the retailer to the devel-

[3] Ownership of property on the premises of the retailer by the developer does not automatically prevent an inducement from qualifying as a nontaxable contribution to capital under section 118(a), provided the taxpayer can establish the facts required for that provision to apply.

oper in another transaction. A rate is not expected to be considered to be above market if it is the same on a square footage basis as the rate charged other retailers at the same location. For example, a developer charges all retailers in the mall a common area maintenance charge. If this charge is equal to a standard rate times the square footage of each store in the mall, it will not be considered to be an above market rate with respect to any single retailer.

The Secretary is also authorized to allocate income and deductions, or reduce the amount of any contribution to capital, to the extent necessary to prevent the abuse of the purposes of this section where the transaction takes place between related parties. It is expected that this authority will be used to prevent the conversion of nondepreciable or longer lived property into costs that may be recovered over a shorter period of time. For example, if a retailer who owns a piece of land contributes that land to a joint venture and then accept the land from the joint venture as an inducement to operate a retail facility for 20 years an anchor for a new mall, it is expected that the Secretary will use its authority to reduce the amount of any contribution to capital in a transaction between related parties to prevent the application of the safeharbor. However, it is not intended that the authority to will be used simply because the retailer and a related party engage in transactions that are concluded on an arm's-length basis and do not result in the conversion of nondepreciable or longer lived assets into costs that may be recovered over a shorter period of time.

The provision does not limit the application of section 118(a) of present law. No inference is intended as to whether any payment constitutes a nontaxable contribution to capital under section 118(a) whether or not such payment qualifies for the safeharbor provided by this provision.

EFFECTIVE DATE

The provision is effective for contributions received after December 31, 1999.

TITLE XII. PENSION REFORM PROVISIONS

A. EXPANDING COVERAGE

1. Increase contribution and benefit limits (sec. 1201 of the bill and secs. 401(a)(17), 402(g), 408(p), 415 and 457 of the Code)

PRESENT LAW

In general

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415), the amount of compensation that may be taken into account under a plan for determining benefits (sec. 401(a)(17)), the maximum amount of elective deferrals that an individual may make to a salary reduction plan or tax sheltered annuity (sec. 402(g)), and deferrals under an eligible deferred compensation plan of a tax-exempt organization or a State or local government (sec. 457).

Limitations on contributions and benefits

Under present law, the limits on contributions and benefits under qualified plans are based on the type of plan. Under a defined contribution plan, the qualification rules limit the annual additions to the plan with respect to each plan participant to the lesser of (1) 25 percent of compensation or (2) $30,000 (for 1999). Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. The $30,000 limit is indexed for cost-of-living adjustments in $5,000 increments.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation, or (2) $130,000 (for 1999). The dollar limit is adjusted for cost-of-living increases in $5,000 increments.

Under present law, in general, the dollar limit on annual benefits is reduced if benefits under the plan begin before the social security retirement age (currently, age 65) and increased if benefits begin after social security retirement age.[4]

Compensation limitation

Under present law, the annual compensation of each participant that may be taken into account for purposes of determining contributions and benefits under a plan, applying the deduction rules, and for nondiscrimination testing purposes is limited to $160,000 (for 1999). The compensation limit is indexed for cost-of-living adjustments in $10,000 increments.

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "section 401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,000 (for 1999). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,000. These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,000 (for 1999) or (2) 33⅓ percent of compensation. The $8,000 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the other-

[4] An overall limit applies if a participant participates in a defined contribution plan and a defined benefit plan maintained by the same employer (sec. 415(e)). This limit is repealed for years beginning after December 31, 1999.

wise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

REASONS FOR CHANGE

The tax benefits provided under qualified plans are a departure from the normally applicable income tax rules. The special tax benefits for qualified plans are generally justified on the ground that they serve an important social policy objective, i.e., the provision of retirement benefits to a broad group of employees. The limits on contributions and benefits, elective deferrals, and compensation that may be taken into account under a qualified plan all serve to limit the tax benefits associated with such plans. The level at which to place such limits involves a balancing of different policy objectives and a judgment as to what limits are most likely to best further policy goals.

One of the factors that may influence the decision of an employer, particularly a small employer, to adopt a plan is the extent to which the owners of the business, the decision-makers, or other highly compensated employees will benefit under the plan. The Committee believes that increasing the dollar limits on qualified plan contributions and benefits will encourage employers to establish qualified plans for their employees.

The Committee understands that, in recent years, section 401(k) plans have become increasingly more prevalent. The Committee believes it is important to increase the amount of employee elective deferrals allowed under such plans, and other plans that allow deferrals, to better enable plan participants to save for their retirement.

EXPLANATION OF PROVISION

Limits on contributions and benefits

The provision increases the $30,000 annual addition limit for defined contribution plans to $40,000. This amount is indexed in $1,000 increments.[5]

The provision increases the $130,000 annual benefit limit under a defined benefit plan to $160,000. The dollar limit is reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.

Compensation limitation

The provision increases the limit on compensation that may be taken into account under a plan to $200,000. This amount is indexed in $5,000 increments.

Elective deferral limitations

Beginning in 2001, the provision increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs in $1,000 annual increments until the limits reach $15,000 in 2005. Beginning in 2001, the provision increases the maximum annual elective deferrals that may

[5] The 25 percent of compensation limitation is increased to 100 percent of compensation under another provision of the bill.

be made to a SIMPLE plan in $1,000 annual increments until the limit reaches $10,000 in 2004. The $15,000 and $10,000 limits are indexed in $500 increments, as under present law.

Section 457 plans

The provision increases the dollar limit on deferrals under a section 457 plan to conform to the elective deferral limitation. Thus, the limit is $11,000 in 2001, and is increased in $1,000 annual increments until the limit reaches $15,000 in 2005. The limit is indexed thereafter in $500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.[6]

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement.

2. Plan loans for subchapter S shareholders, partners, and sole proprietors (sec. 1202 of the bill and sec. 4975 of the Code)

PRESENT LAW

The Internal Revenue Code prohibits certain transactions ("prohibited transactions") between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan participants and beneficiaries.[7] Certain types of transactions are exempted from the prohibited transaction rules, including loans from the plan to plan participants, if certain requirements are satisfied. In addition, the Department of Labor can grant an administrative exemption from the prohibited transaction rules if she finds the exemption is administratively feasible, in the interest of the plan and plan participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan. Pursuant to this exemption process, the Secretary of Labor grants exemptions both with respect to specific transactions and classes of transactions.

The statutory exemptions to the prohibited transaction rules do not apply to certain transactions in which the plan makes a loan to an owner-employee.[8] Loans to participants other than owner-employees are permitted if loans are available to all participants on a reasonably equivalent basis, are not made available to highly compensated employees in an amount greater than made available to other employees, are made in accordance with specific provisions in the plan, bear a reasonable rate of interest, and are adequately secured. In addition, the Code places limits on the amount of loans and repayment terms.

For purposes of the prohibited transaction rules, an owner-employee means (1) a sole proprietor, (2) a partner who owns more than 10 percent of either the capital interest or the profits interest in the partnership, (3) an employee or officer of a Subchapter S cor-

[6] Another provision of the bill increases the 33⅓ percentage of compensation limit to 100 percent.

[7] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), also contains prohibited transaction rules. The Code and ERISA provisions are substantially similar, although not identical.

[8] Certain transactions involving a plan and Subchapter S shareholders are permitted.

poration who owns more than 5 percent of the outstanding stock of the corporation, and (4) the owner of an individual retirement arrangement ("IRA"). The term owner-employee also includes certain family members of an owner-employee and certain corporations owned by an owner-employee.

Under the Internal Revenue Code, a two-tier excise tax is imposed on disqualified persons who engage in a prohibited transaction. The first level tax is equal to 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period, and is equal to 100 percent of the amount involved.

REASONS FOR CHANGE

The Committee believes that the present-law prohibited transaction rules regarding loans unfairly discriminate against the owners of unincorporated businesses and subchapter S corporations. For example, under present law, the sole shareholder of a C corporation may take advantage of the statutory exemption to the prohibited transaction rules for loans, but an individual who does business as a sole proprietor may not.

EXPLANATION OF PROVISION

The provision generally eliminates the special present-law rules relating to plan loans made to an owner-employee. Thus, the general statutory exemption applies to such transactions. Present law continues to apply with respect to IRAs.

EFFECTIVE DATE

The provision is effective with respect to loans made after December 31, 2000.

3. Modification of top-heavy rules (sec. 1203 of the bill and sec. 416 of the Code)

PRESENT LAW

In general

Under present law, additional qualification requirements apply to plans that primarily benefit an employer's key employees ("top-heavy plans"). These additional requirements provide (1) more rapid vesting for plan participants who are non-key employers and (2) minimum nonintegrated employer contributions or benefits for plan participants who are non-key employees.

Definition of top-heavy plan

In general, a top-heavy plan is a plan under which more than 60 percent of the contributions or benefits are provided to key employees. More precisely, a defined benefit plan is a top-heavy plan if more than 60 percent of the cumulative accrued benefits under the plan are for key employees. A defined contribution plan is top heavy if the sum of the account balances of key employees is more than 60 percent of the total account balances under the plan. For each plan year, the determination of top-heavy status generally is made as of the last day of the preceding plan year ("the determination date").

For purposes of determining whether a plan is a top-heavy plan, benefits derived both from employer and employee contributions, including employee elective contributions, are taken into account. In addition, the accrued benefit of a participant in a defined benefit plan and the account balance of a participant in a defined contribution plan includes any amount distributed within the 5–year period ending on the determination date.

An individual's accrued benefit or account balance is not taken into account in determining whether a plan is top-heavy if the individual has not performed services for the employer during the 5-year period ending on the determination date.

In some cases, two or more plans of a single employer must be aggregated for purposes of determining whether the group of plans is top-heavy. The following plans must be aggregated: (1) plans which cover a key employee (including collectively bargained plans); and (2) any plan upon which a plan covering a key employee depends for purposes of satisfying the Code's nondiscrimination rules. The employer may be required to include terminated plans in the required aggregation group. In some circumstances, an employer may elect to aggregate plans for purposes of determining whether they are top heavy.

SIMPLE plans are not subject to the top-heavy rules.

Definition of key employee

A key employee is an employee who, during the plan year that ends on the determination date or any of the 4 preceding plan years, is (1) an officer earning over one-half of the defined benefit plan dollar limitation of section 415 ($65,000 for 1999), (2) a 5-percent owner of the employer, (3) a 1-percent owner of the employer earning over $150,000, or (4) one of the 10 employees earning more than the defined contribution plan dollar limit ($30,000 for 1999) with the largest ownership interests in the employer.

Minimum benefit for non-key employees

A minimum benefit generally must be provided to all non-key employees in a top-heavy plan. In general, a top-heavy defined benefit plan must provide a minimum benefit equal to the lesser of (1) 2 percent of compensation multiplied by the employee's years of service, or (2) 20 percent of compensation. A top-heavy defined contribution plan must provide a minimum annual contribution equal to the lesser of (1) 3 percent of compensation, or (2) the percentage of compensation at which contributions were made for key employees (including employee elective contributions made by key employees and employer matching contributions).

For purposes of the minimum benefit rules, only benefits derived from employer contributions (other than amounts employees have elected to defer) to the plan are taken into account, and an employee's social security benefits are disregarded (i.e., the minimum benefit is nonintegrated). Employer matching contributions may be used to satisfy the minimum contribution requirement; however, in such a case the contributions are not treated as matching contributions for purposes of applying the special nondiscrimination requirements applicable to employee elective contributions and matching contributions under sections 401 (k) and (m). Thus, such contributions would have to meet the general nondiscrimination test of section 401(a)(4).[9]

Top-heavy vesting

Benefits under a top-heavy plan must vest at least as rapidly as under one of the following schedules: (1) 3-year cliff vesting, which provides for 100 percent vesting after 3 years of service; and (2) 2–6 year graduated vesting, which provides for 20 percent vesting after 2 years of service, and 20 percent more each year thereafter so that a participant is fully vested after 6 years of service.[10]

Qualified cash or deferred arrangements

Under a qualified cash or deferred arrangement (a "section 401(k) plan"), an employee may elect to have the employer make payments as contributions to a qualified plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. A special nondiscrimination test applies to elective deferrals under cash or deferred arrangements, which compares the elective deferrals of highly compensated employees with elective deferrals of nonhighly compensated employees. (This test is called the actual deferral percentage test or the "ADP" test.) Employer matching contributions under qualified defined contribution plans are also subject to a similar nondiscrimination test. (This test is called the actual contribution percentage test or the "ACP" test.)

Under a design-based safe harbor, a cash or deferred arrangement is deemed to satisfy the ADP test if the plan satisfies one of two contribution requirements and satisfies a notice requirement. A plan satisfies the contribution requirement under the safe harbor rule for qualified cash or deferred arrangements if the employer either (1) satisfies a matching contribution requirement or (2) makes a nonelective contribution to a defined contribution plan of at least 3 percent of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the arrangement without regard to the permitted disparity rules (sec. 401(l)). A plan satisfies the matching contribution requirement if, under the arrangement: (1) the employer makes a matching contribution on behalf of each nonhighly compensated employee that is equal to (a) 100 percent of the employee's elective deferrals up to 3 percent of compensation and (b) 50 percent of the employee's elective deferrals from 3 to 5 percent of compensation; and (2), the rate of match with respect to any elective contribution for highly compensated employees is not greater than the rate of match for nonhighly compensated employees. Matching contributions that satisfy the design-based safe harbor for cash or deferred arrangements are deemed to satisfy the ACP test. Certain additional matching contributions are also deemed to satisfy the ACP test.

[9] Tres. Reg. sec. 1.416–1 Q&A M–19.

[10] Benefits under a plan that is not top heavy must vest at least as rapidly as under one of the following schedules: (1) 5-year cliff vesting; and (2) 3–7 year graded vesting, which provides for 20 percent vesting after 3 years and 20 percent more each year thereafter so that a participant is fully vested after 7 years of service.

REASONS FOR CHANGE

The top-heavy rules primarily affect the plans of small employers. While the top-heavy rules were intended to provide additional minimum benefits to rank-and-file employees, the Committee is concerned that in some cases the top-heavy rules may act as a deterrent to the establishment of a plan by a small employer. The Committee believes that simplification of the top-heavy rules will help alleviate the additional administrative burdens the rules place on small employers. The Committee also believes that, in applying the top-heavy minimum benefit rules, the employer should receive credit for all contributions the employer makes, including matching contributions.

The Committee understands that some employers may have been discouraged from adopting a safe harbor section 401(k) plan due to concerns about the top-heavy rules. The Committee believes that facilitating the adoption of such plans will broaden coverage. Thus, the Committee believes it appropriate to provide that such plans are not subject to the top-heavy rules.

EXPLANATION OF PROVISION

Definition of top-heavy plan

The provision provides that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan. Matching or nonelective contributions provided under such a plan may be taken into account in satisfying the minimum contribution requirements applicable to top-heavy plans.[11]

In determining whether a plan is top-heavy, the provision provides that distributions during the year ending on the date the top-heavy determination is being made are taken into account. The present-law 5-year rule applies with respect to in-service distributions. Similarly, the provision provides that an individual's accrued benefit or account balance is not taken into account if the individual has not performed services for the employer during the 1-year period ending on the date the top-heavy determination is being made.

Definition of key employee

The provision (1) provides that an employee is not considered a key employee by reason of officer status unless the employee earns more than $150,000 in compensation for the year, and (2) repeals the top-10 owner key employee category.

The provision repeals the 4-year lookback rule for determining key employee status and provides that an employee is a key employee only if he or she is a key employee during the current plan year.

[11] This provision is not intended to preclude the use of nonelective contributions that are used to satisfy the safe harbor rules from being used to satisfy other qualified retirement plan nondiscrimination rules, including those involving cross-testing.

Minimum benefit for non-key employees

Under the provision, matching contributions are taken into account in determining whether the minimum benefit requirement has been satisfied.[12]

The provision provides that, in determining the minimum benefit required under a defined benefit plan, a year of service does not include any year in which no employee benefits under the plan (as determined under sec. 410).

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

4. Elective deferrals not taken into account for purposes of deduction limits (sec. 1204 of the bill and sec. 404 of the Code)

PRESENT LAW

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

For purposes of the deduction limits, employee elective deferral contributions to a section 401(k) plan are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.

Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

REASONS FOR CHANGE

Subjecting elective deferrals to the normally applicable deduction limits may cause employers to restrict the amount of elective contributions an employee may make or to restrict employer contributions to the plan, thereby reducing participants' ultimate retire-

[12] Thus, this provision overrides the provision in Treasury regulations that, if matching contributions are used to satisfy the minimum benefit requirement, then they are not treated as matching contributions for purposes of the section 401(m) nondiscrimination rules.

ment benefits and their ability to save adequately for retirement. The Committee believes that the amount of elective deferrals otherwise allowable should not be further limited through application of the deduction rules.

EXPLANATION OF PROVISION

Under the provision, elective deferral contributions are not subject to the deduction limits, and the application of a deduction limitation to any other employer contribution to a qualified retirement plan does not take into account elective deferral contributions.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

5. Reduced PBGC premiums for small and new plans (secs. 1205 and 1206 of the bill and sec. 4006 of ERISA)

PRESENT LAW

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaranteeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay benefits promised under the plan. The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. The amount of the required annual PBGC premium for a single-employer plan is generally a flat rate premium of $19 per participant and an additional variable rate premium based on a charge of $9 per $1,000 of unfunded vested benefits. Unfunded vested benefits under a plan generally means (1) the unfunded current liability for vested benefits under the plan, over (2) the value of the plan's assets, reduced by any credit balance in the funding standard account. No variable rate premium is imposed for a year if contributions to the plan were at least equal to the full funding limit.

The PBGC guarantee is phased in ratably in the case of plans that have been in effect for less than 5 years, and with respect to benefit increases from a plan amendment that was in effect for less than 5 years before termination of the plan.

REASONS FOR CHANGE

The Committee believes that reducing the PBGC premiums for new and small plans will help encourage the establishment of defined benefit pension plans.

EXPLANATION OF PROVISION

Reduced flat-rate premiums for new plans of small employers

Under the provision, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium is $5 per plan participant.

A small employer is a contributing sponsor that, on the first day of the plan year, has 100 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

A new plan means a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) has not established or maintained a plan subject to PBGC coverage with respect to which benefits were accrued for substantially the same employees as are in the new plan.

Reduced variable PBGC premium for new and small employer plans

The provision provides that the variable premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable premium is a percentage of the variable premium otherwise due, as follows: 0 percent of the otherwise applicable variable premium in the first plan year; 20 percent in the second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan is defined as under the flat-rate premium provision relating to new small employer plans.

The provision also provides that, in the case of any plan (not just a new plan) of an employer with 25 or fewer employees, the variable-rate premium is no more than $5 multiplied by the number of plan participants in the plan at the close of the preceding year.

EFFECTIVE DATE

The provisions relating to new plans are effective for plans established after December 31, 2000. The provision reducing the PBGC variable premium for small plans is effective for years beginning after December 31, 2000.

6. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations (sec. 1207 of the bill and sec. 457 of the Code)

PRESENT LAW

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local government employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,000 (in 1999) or (2) 33⅓ percent of compensation. The $8,000 limit is increased for inflation in $500 increments. Under a special catch-up rule, a section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

The $8,000 limit (as modified under the catch-up rule), applies to all deferrals under all section 457 plans in which the individual participates. In addition, in applying the $8,000 limit, contributions under a tax-sheltered annuity ("section 403(b) annuity"), elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), salary reduction contributions under a simplified employee pension plan ("SEP"), and contributions under a SIMPLE plan are taken into account. Further, the amount deferred under a section 457 plan is taken into account in applying a special catch-up rule for section 403(b) annuities.

REASONS FOR CHANGE

The Committee believes that individuals participating in a section 457 plan should also be able to fully participate in a section 403(b) annuity or section 401(k) plan of the employer. Eliminating the coordination rule may also encourage the establishment of section 403(b) or 401(k) plans by tax-exempt and governmental employers (as permitted under present law).

EXPLANATION OF PROVISION

The provision repeals the rules coordinating the section 457 dollar limit with contributions under other types of plans.[13]

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

7. Eliminate IRS user fees for determination letter requests regarding small employer plans (sec. 1208 of the bill and sec. 7527 of the Code)

PRESENT LAW

An employer that maintains a retirement plan for the benefit of its employees may request from the Internal Revenue Service ("IRS") a determination as to whether the form of the plan satisfies the requirements applicable to tax-qualified plans (sec. 401(a)). In order to obtain from the IRS a determination letter on the qualified status of the plan, the employer must pay a user fee. The user fee may range from $125 to $1,250, depending upon the scope of the request and the type and format of the plan.[14]

REASONS FOR CHANGE

One of the factors affecting the decision of a small employer to adopt a plan is the level of administrative costs associated with the plan. The Committee believes that reducing administrative costs, such as IRS user fees, will help further the establishment of qualified plans by small employers.

[13] The limits on deferrals under a section 457 plan are modified under other provisions of the bill.

[14] User fees are statutorily authorized; however, the IRS sets the dollar amount of the fee applicable to any particular type of request.

EXPLANATION OF PROVISION

A small employer (100 or fewer employees) is not required to pay a user fee for any determination letter with respect to the qualified status of a retirement plan that the employer maintains. The provision applies only to requests by employers for determination letters concerning the qualified retirement plans they maintain. Therefore, a sponsor of a prototype plan is required to pay a user fee for a request for a notification letter, opinion letter, or similar ruling. A small employer that adopts a prototype plan, however, is not required to pay a user fee for a determination letter request with respect to the employer's plan.

EFFECTIVE DATE

The provision is effective for determination letter requests made after December 31, 2000.

8. Definition of compensation for purposes of deduction limits (sec. 1209 of the bill and sec. 404 of the Code)

PRESENT LAW

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan. Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In some cases, the amount of deductible contributions is limited by compensation. In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

In the case of an employee stock ownership plan ("ESOP"), principal payments on a loan used to acquire qualifying employer securities are deductible up to 25 percent of compensation.

For purposes of the deduction limits, employee elective deferral contributions to a qualified cash or deferred arrangement ("section 401(k) plan") are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.[15]

[15] Another provision in the bill provides that elective deferrals are not subject to the deduction limits.

For purposes of the deduction limits, compensation means the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plan, and the beneficiaries under a profit-sharing or stock bonus plan are the employees who benefit under the plan with respect to the employer's contribution.[16] An employee who is eligible to make elective deferrals under a section 401(k) plan is treated as benefitting under the arrangement even if the employee elects not to defer.[17]

For purposes of the deduction rules, compensation generally includes only taxable compensation, and thus does not include salary reduction amounts, such as elective deferrals under a section 401(k) plan or a tax-sheltered annuity ("section 403(b) annuity"), elective contributions under a deferred compensation plan of a tax-exempt organization or a State or local government ("section 457 plan"), and salary reduction contributions under a section 125 cafeteria plan. For purposes of the contribution limits under section 415, compensation does include such salary reduction amounts.

REASONS FOR CHANGE

The Committee believes that compensation unreduced by employee elective contributions is a more appropriate measure of compensation for plan purposes, including deduction limits, than the present-law rule. Applying the same definition for deduction purposes as is generally used for other qualified plan purposes will also simplify application of the qualified plan rules.

EXPLANATION OF PROVISION

Under the provision, the definition of compensation for purposes of the deduction rules includes salary reduction amounts treated as compensation under section 415.[18]

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

9. Option to treat elective deferrals as after-tax contributions (sec. 1210 of the bill and new sec. 402A of the Code)

PRESENT LAW

A qualified cash or deferred arrangement ("section 401(k) plan") or a tax-sheltered annuity ("section 403(b) annuity") may permit a participant to elect to have the employer make payments as contributions to the plan or to the participant directly in cash. Contributions made to the plan at the election of a participant are elective deferrals. Elective deferrals must be nonforfeitable and are subject to an annual dollar limitation (sec. 402(g)) and distribution restrictions. In addition, elective deferrals under a section 401(k) plan are subject to special nondiscrimination rules. Elective defer-

[16] Rev. Rul. 65–295, 1965–2 C.B. 148.
[17] Treas. Reg. sec. 1.410(b)–3.
[18] A technical correction in the bill expands the salary reduction amounts treated as compensation under section 415 to include amounts used to purchase qualified transportation benefits (under sec. 132(f)).

rals (and earnings attributable thereto) are not includable in a participant's gross income until distributed from the plan.

Individuals with adjusted gross income below certain levels generally may make nondeductible contributions to a Roth IRA and may convert a deductible or nondeductible IRA into a Roth IRA. Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includable in income, nor subject to the additional 10–percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, is made on account of death or disability, or is a qualified special purpose distribution (i.e., for first-time homebuyer expenses of up to $10,000). A distribution from a Roth IRA that is not a qualified distribution is includable in income to the extent attributable to earnings, and is subject to the 10-percent tax on early withdrawals (unless an exception applies).[19]

REASONS FOR CHANGE

The recently-enacted Roth IRA provisions have provided individuals with another form of tax-favored retirement savings. For a variety of reasons, some individuals may prefer to save through a Roth IRA rather than a traditional deductible IRA. The Committee believes that similar savings choices should be available to participants in section 401(k) plans and tax-sheltered annuities.

EXPLANATION OF PROVISION

A section 401(k) plan or a section 403(b) annuity is permitted to include a "qualified plus contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as designated plus contributions. Designated plus contributions are elective deferrals that the participant designates as not excludable from the participant's gross income.

The annual dollar limitation on a participant's designated plus contributions is the section 402(g) annual limitation on elective deferrals, reduced by the participant's elective deferrals that the participant does not designate as designated plus contributions. Designated plus contributions are treated as any other elective deferral for purposes of nonforfeitability requirements and distribution restrictions. Under a section 401(k) plan, designated plus contributions also are treated as any other elective deferral for purposes of the special nondiscrimination requirements.

The plan is required to establish a separate account, and maintain separate recordkeeping, for a participant's designated plus contributions (and earnings allocable thereto). A qualified distribution from a participant's designated plus contributions account is not includable in the participant's gross income. A qualified distribution is a distribution that is made after the end of a specified nonexclusion period and that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary

[19] Early distributions of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4–year rule applicable to 1998 conversions.

(or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled.[20] The nonexclusion period is the 5-year-taxable period beginning with the earlier of (1) the first taxable year for which the participant made a designated plus contribution to any designated plus contribution account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated plus contribution account that is the source of the distribution from a designated plus contribution account established for the participant under another plan, the first taxable year for which the participant made a designated plus contribution to the previously established account.

A distribution from a designated plus contributions account that is a corrective distribution of an elective deferral (and income allocable thereto) that exceeds the section 402(g) annual limit on elective deferrals is not a qualified distribution.

A participant is permitted to roll over a distribution from a designated plus contributions account only to another designated plus contributions account or a Roth IRA of the participant.

The Secretary of the Treasury is directed to require the plan administrator of each section 401(k) plan or section 403(b) annuity that permits participants to make designated plus contributions to make such returns and reports regarding designated plus contributions to the Secretary, plan participants and beneficiaries, and other persons that the Secretary may designate.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

10. Increase minimum benefit under defined benefit plans (sec. 1211 of the bill and sec. 415 of the Code)

PRESENT LAW

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of the participant's compensation, or (2) $130,000 (for 1999).[21] Payment of a minimum annual benefit is permitted even if the benefit exceeds the normally applicable benefit limitations. Thus, the limits on benefits are deemed to be satisfied if the aggregate annual retirement benefit of a participant under all defined benefit pension plans of the employer does not exceed $10,000 and the participant has not participated in a defined contribution plan of the employer. The $10,000 limit is reduced for participants with less than 10 years of service with the employer.

REASONS FOR CHANGE

The present-law minimum benefit amount has not been increased since its enactment. The Committee believes that increasing the minimum benefit amount is appropriate because doing so

[20] A qualified special purpose distribution, as defined under the rules relating to Roth IRAs, does not qualify as a tax-free distribution from a designated plus contributions account.

[21] Another provision of the bill increases the dollar limit on the annual benefit under a defined benefit plan.

will increase benefits for certain workers, particularly lower-paid, longer service employees.

EXPLANATION OF PROVISION

Under the provision, beginning in 2001, the minimum annual benefit permitted under a defined benefit plan is increased in $10,000 annual increments until the minimum benefit amount reaches $40,000 in 2003. The $40,000 amount is not indexed. In addition, a participant is entitled to the minimum benefit even if the participant had participated in a defined contribution plan of the employer.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

B. Enhancing Fairness for Women

1. Additional salary reduction catch-up contributions (sec. 1221 of the bill and secs. 402(g), 408(p), and 457 of the Code)

PRESENT LAW

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,000 (for 1999). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,000. These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,000 (for 1999) or (2) 33⅓ percent of compensation. The $8,000 limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

REASONS FOR CHANGE

Although the Committee believes that individuals should be saving for retirement throughout their working lives, as a practical matter, many individuals simply do not focus on the amount of retirement savings they need until they near retirement. In addition, many individuals may have difficulty saving more in earlier years, e.g., because an employee leaves the workplace to care for a family. Some individuals may have a greater ability to save as they near retirement.

The Committee believes that the pension laws should assist individuals who are nearing retirement to save more for their retirement.

EXPLANATION OF PROVISION

The provision provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, or SIMPLE, or deferrals under a section 457 plan are increased for individuals who have attained age 50 by the end of the year.[22] The otherwise applicable dollar limit is increased by $1,000 in each year beginning in 2001 until the amount of the increase is $5,000 in 2005. Thereafter, the $5,000 limit is indexed for inflation in $500 increments. In the case of section 457 plans, this catch-up rule does not apply during the participant's last 3 years before retirement (in those years, the regularly applicable dollar limit is doubled).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

2. Equitable treatment for contributions of employees to defined contribution plans (sec. 1222 of the bill and secs. 403(b), 415, and 457 of the Code)

PRESENT LAW

Present law imposes limits on the contributions that may be made to tax-favored retirement plans.

Defined contribution plans

In the case of a tax-qualified defined contribution plan, the limit on annual additions that can be made to the plan on behalf of an employee is the lesser of $30,000 (for 1999) or 25 percent of the employee's compensation (sec. 415(c)). Annual additions include employer contributions, including contributions made at the election of the employee (i.e., employee elective deferrals), after-tax employee contributions, and any forfeitures allocated to the employee. For this purpose, compensation means taxable compensation of the employee, plus elective deferrals, and similar salary reduction contributions.

Tax-sheltered annuities

In the case of a tax-sheltered annuity (a "section 403(b) annuity"), the annual contribution generally cannot exceed the lesser of the exclusion allowance or the section 415(c) defined contribution limit. The exclusion allowance for a year is equal to 20 percent of

[22] Another provision in the bill increases the dollar limit on elective deferrals under such arrangements.

the employee's includible compensation, multiplied by the employee's years of service, minus excludable contributions for prior years under qualified plans, tax-sheltered annuities or section 457 plans of the employer.

In addition to this general rule, employees of nonprofit educational institutions, hospitals, home health service agencies, health and welfare service agencies, and churches may elect application of one of several special rules that increase the amount of the otherwise permitted contributions. The election of a special rule is irrevocable; an employee may not elect to have more than one special rule apply.

Under one special rule, in the year the employee separates from service, the employee may elect to contribute up to the exclusion allowance, without regard to the 25 percent of compensation limit under section 415. Under this rule, the exclusion allowance is determined by taking into account no more than 10 years of service.

Under a second special rule, the employee may contribute up to the lesser of: (1) the exclusion allowance; (2) 25 percent of the participant's includible compensation; or (3) $15,000.

Under a third special rule, the employee may elect to contribute up to the section 415(c) limit, without regard to the exclusion allowance. If this option is elected, then contributions to other plans of the employer are also taken into account in applying the limit.

For purposes of determining the contribution limits applicable to section 403(b) annuities, includible compensation means the amount of compensation received from the employer for the most recent period which may be counted as a year of service under the exclusion allowance. In addition, includible compensation includes elective deferrals and similar salary reduction amounts.

Section 457 plans

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local governmental employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,000 (in 1999) or (2) 33⅓ percent of compensation. The $8,000 limit is increased for inflation in $500 increments.

REASONS FOR CHANGE

The present-law rules that limit contributions to defined contribution plans by a percentage of compensation reduce the amount that lower- and middle-income workers can save for retirement. The present-law limits may not allow such workers to accumulate adequate retirement benefits, particularly if a defined contribution plan is the only type of retirement plan maintained by the employer.

Conforming the contribution limits for tax-sheltered annuities to the limits applicable to retirement plans will simplify the administration of the pension laws, and provide more equitable treatment for participants in similar types of plans.

EXPLANATION OF PROVISION

Increase in defined contribution plan limit

The provision increases the 25 percent of compensation limitation on annual additions under a defined contribution plan to 100 percent.[23]

Conforming limits on tax-sheltered annuities

The provision repeals the exclusion allowance applicable to contributions to tax-sheltered annuities. Thus, such annuities are subject to the limits applicable to tax-qualified plans.

Section 457 plans

The provision increases the 33⅓ percent of compensation limitation on deferrals under a section 457 plan to 100 percent of compensation.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

3. Faster vesting of employer matching contributions (sec. 1223 of the bill and sec. 411 of the Code)

PRESENT LAW

Under present law, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of 5 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after 3 years of service, 40 percent after 4 years of service, 60 percent after 5 years of service, 80 percent after 6 years of service, and 100 percent after 7 years of service.[24]

REASONS FOR CHANGE

The Committee understands that many employees, particularly lower- and middle-income employees, do not take full advantage of the retirement savings opportunities provided by their employer's section 401(k) plan. The Committee believes that providing faster vesting for matching contributions will make section 401(k) plans more attractive for employees, particularly lower- and middle-income employees, and will encourage employees to save more for their own retirement. In addition, faster vesting for matching contributions will enable short-service employees to accumulate greater retirement savings.

[23] Another provision of the bill increases the defined contribution plan dollar limit.
[24] The minimum vesting requirements are also contained in Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

EXPLANATION OF PROVISION

The provision applies faster vesting schedules to employer matching contributions. Under the provision, employer matching contributions have to vest at least as rapidly as under one of the following two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of employer matching contributions upon the completion of 3 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of employer matching contributions for each year of service beginning with the participant's second year of service and ending with 100 percent after 6 years of service.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. The provision does not apply to any employee until the employee has an hour of service after the effective date. In applying the new vesting schedule, service before the effective date is taken into account.

4. Simplify and update the minimum distribution rules (secs. 1224 and 1239 of the bill and secs. 401(a)(9) and 457 of the Code)

PRESENT LAW

In general

Minimum distribution rules apply to all types of tax-favored retirement vehicles, including qualified plans, individual retirement arrangements ("IRAs"), tax-sheltered annuities ("section 403(b) annuities"), and eligible deferred compensation plans of tax-exempt and State and local government employers ("section 457 plans"). In general, under these rules, distribution of minimum benefits must begin no later than the required beginning date. Minimum distribution rules also apply to benefits payable with respect to a plan participant who has died. Failure to comply with the minimum distribution rules results in an excise tax imposed on the individual plan participant equal to 50 percent of the required minimum distribution not distributed for the year. The excise tax can be waived if the individual establishes to the satisfaction of the Secretary that the shortfall in the amount distributed was due to reasonable error and reasonable steps are being taken to remedy the shortfall.

Distributions prior to the death of the individual

In the case of distributions prior to the death of the plan participant, the minimum distribution rules are satisfied if either (1) the participant's entire interest in the plan is distributed by the required beginning date, or (2) the participant's interest in the plan is to be distributed (in accordance with regulations), beginning not later than the required beginning date, over a permissible period. The permissible periods are (1) the life of the participant, (2) the lives of the participant and a designated beneficiary, (3) the life expectancy of the participant, or (4) the joint life and last survivor expectancy of the participant and a designated beneficiary. In calculating minimum required distributions, life expectancies of the participant and the participant's spouse may be recomputed annually.

In the case of qualified plans, tax-sheltered annuities, and section 457 plans, the required beginning date is the April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, in the case of a 5–percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the 5–percent owner attains age 70½. If commencement of benefits is delayed beyond age 70½ from a defined benefit plan, then the accrued benefit of the employee must be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan.[25] In the case of distributions from an IRA other than a Roth IRA, the required beginning date is the April 1 following the calendar year in which the IRA owner attains age 70½. The pre-death minimum distribution rules do not apply to Roth IRAs.

In general, under proposed regulations, in order to satisfy the minimum distribution rules, annuity payments under a defined benefit plan must be paid in period payments made at intervals not longer than one year over a permissible period, and must be nonincreasing, or increase only as a result of the following: (1) cost-of-living adjustments; (2) cash refunds of employee contributions; (3) benefit increases under the plan; or (4) an adjustment due to death of the employee's beneficiary. In the case of a defined contribution plan, the minimum required distribution is determined by dividing the employee's benefit by the applicable life expectancy.

Distributions after the death of the plan participant

The minimum distribution rules also apply to distributions to beneficiaries of deceased participants. In general, if the participant dies after minimum distributions have begun, the remaining interest must be distributed at least as rapidly as under the minimum distribution method being used as of the date of death. If the participant dies before minimum distributions have begun, then the entire remaining interest must generally be distributed within 5 years of the participant's death. The 5-year rule does not apply if distributions begin within 1 year of the participant's death and are payable over the life of a designated beneficiary or over the life expectancy of a designated beneficiary. A surviving spouse beneficiary is not required to begin distribution until the date the deceased participant would have attained age 70½.

Special rules for section 457 plans

Eligible deferred compensation plans of State and local and tax-exempt employers ("section 457 plans") are subject to the minimum distribution rules described above. Such plans are also subject to additional minimum distribution requirements (sec. 457(d)(2)(b)).

[25] State and local government plans and church plans are not required to actuarially increase benefits that begin after age 70½.

REASONS FOR CHANGE

The Committee believes that the minimum distribution rules are among the most complex of the rules relating to tax-favored arrangements. While a plan or IRA trustee may assist the individual in complying with the minimum distribution rules, ultimately the responsibility for compliance falls on the individual. Many of the complexities of the present-law rules are contained in Treasury regulations, which have not yet been finalized. The Committee believes that the present-law rules impose undue burdens on individuals and plan administrators.

The sanction for failure to comply with the minimum distribution rules is severe. The Committee believes this sanction is inappropriate, particularly given the complexity of the rules, and the likelihood of inadvertent mistakes.

EXPLANATION OF PROVISION

Modification of post-death distribution rules

The provision applies the present-law rules applicable if the participant dies before distribution of minimum benefits has begun to all post-death distributions. Thus, in general, if the employee dies before his or her entire interest has been distributed, distribution of the remaining interest must be made within 5 years of the date of death, or begin within one year of the date of death and paid over the life or life expectancy of a designated beneficiary. In the case of a surviving spouse, distributions are not required to begin until the surviving spouse attains age 70½. Minimum distributions that have already begun may be recalculated under the new rule.

Reduction in excise tax

The provision reduces the excise tax on failures to satisfy the minimum distribution rules to 10 percent of the amount that was required to be distributed but was not distributed.

Treasury regulations

The Treasury is directed to update, simplify and finalize the regulations relating to the minimum distribution rules. The Treasury is directed to reflect in the regulations current life expectancies and to revise the required distribution methods so that, under reasonable assumptions, the amount of the required distribution does not decrease over time. The regulations are to permit recalculation of distributions for future years to reflect the change in the regulations, and to permit the election of a new designated beneficiary and method of calculating life expectancy. The regulations are to be effective for years beginning after December 31, 2000.

Section 457 plans

The provision repeals the special minimum distribution rules applicable to section 457 plans. Thus, such plans are subject to the same minimum distribution rules applicable to other types of tax-favored arrangements.

EFFECTIVE DATE

In general, the provision is effective for years beginning after December 31, 2000.

5. Clarification of tax treatment of division of section 457 plan benefits upon divorce (sec. 1225 of the bill and secs. 414(p) and 457 of the Code)

PRESENT LAW

Under present law, benefits provided under a qualified retirement plan for a participant may not be assigned or alienated to creditors of the participant, except in very limited circumstances. One exception to the prohibition on assignment or alienation rule is a qualified domestic relations order ("QDRO"). A QDRO is a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant, and that meets certain procedural requirements.

Under present law, a distribution from a governmental plan or a church plan is treated as made pursuant to a QDRO if it is made pursuant to a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant. Such distributions are not required to meet the procedural requirements that apply with respect to distributions from qualified plans.

Under present law, amounts distributed from a qualified plan generally are taxable to the participant in the year of distribution. However, if amounts are distributed to the spouse (or former spouse) of the participant by reason of a QDRO, the benefits are taxable to the spouse (or former spouse). Amounts distributed pursuant to a QDRO to an alternate payee other than the spouse (or former spouse) are taxable to the plan participant.

Section 457 of the Internal Revenue Code provides rules for deferral of compensation by an individual participating in an eligible deferred compensation plan ("section 457 plan") of a tax-exempt or State and local government employer. The QDRO rules do not apply to section 457 plans.

REASONS FOR CHANGE

The Committee believes that the rules regarding qualified domestic relations orders should apply to all types of employer-sponsored retirement plans.

EXPLANATION OF PROVISION

The provision applies the taxation rules for qualified plan distributions pursuant to a QDRO to distributions made pursuant to a domestic relations order from a section 457 plan. In addition, a section 457 plan is not treated as violating the restrictions on distributions from such plans due to payments to an alternate payee under a QDRO. The special rule applicable to governmental plans and church plans applies for purposes of determining whether a distribution is pursuant to a QDRO.

EFFECTIVE DATE

The provision is effective for transfers, distributions and payments made after December 31, 2000.

C. Increasing Portability for Participants

1. Rollovers of retirement plan and IRA distributions (secs. 1231–1233 and 1239 of the bill and secs. 401, 402, 403(b), 408, 457, and 3405 of the Code)

PRESENT LAW

In general

Present law permits the rollover of funds from a tax-favored retirement plan to another tax-favored retirement plan. The rules that apply depend on the type of plan involved. Similarly, the rules regarding the tax treatment of amounts that are not rolled over depend on the type of plan involved.

Distributions from qualified plans

Under present law, an "eligible rollover distribution" from a tax-qualified employer-sponsored retirement plan may be rolled over tax free to a traditional individual retirement arrangement ("IRA")[26] or another qualified plan.[27] An "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan, except the term does not include (1) any distribution which is one of a series of substantially equal periodic payments made (a) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (b) for a specified period of 10 years or more, (2) any distribution to the extent such distribution is required under the minimum distribution rules, and (3) certain hardship distributions. The maximum amount that can be rolled over is the amount of the distribution includible in income, i.e., after-tax employee contributions cannot be rolled over. Qualified plans are not required to accept rollovers.

Distributions from tax-sheltered annuities

Eligible rollover distributions from a tax-sheltered annuity ("section 403(b) annuity") may be rolled over into an IRA or another section 403(b) annuity. Distributions from a section 403(b) annuity cannot be rolled over into a tax-qualified plan. Section 403(b) annuities are not required to accept rollovers.

IRA distributions

Distributions from a traditional IRA, other than minimum required distributions, can be rolled over into another IRA. In general, distributions from an IRA cannot be rolled over into a qualified plan or section 403(b) annuity. An exception to this rule ap-

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[26] A "traditional" IRA refers to IRAs other than Roth IRAs or SIMPLE IRAs. All references to IRAs refers only to traditional IRAs.

[27] An eligible rollover distribution may either be rolled over by the distributee within 60 days of the date of the distribution or, as described below, directly rolled over by the distributing plan.

plies in the case of so-called "conduit IRAs." Under the conduit IRA rule, amounts can be rolled from a qualified plan into an IRA and then subsequently rolled back to another qualified plan if the amounts in the IRA are attributable solely to rollovers from a qualified plan. Similarly, an amount may be rolled over from a section 403(b) annuity to an IRA and subsequently rolled back into a section 403(b) annuity if the amounts in the IRA are attributable solely to rollovers from a section 403(b) annuity.

Distributions from section 457 plans

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. In some cases, different rules apply under section 457 to governmental plans and plans of tax-exempt employers. For example, governmental section 457 plans are like qualified plans in that plan assets are required to be held in a trust for the exclusive benefit of plan participants and beneficiaries. In contrast, benefits under a section 457 plan of a tax-exempt employer are unfunded, like nonqualified deferred compensation plans of private employers.

Section 457 benefits can be transferred to another section 457 plan. Distributions from a section 457 plan cannot be rolled over to another section 457 plan, a qualified plan, a section 403(b) annuity, or an IRA.

Rollovers by surviving spouses

A surviving spouse that receives an eligible rollover distribution may roll over the distribution into an IRA, but not a qualified plan or section 403(b) annuity.

Direct rollovers and withholding requirements

Qualified plans and section 403(b) annuities are required to provide that a plan participant has the right to elect that an eligible rollover distribution be directly rolled over to another eligible retirement plan. If the plan participant does not elect the direct rollover option, then withholding is required on the distribution at a 20-percent rate.

Notice of eligible rollover distribution

The plan administrator of a qualified plan or a section 403(b) annuity is required to provide a written explanation of rollover rules to individuals who receive a distribution eligible for rollover. In general, the notice is to be provided within a reasonable period of time before making the distribution and is to include an explanation of (1) the provisions under which the individual may have the distribution directly rolled over to another eligible retirement plan, (2) the provision that requires withholding if the distribution is not directly rolled over, (3) the provision under which the distribution may be rolled over within 60 days of receipt, and (4) if applicable, certain other rules that may apply to the distribution. The Treasury Department has provided more specific guidance regarding timing and content of the notice.

Taxation of distributions

As is the case with the rollover rules, different rules regarding taxation of benefits apply to different types of tax-favored arrangements. In general, distributions from a qualified plan, section 403(b) annuity, or IRA are includible in income in the year received. In certain cases, distributions from qualified plans are eligible for capital gains treatment and averaging. These rules do not apply to distributions from another type of plan. Distributions from a qualified plan, IRA, and section 403(b) annuity generally are subject to an additional 10–percent early withdrawal tax if made before age 59½. There are a number of exceptions to the early withdrawal tax. Some of the exceptions apply to all three types of plans, and others apply only to certain types of plans. For example, the 10-percent early withdrawal tax does not apply to IRA distributions for educational expenses, but does apply to similar distributions from qualified plans and section 403(b) annuities. Benefits under a section 457 plan are generally includible in income when paid or made available. The 10-percent early withdrawal tax does not apply to section 457 plans.

REASONS FOR CHANGE

Present law encourages individuals who receive distributions from qualified plans and similar arrangements to save those distributions for retirement by facilitating tax-free rollovers to an IRA or another qualified plan. The Committee believes that expanding the rollover options for individuals in employer-sponsored retirement plans and owners of IRAs will provide further incentives for individuals to continue to accumulate funds for retirement. The Committee believes it appropriate to extend the same rollover rules to governmental section 457 plans; like qualified plans, such plans are required to hold plan assets in trust for employees.

EXPLANATION OF PROVISION

In general

The provision provides that eligible rollover distributions from qualified retirement plans, section 403(b) annuities, and governmental section 457 plans generally could be rolled over to any of such plans or arrangements.[28] Similarly, distributions from an IRA generally may be rolled over into a qualified plan, section 403(b) annuity, or governmental section 457 plan. The direct rollover and withholding rules are extended to distributions from a governmental section 457 plan, and such plans are required to provide the written notification regarding eligible rollover distributions. The rollover notice (with respect to all plans) is required to include a description of the provisions under which distributions from the plan to which the distribution is rolled over may be subject to restrictions and tax consequences different than those applicable to distributions from the distributing plan. Qualified plans, section 403(b) annuities, and section 457 plans are not required to accept rollovers.

[28] Hardship distributions from governmental section 457 plans would be considered eligible rollover distributions.

Some special rules apply in certain cases. A distribution from a qualified plan is not eligible for capital gains or averaging treatment if there was a rollover to the plan that would not have been permitted under present law. Thus, in order to preserve capital gains and averaging treatment for a qualified plan distribution that is rolled over, the rollover has to be made to a "conduit IRA" as under present law, and then rolled back into a qualified plan. Amounts distributed from a section 457 plan are subject to the early withdrawal tax to the extent the distribution consists of amounts attributable to rollovers from another type of plan. Section 457 plans are required to separately account for such amounts.

The provision also provides that benefits in governmental section 457 plans are includible in income when paid.

Rollover of after-tax contributions

The provision provides that employee after-tax contributions may be rolled over into another qualified plan or a traditional IRA. In the case of a rollover from a qualified plan to another qualified plan, the rollover may be accomplished only through a direct rollover. In addition, a qualified plan may not accept rollovers of after-tax contributions unless the plan provides separate accounting for such contributions (and earnings thereon). After-tax contributions (including nondeductible contributions to an IRA) may not be rolled over from an IRA into a qualified plan, tax-sheltered annuity, or section 457 plan.

In the case of a distribution from a traditional IRA that is rolled over into an eligible rollover plan that is not an IRA, the distribution is attributed first to amounts other than after-tax contributions.

Expansion of spousal rollovers

The provision provides that surviving spouses may roll over distributions to a qualified plan, section 403(b) annuity, or governmental section 457 plan in which the spouse participates.

Treasury regulations

The Secretary is directed to prescribe rules necessary to carry out the provisions. Such rules may include, for example, reporting requirements and mechanisms to address mistakes relating to rollovers. It is anticipated that the IRS will develop forms to assist individuals who roll over after-tax contributions to an IRA in keeping track of such contributions. Such forms could, for example, expand Form 8606—Nondeductible IRAs, to include information regarding after-tax contributions.

EFFECTIVE DATE

The provision is effective for distributions made after December 31, 2000.

2. Waiver of 60-day rule (sec. 1234 of the bill and secs. 402 and 408 of the Code)

PRESENT LAW

Under present law, amounts received from an IRA or qualified plan may be rolled over tax free if the rollover is made within 60 days of the date of the distribution. The Secretary does not have the authority to waive the 60-day requirement.

REASONS FOR CHANGE

The inability of the Secretary to waive the 60-day rollover period can result in adverse tax consequences for individuals. The Committee believes such harsh results are inappropriate and that providing for waivers of the rule will help facilitate rollovers.

EXPLANATION OF PROVISION

The provision provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.

EFFECTIVE DATE

The provision applies to distributions made after December 31, 2000.

3. Treatment of forms of distribution (sec. 1235 of the bill and sec. 411(d)(6) of the Code)

PRESENT LAW

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant. An amendment is treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit (sec. 411(d)(6)).[29]

The prohibition against the elimination of an optional form of benefit applies to plan mergers, spinoffs, transfers, and transactions amending or having the effect of amending a plan or plans to transfer plan benefits. For example, if Plan A, a profit-sharing plan that provides for distribution of benefits in annual installments over ten or twenty years, is merged with Plan B, a profit-sharing plan that provides for distribution of benefits in annual installments over life expectancy at the time of retirement, the merged plan must preserve the ten- or twenty-year installment option with respect to benefits accrued under Plan A as of the date of the merger and the installments over life expectancy with respect to benefits accrued under Plan B as of the date of the merger. Similarly, for example, if a participant's benefit under a defined contribution plan is transferred to another defined contribution plan maintained by the same or a different employer, the optional

[29] A similar provision is contained in Title I of ERISA.

forms of benefit available with respect to the participant's accrued benefit under the transferor plan must be preserved.[30]

REASONS FOR CHANGE

The Committee understands that the application of the prohibition against the elimination of any optional form of benefit to plan mergers and transfers with respect to defined contribution plans frequently results in complexity and confusion, especially in the context of business acquisitions and similar transactions. In addition, the Committee understands that a defined contribution plan participant who is entitled to receive a single sum distribution generally may roll over such a distribution to an IRA and control the manner of distribution from the IRA.

EXPLANATION OF PROVISION

A defined contribution plan to which benefits are transferred is not treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer (including consolidations of benefits attributable to different employers within a multiple employer plan), (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, (4) if the transferor plan provides for an annuity as the normal form of distribution in accordance with the joint and survivor annuity rules (sec. 417), the participant's spouse (if any) consents to the transfer in a manner similar to the consent required by section 417, and (5) the transferee plan allows the participant or beneficiary to receive distribution of his or her benefit under the transferee plan in the form of a single sum distribution.

In addition, except to the extent provided by the Secretary of the Treasury in regulations, a defined contribution plan is not treated as reducing a participant's accrued benefit if (1) a plan amendment eliminates a form of distribution previously available under the plan, (2) a single sum distribution is available to the participant at the same time or times as the form of distribution eliminated by the amendment, and (3) the single sum distribution is based on the same or greater portion of the participant's accrued benefit as the form of distribution eliminated by the amendment.

The Secretary is directed to issue, not later than December 31, 2001, final regulations under section 411(d)(6) implementing the provision.

Furthermore, the provision authorizes the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit not apply to plan amend-

[30] Treas. Reg. sec. 1.411(d)–4, Q&A–2(a)(3)(i).

ments that do not adversely affect the rights of participants in a material manner but that do eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants.

It is intended that the factors to be considered in determining whether an amendment has a materially adverse effect on a participant would include (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefits that are reduced or eliminated by the amendment, (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment, (3) the number of years before the participant attains normal retirement age under the plan (or early retirement age, as applicable), (4) the size of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation, and (5) the number of years before the plan amendment is effective.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

4. Rationalization of restrictions on distributions (sec. 1236 of the bill and secs. 401(k), 403(b), and 457 of the Code)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), tax-sheltered annuity ("section 403(b) annuity"), or an eligible deferred compensation plan of a tax-exempt organization or State or local government ("section 457 plan"), may not be distributable prior to the occurrence of one or more specified events. These permissible distributable events include "separation from service."

A separation from service occurs only upon a participant's death, retirement, resignation or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, consolidation or other similar corporate transaction. A severance from employment occurs when a participant ceases to be employed by the employer that maintains the plan. Under a so-called "same desk rule," a participant's severance from employment does not necessarily result in a separation from service.[31]

In addition to separation from service and other events, a section 401(k) plan that is maintained by a corporation may permit distributions to certain employees who experience a severance from employment with the corporation that maintains the plan but does not experience a separation from service because the employee continues on the same job for a different employer as a result of a corporate transaction. If the corporation disposes of substantially all

[31] Rev. Rul. 79–336, 1979–2 C.B. 187.

of the assets used by the corporation in a trade or business, a distributable event occurs with respect to the accounts of the employees who continue employment with the corporation that acquires the assets. If the corporation disposes of its interest in a subsidiary, a distributable event occurs with respect to the accounts of the employees who continue employment with the subsidiary.

REASONS FOR CHANGE

The Committee believes that application of the "same desk" rule is inappropriate because it hinders portability of retirement benefits, creates confusion for employees, and results in significant administrative burdens for employers that engage in business acquisition transactions.

EXPLANATION OF PROVISION

The provision modifies the distribution restrictions applicable to section 401(k) plans, section 403(b) annuities, and section 457 plans to provide that distribution may occur upon severance from employment rather than separation from service. In addition, the provisions for distribution from a section 401(k) plan based upon a corporation's disposition of its assets or a subsidiary are repealed; this special rule is no longer necessary under the provision.

EFFECTIVE DATE

The provision is effective for distributions after December 31, 2000.

5. Purchase of service credit under governmental pension plans (sec. 1237 of the bill and secs. 403(b) and 457 of the Code)

PRESENT LAW

A qualified retirement plan maintained by a State or local government employer may provide that a participant may make after-tax employee contributions in order to purchase permissive service credit, subject to certain limits (sec. 415). Permissive service credit means credit for a period of service recognized by the governmental plan only if the employee voluntarily contributes to the plan an amount (as determined by the plan) that does not exceed the amount necessary to fund the benefit attributable to the period of service and that is in addition to the regular employee contributions, if any, under the plan.

In the case of any repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State), any such repayment is not taken into account for purposes of the section 415 limits on contributions and benefits. Also, service credit obtained as a result of such a repayment is not considered permissive service credit for purposes of the section 415 limits.

A participant may not use a rollover or direct transfer of benefits from a tax-sheltered annuity ("section 403(b) annuity") or an eligible deferred compensation plan of a tax-exempt organization of a State or local government ("section 457 plan") to purchase permissive service credits or repay contributions and earnings with respect to a forfeiture of service credit.

REASONS FOR CHANGE

The Committee understands that many employees work for multiple State or local government employers during their careers. The Committee believes that allowing such employees to use their section 403(b) annuity and section 457 plan accounts to purchase permissive service credits or make repayments with respect to forfeitures of service credit will result in more significant retirement benefits for employees who would not otherwise be able to afford such credits or repayments.

EXPLANATION OF PROVISION

A participant in a State or local governmental plan is not required to include in gross income a direct trustee-to-trustee transfer to a governmental defined benefit plan from a section 403(b) annuity or a section 457 plan if the transferred amount is used (1) to purchase permissive service credits under the plan, or (2) to repay contributions and earnings with respect to an amount previously refunded under a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State).

EFFECTIVE DATE

The provision is effective for transfers after December 31, 2000.

6. Employers may disregard rollovers for purposes of cash-out rules (sec. 1238 of the bill and sec. 411(a)(11) of the Code)

PRESENT LAW

If an qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. If such an involuntary distribution occurs and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which a benefit was involuntarily distributed unless the employee repays the benefit.[32]

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan.[33]

REASONS FOR CHANGE

The present-law cash-out rule reflects a balancing of various policies. On the one hand is the desire to assist individuals to save for retirement by making it easier to keep retirement funds in tax-favored vehicles. On the other hand is the recognition that keeping track of small account balances of former employees creates administrative burdens for plans.

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[32] A similiar provision is contained in Title I of ERISA.
[33] Other provisions of the bill expand the kinds of plans to which benefits may be rolled over.

The Committee is concerned that, in some cases, the cash-out rule may discourage plans from accepting rollovers because the rollover will increase participants' benefits to above the cash-out amount, and increase administrative burdens. The Committee believes that disregarding rollovers for purposes of the cash-out rule will further the intent of the cash-out rule by removing a possible disincentive for plans to accept rollovers.

EXPLANATION OF PROVISION

A plan is permitted to provide that the present value of a participant's nonforfeitable accrued benefit is determined without regard to the portion of such benefit that is attributable to rollover contributions (and any earnings allocable thereto).

EFFECTIVE DATE

The provision is effective for distributions after December 31, 2000.

D. Strengthening Pension Security and Enforcement

1. Phase in repeal of 150 percent of current liability funding limit; deduction for contributions to fund termination liability (secs. 1241 and 1242 of the bill and secs. 404(a)(1), 412(c)(7), and 4972(c) of the Code)

PRESENT LAW

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 155 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)).[34] In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[35] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an em-

[34] The minimum funding requirements, including the full funding limit, are also contained in title I of ERISA.

[35] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, and adopted the scheduled increases described in the text.

ployer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

REASONS FOR CHANGE

The Committee is concerned that the current liability full funding limit may result in inadequate funding of pension plans and thus jeopardize pension security. Also, the Committee believes that the special deduction rule should be expanded to give more plan sponsors incentives to adequately fund their plans.

EXPLANATION OF PROVISION

Current liability full funding limit

The provision gradually increases and then repeals the current liability full funding limit. The current liability full funding limit is 160 percent of current liability for plan years beginning in 2001, 165 percent for plan years beginning in 2002, and 170 percent for plan years beginning in 2003. The current liability full funding limit is repealed for plan years beginning in 2004 and thereafter.

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans, i.e., the provision applies to multiemployer plans and plans with 100 or fewer participants. The special rule does not apply to plans not covered by the PBGC termination insurance program.[36]

The provision also modifies the rule by providing that the deduction is for up to 100 percent of unfunded termination liability, determined as if the plan terminated at the end of the plan year. In the case of a plan with less than 100 participants for the plan year, termination liability does not include the liability attributable to benefit increases for highly compensated employees resulting from a plan amendment which was made or became effective, whichever is later, within the last two years.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

2. Extension of PBGC missing participants program (sec. 1243 of the bill and secs. 206(f), 401(a)(34), and 4050 of ERISA)

PRESENT LAW

The plan administrator of a defined benefit pension plan that is subject to Title IV of ERISA, is maintained by a single employer, and terminates under a standard termination is required to distribute the assets of the plan. With respect to a participant whom the plan administrator cannot locate after a diligent search, the plan administrator satisfies the distribution requirement only by purchasing irrevocable commitments from an insurer to provide all

[36] The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

benefit liabilities under the plan or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.

The PBGC missing participant program is not available to multiemployer plans or defined contribution plans and other plans not covered by Title IV of ERISA.

REASONS FOR CHANGE

The Committee recognizes that no statutory provision or formal regulatory guidance exists concerning an appropriate method of handling missing participants in terminated multiemployer plans and plans that are not covered by Title IV of ERISA. Therefore, sponsors of these plans face uncertainty with respect to missing participants. The Committee believes that it is appropriate to extend the established PBGC missing participant program to these plans in order to reduce uncertainty for plan sponsors and increase the likelihood that missing participants will receive their retirement benefits.

EXPLANATION OF PROVISION

The PBGC is directed to prescribe for terminating multiemployer plans rules similar to the present-law missing participant rules applicable to terminating single employer plans that are subject to Title IV of ERISA.

In addition, to the extent provided in PBGC regulations, plan administrators of certain types of plans that are not covered by the PBGC missing participant program under present law are permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the provision extends the missing participants program to defined contribution plans, defined benefit plans that do not have more than 25 active participants and are maintained by professional service employers, and the portions of defined benefit plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

EFFECTIVE DATE

The provision is effective for distributions from terminating plans that occur after the PBGC adopts final regulations implementing the provision.

3. Excise tax relief for sound pension funding (sec. 1243 of the bill and sec. 4972 of the Code)

PRESENT LAW

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 155 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)). In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[37] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

Present law also provides that contributions to defined contribution plans are deductible, subject to certain limitations.

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year. The 10-percent excise tax does not apply to contributions to certain terminating defined benefit plans. The 10-percent excise tax also does not apply to contributions of up to 6 percent of compensation to a defined contribution plan for employer matching and employee elective deferrals.

REASONS FOR CHANGE

The Committee believes that employers should be encouraged to adequately fund their pension plans. Therefore, the Committee does not believe that an excise tax should be imposed on employer contributions that do not exceed the accrued liability full funding limit.

EXPLANATION OF PROVISION

In determining the amount of nondeductible contributions, the employer may elect not to take into account contributions to a defined benefit pension plan except to the extent they exceed the accrued liability full funding limit. Thus, if an employer elects, contributions in excess of the current liability full funding limit are not subject to the excise tax on nondeductible contributions. An employer making such an election for a year may not take advantage of the present-law exceptions for certain terminating plans and certain contributions to defined contribution plans.

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[37] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, and adopted the scheduled increases described in the text. Another provision in the bill gradually increases and then repeals the current liability full funding limit.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

4. Notice of significant reduction in plan benefit accruals (sec. 1245 of the bill and new sec. 4980F of the Code)

PRESENT LAW

Section 204(h) of Title I of ERISA provides that a defined benefit pension plan or a money purchase pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless, after adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment, the plan administrator provides a written notice ("section 204(h) notice"), setting forth the plan amendment (or a summary of the amendment written in a manner calculated to be understood by the average plan participant) and its effective date. The plan administrator must provide the section 204(h) notice to each plan participant, each alternate payee under an applicable qualified domestic relations order ("QDRO"), and each employee organization representing participants in the plan. The applicable Treasury regulations [38] provide, however, that a plan administrator need not provide the section 204(h) notice to any participant or alternate payee whose rate of future benefit accrual is reasonably expected not to be reduced by the amendment, nor to an employee organization that does not represent a participant to whom the section 204(h) notice must be provided. In addition, the regulations provide that the rate of future benefit accrual is determined without regard to optional forms of benefit, early retirement benefits, retirement-type subsidiaries, ancillary benefits, and certain other rights and features.

A covered amendment generally will not become effective with respect to any participants and alternate payees whose rate of future benefit accrual is reasonably expected to be reduced by the amendment but who do not receive a section 204(h) notice. An amendment will become effective with respect to all participants and alternate payees to whom the section 204(h) notice was required to be provided if the plan administrator (1) has made a good faith effort to comply with the section 204(h) notice requirements, (2) has provided a section 204(h) notice to each employee organization that represents any participant to whom a section 204(h) notice was required to be provided, (3) has failed to provide a section 204(h) notice to no more than a de minimis percentage of participants and alternate payees to whom a section 204(h) notice was required to be provided, and (4) promptly upon discovering the oversight, provides a section 204(h) notice to each omitted participant and alternate payee.

The Internal Revenue Code does not require any notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual.

[38] Treas. Reg. sec. 1.411(d)–(6).

REASONS FOR CHANGE

The Committee is aware of recent significant publicity concerning conversions of traditional defined benefit pension plans to "cash balance" plans, with particular focus on the impact such conversions have on affected workers. Legislation has been introduced to address some of the issues relating to such conversions.[39]

The Committee believes that employees are entitled to meaningful disclosure concerning plan amendments that may result in reductions of future benefit accruals. The Committee has determined that present law does not require employers to provide such disclosure, particularly in cases where traditional defined benefit plans are converted to cash balance plans. The Committee also believes that any disclosure requirements applicable to plan amendments should strike a balance between providing meaningful disclosure and avoiding the imposition of unnecessary administrative burdens on employers, and that this balance may best be struck through the regulatory process with an opportunity for input from affected parties.

EXPLANATION OF PROVISION

The provisions adds to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan or a money purchase pension plan with more than 100 participants furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual. The plan administrator is required to provide in this notice, in a manner calculated to be understood by the average plan participant, sufficient information (as defined in Treasury regulations) to allow participants to understand the effect of the amendment.

The plan administrator is required to provide this notice to each affected participant, each affected alternate payee, and each employee organization representing affected participants. For purposes of the provision, an affected participant or alternate payee is a participant or alternate payee to whom the significant reduction in the rate of future benefit accrual is reasonably expected to apply.

Except to the extent provided by Treasury regulations, the plan administrator is required to provide the notice within a reasonable time before the effective date of the plan amendment.

The provision imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. For failures due to reasonable cause and not to willful neglect, the total excise tax imposed during a taxable year of the employer will not exceed $500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive relative to the failure involved.

The Committee anticipates that the Secretary will issue the necessary regulations within 90 days of enactment. The Committee

[39] See, e.g., section 407 of H.R. 1102 introduced by Congressman Portman and Congressman Cardin on March 11, 1999, and H.R. 1176 introduced by Congressman Weller (along with Congressmen Bentsen and Ney) on March 18, 1999 (with companion legislation, S. 659, introduced by Senator Moynihan). Also, see the conceptual proposal released by the Administration on July 13, 1999.

also anticipates that such guidance may be relatively detailed because of the need to provide for alternative disclosures rather than a single disclosure methodology that may not fit all situations, and the need to consider the complex actuarial calculations and assumptions involved in providing necessary disclosures.

EFFECTIVE DATE

The provision is effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the provision will not end before the last day of the 3-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan will be treated as meeting the requirements of the provision if the plan makes a good faith effort to comply with such requirements.

E. Reducing Regulatory Burdens

1. Repeal of the multiple use test (sec. 1251 of the bill and sec. 401(m) of the Code)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan") are subject to a special annual nondiscrimination test ("ADP test"). The ADP test compares the actual deferral percentages ("ADPs") of the highly compensated employee group and the nonhighly compensated employee group. The ADP for each group generally is the average of the deferral percentages separately calculated for the employees in the group who are eligible to make elective deferrals for all or a portion of the relevant plan year. Each eligible employee's deferral percentage generally is the employee's elective deferrals for the year divided by the employee's compensation for the year.

The plan generally satisfies the ADP test if the ADP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ADP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ADP of the nonhighly compensated employee group for the prior plan year and not more than 2 percentage points greater than the ADP of the nonhighly compensated employee group for the prior plan year.

Employer matching contributions and after-tax employee contributions under a defined contribution plan also are subject to a special annual nondiscrimination test ("ACP test"). The ACP test compares the actual deferral percentages ("ACPs") of the highly compensated employee group and the nonhighly compensated employee group. The ACP for each group generally is the average of the contribution percentages separately calculated for the employees in the group who are eligible to make after-tax employee contributions or who are eligible for an allocation of matching contributions for all or a portion of the relevant plan year. Each eligible employee's contribution percentage generally is the employee's aggregate after-tax employee contributions and matching contributions for the year divided by the employee's compensation for the year.

The plan generally satisfies the ACP test if the ACP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ACP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ACP of the nonhighly compensated employee group for the prior plan year and not more than 2 percentage points greater than the ACP of the nonhighly compensated employee group for the prior plan year.

For any year in which (1) at least one highly compensated employee is eligible to participate in an employer's plan or plans that are subject to both the ADP test and the ACP test, (2) the plan subject to the ADP test satisfies the ADP test but the ADP of the highly compensated employee group exceeds 125 percent of the ADP of the nonhighly compensated employee group, and (3) the plan subject to the ACP test satisfies the ACP test but the ACP of the highly compensated employee group exceeds 125 percent of the ACP of the nonhighly compensated employee group, an additional special nondiscrimination test ("Multiple Use test") applies to the elective deferrals, employer matching contributions, and after-tax employee contributions. The plan or plans generally satisfy the Multiple Use test if the sum of the ADP and the ACP of the highly compensated employee group does not exceed the greater of (1) the sum of (A) 1.25 times the greater of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the lesser of the ADP or the ACP of the nonhighly compensated employee group, or (2) the sum of (A) 1.25 times the lesser of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the greater of the ADP or the ACP of the nonhighly compensated employee group.

REASONS FOR CHANGE

The Committee believes that the ADP test and the ACP test are adequate to prevent discrimination in favor of highly compensated employees under 401(k) plans and has determined that the Multiple Use test unnecessarily complicates 401(k) plan administration.

EXPLANATION OF PROVISION

The provision repeals the Multiple Use test.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

2. Flexibility in nondiscrimination and line of business rules (sec. 1253 of the bill)

PRESENT LAW

A plan is not a qualified retirement plan if the contributions or benefits provided under the plan discriminate in favor of highly compensated employees (sec. 401(a)(4)). The applicable Treasury regulations set forth the exclusive rules for determining whether a plan satisfies the nondiscrimination requirement. These regulations state that the form of the plan and the effect of the plan in operation determine whether the plan is nondiscriminatory and that intent is irrelevant.

Similarly, a plan is not a qualified retirement plan if the plan does not benefit a minimum number of employees (sec. 410(b)). A plan satisfies this minimum coverage requirement if and only if it satisfies one of the tests specified in the applicable Treasury regulations. If an employer is treated as operating separate lines of business, the employer may apply the minimum coverage requirements to a plan separately with respect to the employees in each separate line of business (sec. 414(r)). Under a so-called "gateway" requirement, however, the plan must benefit a classification of employees that does not discriminate in favor of highly compensated employees in order for the employer to apply the minimum coverage requirements separately for the employees in each separate line of business. A plan satisfies this gateway requirement only if it satisfies one of the tests specified in the applicable Treasury regulations.

REASONS FOR CHANGE

It has been brought to the attention of the Committee that some plans are unable to satisfy the mechanical tests used to determine compliance with the nondiscrimination and line of business requirements solely as a result of relatively minor plan provisions. The Committee believes that, in such cases, it may be appropriate to expand the consideration of facts and circumstances in the application of the mechanical tests.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to modify, on or before December 31, 2000, the existing regulations issued under section 401(a)(4) and section 414(r) in order to expand (to the extent that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the nondiscrimination and line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

EFFECTIVE DATE

The provision is effective on the date of enactment.

3. Modification of timing of plan valuations (sec. 1252 of the bill and sec. 412 of the Code)

PRESENT LAW

Under present law, in the case of plans subject to the minimum funding rules, a plan valuation is generally required annually. The Secretary may require that a valuation be made more frequently in particular cases.

Prior to the Retirement Protection Act of 1994, plan valuations generally were required at least once every three years.

REASONS FOR CHANGE

While plan valuations are necessary to ensure adequate funding of defined benefit pension plans, they also create administrative burdens for employers. The Committee believes that requiring valuations at least once every three years in the case of well-funded plans strikes an appropriate balance between funding concerns and employer concerns about plan administrative costs.

EXPLANATION OF PROVISION

The provision allows an employer to elect to use the prior year's plan valuation in certain cases. The election may be made only with respect to a defined benefit plan with assets of at least 125 percent of current liability (determined as of the valuation date for the preceding year). If the prior year's valuation is used, it must be adjusted, as provided in regulations, to reflect significant differences in participants. An election made under the provision may be revoked only with the consent of the Secretary. In any event, a plan valuation is required once every three years.[40]

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

4. Rules for substantial owner benefits in terminated plans (sec. 1254 of the bill and secs. 4021, 4022, 4043 and 4044 of ERISA)

PRESENT LAW

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides participants and beneficiaries in a defined benefit pension plan with certain minimal guarantees as to the receipt of benefits under the plan in case of plan termination. The employer sponsoring the defined benefit pension plan is required to pay premiums to the PBGC to provide insurance for the guaranteed benefits. In general, the PBGC will guarantee all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. The amount of the guaranteed benefit is subject to certain limitations. One limitation is that the plan (or an amendment to the plan which increases benefits) must be in effect for 60 months before termination for the PBGC to guarantee the full amount of basic benefits for a plan participant, other than a substantial owner. In the case of a substantial owner, the guaranteed basic benefit is phased in over 30 years beginning with participation in the plan. A substantial owner is one who owns, directly or indirectly, more than 10 percent of the voting stock of a corporation or all the stock of a corporation. Special rules restricting the amount of benefit guaranteed and the allocation of assets also apply to substantial owners.

[40] As under present law, the Secretary could require that a valuation be made more frequently in particular cases.

REASONS FOR CHANGE

The Committee believes that the present-law rules concerning limitations on guaranteed benefits for substantial owners are overly complicated and restrictive and thus may discourage some small business owners from establishing defined benefit pension plans.

EXPLANATION OF PROVISION

The provision provides that the 60 month phase-in of guaranteed benefits applies to a substantial owner with less than 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest ("majority owner"), the phase-in depends on the number of years the plan has been in effect. The majority owner's guaranteed benefit is limited so that it may not be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets apply to substantial owners, other than majority owners, in the same manner as other participants.

EFFECTIVE DATE

The provision is effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC after December 31, 2000.

5. ESOP dividends may be reinvested without loss of dividend deduction (sec. 1255 of the bill and sec. 404 of the Code)

PRESENT LAW

An employer is entitled to deduct certain dividends paid in cash during the employer's taxable year with respect to stock of the employer that is held by an employee stock ownership plan ("ESOP"). The deduction is allowed with respect to dividends that, in accordance with plan provisions, are (1) paid in cash directly to the plan participants or their beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) used to make payments on loans (including payments of interest as well as principal) that were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid.

REASONS FOR CHANGE

The Committee believes that it is appropriate to provide incentives for the accumulation of retirement benefits and expansion of employee ownership. The Committee has determined that the present-law rules concerning the deduction of dividends on employer stock held by an ESOP discourage employers from permitting such dividends to be reinvested in employer stock and accumulate for retirement purposes.

EXPLANATION OF PROVISION

In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer is entitled to deduct dividends that, at the election of plan participants or their beneficiaries, are (1) payable in cash directly to plan participants or beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) paid to the plan and reinvested in qualifying employer securities.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

6. Notice and consent period regarding distributions (sec. 1256 of the bill and sec. 417 of the Code)

PRESENT LAW

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.[41]

If the present value of the participant's vested accrued benefit exceeds $5,000, the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, (2) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (3) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements apply to the participant, this notice also must contain a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. The plan generally is required, however, to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (2) the rules concerning the taxation of a distribution. The plan generally

[41] Similar provisions are contained in Title I of ERISA.

must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

REASONS FOR CHANGE

The Committee understands that an employee is not always able to evaluate distribution alternatives, select the most appropriate alternative, and notify the plan of the selection within a 90–day period. The Committee believes that requiring a plan to furnish multiple distribution notices to an employee who does not make a distribution election within 90 days is administratively burdensome. In addition, the Committee believes that participants who are entitled to defer distributions should be informed of the impact of a decision not to defer distribution on the taxation and accumulation of their retirement benefits.

EXPLANATION OF PROVISION

A qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than 6 months before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to 6 months and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

7. Repeal transition rule relating to certain highly compensated employees (sec. 1257 of the bill and sec. 1114(c)(4) of the Tax Reform Act of 1986)

PRESENT LAW

Under present law, for purposes of the rules relating to qualified plans, a highly compensated employee is generally defined as an employee [42] who (1) was a 5–percent owner of the employer at any time during the year or the preceding year or (2) either (a) had compensation for the preceding year in excess of $80,000 (for 1999) or (b) at the election of the employer, had compensation in excess of $80,000 for the preceding year and was in the top 20 percent of employees by compensation for such year.

Under a rule enacted in the Tax Reform Act of 1986, a special definition of highly compensated employee applies for purposes of the nondiscrimination rules relating to qualified cash or deferred arrangements ("section 401(k) plans") and matching contributions. This special definition applies to an employer incorporated on December 15, 1924, that meets certain specific requirements.

REASONS FOR CHANGE

The Committee believes that it is appropriate to repeal the special definition of highly compensated employee in light of the sub-

[40] An employee includes a self-employed individual.

stantial modification of the general definition of highly compensated employee in the Small Business Job Protection Act of 1996.

EXPLANATION OF PROVISION

The provision repeals the special definition of highly compensated employee under the Tax Reform Act of 1986. Thus, the present-law definition applies.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

8. Employees of tax-exempt entities (sec. 1258 of the bill)

PRESENT LAW

The Tax Reform Act of 1986 provided that nongovernmental tax-exempt employers were not permitted to maintain a qualified cash or deferred arrangement ("section 401(k) plan"). This prohibition was repealed, effective for years beginning after December 31, 1996, by the Small Business Job Protection Act of 1996.

Treasury regulations provide that, in applying the nondiscrimination rules to a section 401(k) plan (or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan), the employer may treat as excludable those employees of a tax-exempt entity who could not participate in the arrangement due to the prohibition on maintenance of a section 401(k) plan by such entities. Such employees may be disregarded only if more than 95 percent of the employees who could participate in the section 401(k) plan benefit under the plan for the plan year.[43]

Tax-exempt charitable organizations may maintain a tax-sheltered annuity (a "section 403(b) annuity") that allows employees to make salary reduction contributions.

REASONS FOR CHANGE

The Committee believes that it is appropriate to modify the special rule regarding the treatment of certain employees of a tax-exempt organization as excludable for section 401(k) plan nondiscrimination testing purposes in light of the provision of the Small Business Job Protection Act of 1996 that permits such organizations to maintain section 401(k) plans.

EXPLANATION OF PROVISION

The Treasury Department is directed to revise its regulations under section 410(b) to provide that employees of a tax-exempt charitable organization who are eligible to make salary reduction contributions under a section 403(b) annuity may be treated as excludable employees for purposes of testing a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan of the employer if (1) no employee of such tax-exempt entity is eligible to participate in the sec-

[43] Treas. Reg. sec. 1.410(b)–6(g).

tion 401(k) or 401(m) plan and (2) at least 95 percent of the employees who are not employees of the charitable employer are eligible to participate in such section 401(k) plan or section 401(m) plan.

The revised regulations will be effective for years beginning after December 31, 1996.

EFFECTIVE DATE

The provision is effective on the date of enactment.

9. Treatment of employer-provided retirement advice (sec. 1259 of the bill and sec. 132 of the Code)

PRESENT LAW

Under present law, certain employer-provided fringe benefits are excludable from gross income (sec. 132) and wages for employment tax purposes. These excludable fringe benefits include working condition fringe benefits and de minimis fringes. In general, a working condition fringe benefit is any property or services provided by an employer to an employee to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction as a business expense. A de minimis fringe benefit is any property or services provided by the employer the value of which, after taking into account the frequency with which similar fringes are provided, is so small as to make accounting for it unreasonable or administratively impracticable.

In addition, if certain requirements are satisfied, up to $5,250 annually of employer-provided educational assistance is excludable from gross income (sec. 127) and wages. This exclusion expires with respect to courses beginning after May 31, 2000.[44] Education not excludable under section 127 may be excludable as a working condition fringe.

There is no specific exclusion under present law for employer-provided retirement planning services. However, such services may be excludable as employer-provided educational assistance or a fringe benefit.

REASONS FOR CHANGE

In order to plan adequately for retirement, individuals must anticipate retirement income needs and understand how their retirement income goals can be achieved. Employer-sponsored plans are a key part of retirement income planning. The Committee believes that employers sponsoring retirement plans should be encouraged to provide retirement planning services for their employees in order to assist them in preparing for retirement.

EXPLANATION OF PROVISION

Qualified retirement planning services provided to an employee and his or her spouse are excludable from income and wages. The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided

[44] The exclusion does not apply with respect to graduate-level courses.

education and information regarding the employer's pension plan. The exclusion is not limited to information regarding the plan but includes, for example, information regarding how the plan relates to retirement income planning as a whole.

EFFECTIVE DATE

The provision is effective with respect to taxable years beginning after December 31, 2000.

10. Provisions relating to plan amendments (sec. 1260 of the bill)

PRESENT LAW

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

REASONS FOR CHANGE

The Committee believes that employers should have adequate time to amend their plans to reflect amendments to the law.

EXPLANATION OF PROVISION

Any amendments to a plan or annuity contract required to be made by the provision are not required to be made before the last day of the first plan year beginning on or after January 1, 2003. In the case of a governmental plan, the date for amendments is extended to the last day of the first plan year beginning on or after January 1, 2005.

EFFECTIVE DATE

The provision is effective on the date of enactment.

11. Reporting simplification (sec. 1262 of the bill)

PRESENT LAW

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.[45] The Form 5500 series annual return/report, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Internal Revenue Service ("IRS"), which forwards the form to the Department of Labor and the PBGC.

[45] Treas. Reg. sec. 301.6058–1(a).

The Form 5500 series consists of 3 different forms: Form 5500, Form 5500–C/R, and Form 5500–EZ. Form 5500 is the most comprehensive of the forms and requires the most detailed financial information. Form 5500–C/R requires less information than Form 5500, and Form 5500–EZ, which consists of only 1 page, is the simplest of the forms.

The size of the plan determines which form a plan administrator must file. If the plan has more than 100 participants at the beginning of the plan year, the plan administrator generally must file Form 5500. If the plan has fewer than 100 participants at the beginning of the plan year, the plan administrator generally may file Form 5500–C/R. A plan administrator generally may file Form 5500–EZ if (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses), (2) the plan is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) the employer is not a member of a related group of employers, and (4) the employer does not receive the services of leased employees. If the plan satisfies the eligibility requirements for Form 5500–EZ and the total value of the plan assets as of the end of the plan year and all prior plan years does not exceed $100,000, the plan administrator is not required to file a return.

REASONS FOR CHANGE

The Committee believes that simplification of the reporting requirements applicable to plans of small employers will encourage such employers to provide retirement benefits for their employees.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to provide for the filing of a simplified annual return substantially similar to the Form 5500–EZ by a plan that (1) covers less than 25 employees on the first day of the plan year, (2) is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) is maintained by an employer that is not a member of a related group of employers, and (4) is maintained by an employer that does not receive the services of leased employees.

EFFECTIVE DATE

The provision is effective on the date of enactment.

12. Model plans for small businesses (sec. 1261 of the bill)

PRESENT LAW

The Internal Revenue Service ("IRS") previously has established uniform plan [46] and prototype plan [47] programs that were designed, in part, to simplify the preparation of qualified retirement plan documents and the determination letter application process. Nei-

[46] Rev. Proc. 84–46, 1984–2 C.B. 787.
[47] Rev. Proc. 84–23, 1984–1 C.B. 457; Rev. Proc. 89–9, 1989–1 C.B. 780; Rev. Proc. 89–13, 1989–1 C.B. 801.

ther the IRS nor the Secretary of the Treasury previously have issued model plan documents.

REASONS FOR CHANGE

The Committee believes that the availability of model retirement plans, or the expanded availability of pre-approved prototype plan documents, will encourage small employers to provide retirement benefits for their employees.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to issue, not later than December 31, 2000, at least one model defined contribution plan document and at least one model defined benefit plan document that fit the needs of small businesses and that is treated as meeting the requirements of section 401(a) with respect to the form of the plan. To the extent that the requirements of section 401(a) are modified after the issuance of the model plans, the Secretary is directed to issue, in a timely manner, model amendments that, if adopted in a timely manner by an employer that adopts a model plan, will cause the model plan to be treated as meeting the requirements of section 401(a), as modified, with respect to the form of the plan.

Alternatively, the Secretary is permitted, in its discretion, to enhance and simplify the existing prototype plan programs in a manner that achieves the purposes of the model plans.

EFFECTIVE DATE

The provision is effective on the date of enactment.

13. Improvement to Employee Plans Compliance Resolution System (sec. 1263 of the bill)

PRESENT LAW

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a) and section 403(b), as applicable.[48] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for compliance failures

[48] Rev. Proc. 98–22, 1998–12 I.R.B. 11, as modified by Rev. Proc. 99–13, 1999–5, I.R.B. 52.

identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Administrative Policy Regarding Self-Correction ("APRSC") permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a 2-year period, without payment of any fee or sanction. The Voluntary Compliance Resolution ("VCR") program, the Walk-In Closing Agreement Program ("Walk-In CAP"), and the Tax-Sheltered Annuity Voluntary Correction ("TVC") program permit an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

The IRS has expressed its intent that EPCRS will be updated and improved periodically in light of experience and comments from those who use it.

REASONS FOR CHANGE

The Committee commends the IRS for the establishment of EPCRS and agrees with the IRS that EPCRS should be updated and improved periodically. The Committee believes that future improvements should facilitate use of the compliance and correction programs by small employers and expand the flexibility of the programs.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to continue to update and improve EPCRS, giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under APRSC for significant compliance failures, (4) expanding the availability to correct insignificant compliance failures under APRSC during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

EFFECTIVE DATE

The provision is effective on the date of enactment.

TITLE XIII. MISCELLANEOUS PROVISIONS

A. EXPAND THE EXCLUSION FROM INCOME FOR CERTAIN FOSTER CARE PAYMENTS

(sec. 1301 of the bill and sec. 131 of the Code)

PRESENT LAW

Generally, a foster care provider may exclude qualified foster care payments, (including difficulty of care payments) from gross income if certain requirements are satisfied.[49] First, such payments must be paid to the foster care providers by either (1) a State or political subdivision of a State; or (2) a tax-exempt placement agency. Second, the payments, including difficulty of care payments, must be paid to the foster care provider for the care of a "qualified foster individual" in the foster care provider's home. A qualified foster individual is an individual living in a foster care family home in which the individual was placed by: (1) an agency of the State or a political subdivision of a State; or (2) a tax-exempt placement agency if such individual was under the age of 19 at the time of placement. Third, the exclusion of foster care payments generally applies to qualified foster care payments for five or fewer foster care individuals over the age of 19 in a foster home. In the case of difficulty of care payments, the exclusion applies to payments for ten or fewer foster care individuals under the age of 19 in a foster home and to payments for five or fewer foster care individuals at least age 19 in a foster home.

REASONS FOR CHANGE

The Committee recognizes that some States want to use both taxable and tax-exempt organizations to improve the administration of their foster care programs (e.g., out-sourcing of the placement function of their foster care program). This provision is intended to give the States more flexibility in meeting the goals of foster care without expanding the application of the exclusion to payments which are not made under the State's foster care program.

EXPLANATION OF PROVISION

The bill makes two principal modifications to the exclusion for qualified foster care payments. First, the bill expands the list of persons eligible to make qualified foster care payments. Therefore, the exclusion applies to qualified payments made pursuant to a foster care program of a State or local government which are paid by either: (1) a State or political subdivision of a State; or (2) a qualified foster care placement agency, whether taxable or tax-exempt. Second, the bill expands the list of persons eligible to place foster care individuals. Specifically, the bill allows placements by either: (1) a State or a political subdivision of a State; or (2) a qualified foster care placement agency. For these purposes, a qualified foster

[49] A difficulty of care payment is a payment designated by the person making such payment as compensation for providing the additional care of a qualified foster care individual which is required by reason of a physicial, mental, or emotional handicap of such individual and with respect to which the State has determined that there is a need for additional compensation.

care placement agency is defined as any placement agency which is licensed or certified by: (1) a State or political subdivision of a State; or (2) an entity designated by a State or political subdivision thereof, for the foster care program of such State or political subdivision to make payments to providers of foster care.

The bill allows State and local governments to employ both tax-exempt and taxable entities to administer their foster care programs more efficiently; however, it does not extend the exclusion to payments outside such foster care programs (e.g., payments to a foster care provider from friends or relatives of foster care individual in its care).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

B. PROVIDE EXCLUSION FOR MILEAGE REIMBURSEMENTS BY CHARITABLE ORGANIZATIONS

(sec. 1302 of the bill and new sec. 138A of the Code)

PRESENT LAW

In computing taxable income, individuals who do not elect the standard deduction may claim itemized deductions, including a deduction (subject to certain limitations) for charitable contributions or gifts made during the taxable year to a qualified charitable organization or governmental entity (sec. 170). Individuals who elect the standard deduction may not claim a deduction for charitable contributions made during the taxable year.

No charitable contribution deduction is allowed for a contribution of services. However, unreimbursed expenditures made incident to providing donated services to a qualified charitable organization—such as out-of-pocket transportation expenses necessarily incurred in performing donated services—may constitute a deductible contribution (Treas. Reg. sec. 1.170A–1(g)).[50] However, no charitable contribution deduction is allowed for traveling expenses (including expenses 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 (sec. 170(j)). Moreover, a taxpayer may not deduct as a charitable contribution out-of-pocket expenditures incurred on behalf of a charity if such expenditures are made for the purposes of influencing legislation (sec. 170(f)(6)).

For purposes of computing the charitable contribution deduction for the use of a passenger automobile (including vans, pickups, and panel trucks) in connection with providing donated services to a qualified charitable organization, the standard mileage rate is 14 cents per mile (sec. 170(i)). Volunteer drivers who are reimbursed for mileage expenses have taxable income to the extent the reimbursement exceeds 14 cents per mile.

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[50] Treasury Regulation section 1.170A–1(g) allows taxpayers to deduct only their own unreimbursed expenses incurred in performing services for a qualified charitable organization, and not expenses incident to a third party's performance of services. See *Davis v. United States,* 495 U.S. 472 (1990).

REASONS FOR CHANGE

The Committee believes that it is important to recognize the valuable contributions made by volunteers to charitable organizations by providing an exclusion from income up to the applicable business rate for volunteers who receive reimbursements for the costs of using their automobiles while performing services for charitable organizations.

EXPLANATION OF PROVISION

Under the bill, reimbursement by an entity or organization described in section 170(c) (including public charities and private foundations) for the costs of using an automobile in connection with providing donated services is excludable from the gross income of the volunteer, provided that (1) reimbursement does not exceed the rate prescribed for business use, and (2) applicable recordkeeping requirements are satisfied. The bill does not permit a volunteer to exclude a reimbursement from income if the volunteer claims a deduction or credit with respect to his or her automobile transportation expenses incurred in connection with providing donated services.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

C. Expand Employer Reporting on Annual Wage and Tax Statements

(sec. 1303 of the bill and sec. 6051 of the Code)

PRESENT LAW

An employer must provide certain information annually to each employee in the form of a wage and tax statement ("Form W–2"). The information required to be included on such form includes the individual's name, address, social security number and a statement of total wages, tips, and other compensation for the year. The form must also include the amount of federal income tax withheld as well as the employee's share of social security and medicare taxes withheld for the year by the employer. There is no requirement that the form include a statement of the employer's share of social security and medicare taxes paid by the employer with respect to that individual.

REASONS FOR CHANGE

The Committee believes that American workers should be informed of the true level of taxation under Social Security and Medicare. The Committee believes that this additional information will allow more informed decision making on possible reforms of these two programs.

EXPLANATION OF PROVISION

The bill requires the Form W–2 to include a statement of social security and medicare taxes paid by the employer on behalf of each employee.

EFFECTIVE DATE

The provision is effective with respect to Form W–2's with respect to remuneration paid after December 31, 1999.

D. SURVIVOR BENEFITS OF PUBLIC SAFETY OFFICERS KILLED IN THE LINE OF DUTY

(sec. 1304 of the bill and sec. 101 of the Code)

PRESENT LAW

The Taxpayer Relief Act of 1997 included a provision providing that an amount paid as a survivor annuity on account of the death of a public safety officer who is killed in the line of duty is excludable from income to the extent the survivor annuity is attributable to the officer's service as a law enforcement officer. The survivor annuity must be provided under a governmental plan to the surviving spouse (or former spouse) of the public safety officer or to a child of the officer. Public safety officers include law enforcement officers, firefighters, rescue squad or ambulance crew. The provision does not apply with respect to the death of a public safety officer if it is determined by the appropriate supervising authority that (1) the death was caused by the intentional misconduct of the officer or by the officer's intention to bring about the death, (2) the officer was voluntarily intoxicated at the time of death, (3) the officer was performing his or her duties in a grossly negligent manner at the time of death, or (4) the actions of the individual to whom payment is to be made were a substantial contributing factor to the death of the officer.

The provision applies to amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after that date.

REASONS FOR CHANGE

The Committee believes that survivors of public safety officers killed in the line of duty should all receive the same tax treatment, regardless of when the officer died.

EXPLANATION OF PROVISION

The provision extends the present-law treatment of survivor annuities with respect to public safety officers killed in the line of duty to payments received in taxable years beginning after December 31, 1999, with respect to individuals dying on or before December 31, 1996.

EFFECTIVE DATE

The provision is effective on the date of enactment.

E. Distributions From Publicly Traded Partnerships Treated as Qualifying Income of Regulated Investment Companies

(secs. 1311 and 1312 of the bill and secs. 851(b) and 469(k) of the Code)

PRESENT LAW

A regulated investment company ("RIC") generally is treated as a conduit for Federal income tax purposes. In computing its taxable income, a RIC deducts dividends paid to its shareholders to achieve conduit treatment (sec. 852(b)). In order to qualify for conduit treatment, a RIC must be a domestic corporation that, at all times during the taxable year, is registered under the Investment Company Act of 1940 as a management company or as a unit investment trust, or has elected to be treated as a business development company under that Act (sec. 851(a)). In addition, the corporation must elect RIC status, and must satisfy certain other requirements (sec. 851(b)).

One of the requirements is that at least 90 percent of its gross income is derived from dividends, interest, payments with respect to securities loans, and gains from the sale or other disposition of stock or securities or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies. Income derived from a partnership is treated as meeting this requirement only to the extent such income is attributable to items of income of the partnership that would meet the requirement if realized by the RIC in the same manner as realized by the partnership (the "look-through" rule for partnership income). Under present law, no distinction is made under this rule between a publicly traded partnership and any other partnership.

Present law provides that a publicly traded partnership means a partnership, interests in which are traded on an established securities market, or are readily tradable on a secondary market (or the substantial equivalent thereof). In general, a publicly traded partnership is treated as a corporation (sec. 7704(a)), but an exception to corporate treatment is provided if 90 percent or more of its gross income is interest, dividends, real property rents, or certain other types of qualifying income (sec. 7704(c) and (d)).

A special rule for publicly traded partnerships applies under the passive loss rules. The passive loss rules limit deductions and credits from passive trade or business activities (sec. 469). Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person. The special rule for publicly traded partnerships provides that the passive loss rules are applied separately with respect to items attributable to each publicly traded partnership (sec. 469(k)). Thus, income or loss from the publicly traded partnership is treated as separate from income or loss from other passive activities.

REASONS FOR CHANGE

The Committee understands that mutual funds are an increasingly important part of the capital markets. They are deterred by the 90–percent rule and the look-through rule of present law from deriving more than 10 percent of their income from partnerships (including publicly traded partnerships) whose income is not income such as dividends, interest, or other income that would qualify under the 90 percent rule if realized by the mutual fund in the same manner as by the partnership. This makes it more difficult for publicly traded partnerships to raise capital. Thus, the Committee bill modifies these limitations in the case of publicly traded partnerships. In addition, so that the separate application of the passive loss rules is not avoided by passing publicly traded partnership income through a mutual fund, the passsive loss rules are applied to mutual funds in a similar manner.

EXPLANATION OF PROVISION

The provision modifies the 90 percent test with respect to income of a RIC to include income derived from an interest in a publicly traded partnership. The provision also modifies the lookthrough rule for partnership income of a RIC so that it applies only to income from a partnership other than a publicly traded partnership.

The provision provides that the special rule for publicly traded partnerships under the passive loss rules (requiring separate treatment) applies to a RIC holding an interest in a publicly traded partnership, with respect to items attributable to the interest in the publicly traded partnership.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

F. EQUALIZE THE TAX TREATMENT OF "CLEAN FUEL" VEHICLES AND OVERSIZED VEHICLES

(sec. 1313 of the bill and sec. 30 and 179A of the Code)

PRESENT LAW

Taxpayers may claim a credit of 10 percent of the cost of an electric vehicle up to a maximum credit of $4,000 (sec. 30). Taxpayers may claim an immediate deduction (expensing) for up to $50,000 of the cost of a qualified clean-fuel vehicle which is a truck or van with a gross vehicle weight greater than 13 tons or a bus with a seating capacity of at least 20 adults (sec. 179A). For the purposes of the deduction permitted under section 179A, electric trucks, vans, or buses are not qualified clean fuel vehicles.

REASONS FOR CHANGE

The purchase of a large truck, van, or bus requires a substantial cost. The Committee observes that, under present law, a taxpayer purchasing a large electric vehicle may claim a credit against tax liability with a maximum value of $4,000, while a taxpayer purchasing a large "clean fuel" vehicle may expense up to $50,000 of cost. These two alternatives do not produce equivalent tax benefits. The Committee believes that a taxpayer's choice between these such "environmentally friendly" vehicles should be based on the merits of the vehicles and not on a disparity in tax benefits.

EXPLANATION OF PROVISION

The bill provides that an electric truck or van with a gross vehicle weight rating greater than 13 tons or an electric bus which has seating capacity of at least 20 adults is a qualified clean fuel vehicle for which the taxpayer may expense up to $50,000 of cost and that such vehicles are not eligible for the electric vehicle credit.

EFFECTIVE DATE

The provision is effective for vehicles placed in service after December 31, 1999.

G. Nuclear Decommissioning Costs

(sec. 1314 of the bill and sec. 468A of the Code)

PRESENT LAW

Special rules dealing with nuclear decommissioning reserve funds were adopted by Congress in the Deficit Reduction Act of 1984 ("1984 Act") when tax issues regarding the time value of money were addressed generally. Under general tax accounting rules, a deduction for accrual basis taxpayers generally is deferred until there is economic performance for the item for which the deduction is claimed. However, the 1984 Act contains an exception to those rules under which a taxpayer responsible for nuclear power plant decommissioning may elect to deduct contributions made to a qualified nuclear decommissioning fund for future payment costs. Taxpayers who do not elect this provision are subject to the general rules in the 1984 Act.

A qualified decommissioning fund is a segregated fund established by the taxpayer that is used exclusively for the payment of decommissioning costs, taxes on fund income, payment of management costs of the fund, and making investments. The fund is prohibited from dealing with the taxpayer that established the fund. The income of the fund is taxed at a reduced rate of 20 percent [51] for taxable years beginning after December 31, 1995.

Contributions to the fund are deductible in the year made to the extent that these amounts were collected as part of the cost of service to ratepayers. Withdrawal of funds by the taxpayer to pay for decommissioning expenses are included in income at that time, but the taxpayer also is entitled to a deduction at that time for decommissioning expenses as economic performance for those costs occurs.

[51] As originally enacted in 1984, the fund paid tax on its earnings at the top corporate rate and, as a result, there would be no present-value tax benefit of making deductible contributions to the fund. Also, as originally enacted, the funds in the trust could be invested only in certain low risk investments. Subsequent amendments to the provision have reduced the rate of tax on the fund to 20 percent, and removed the restrictions on the type of permitted investments that the fund can make.

A taxpayer's contributions to the fund may not exceed the amount of nuclear decommissioning costs included in the taxpayer's cost of service for ratemaking purposes for the taxable year. Additionally, in order to prevent accumulations of funds over the remaining life of a nuclear power plant in excess of those required to pay future decommissioning costs and to ensure that contributions to the funds are not deducted more rapidly than level funding, taxpayers must obtain a ruling from the IRS to establish the maximum contribution that may be made to the fund.

If the decommissioning fund fails to comply with the qualification requirements or when the decommissioning is substantially completed, the fund's qualification may be terminated, in which case the amounts in the fund must be included in income of the taxpayer.

A qualified decommissioning fund may be transferred in connection with the sale, exchange or other transfer of the nuclear power plant to which it relates. If the transferee is a regulated public utility and meets certain other requirements, the transfer will be treated as a nontaxable transaction. No gain or loss will be recognized on the transfer of the qualified decommissioning fund and the transferee will take the transferor's basis in the fund.[52] The transferee is required to obtain a new ruling amount from the IRS, or accept a discretionary determination by the IRS.[53] However, if the transferee does not qualify to continue the qualified decommissioning fund, the balance in the fund will be treated as distributed (and thus taxable) at the time of the transfer.

State and Federal regulators may require utilities to set aside funds for nuclear decommissioning purposes in excess of the amount allowed as a deductible contribution to a qualified decommissioning fund. In addition, the taxpayer may have set aside funds prior to the effective date of the qualified decommissioning fund rules. In some cases, a deduction may have been taken for such amounts at the time they were set aside.[54] These nonqualified funds are not eligible for the special rules that apply to qualified decommissioning funds. Since 1984, no deduction has been allowed with respect to the contribution or segregation of nonqualified funds, and the income on nonqualified funds is taxed to the taxpayer at the taxpayer's marginal rate.

REASONS FOR CHANGE

The Committee is concerned that appropriate incentives be provided to insure that adequate funds are available for the decommissioning of nuclear power plants. The Committee believes that it is appropriate to extend those incentives to all funds that have previously been irrevocably set aside for decommissioning purposes. In addition, the Committee does not believe that it is appropriate to impose the cost of service limitation on the amount that can be

[52] Treas. Regs. sec. 1.468A–6.
[53] Treas. Regs. sec. 1.468A–6(f).
[54] Prior to July 17, 1984 (the date of enactment of the Deficit Reduction Act of 1984), accrual basis taxpayers could be deduct items without regard to the time the items were economically performed. Some taxpayers may have taken the position that amounts irrevocably set aside for nuclear decommissioning purposes prior to July 17, 1984 were deductible.

contibuted to a qualified nuclear decommissioning fund if electric generation has been deregulated by a State.

The Committee recognizes that electricity deregulation has been occurring, and continues to occur, at the State level. Although the deregulation process creates the need for tax-related changes, the Committee is wary of making significant tax changes except in the context of broader Federal electricity restructuring legislation. The Committee believes, however, that the bill's limited changes to the nuclear decommissioning fund rulese are an appropriate interim measure and that the more fundamental changes required by electricity restructuring should be delayed until the appropriate time.

EXPLANATION OF PROVISION

The cost of service requirement for deductible contributions to nuclear decommissioning funds is repealed. Taxpayers, including unregulated taxpayers, are allowed a deduction for amounts contributed to a qualified nuclear decommissioning fund. As under current law, however, the maximum contribution and deduction for a taxable year can not exceed the IRS ruling amount for that year.

The provision also clarifies the Federal income tax treatment of the transfer of qualified nuclear decommissioning funds. No gain or loss is recognized to the transferor or the transferee as a result of the transfer of a qualified fund in connection with the transfer of the power plant with respect to which the fund was established.

The provision provides an election to transfer the balance of certain nonqualified funds to qualified fund. Any portion of the amount transferred that has not previously been deducted is allowed as a deduction over the remainder of the useful life of the nuclear power plant (as determined for the purpose of the ruling amount) beginning with the first taxable year that begins after 2001. If a qualified fund that has received a transfer from a nonqualified fund is transferred to another person, that person will be entitled to the deduction at the same time and in the same manner as the transferor. Thus, if the transferor was not subject to tax at the time and thus would have been unable to utilize the deduction, the transferee will similarly not be able to utilize the deduction. A taxpayer is not considered to have a basis in any qualified nuclear decommissioning fund.

Nonqualified funds eligible to be transferred to a qualified fund are funds that have been irrevocably set aside pursuant to the requirements of a state of Federal agency exclusively for the purpose of funding the decommissioning of the taxpayer's nuclear power plant. Funds that constitute a "prepaid decommissioning fund" or "external sinking trust fund" that would qualify for the purpose of providing financial assurance that funds will be available for the decommisioning process under 10 CFR 50.75 are expected to meet the definition of nonqualified funds for this purpose.

A new ruling amount must be obtained following the transfer of nonqualified funds to a qualified fund.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

H. Permit Consolidation of Life and Nonlife Insurance Companies

(sec. 1315 of the bill and secs. 1503(c)(2), 1504(b)(2), and 1504(c) of the Code)

PRESENT LAW

Under present law, an affiliated group of corporations means one or more chains of includible corporations connected through stock ownership with a common parent corporation (sec. 1504(a)(1)). The stock ownership requirement consists of an 80-percent voting and value test. In general, an affiliated group of corporations may file a consolidated tax return for Federal income tax purposes.

Life insurance companies (subject to tax under section 801) generally are not treated as includible corporations, and therefore may not be included in a consolidated return of an affiliated group including nonlife-insurance companies, unless the common parent of the group elects to treat the life insurance companies as includible corporations (sec. 1504(c)(2)).

Under the election to treat life insurance companies as includible corporations of an affiliated group, two special 5-year limitation rules apply. The first 5-year rule provides that a life insurance company may not be treated as an includible corporation until it has been a member of the group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed (sec. 1504(c)(2)). The second 5-year rule provides that any net operating loss of a nonlife-insurance member of the group may not offset the taxable income of a life insurance member for any of the first 5 years the life insurance company has been a member of the group (sec. 1503(c)(2)). This rule applies to nonlife losses for the current taxable year or as a carryover or carryback.

A separate 35-percent limitation also applies under the election to treat life insurance companies as includible corporations of an affiliated group (sec. 1503(c)(1)). This rule provides that if the nonlife-insurance members of the group have a net operating loss, then the amount of the loss that is not absorbed by carrybacks against the nonlife-insurance members' income may offset the life insurance members' income only to the extent of the lesser of: (1) 35 percent of the amount of the loss; or (2) 35 percent of the life insurance members' taxable income. The unused portion of the loss is available as a carryover and is added to subsequent-year losses, subject to the same 35-percent limitation.

REASONS FOR CHANGE

The Committee understands that the five-year limitation rules under the election to treat life insurance companies as includible corporations give rise to considerable complexity in application, especially as the two five-year rules interact with each other. The Committee believes that desirable simplification of the tax law can be achieved by repeal of the two five-year rules.

EXPLANATION OF PROVISION

The provision repeals the two 5-year limitation rules under the election to treat life insurance companies as includible corporations of an affiliated group. The provision also repeals the rule that a life insurance corporation is not an includible corporation unless the common parent makes an election to treat life insurance companies as includible corporations. Thus, under the provision, a life insurance company is treated as an includible corporation starting with the first taxable year for which it becomes a member of the affiliated group and otherwise meets the definition of an includible corporation. In addition, any net operating loss of a nonlife-insurance member of the group can offset the taxable income of a life insurance member starting with the first taxable year for which it becomes a member of the affiliated group and otherwise meets the definition of an includible corporation. The provision retains the 35-percent limitation of present law with respect to any life insurance company that is an includible corporation of an affiliated group.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2004.

To the extent that a consolidated net operating loss is created or increased by the provision, the loss may not be carried back to a taxable year beginning before January 1, 2005. In addition, no affilated group terminates solely by reason of the provision. The provision waives the 5-year waiting period for reconsolidation under section 1504(a)(3), in the case of any corporation that was previously an includible corporation, but was subsequently deemed not to be an includible corporation as a result of becoming a subsidiary of a corporation that was not an includible corporation by reason of the 5-year rule of section 1504(c)(2) (providing that a life insurance company may not be treated as an includible corporation until it has been a member of the group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed).

I. CONSOLIDATE CODE PROVISIONS GOVERNING THE HAZARDOUS SUBSTANCE SUPERFUND AND THE LEAKING UNDERGROUND STORAGE TANK TRUST FUND

(sec. 1321 of the bill and secs. 9507 and 9508 of the Code)

PRESENT LAW

Present law includes two separate Trust Funds to finance similar ground and water cleanup programs related to hazardous substances. These funds are the Hazardous Substance Superfund (the "Superfund") and the Leaking Underground Storage Tank Trust Fund (the "LUST Trust Fund"). Amounts in both Trust Funds are available as provided in cross-referenced authorization and appropriations Acts.

REASONS FOR CHANGE

The Committee observes that both the Superfund and the LUST Trust Fund provide monies for remediation of soil and groundwater related to contamination generally from chemicals and petroleum products in the case of the Superfund and generally from petroleum products in the case of the LUST Trust Fund. Because of the similarity of purpose of the two present-law trust funds, the Committee believes there will be some administrative economies to be gained from combining the two present-law trust funds into one Environmental Remediation Trust Fund.

EXPLANATION OF PROVISION

The Code provisions governing the Superfund and the LUST Trust Fund are consolidated into a single Environmental Remediation Trust Fund (the "Environmental Trust Fund"). Amounts in the consolidated Trust Fund (i.e., all amounts in both of the present-law Trust Funds) are available for expenditure, as provided in appropriations Acts, for the combined purposes of the two present-law Trust Funds, as of July 12, 1999.

Provisions like those currently included in the Highway Trust Fund, the Aquatic Resources Trust Fund, and the Vaccine Injury Compensation Trust Fund clarifying that expenditures from the Environmental Trust Fund may occur only as provided in the Code are incorporated into the new Trust Fund statute, notwithstanding provisions of any other Act (including subsequently enacted non-revenue Act legislation). If any subsequent non-revenue legislation provides for expenditures not provided for in the Code, or if any executive agency authorizes such expenditure in contravention of the Code restrictions, excise tax and other Federal revenues otherwise to be deposited in the Environmental Trust Fund will be retained in the General Fund beginning on the date of enactment of such legislation or the date of such executive agency action. Furthermore, no future interest will accrue on the unobligated balances of the Environmental Trust Fund.

EFFECTIVE DATE

The provision is effective on October 1, 1999.

J. Repeal Certain Excise Taxes on Rail Diesel Fuel and Inland Waterway Barge Fuels

(sec. 1322 of the bill and secs. 4041 and 4042 of the Code)

PRESENT LAW

Under present law, diesel fuel used in trains is subject to a 4.4-cents-per gallon excise tax. Revenues from 4.3 cents per gallon of this excise tax are retained in the General Fund of the Treasury. The remaining 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank ("LUST") Trust Fund.

Similarly, fuels used in barges operating on the designated inland waterways system is subject to a 4.3-cents-per-gallon General Fund excise tax. This tax is in addition to the 20.1-cents-per-gallon tax rates that are imposed on fuels used in these barges to fund the Inland Waterways Trust Fund and the Leaking Underground Storage Tank Trust Fund.

In both cases, the 4.3-cents-per-gallon excise tax rates are permanent. The LUST tax is scheduled to expire after March 31, 2005.

REASONS FOR CHANGE

The Committee notes that in 1993 the Congress enacted the present-law 4.3-cents-per-gallon excise tax as a motor fuels tax on almost all motor fuel uses with the receipts payable to the General Fund. Since that time, the Congress has diverted the 4.3-cents-per-gallon excise tax for most uses to specified trust funds which provide benefits for those motor fuel users who ultimately bear the burden of these taxes. As a result, the Committee finds that generally only rail and barge operators remain as motor fuel users subject to the 4.3-cents-per-gallon excise tax who receive no benefits from a dedicated trust fund as a result of their tax burden. The Committee observes that rail and barge operators compete with other transportation service providers who benefit from expenditures paid from dedicated trust funds. The Committee concluded that it is inequitable and distortive of transportation decisions to continue to impose the 4.3-cents-per-gallon excise tax on diesel fuel used in trains and barges. In addition, the Committee notes that upon repeal of the 4.3-cents-per-gallon excise tax applicable to rail diesel fuel that rail diesel fuel would be subject only to the 0.1-cent-per-gallon excise tax for deposit in the LUST Trust Fund. The Committee believes that some simplicity of excise tax administration will be achieved by repeal of the remaining 0.1-cent-per-gallon excise tax (deposited in the LUST Trust Fund) on diesel fuel used by trains. Further, this repeal is consistent with the general rule that only these taxpayers subject to a tax on motor fuels for other purposes are subject to the LUST tax.

EXPLANATION OF PROVISION

The 0.1-cent-per-gallon LUST tax on diesel fuel used in trains is repealed. (The LUST tax is an add-on tax on otherwise taxable fuels. Upon repeal of the 4.3-cents-per-gallon General Fund tax on diesel fuel used in trains, this tax automatically would expire absent affirmative action by Congress to impose it separately. The effect of this separate provision to repeal the LUST tax of fuel used in trains two years earlier that otherwise would occur.)

In addition, the 4.3-cents-per-gallon General Fund excise tax rates on diesel fuel used in trains and fuels used in barges operating on the designated inland waterways system is repealed.

EFFECTIVE DATES

The repeal of the 0.1-cent-per-gallon LUST tax on diesel fuel used in trains is effective on October 1, 1999. The repeal of the 4.3-cents-per-gallon excise taxes on train diesel and inland waterway barge fuels is effective after September 30, 2003.

Repeal of these taxes is contingent upon enactment as part of the bill of a separate provision that consolidates the Code provisions governing the Hazardous Substance Superfund and the Leaking Underground Storage Tank Trust Fund into an Environmental Remediation Trust Fund.

K. Repeal Excise Tax on Fishing Tackle Boxes

(sec. 1323 of the bill and sec. 4162 of the Code)

PRESENT LAW

Under present law, a 10-percent manufacturer's excise tax is imposed on specified sport fishing equipment. Examples of taxable equipment include fishing rods and poles, fishing reels, artificial bait, fishing lures, line and hooks, and fishing tackle boxes. Revenues from the excise tax on sport fishing equipment are deposited in the Sport Fishing Account of the Aquatic Resources Trust Fund. Monies in the fund are spent, subject to an existing permanent appropriation, to support Federal-State sport fish enhancement and safety programs.

REASONS FOR CHANGE

The Committee observes that fishing "tackle boxes" are little different in design and appearance from "tool boxes," yet the former are subject to a Federal excise tax at a rate of 10-percent, while the latter are not subject to Federal excise tax. This excise tax can create a sufficiently large price difference that some fishermen will choose to use a "tool box" to hold their hooks and lures rather than a traditional "tackle box." The Committee finds that such a distortion of consumer choice places an inappropriate burden on the manufacturers and purchasers of traditional tackle boxes, particularly in comparison to the modest amount of revenue raised by the present-law provision, and that this burden warrants repeal of the tax. The Committee also believes that elimination of the excise tax on tackle boxes will provide some modest simplification of the tax system for both taxpayers and the Internal Revenue Service.

EXPLANATION OF PROVISION

The excise tax on fishing tackle boxes is repealed.

EFFECTIVE DATE

The provision is effective beginning 30 days after the date of enactment.

L. Modify Excise Tax on Arrow Components and Accessories

(sec. 1324 of the bill and sec. 4161 of the Code)

PRESENT LAW

A 12.4 percent excise tax is imposed on the sale by a manufacturer or importer of any shaft, point, nock, or vane designed for use as part of an arrow which (1) is over 18 inches long, or (2) is designed for use with a taxable bow (if shorter than 18 inches). An 11-percent tax is imposed on certain bows and on certain accessories for taxable bows and arrows.

REASONS FOR CHANGE

The Committee believes that modifications must be made to the present-law tax on arrows and points to better reflect current design and practice in the manufacture of arrows and points.

EXPLANATION OF PROVISION

The bill makes two modifications to the excise tax on arrows and arrow accessories. First, the bill extends the 12.4-percent tax on arrow components to inserts and outserts designed for use with taxable arrows. Inserts and outserts are defined as articles used to attach a point to an arrow shaft. Second, the bill reclassifies "broadheads," or arrow points designed for hunting fish or large animals, as arrow accessories subject to the 11-percent tax rather than arrow points subject to the 12.4-percent tax (as under present law).

EFFECTIVE DATE

The provisions of the bill apply to sales by manufacturers beginning on the first day of the first calendar quarter that begins more than 30 days after the bill's enactment.

M. Increase Low-income Housing Tax Credit Cap and Make Other Modifications

(secs. 1331–1337 of the bill and sec. 42 of the Code)

PRESENT LAW

In general

The low-income housing tax credit may be claimed over a 10-year period for the cost of rental housing occupied by tenants having incomes below specified levels. The credit percentage for newly constructed or substantially rehabilitated housing that is not Federally subsidized is adjusted monthly by the Internal Revenue Service so that the 10 annual installments have a present value of 70 percent of the total qualified expenditures. The credit percentage for new substantially rehabilitated housing that is Federally subsidized and for existing housing that is substantially rehabilitated is calculated to have a present value of 30 percent qualified expenditures.

Credit cap

The aggregate credit authority provided annually to each State is $1.25 per resident, except in the case of projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit and certain carry-over amounts,

Expenditure test

Generally, the building must be placed in service in the year in which it receives an allocation to qualify for the credit. An exception is provided in the case where the taxpayer has expended an amount equal to 10-percent or more of the taxpayer's reasonably expected basis in the building by the end of the calendar year in which the allocation is received and certain other requirements are met.

Basis of building eligible for the credit

Buildings receiving assistance under the HOME investment partnerships act ("HOME") are not eligible for the enhanced credit for buildings located in high cost areas (i.e., qualified census tracts and difficult development areas). Under the enhanced credit, the 70-percent and 30-percent credit are increased to a 91-percent and 39-percent credit, respectfully.

Eligible basis is generally limited to the portion of the building used by qualified low-income tenants for residential living and some common areas.

State allocation plans

Each State must develop a plan for allocating credits and such plan must include certain allocation criteria including: (1) project location; (2) housing needs characteristics; (3) project characteristics; (4) sponsor characteristics; (5) participation of local tax-exempts; (6) tenant populations with special needs; and (7) public housing waiting lists. The State allocation plan must also give preference to housing projects: (1) that serve the lowest income tenants; and (2) that are obligated to serve qualified tenants for the longest periods.

Credit administration

There are no explicit requirements that housing credit agencies perform a comprehensive market study of the housing needs of the low-income individuals in the area to be served by the project, nor that such agency conduct site visits to monitor for compliance with habitability standards.

Stacking rule

Authority to allocate credits remains at the State (as opposed to local) government level unless State law provides otherwise. [55] Generally, credits may be allocated only from volume authority arising during the calendar year in which the building is placed in service, except in the case of: (1) credits claimed on additions to qualified basis; (2) credits allocated in a later year pursuant to an earlier binding commitment made no later than the year in which the building is placed in service; and (3) carryover allocations.

Each State annually receives low-income housing credit authority equal to $1.25 per State resident for allocation to qualified low-income projects. [56] In addition to this $1.25 per resident amount, each State's "housing credit ceiling" includes the following amounts: (1) the unused State housing credit ceiling (if any) of such State for the preceding calendar year; [57] (2) the amount of the State housing

[55] For example, constitutional home rule cities in Illinois are guaranteed their proportionate share of the $1.25 amount, based on their population relative to that of the State as a whole.

[56] A State's population, for these purpoes, is the most recent estimate of the State's population released by the Bureau of the Census before the beginning of the year to which the limitation applies. Also, for these purposes, the District of Columbia and the U.S. possessions (i.e., Puerto Rico, the Virgin Islands, Guam, the Northern Marianas and American Samoa) are treated as States.

[57] The unused State housing credit ceiling is the amount (if positive) of the previous year's annual credit limitation plus credit returns less the credit actually allocated in that year.

credit ceiling (if any) returned in the calendar year;[58] and (3) the amount of the national pool (if any) allocated to such State by the Treasury Department.

The national pool consists of States' unused housing credit carryovers. For each State, the unused housing credit carryover for a calendar year consists of the excess (if any) of the unused State housing credit ceiling for such year over the excess (if any) of the aggregate housing credit dollar amount allocated for such year over the sum of $1.25 per resident and the credit returns for such year. The amounts in the national pool are allocated only to a State which allocated its entire housing credit ceiling for the preceding calendar year, and requested a share in the national pool not later than May 1 of the calendar year. The national pool allocation to qualified States is made on a pro rata basis equivalent to the fraction that a State's population enjoys relative to the total population of all qualified States for that year.

The present-law stacking rule provides that a State is treated as using its annual allocation of credit authority ($1.25 per State resident) and any returns during the calendar year followed by any unused credits carried forward from the preceding year's credit ceiling and finally any applicable allocations from the National pool.

REASONS FOR CHANGE

The Committee believes that the credit acts as a stimulus for low-income housing. It believes that the expansion of the credit cap will allow the construction and substantial rehabilitation of more affordable rental housing for low-income individuals in the future. The other changes to the credit program are intended to improve the operation of the credit.

EXPLANATION OF PROVISION

Credit cap

The $1.25 per capita cap is increased to $1.75 per capita. This increase is phased-in by increasing the credit cap by 10 cents per capita each year for five years. The credit cap would be: $1.35 in calendar year 2000; $1.45 in calendar 2001; $1.55 in calendar year 2002; $1.65 in calendar year 2003; and $1.75 in calendar year 2004. The $1.75 per capita credit cap is indexed for inflation beginning in 2004.

Expenditure test

The bill allows a building which receives an allocation in the second half of a calendar to qualify under the 10-percent test if the taxpayer expends an amount equal to 10-percent or more of the taxpayer's reasonably expected basis in the building within six months of receiving the allocation regardless of whether the 10-percent test is met by the end of the calendar year.

[58] Credit returns are the sum of any amounts allocated to projects within a State which fail to become a qualified low-income housing project within the allowable time period plus any amounts allocated to a project within a State under an allocation which is canceled by mutual consent of the housing credit agency and the allocation recipient.

Basis of building eligible for the credit

The bill makes three changes to the basis rules of the credit. First, buildings receiving HOME assistance are made eligible for the enhanced credit. Second, the definition of qualified census tracts for purposes of the enhanced credit is expanded to include any census tracts with a poverty rate of 25 percent or more. Third, the bill extends the credit to a portion of the building used as a community service facility not in excess of 20 percent of the total eligible basis in the building. A community service facility is defined as any facility designed to serve primarily individuals whose income is 60 percent or less of area median income.

State allocation plans

The bill strikes the plan criteria relating to participation of local tax-exempts, replacing it with two other criteria: tenant populations of individuals with children and projects intended for eventual tenant ownership. It also provides that the present-law criteria relating to sponsor characteristics include whether the project involves the use of existing housing as part of a community revitalization plan. Also, the bill adds a third category of housing projects to the preferential list. That third category is for projects located in qualified census tracts which contribute to a concerted community revitalization plan.

Credit administration

The bill requires a comprehensive market study of the housing needs of the low-income individuals in the area to be served by the project and a written explanation available to the general public for any allocation not made in accordance with the established priorities and selection criteria of the housing credit agency. It also requires site inspections by the housing credit agency to monitor compliance with habitability standards applicable to the project.

Stacking rule

The bill modifies the stacking rule so that each State would be treated as using its allocation of the unused State housing credit ceiling (if any) from the preceding calendar before the current year's allocation of credit (including any credits returned to the State) and then finally any National pool allocations.

EFFECTIVE DATE

In general, the bill is effective for calendar years beginning after December 31, 2000, and buildings placed-in-service after such date in the case of projects that also receive financing with proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued after such date. The increase and indexing of the credit cap is effective for calendar years after December 31, 1999.

N. Entrepreneurial Equity Capital Formation

(secs. 1341–1347 of the bill and secs. 851, 1044 and 1202 of the Code)

PRESENT LAW

Under present law, a taxpayer may elect to roll over without payment of tax any capital gain realized upon the sale of publicly-traded securities where the taxpayer uses the proceeds from the sale to purchase common stock in a specialized small business investment company ("SSBIC") within 60 days of the sale of the securities. The maximum amount of gain that an individual may roll over under this provision for a taxable year is limited to the lesser of (1) $50,000 or (2) $500,000 reduced by any gain previously excluded under this provision. For corporations, these limits are $250,000 and $1 million.

In addition, under present law, an individual may exclude 50 percent of the gain [59] from the sale of qualifying small business stock held more than five years. An SSBIC is automatically deemed to satisfy the active business requirement which a corporation must satisfy to qualify its stock for the exclusion.

Regulated investment companies ("RICs") are entitled to deduct dividends paid to shareholders. To qualify for the deduction, 90 percent of the company's income must be derived from dividends, interest and other specified passive income, the company must distribute 90 percent of its investment income, and at least 50 percent of the value of its assets must be invested in certain diversified investments.

For purposes of these provisions, an SSBIC means any partnership or corporation that is licensed by the Small Business Administration under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993). SSBICs make long-term loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged.

REASONS FOR CHANGE

The Committee believes that the provision will make investments in SSBICs more attractive by providing tax advantages of deferral and lower capital gains taxes.

EXPLANATION OF PROVISION

Under the bill, the tax-free rollover provision is expanded by (1) extending the 60-day period to 180 days, (2) making preferred stock (as well as common stock) in an SSBIC an eligible investment, and (3) increasing the lifetime caps to $750,000 in the case of an individual and to $2 million in the case of a corporation, and repealing the annual caps.

The bill also provides that an SSBIC that is organized as a corporation may convert to a partnership without imposition of a tax to either the corporation or its shareholders, by transferring its assets to a partnership in which it holds at least an 80-percent inter-

[59] The portion of the capital gain included in income is subject to a maximum regular tax rate of 28 percent, and 42 percent of the excluded gain is a minimum tax preference.

est and then liquidating. The corporation is required to distribute all its earnings and profits before liquidating. The transaction must take place within 180 days of enactment of the bill. The partnership will be liable for a tax on any "built-in" gain in the assets transferred by the corporation at the time of the conversion.

The 50-percent exclusion for gain on the sale of qualifying small business stock is increased to 60 percent where the taxpayer, or a pass-through entity in which the taxpayer holds an interest, sells qualifying stock of an SSBIC.

For purposes of determining status as a RIC eligible for the dividends received deduction, the proposal would treat income derived by a SSBIC from its limited partner interest in a partnership whose business operations the SSBIC does not actively manage as income qualifying for the 90-percent test; would deem the SSBIC to satisfy the 90-percent distribution requirement if it distributes all its income that it is permitted to distribute under the Small Business Investment Act of 1958; and would deem the RIC diversification of assets requirement to be met to the extent the SSBIC's investments are permitted under that Act.

EFFECTIVE DATE

The rollover and small business stock provisions of the proposal are effective for sales after date of enactment. The RIC provisions are effective for taxable years beginning after date of enactment.

O. Accelerate Scheduled Increase in State Volume Limits on Tax-Exempt Private Activity Bonds

(sec. 1331 of the bill and sec. 146 of the Code)

PRESENT LAW

Interest on bonds issued by States and local governments is excluded from income if the proceeds of the bonds are used to finance activities conducted and paid for by the governmental units (sec. 103). Interest on bonds issued by these governmental units to finance activities carried out and paid for by private persons ("private activity bonds") is taxable unless the activities are specified in the Internal Revenue Code. Private activity bonds on which interest may be tax-exempt include bonds for privately operated transportation facilities (airports, docks and wharves, mass transit, and high speed rail facilities), privately owned and/or provided municipal services (water, sewer, solid waste disposal, and certain electric and heating facilities), economic development (small manufacturing facilities and redevelopment in economically depressed areas), and certain social programs (low-income rental housing, qualified mortgage bonds, student loan bonds, and exempt activities of charitable organizations described in sec. 501(c)(3)).

The volume of tax-exempt private activity bonds that States and local governments may issue for most of these purposes in each calendar year is limited by State-wide volume limits. The current annual volume limits are $50 per resident of the State or $150 million if greater. The volume limits do not apply to private activity bonds to finance airports, docks and wharves, certain governmentally owned, but privately operated solid waste disposal facilities, certain high speed rail facilities, and to certain types of private activity tax-exempt bonds that are subject to other limits on their volume (qualified veterans' mortgage bonds and certain "new" empowerment zone and enterprise community bonds).

The current annual volume limits that apply to private activity tax-exempt bonds increase to $75 per resident of each State or $225 million, if greater, beginning in calendar year 2007. The increase is, ratably phased in, beginning with $55 per capita or $165 million, if greater, in calendar year 2003.

REASONS FOR CHANGE

The Committee determined that an adjustment to the annual State private activity bond volume limits to levels comparable to the dollar limits that first applied after enactment of the Tax Reform Act of 1986 is appropriate. Such an adjustment will assist States in meeting infrastructure needs and encouraging economic development and will facilitate continuation of privatization efforts regarding municipal services such as solid waste disposal, water, and sewer services without reversing the general policy of limiting the use of this Federal subsidy for conduit borrowing in transactions that distort market choice and efficiency.

EXPLANATION OF PROVISION

The bill increases the present-law annual State private activity bond volume limits to $75 per resident of each State or $225 million (if greater).

EFFECTIVE DATE

The volume limit increases are effective for calender years after December 31, 1999.

P. Tax Treatment of Alaska Native Settlement Trusts

(sec. 1332 of the bill and new sec. 646 of the Code)

PRESENT LAW

An Alaska Native Settlement Corporation ("ANC") may establish a Settlement Trust ("Trust") under section 39 of the Alaska Native Claims Settlement Act ("ANCSA")[60] and transfer money or other property to such Trust for the benefit of beneficiaries who constitute all or a class of the shareholders of the ANC, to promote the health, education and welfare of the beneficiaries and preserve the heritage and culture of Alaska Natives.

With certain exceptions, once an ANC has made a conveyance to a Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgement, except with respect to the lawful debts and obligations of the trust.

The Internal Revenue Service has indicated that contributions to a Trust constitute distributions to the beneficiary-shareholders at the time of the contribution and are treated as dividends to the extent of earnings and profits as provided under section 301 of the

[60] 43 U.S.C. 1601 et seq.

Code. The Trust and its beneficiaries are taxed according to the rules of Subchapter J of the Code.

REASONS FOR CHANGE

The Committee believes that contributions to a Trust by an ANC should not be taxed as distributions to beneficiary-shareholders at the time of the contribution. If and when such principal amounts of the Trust are ultimately distributed to beneficiaries, however, tax at ordinary income rates will apply. Such a distribution might occur only many years after the original contribution, thus the deferral on the original contribution is expected to provide relief. Tax is imposed at the time the principal is distributed in order to prevent the ANC from contributing assets to a Trust as a conduit and immediately liquidating the Trust to avoid the shareholder tax on corporate distributions.

This change permits the contribution of assets to the Trust in a manner that reduces the impact of the corporate structure of ANC's on the establishment of Trusts. Once the Trust is established, ordinary trust tax principles apply with respect to Trust and beneficiary taxation. Income retained by the Trust will be taxed as ordinary income or capital gains, in accordance with the normal trust provisions. Amounts taxed at the trust level and later distributed to beneficiaries will not be taxed to the beneficiaries when distributed.

EXPLANATION OF PROVISION

An Alaska Native Corporation may establish a Trust under section 39 of ANCSA and if the Trust makes an election for its first taxable year ending after December 31, 1999, no amount will be includible in the gross income of a beneficiary of such Trust by reason of a contribution to the Trust. [6]

The earnings and profits of the ANC are not reduced by the amount of such contribution. However, the ANC earnings and profits are reduced (up to the amount of the contribution) as distributions are thereafter made by the Trust which would exceed the Trusts's total undistributed net income for all prior years during which an election is in effect plus the Trust's distributable net income for the current year, computed under Subchapter J. Beneficiaries of the Trust would be taxed on such excess distributions as ordinary income, and reporting to beneficiaries for such amounts could be made on Form 1099 rather than Form K–1.

Apart from these rules, the Trust and its beneficiaries are, as under present law, subject to tax in accordance with the rules of Subchapter J.

Certain additional restrictions apply. If the beneficial interests in the Trust or shares of the ANC may be sold or exchanged to a person in a manner that would not be permitted under ANCSA (generally, to a person other than an Alaska Native), then future contributions to the Trust are treated as distributions to the beneficiaries at the time of contribution as under present law, and the

[61] If the ANC conveys appreciated assets to the trust, the section 311 corporate level tax on the appreciation continues to apply as under present law.

"excess" distribution provisions described above do not apply with respect to such contributions.

In the case of an electing Trust, distributions to beneficiaries that reduce the earnings and profits of an ANC are subject to withholding to the extent that such distributions, on an annualized basis, exceed the sum of the standard deduction and personal exemption for the taxable year.

EFFECTIVE DATE

The provision is effective for taxable years of Settlement Trusts, and contributions to such Trusts, after December 31, 1999.

Q. INCREASE JOINT COMMITTEE ON TAXATION REFUND REVIEW THRESHOLD TO $2 MILLION

(sec. 1353 of the bill and sec. 6405 of the Code)

PRESENT LAW

No refund or credit in excess of $1,000,000 of any income tax, estate or gift tax, or certain other specified taxes, may be made until 30 days after the date a report on the refund is provided to the Joint Committee on Taxation (sec. 6405). A report is also required in the case of certain tentative refunds. Additionally, the staff of the Joint Committee on Taxation conducts post-audit reviews of large deficiency cases and other select issues.

REASONS FOR CHANGE

The Committee believes that it is appropriate to increase the refund review threshold, which has been set at $1,000,000 since 1990. Increasing it will accelerate the issuance of refunds between $1,000,000 and $2,000,000 to the taxpayers involved. In addition, this increase will free up significant resources of both the Internal Revenue Service and the staff of the Joint Committee on Taxation, without materially impairing the ability to monitor problems in the administration of the tax laws.

EXPLANATION OF PROVISION

The provision increases the threshold above which refunds must be submitted to the Joint Committee on Taxation for review from $1,000,000 to $2,000,000. The staff of the Joint Committee on Taxation would continue to exercise its existing statutory authority to conduct a program of expanded post-audit reviews of large deficiency cases and other select issues, and the IRS is expected to cooperate fully in this expanded program.

EFFECTIVE DATE

The provision is effective on the date of enactment, except that the higher threshold does not apply to a refund or credit with respect to which a report was made before the date of enactment.

R. Clarification of Depreciation Study

(sec. 1354 of the bill)

PRESENT LAW

The Secretary of the Treasury (or his delegate) is directed to conduct a comprehensive study of the recovery periods and depreciation methods under section 168 of the Code, and to provide recommendations for determining such periods and methods in a more rational manner. The Secretary of the Treasury (or his delegate) is directed to submit the results of the study and recommendations to the House Ways and Means and Senate Finance Committees by March 31, 2000.

REASONS FOR CHANGE

The Committee wishes to insure that the treatment of long-lived real property used in connection with a franchise is included in the study.

EXPLANATION OF PROVISION

The Secretary of the Treasury (or his delegate) is directed to include a study of such periods and methods applicable to section 1250 property used in connection with a franchise (within the meaning of section 1253) and owned by the franchisee in the study of recovery periods and depreciation methods under section 168 of the Code that is due to be submitted to the House Ways and Means and Senate Finance Committees by March 31, 2000.

EFFECTIVE DATE

The provision is effective on the date of enactment.

S. Tax Court Provisions

1. Tax Court filing fee (sec. 1361 of the bill and sec. 7451 of the Code)

PRESENT LAW

Section 7451 authorizes the Tax Court to impose a fee of up to $60 for the filing of any petition "for the redetermination of a deficiency or for a declaratory judgment under part IV of this subchapter or under section 7428 or for judicial review under section 6226 or section 6228(a)." The statute does not specifically authorize the Tax Court to impose a filing fee for the filing of a petition for review of the IRS's failure to abate interest under section 6404 or for administrative costs under section 7430. The practice of the Tax Court is to impose a $60 filing fee in all cases commenced by petition.[62]

REASONS FOR CHANGE

The Committee believes it is appropriate to expand the Tax Court filing fee to apply to any cases commenced by the filing of a petition.

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[62] See Rule 20(a) of the Tax Court Rules of Practices and Procedure.

EXPLANATION OF PROVISION

Under the bill, section 7451 is amended to provide that the Tax Court is authorized to charge a filing fee of up to $60 in all cases commenced by the filing of a petition.

EFFECTIVE DATE

The provision is effective on the date of enactment.

2. Use of practitioner fee (sec. 1362 of the bill and sec. 7475 of the Code)

PRESENT LAW

Section 7475 authorizes the Tax Court to impose on practitioners a fee of up to $30 per year and permits these fees to be used to employ independent counsel to pursue disciplinary matters.

REASONS FOR CHANGE

The Committee believes it is appropriate for Tax Court fees imposed on practitioners also to be available to provide services to pro se taxpayers.

EXPLANATION OF PROVISION

The bill provides that Tax Court fees imposed on practitioners also are available to provide services to pro se taxpayers.

EFFECTIVE DATE

The provision is effective on the date of enactment.

3. Tax Court authority to apply equitable recoupment (sec. 1363 of the bill and sec. 6214 of the Code)

PRESENT LAW

Equitable recoupment is a common-law equitable principle which permits the defensive use of an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. U.S. District Courts and the U.S. Court of Federal Claims, the two Federal tax refund forums, may apply equitable recoupment in deciding tax refund cases.[63] In *Estate of Mueller* v. *Commissioner*[64], the Tax Court held that it may apply equitable recoupment in deciding cases over which it has jurisdiction. However, the Court of Appeals for the Sixth Circuit recently held that the Tax Court may not apply the doctrine of equitable recoupment.[65]

REASONS FOR CHANGE

The Committee believes that the doctrine of equitable recoupment should also be available in the Tax Court.

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[63] See *Stone* v. *White,* 301 U.S. 532 (1937), *Bull* v. *United States,* 295 U.S. 247 (1935).
[64] 101 T.C. 551 (1993).
[65] See *Estate of Mueller* v. *Commissioner,* 153 F.3d 302 (6th Cir. 1998), cert. denied, 67 U.S.L.W. 3525 (U.S. Feb. 22, 1999) (No. 98–794).In an earlier case, the Supreme Court specifically reserved ruling on whether the Tax Curt may apply equitable recoupment in a case over which it otherwise has jurisdiction. *United States* v. *Dalm,* 494 U.S. 596, 611 n.8 (1990).

EXPLANATION OF PROVISION

Under the bill, Section 6214(b) is amended to provide that the Tax Court may apply the principle of equitable recoupment to the same extent that it may be applied in Federal civil tax cases by the District Courts and the Court of Federal Claims.[66]

EFFECTIVE DATE

The provision is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

T. Allow Certain Wholesale Distributors and Control State Entities To Elect To Be Treated as Distilled Spirits Plants Operators

(sec. 1371 of the bill and secs. 5002, 5005, 5011, 5113, 5171, 5178, 5212, 5214, 5232, 5551, 5601, 5602, and 5684 of the Code)

PRESENT LAW

Distilled spirits produced or imported (or brought) into the United States are subject to a $13.50 per proof gallon excise tax. A proof gallon is a U.S. gallon consisting of 50 percent alcohol. The tax is imposed on removal of the distilled spirits from the distillery where produced in the case of domestically produced spirits. In the case of distilled spirits imported in bulk and transferred to a U.S. distillery, the tax is imposed upon removal from the distillery. In the case of bottled distilled spirits imported into the United States, the tax is imposed on removal of the spirits from customs custody or the first customs bonded warehouse in the United States (or in a foreign trade zone) to which the spirits are transferred.

REASONS FOR CHANGE

The Committee observes that imported distilled spirits may be warehoused, in bonded warehouses, and the excise tax on the imported spirits could be paid upon dispatch of the spirits from the warehouse to a retail outlet, assuming that the spirits were transferred direct to retail from the first warehouse in which they were located upon entry into the United States. The domestic distiller, on the other hand, pays the excise tax on distilled spirits upon removal from the distillery, even though such spirits may be marketed through an independent wholesaler prior to shipment to retail outlets. The Committee believes that wholesalers lose more time value of money on their tax payments with regard to domestic spirits prior to recovery from retail sales than with respect to imported spirits they handle. The Committee believes it is appropriate to equalize the timing of the payment of the distilled spirits excise tax.

[66] No inference is intended with respect to whether the Tax Court has the authority to continue to apply other equitable principles in deciding matters over which it has jurisdiction.

EXPLANATION OF PROVISION

In general

The bill allows certain wholesale dealers and certain control State entities [67] (collectively, "bonded dealers") to elect to become distilled spirits taxpayers. Bonded dealers qualifying to receive non-tax-paid distilled spirits from distilled spirits plants under this provision must be approved by the Treasury Department and post appropriate bond as required under present law for operators of distilled spirits plants.[68] The election to become a bonded dealer must be made in the manner prescribed the Treasury Department and is governed by the rules applicable to applications for basic permits under section 204(a)(2) of Title 27 of the U.S. Code (the "Federal Alcohol Administration Act").[69] Code regulations relating to operation of distilled spirits plants, other than requirements directly related to production and bottling of distilled spirits, are extended to qualified bonded dealers.

As under present law, excise tax will be determined in all cases upon removal from the distilled spirits plant or upon importation; however, in the case of distilled spirits transferred to a bonded dealer, payment of the tax will be delayed until the distilled spirits are removed from the bonded dealer's premises. All removals (including removals to other bonded dealers) of non-tax-paid distilled spirits by bonded dealers are subject to tax.

Operators of distilled spirits plants and importers will be required to certify to bonded dealers the amount of tax due with respect to all distilled spirits transferred without payment of tax. Bonded dealers are liable for the full amount of tax reflected in the certification supplied by the operator of distilled spirits plant from which the spirits are transferred without payment of tax. Distilled spirits plant operators remain liable for any understatement of tax on the certifications.

Only wholesale distributors or control State entities having gross receipts from the sale of distilled spirits within the United States in the 12–month period preceding the date on which the election is made equal to or exceeding $10 million may qualify as bonded dealers. Additionally, except in the case of control State entities, bonded dealers qualify only if they sell distilled spirits exclusively to other wholesale distributors (including other bonded dealers) or to independent retail dealers. Retail dealers, other than control State entities, are not permitted to be bonded dealers. For purposes of this rule, a wholesale distributor is treated as a retail dealer if

[67] A control State entity is a State or political subdivision of a State in which only the State or political subdivision is allowed by law to perform distilled spirits operations.

[68] The provision does not affect (i.e., narrow or expand) the circumstances in which distilled spirits may be transferred without payment of tax from a distilled spirits plant (the first warehouse in which spirits are landed in the case of bottled imported spirits). Thus, transfers of bottled distilled spirits between distilled spirits premises, or between customs bonded warehouses is not permitted.

[69] If an otherwise qualified wholesale distributor or control State entity applies for bonded dealer status, and the Treasury Department has not acted on that application within nine months of its filing, the wholesale distributor or control State entity is permitted to operate as a bonded dealer until action is taken on the application. This exception applies only to wholesale distributors that have received basic permits as an importer, wholesaler, or both, and have obtained a bond required under the Code, prior to filing an application for bonded dealer status. The requirement that a basis permit have been issued is waived in the case of controlled State entities making the election.

the dealer directly, or indirectly through common ownership by or of a third party, more than 10 percent of a retail dealer.

Imposition of new surtax on non-tax-paid distilled spirits transferred to premises of bonded dealers

As a condition of being granted and retaining bonded dealers status, electing wholesale distributors and control State entities are subject to a new Federal excise surtax equal to 1.5 percent of their liability for distilled spirits tax. The surtax is imposed in the same manner as the present-law distilled spirits tax; payment of the tax must be made in the same manner as the underlying distilled spirits excise tax. The surtax will expire after December 31, 2010.

Rules governing payment of distilled spirits excise taxes

Subject to two exceptions, payment of excise tax by bonded dealers generally is subject to the same rules as apply to payment by operators of distilled spirits plants under present law.[70] First, a special accelerated payment requirement applies to distilled spirits tax (including the new 1.5-percent surtax) imposed on non-tax-paid spirits transferred to bonded dealers. Under this special payment requirement, on each September 20, bonded dealers will be required to pay all excise tax deposits that otherwise would be due for the period September 16–30 and for all semi-monthly periods in the months of October and November. The bill includes a safe harbor against underpayment penalties and interest if this advance payment equals at least the amount that was due in the previous September 20 (or would have been due had the bonded dealer been qualified to receive non-tax-paid distilled spirits).

Second, all bonded dealers must pay their distilled spirits excise tax (including the new surtax) by electronic funds transfer.

Studies and reports

The bill directs the Treasury Department to study and report to the House Committee on Ways and Means and the Senate Committee on Finance whether administrative efficiencies could result from cooperative tax collection agreements between the Federal Government and States. This report is due no later than the date which is one year after the bill's enactment.

The bill further directs the Treasury Department to study and report to these two Committees, the effect allowing bonded dealers to receive non-tax-paid distilled spirits on taxpayer compliance with the provisions of Code section 5010 (the "wine and flavors credits"). This report is due no later than June 1, 2002.

EFFECTIVE DATE

The provision is effective beginning on the first day of the first calendar quarter that begins at least 120 days after the bill's enactment.

[70] In addition to non-tax-paid distilled spirits, bonded dealers are permitted to store on their business premises, tax-paid distilled spirits and other alcoholic beverages and untaxed merchandise.

TITLE XIV. EXTENSION OF EXPIRING TAX PROVISIONS

A. EXTENSION OF RESEARCH AND EXPERIMENTATION CREDIT AND INCREASE IN THE RATES FOR THE ALTERNATIVE INCREMENTAL RESEARCH CREDIT

(sec. 1401 of the bill and sec. 41 of the Code)

PRESENT LAW

General rule

Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceeded its base amount for that year. The research tax credit expired and generally does not apply to amounts paid or incurred after June 30, 1999.

A 20-percent research tax credit also applied to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the "university basic research credit" (see sec. 41(e)).

Computation of allowable credit

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of 3 percent.[71]

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

[71] A special rule is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm will be assigned a fixed-based percentage of 3 percent for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. In the event that the research credit is extended beyond the scheduled expiration date, a start-up firm's fixed-based percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenditures will be a phased-in ratio based on its actual research experience. For all subsequent taxable years, the taxpayer's fixed-based percentage will be its actual ratio of qualified research expenditures to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993 (sec. 41(c)(3)(B)).

Alternative incremental research credit regime

Taxpayers are allowed to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative credit regime, a credit rate of 1.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1 percent (i.e., the base amount equals 1 percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 2.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of 2 percent. A credit rate of 2.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 2 percent. An election to be subject to this alternative incremental credit regime applies to the taxable year in which the election is made and all subsequent years (in the event that the credit subsequently is extended by Congress) unless revoked with the consent of the Secretary of the Treasury.

Eligible expenditures

Qualified research expenditures eligible for the research tax credit consist of: (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses").[72]

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must involve a process of experimentation related to functional aspects, performance, reliability, or quality of a business component.

Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

[72] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research is treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under sec. 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer.

Relation to deduction

Deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year. Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

REASONS FOR CHANGE

The Committee believes that increasing technological knowledge ultimately will lead to new and better products produced at lower costs. New and better products and lower production costs are the genesis of economic growth. For this reason, the Committee believes it is important to extend the research and experimentation tax credit.

In addition, the Committee believes the alternative incremental credit enacted in 1996 should be strengthened. The alternative incremental research credit was enacted to respond to the changing economic circumstances of many taxpayers which invest heavily in research. However, the Committee believes that under current law, the alternative incremental research credit provides less of a research incentive than does the regular research and experimentation tax credit. Therefore, the Committee believes it is appropriate to increase the rate of the alternative incremental research credit.

EXPLANATION OF PROVISION

The bill extends the research tax credit for five years—i.e., generally, for the period July 1, 1999, through June 30, 2004.

In addition, the bill increases the credit rate applicable under the alternative incremental research credit one percentage point per step, that is from 1.65 percent to 2.65 percent when a taxpayer's current-year research expenses exceed a base amount of 1 percent but do not exceed a base amount of 1.5 percent; from 2.2 percent to 3.2 percent when a taxpayer's current-year research expenses exceed a base amount of 1.5 percent but do not exceed a base amount of 2 percent; and from 2.75 percent to 3.75 percent when a taxpayer's current-year research expenses exceed a base amount of 2 percent.

EFFECTIVE DATE

The extension of the research credit is effective for qualified research expenditures paid or incurred during the period July 1, 1999, through June 30, 2004. The increase in the credit rate under the alternative incremental research credit is effective for taxable years beginning after June 30, 1999.

B. EXTEND EXCEPTIONS UNDER SUBPART F FOR ACTIVE FINANCING INCOME

(sec. 1402 of the bill and secs. 953 and 954 of the Code)

PRESENT LAW

Under the subpart F rules, 10-percent U.S. shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, foreign personal holding company income and insurance income. In addition, 10-percent U.S. shareholders of a CFC are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (i.e., income derived from services performed for a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and REMICs; (3) net gains from commodities transactions; (4) net gains from foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; and (7) payments in lieu of dividends.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other-country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income (Prop. Treas. Reg. sec. 1.953–1(a)).

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business (so-called "active financing income"). These exceptions are applicable only for taxable years beginning in 1999.[73]

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the exceptions. In addition, certain nexus requirements apply, which pro-

[73] Temporary exceptions from the subpart F provisions for certain active financing income applied only for taxable years beginning in 1998. Those exceptions were extended and modified as part of the present-law provision.

vide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of insurance, in addition to a temporary exception from foreign personal holding company income for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization, certain temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met.

REASONS FOR CHANGE

In the Taxpayer Relief Act of 1997, one-year temporary exceptions from foreign personal holding company income were enacted [74] for income from the active conduct of an insurance, banking, financing, or similar business. In the Tax and Trade Relief Extension Act of 1998 (the "1998 Act"),[75] the Congress extended the temporary exceptions for an additional year, with certain modifications designed to treat various types of businesses with active financing income more similarly to each other than did the 1997 provision. The Committee believes that it is appropriate to extend the temporary exceptions, as modified in the 1998 Act, for another five years.

EXPLANATION OF PROVISION

The bill extends for five years the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

[74] The President canceled this provision in1997 pursuant to the Line Item Veto Act. On June 25, 1998, the U.S. Supreme Court held that the cancellation procedures set forth in the Line Item Veto Act are unconstitutional. *Clinton* v. *City of New York*, 118 S. Ct. 2091 (June 25, 1998).

[75] Division J of H.R. 4328, the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999.

EFFECTIVE DATE

The provision is effective for taxable years of a foreign corporation beginning after December 31, 1999, and before January 1, 2005, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporation end.

C. Extend Suspension of Net Income Limitation on Percentage Depletion From Marginal Oil and Gas Wells

(sec. 1403 of the bill and sec. 613A of the Code)

PRESENT LAW

The Code permits taxpayers to recover their investments in oil and gas wells through depletion deductions. In the case of certain properties, the deductions may be determined using the percentage depletion method. Among the limitations that apply in calculating percentage depletion deductions is a restriction that, for oil and gas properties, the amount deducted may not exceed 100 percent of the net income from that property in any year (sec. 613(a)).

Special percentage depletion rules apply to oil and gas production from "marginal" properties (sec. 613A(c)(6)). Marginal production is defined as domestic crude oil and natural gas production from stripper well property or from property substantially all of the production from which during the calendar year is heavy oil. Stripper well property is property from which the average daily production is 15 barrel equivalents or less, determined by dividing the average daily production of domestic crude oil and domestic natural gas from producing wells on the property for the calendar year by the number of wells. Heavy oil is domestic crude oil with a weighted average gravity of 20 degrees API or less (corrected to 60 degrees Farenheit). Under one such special rule, the 100-percent-of-net-income limitation does not apply to domestic oil and gas production from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

REASONS FOR CHANGE

The Committee notes that oil is, and will continue to be, vital to the American economy. The Committee observes that low oil prices have created substantial economic hardship in the oil industry and particularly in those communities where the majority of jobs are related to providing this vital commodity to the nation. Skilled workers and industry know-how will be critical to the exploration for and production of oil and gas in the future. The Committee, therefore, is concerned that the current economic hardship in the industry could lead to business failures and job losses. The Committee understands that many of these businesses are cash starved. The Committee finds it appropriate to extend the present-law rule suspending the 100-percent-of-net-income limitation with respect to oil and gas production from marginal wells. The Committee believes that by reducing current taxable income, less cash will have to be devoted to income tax payments and the current cash position of many such businesses will improve, helping them weather this current economic storm.

EXPLANATION OF PROVISION

The bill extends the present-law rule suspending the 100-percent-of-net-income limitation with respect to oil and gas production from marginal wells to include taxable years beginning after December 31, 1999, and before January 1, 2005.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1999.

D. Extend the Work Opportunity Tax Credit

(sec. 1404 of the bill and sec. 51 of the Code)

PRESENT LAW

The work opportunity tax credit ("WOTC") is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The credit generally is equal to a percentage of qualified wages. The credit percentage is 25 percent for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 hours or more. Qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer.

Generally, no more than $6,000 of wages during the first year of employment is permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual is $2,400. With respect to qualified summer youth employees, the maximum credit is 40 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,200. The credit is only effective for wages paid to, or incurred with respect to, qualified individuals who began work for the employer before July 1, 1999.

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

REASONS FOR CHANGE

The Committee believes the preliminary experience of the WOTC is promising as an incentive for employers to hire individuals who are under-skilled, undereducated, or who generally may be less desirable (e.g., lacking in work experience) to employers. A temporary extension of this credit will allow the Congress and the Treasury and Labor Departments to continue to monitor the effectiveness of the credit. The Committee also believes that the electronic filing of the request for certification (the "Form 8850") will reduce the administrative burden involved in claiming the credit and encourage more employers to participate in the program.

EXPLANATION OF PROVISION

The bill extends the WOTC for 30 months (through December 31, 2001).

The bill also directs to the Secretary of the Treasury to expedite procedures to allow taxpayers to satisfy their WOTC filing requirements (e.g., Form 8850) by electronic means.

EFFECTIVE DATE

Generally, the provision is effective for wages paid to, or incurred with respect to, qualified individuals who begin work for the employer on or after July 1, 1999, and before January 1, 2002.

E. EXTEND THE WELFARE-TO-WORK TAX CREDIT

(sec. 1404 of the bill and sec. 51A of the Code)

PRESENT LAW

The Code provides a tax credit to employers on the first $20,000 of eligible wages paid to qualified long-term family assistance ("TANF") recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The maximum credit is $8,500 per qualified employee.

Qualified long-term family assistance recipients are: (1) members of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of this credit) if they are hired within 2 years after the date that the 18-month total is reached; and (3) members of a family who are no longer eligible for family assistance because of either Federal or State time limits, if they are hired within 2 years after the Federal or State time limits made the family ineligible for family assistance.

Eligible wages include cash wages paid to an employee plus amounts paid by the employer for the following: (1) educational assistance excludable under a section 127 program (or that would be excludable but for the expiration of sec. 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

The welfare to work credit is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 1998, and before June 30, 1999.

REASONS FOR CHANGE

The Committee believes that the credit should be temporarily extended to provide the Congress and the Treasury and Labor Departments a better opportunity to assess the operation and effectiveness of the credit in meeting its goals. When enacted in the Taxpayer Relief Act of 1997, the goals of the welfare-to-work credit were: (1) to provide an incentive to hire long-term welfare recipients; (2) to promote the transition from welfare to work by increasing access to employment; and (3) to encourage employers to provide these individuals with training, health coverage, dependent care and ultimately better job attachment.

EXPLANATION OF PROVISION

The bill extends the welfare-to-work credit for 30 months, so that the credit is available for eligible individuals who begin work for an employer before January 1, 2002.

EFFECTIVE DATE

The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after July 1, 1999, and before January 1, 2002.

TITLE XV. REVENUE OFFSET PROVISIONS

A. EXPAND REPORTING OF CANCELLATION OF INDEBTEDNESS INCOME

(sec. 1501 of the bill and sec. 6050P of the Code)

PRESENT LAW

Under section 61(a)(12), a taxpayer's gross income includes income from the discharge of indebtedness. Section 6050P requires "applicable entities" to file information returns with the Internal Revenue Service (IRS) regarding any discharge of indebtedness of $600 or more.

The information return must set forth the name, address, and taxpayer identification number of the person whose debt was discharged, the amount of debt discharged, the date on which the debt was discharged, and any other information that the IRS requires to be provided. The information return must be filed in the manner and at the time specified by the IRS. The same information also must be provided to the person whose debt is discharged by January 31 of the year following the discharge.

"Applicable entities" include: (1) the Federal Deposit Insurance Corporation (FDIC), the Resolution Trust Corporation (RTC), the National Credit Union Administration, and any successor or subunit of any of them; (2) any financial institution (as described in sec. 581 (relating to banks) or sec. 591(a) (relating to savings institutions)); (3) any credit union; (4) any corporation that is a direct or indirect subsidiary of an entity described in (2) or (3) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities; and (5) an executive, judicial, or legislative agency (as defined in 31 U.S.C. sec. 3701(a)(4)).

Failures to file correct information returns with the IRS or to furnish statements to taxpayers with respect to these discharges of indebtedness are subject to the same general penalty that is imposed with respect to failures to provide other types of information returns. Accordingly, the penalty for failure to furnish statements to taxpayers is generally $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

REASONS FOR CHANGE

The Committee believes that it is appropriate to treat discharges of indebtedness that are made by similar entities in a similar manner. Accordingly, the Committee believes that it is appropriate to extend the scope of this information reporting provision to include indebtedness discharged by any organization a significant trade or business of which is the lending of money (such as finance companies and credit card companies whether or not affiliated with financial institutions).

EXPLANATION OF PROVISION

The bill requires information reporting on indebtedness discharged by any organization a significant trade or business of which is the lending of money (such as finance companies and credit card companies whether or not affiliated with financial institutions).

EFFECTIVE DATE

The provision is effective with respect to discharges of indebtedness after December 31, 1999.

B. Extension of IRS User Fees

(sec. 1502 of the bill and new sec. 7527 of the Code)

PRESENT LAW

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104–117 [76] extended the statutory authorization for these user fees [77] through September 30, 2003.

REASONS FOR CHANGE

The Committee believes that it is appropriate to extend the statutory authorization for these user fees for an additional six years.

EXPLANATION OF PROVISION

The bill extends the statutory authorization for these user fees through September 30, 2009. The bill also moves the statutory authorization for these fees into the Internal Revenue Code.

EFFECTIVE DATE

The provision, including moving the statutory authorization for these fees into the Code and repealing the off-Code statutory authorization for these fees, is effective for requests made after the date of enactment.

[76] An Act to provide that members of the Armed Forces performing services for the peackeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996).

[77] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Public Law 100–203, December 22, 1987).

C. Impose Limitation on Prefunding of Certain Employee Benefits

(sec. 1503 of the bill and secs. 419A and 4976 of the Code)

PRESENT LAW

Under present law, contributions to a welfare benefit fund generally are deductible when paid, but only to the extent permitted under the rules of sections 419 and 419A. The amount of an employer's deduction in any year for contributions to a welfare benefit fund cannot exceed the fund's qualified cost for the year minus the fund's after-tax income for the year. With certain exceptions, the term qualified cost means the sum of (1) the amount that would be deductible for benefits provided during the year if the employer paid them directly and was on the cash method of accounting, and (2) within limits, the amount of any addition to a qualified asset account for the year. A qualified asset account includes any account consisting of assets set aside for the payment of disability benefits, medical benefits, supplemental unemployment compensation or severance pay benefits, or life insurance benefits. The account limit for a qualified asset account for a taxable year is generally the amount reasonably and actuarially necessary to fund claims incurred but unpaid (as of the close of the taxable year) for benefits with respect to which the account is maintained and the administrative costs incurred with respect to those claims. Specific additional reserves are allowed for future provision of post-retirement medical and life insurance benefits.

The deduction limits of sections 419 and 419A for contributions to welfare benefit funds do not apply in the case of certain 10-or-more employer plans. A plan is a 10-or-more employer plan if (1) more than one employer contributes to it, and (2) no employer is normally required to contribute more than 10 percent of the total contributions contributed under the plan by all employers. The exception is not available if the plan maintains experience-rating arrangements with respect to individual employers.

If any portion of a welfare benefit fund reverts to the benefit of an employer, an excise tax equal to 100 percent of the reversion is imposed on the employer.

REASONS FOR CHANGE

The Committee understands that the exception to the welfare benefit fund deduction limits for 10-or-more employer plans has been utilized to fund retirement-type benefits that avoid the dollar limitations and other rules applicable to qualified retirement plans and the deduction timing rules applicable to nonqualified deferred compensation arrangements. Congress intended the exception to apply to a multiple employer welfare benefit plan under which the relationship of a participating employer to the plan is similar to the relationship of an insured to an insurer, and did not intend the exception to apply if the liability of any employer under the plan is determined on the basis of experience rating, which can create, in effect, a single-employer plan within a 10-or-more-employer arrangement. It is difficult to identify whether experience rating is present with respect to the provision of some benefits, such as severance pay and certain death benefits, because of the complexity of the arrangements. Therefore, the Committee believes that it is appropriate to limit the benefits for which the 10-or-more employer exception is available.

EXPLANATION OF PROVISION

Under the provision, the present-law exception to the deduction limit for 10-or-more employer plans is limited to plans that provide only medical benefits, disability benefits, and qualifying group-term life insurance benefits to plan beneficiaries. For purposes of this provision, qualifying group-term life insurance benefits do not include any arrangements that permit a plan beneficiary to directly or indirectly access all or part of the account value of any life insurance contract, whether through a policy loan, a partial or complete surrender of the policy, or otherwise. It is intended that qualifying group-term life insurance benefits do not include any arrangement whereby a plan beneficiary may receive a policy without a stated account value that has the potential to give rise to an account value whether through the exchange of such policy for another policy that would have an account value or otherwise. The 10-or- more employer plan exception is no longer available with respect to plans that provide supplemental unemployment compensation, severance pay, or life insurance (other than qualifying group-term life insurance) benefits. Thus, the generally applicable deduction limits (sections 419 and 419A) apply to plans providing these benefits.

In addition, if any portion of a welfare benefit fund attributable to contributions that are deductible pursuant to the 10-or-more employer exception (and earnings thereon) is used for a purpose other than for providing medical benefits, disability benefits, or qualifying group-term life insurance benefits to plan beneficiaries, such portion is treated as reverting to the benefit of the employers maintaining the fund and is subject to the imposition of the 100-percent excise tax. Thus, for example, cash payments to employees upon termination of the fund, and loans or other distributions to the employee or employer, would be treated as giving rise to a reversion that is subject to the excise tax.

Under the provision, no inference is intended with respect to the validity of any 10-or-more employer arrangement under the provisions of present law.

EFFECTIVE DATE

The provision is effective with respect to contributions paid or accrued on or after June 9, 1999, in taxable years ending after such date.

D. Increase Elective Withholding Rate for Nonperiodic Distributions From Deferred Compensation Plans

(sec. 1504 of the bill and sec. 3405 of the Code)

PRESENT LAW

Present law provides that income tax withholding is required on designated distributions from employer compensation plans (whether or not such plans are tax qualified), individual retirement arrangements ("IRAs"), and commercial annuities unless the payee elects not to have withholding apply. A designated distribution does not include any payment (1) that is wages, (2) the portion of which it is reasonable to believe is not includible in gross income,[78] (3) that is subject to withholding of tax on nonresident aliens and foreign corporations (or would be subject to such withholding but for a tax treaty), or (4) that is a dividend paid on certain employer securities (as defined in sec. 404(k)(2)).

Tax is generally withheld on the taxable portion of any periodic payment as if the payment is wages to the payee. A periodic payment is a designated distribution that is an annuity or similar periodic payment.

In the case of a nonperiodic distribution, tax generally is withheld at a flat 10-percent rate unless the payee makes an election not to have withholding apply. A nonperiodic distribution is any distribution that is not a periodic distribution. Under current administrative rules, an individual receiving a nonperiodic distribution can designate an amount to be withheld in addition to the 10-percent otherwise required to be withheld.

Under present law, in the case of a nonperiodic distribution that is an eligible rollover distribution, tax is withheld at a 20-percent rate unless the payee elects to have the distribution rolled directly over to an eligible retirement plan (i.e., an IRA, a qualified plan (sec. 401(a)) that is a defined contribution plan permitting direct deposits of rollover contributions, or a qualified annuity plan (sec. 403(a)). In general, an eligible rollover distribution includes any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan or qualified annuity plan. An eligible rollover distribution does not include any distribution that is part of a series of substantially equal periodic payments made (1) for the life (or life expectancy) of the employee or for the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (2) over the a specified period of 10 years or more. An eligible rollover distribution also does not include any distribution required under the minimum distribution rules of section 401(a)(9), hardship distributions from section 401(k) plans, or the portion of a distribution that is not includible in income. The payee of an eligible rollover distribution can only elect not to have withholding apply by making the direct rollover election.

REASONS FOR CHANGE

The present-law 10-percent withholding rate is lower than the lowest income tax rate. Increasing the withholding rate to the lowest income tax rate makes it more likely that individuals who want withholding will have the correct amount of tax withheld.

EXPLANATION OF PROVISION

Under the bill, the withholding rate for nonperiodic distributions would be increased from 10 percent to 15 percent. As under present

[78] All IRA distributions are treated as if includible in income for purposes of this rule. A technical correction contained in the bill modifies this rule in the case of Roth IRAs.

law, unless the distribution is an eligible rollover distribution, the payee could elect not to have withholding apply. The bill does not modify the 20-percent withholding rate that applies to any distribution that is an eligible rollover distribution.

EFFECTIVE DATE

The provision is effective for distributions made after December 31, 1999.

E. MODIFY TREATMENT OF CLOSELY-HELD REITS

(sec. 1505 of the bill and sec. 856 of the Code)

PRESENT LAW

In general, a real estate investment trust ("REIT") is an entity that receives most of its income from passive real estate related investments and that receives pass-through treatment for income that is distributed to shareholders. If an electing entity meets the qualifications for REIT status, the portion of its income that is distributed to the investors each year generally is taxed to the investors without being subjected to tax at the REIT level.

A REIT must satisfy a number of tests on a year-by-year basis that relate to the entity's: (1) organizational structure; (2) source of income; (3) nature of assets; and (4) distribution of income.

Under the organizational structure test, except for the first taxable year for which an entity elects to be a REIT, the beneficial ownership of the entity must be held by 100 or more persons. Generally, no more than 50 percent of the value of the REIT's stock can be owned by five or fewer individuals during the last half of the taxable year. Certain attribution rules apply in making this determination. No similar rule applies to corporate ownership of a REIT. Certain transactions have been structured to attempt to achieve special tax benefits for an entity that controls a REIT.

REASONS FOR CHANGE

The Committee is aware of a number of situations in which a closely held REIT may be used as a conduit to recharacterize items of income. Some cases causing concern have already been addressed by legislation (e.g., "liquidating reits," which attempted to eliminate tax on income for a period of years) or by regulations (e.g., "step-down preferred" stock, which attempted to provide a corporate borrower with a deduction for payment of principal as well as interest on a loan).

Nevertheless, the Committee is concerned that closely-held REITs may be used to obtain other tax benefits, chiefly from the ability to recharacterize the income earned by the REIT as a dividend to the REIT owners, as well as to control the timing of such a dividend. Therefore, the provision adds new ownership restrictions designed to limit opportunities for inappropriate income recharacterization.

In certain limited cases, the Committee believes that additional time to satisfy the new requirements should be granted to enable the REIT to establish an operating history before going REIT public.

EXPLANATION OF PROVISION

The provision imposes as an additional requirement for REIT qualification that, except for the first taxable year for which an entity elects to be a REIT, no one person can own stock of a REIT possessing 50 percent or more of the combined voting power of all classes of voting stock or 50 percent or more of the total value of shares of all classes of stock of the REIT. For purposes of determining a person's stock ownership, rules similar to attribution rules for REIT qualification under present law apply (secs. 856(d)(5) and 856(h)(3)). The provision does not apply to ownership by a REIT of 50 percent or more of the stock (by vote or value) of another REIT.

An exception applies for a limited period to certain "incubator REITs". An incubator REIT is a corporation that elects to be treated as an incubator REIT and that meets all the following other requirements. (1) it has only voting common stock outstanding, (2) not more than 50 percent of the corporation's real estate assets consist of mortgages, (3) from not later than the beginning of the last half of the second taxable year, at least 10 percent of the corporation's capital is provided by lenders or equity investors who are unrelated to the corporation's largest shareholder, (4) the directors of the corporation adopt a resolution setting forth an intent to engage in a going public transaction, and (5) no predecessor entity (including any entity from which the electing incubator REIT acquired assets in a transaction in which gain or loss was not recognized in whole or in part) had elected incubator REIT status.

The new ownership requirement does not apply to an electing incubator REIT until the end of the REIT's third taxable year; and may be extended for an additional two taxable years if the REIT so elects. However, a REIT cannot elect the additional two year extension unless the REIT agrees that if it does not engage in a going public transaction by the end of the extended eligibility period, it is required to pay Federal income taxes for the two years of the extended period as if it had not made an incubator REIT election and had ceased to qualify as a REIT for those two taxable years. In such case, the corporation is required to file appropriate amended returns with 3 months of the close of the extended eligibility period. Interest is payable, but no substantial underpayment penalties apply except in cases where there is a finding that incubator REIT status was elected for a principal purpose other than as part of a reasonable plan to engage in a going public transaction. Notification of shareholders and any other person whose tax position would reasonably be expected to be affected is also required.

If an electing incubator REIT does not elect to extend its initial 2-year extended eligibility period and has not engaged in a going public transaction by the end of such period, it must satisfy the new control requirements as of the beginning of its fourth taxable year (i.e., immediately after the close of the last taxable year of the two-year initial extension period) or it is required to notify its shareholders and other persons that may be affected by its tax status, and pay Federal income tax as a corporation that has ceased to qualify as a REIT as of that time.

If the Secretary of the Treasury determines that an incubator REIT election was filed for a principal purpose other than as part of a reasonable plan to undertake a going public transaction, an excise tax of $20,000 is imposed on each of the corporation's directors for each taxable year for which the election was in effect.

A going public transaction is defined as either (1) a public offering of shares of stock of the incubator REIT, (2) a transaction, or series of transactions, that result in the incubator REIT stock being regularly traded on an established securities market (as defined in section 897) and being held by shareholders unrelated to persons who held such stock before it began to be so regularly traded, or (3) any transaction resulting in ownership of the REIT by 200 or more persons (excluding the largest single shareholder) who in the aggregate own at least 50 percent of the stock of the REIT. Attribution rules apply in determining ownership of stock.

EFFECTIVE DATE

The provision is effective for entities electing REIT status for taxable years ending after July 12, 1999. Any entity that is a controlled entity on July 12, 1999, that is a REIT for a taxable year including such date, and that has significant business assets or activities as of such date will not be subject to the proposal.

Under this rule, a controlled entity with significant business assets or activities as of July 12, 1999 can be grandfathered even if it makes its first REIT election after that date with its return for the taxable year including that date. In such a case, the significant assets in place as of July 12, 1999 must be real estate assets that would be qualified real estate assets for purposes of the REIT asset rules. The assets and activities in place on that date must also be of a type that would produce qualified real estate-related income for a REIT.

F. Limit Conversion of Character of Income From Constructive Ownership Transactions

(sec. 1506 of the bill and new sec. 1260 of the Code)

PRESENT LAW

The maximum individual income tax rate on ordinary income and short-term capital gain is 39.6 percent, while the maximum individual income tax rate on long-term capital gain generally is 20 percent. Long-term capital gain means gain from the sale or exchange of a capital asset held more than one year. For this purpose, gain from the termination of a right with respect to property which would be a capital asset in the hands of the taxpayer is treated as capital gain.[79]

A pass-thru entity (such as a partnership) generally is not subject to Federal income tax. Rather, each owner includes its share a of pass-thru entity's income, gain, loss, deduction or credit in its taxable income. Generally, the character of the item is determined at the entity level and flows through to the owners. Thus, for example, the treatment of an item of income by a partnership as ordi-

[79] Section 1234A. as amended by the Taxpayer Relief Act of 1997.

nary income, short-term capital gain, or long-term capital gain retains its character when reported by each of the partners.

Investors may enter into forward contracts, notional principal contracts, and other similar arrangements with respect to property that provides the investor with the same or similar economic benefits as owning the property directly but with potentially different tax consequences (as to the character and timing of any gain).

REASONS FOR CHANGE

The Committee is concerned with the use of derivative contracts by taxpayers in arrangements that are primarily designed to convert what otherwise would be ordinary income and short-term capital gain into long-term capital gain. Of particular concern are derivative contracts with respect to partnerships and other pass-through entities. The use of such derivative contracts results in the taxpayer being taxed in a more favorable manner than had the taxpayer actually acquired an ownership interest in the entity. The current rules designed to prevent the conversion of ordinary income into capital gain (sec. 1258) only apply to transactions where the taxpayer's expected return is attributable solely to the time value of the taxpayer's net investment.

One example of a conversion transaction involving a derivative contract is when a taxpayer enters into an arrangement with a securities dealer[80] whereby the dealer agrees to pay the taxpayer any appreciation with respect to a notional investment in a "hedge fund" partnership. In return, the taxpayer agrees to pay the securities dealer any depreciation in the value of the notional investment. The arrangement lasts for more than one year. The taxpayer is in the same economic position as if he or she owned the interest in the hedge fund. However, the taxpayer may treat any appreciation resulting from the contractual arrangement as long-term capital gain. Moreover, any tax attributable to such gain is deferred until the arrangement is terminated.

EXPLANATION OF PROVISION

The provision limits the amount of long-term capital gain a taxpayer could recognize from certain derivative contracts ("constructive ownership transaction") with respect to certain financial assets. The amount of long-term capital gain is limited to the amount of such gain the taxpayer would have had if the taxpayer held the asset directly during the term of the derivative contract. Any gain in excess of this amount is treated as ordinary income. An interest charge is imposed on the amount of gain that is treated as ordinary income. The bill does not alter the tax treatment of the long-term capital gain that is not treated as ordinary income.

A taxpayer is treated as having entered into a constructive ownership transaction if the taxpayer (1) holds a long position under a notional principal contract with respect to the financial asset, (2) enters into a forward contract to acquire the financial asset, (3) is the holder of a call option, and the grantor of a put option, with

[80] Assuming the securities dealer purchases the financial asset, the dealer would mark both the financial asset and the contractual arrangement to market under Code sec. 475, and the economic consequences of the two positions would offset each other.

respect to a financial asset, and the options have substantially equal strike prices and substantially contemporaneous maturity dates, or (4) to the extent provided in regulations, enters into one or more transactions, or acquires one or more other positions, that have substantially the same effect as any of the transactions described.

The Committee anticipates that Treasury regulations, when issued, will provide specific standards for determining when other types of financial transactions, like those specified in the provision, have the effect of replicating the economic benefits of direct ownership of a financial asset (and will be treated as a constructive ownership transaction).

A "financial asset" is defined as (1) any equity interest in a pass-thru entity, and (2) to the extent provided in regulations, any debt instrument and any stock in a corporation that is not a pass-thru entity. A "pass-thru entity" refers to (1) a regulated investment company, (2) a real estate investment trust, (3) an S corporation, (4) a partnership, (5) a trust, (6) a common trust fund, (7) a passive foreign investment company, (8) a foreign personal holding company, and (9) a foreign investment company.

The amount of recharacterized gain is calculated as the excess of the amount of long-term gain the taxpayer would have had absent this provision over the "net underlying long-term capital gain" attributable to the financial asset. The net underlying long-term capital gain is the amount of net capital gain the taxpayer would have realized if it had acquired the financial asset for its fair market value on the date the constructive ownership transaction was opened and sold the financial asset on the date the transaction was closed (only taking into account gains and losses that would have resulted from the constructive ownership of the financial asset).[81] The long-term capital gains rate on the net underlying long-term capital gain is determined by reference to the individual capital gains rates in section 1(h).

Example 1: On January 1, 2000, Taxpayer enters into a three-year notional principal contract (a constructive ownership transaction) with a securities dealer whereby, on the settlement date, the dealer agrees to pay Taxpayer the amount of any increase in the notional value of an interest in an investment partnership (the financial asset). After three years, the value of the notional principal contract increased by $200,000, of which $150,000 is attributable to ordinary income and net short-term capital gain ($50,000 is attributable to net long-term capital gains). The amount of the net underlying long-term capital gains is $50,000, and the amount of gain that is recharacterized as ordinary income is $150,000 (the excess of $200,000 of long-term gain over the $50,000 of net underlying long-term capital gain).

An interest charge is imposed on the underpayment of tax for each year that the constructive ownership transaction was open. The interest charge is the amount of interest that would be imposed under section 6601 had the recharacterized gain been included in the taxpayer's gross income during the term of the con-

[81] A taxpayer must establish the amount of the net underlying long-term capital gain with clear and convincing evidence; otherwise, the amount is deemed to be zero.

structive ownership transaction. The recharacterized gain is treated as having accrued such that the gain in each successive year is equal to the gain in the prior year increased by a constant growth rate [82] during the term of the constructive ownership transaction.

Example 2: Same facts as in *example 1,* and assume the applicable Federal rate on December 31, 2002, is six percent. For purposes of calculating the interest charge, Taxpayer must allocate the $150,000 of recharacterized ordinary income to the three year-term of the constructive ownership transaction as follows: $47,116.47 is allocated to year 2000, $49,943.46 is allocated to year 2001, and $52,940.07 is allocated to year 2002.

A taxpayer is treated as holding a long position under a notional principal contract with respect to a financial asset if the person (1) has the right to be paid (or receive credit for) all or substantially all of the investment yield (including appreciation) on the financial asset for a specified period, and (2) is obligated to reimburse (or provide credit) for all or substantially all of any decline in the value of the financial asset. A forward contract is a contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.

If the constructive ownership transaction is closed by reason of taking delivery of the underlying financial asset, the taxpayer is treated as having sold the contracts, options, or other positions that are part of the transaction for its fair market value on the closing date. However, the amount of gain that is recognized as a result of having taken delivery is limited to the amount of gain that is treated as ordinary income by reason of this provision (with appropriate basis adjustments for such gain).

The provision does not apply to any constructive ownership transaction if all of the positions that are part of the transaction are marked to market under the Code or regulations. The provision also does not apply to transactions entered into by tax-exempt organizations and foreign taxpayers.

The Treasury Department is authorized to prescribe regulations as necessary to carry out the purposes of the provision, including to (1) permit taxpayers to mark to market constructive ownership transactions in lieu of the provision, and (2) exclude certain forward contracts that do not convey substantially all of the economic return with respect to a financial asset.

EFFECTIVE DATE

The provision applies to transactions entered into on or after July 12, 1999.

G. TREATMENT OF EXCESS PENSION ASSETS USED FOR RETIREE HEALTH BENEFITS

(sec. 1507 of the bill and sec. 420 of the Code)

PRESENT LAW

Defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfac-

[82] The accrual rate is the applicable Federal rate on the day the transaction closed.

tion of all plan liabilities. A reversion prior to plan termination may constitute a prohibited transaction and may result in disqualification of the plan. Certain limitations and procedural requirements apply to a reversion upon plan termination. Any assets that revert to the employer upon plan termination are includible in the gross income of the employer and subject to an excise tax. The excise tax rate, which may be as high as 50 percent of the reversion, varies depending upon whether or not the employer maintains a replacement plan or makes certain benefit increases. Upon plan termination, the accrued benefits of all plan participants are required to be 100–percent vested.

A pension plan may provide medical benefits to retired employees through a section 401(h) account that is a part of such plan. A qualified transfer of excess assets of a defined benefit pension plan (other than a multiemployer plan) into a section 401(h) account that is a part of such plan does not result in plan disqualification and is not treated as a reversion to the employer or a prohibited transaction. Therefore, the transferred assets are not includible in the gross income of the employer and are not subject to the excise tax on reversions.

Qualified transfers are subject to amount and frequency limitations, use requirements, deduction limitations, vesting requirements and minimum benefit requirements. Excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. No more than one qualified transfer with respect to any plan may occur in any taxable year.

The transferred assets (and any income thereon) must be used to pay qualified current retiree health liabilities (either directly or through reimbursement) for the taxable year of the transfer. Transferred amounts generally must benefit all pension plan participants, other than key employees, who are entitled upon retirement to receive retiree medical benefits through the section 401(h) account. Retiree health benefits of key employees may not be paid (directly or indirectly) out of transferred assets. Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned at the end of the taxable year to the general assets of the plan. These amounts are not includible in the gross income of the employer, but are treated as an employer reversion and are subject to a 20-percent excise tax.

No deduction is allowed for (1) a qualified transfer of excess pension assets into a section 401(h) account, (2) the payment of qualified current retiree health liabilities out of transferred assets (and any income thereon) or (3) a return of amounts not used to pay qualified current retiree health liabilities to the general assets of the pension plan.

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer.

The minimum benefit requirement requires each group health plan under which applicable heath benefits are provided to provide substantially the same level of applicable health benefits for the taxable year of the transfer and the following 4 taxable years. The level of benefits that must be maintained is based on benefits provided in the year immediately preceding the taxable year of the transfer. Applicable health benefits are health benefits or coverage that are provided to (1) retirees who, immediately before the transfer, are entitled to receive such benefits upon retirement and who are entitled to pension benefits under the plan and (2) the spouses and dependents of such retirees.

The provision permitting a qualified transfer of excess pension assets to pay qualified current retiree health liabilities expires for taxable years beginning after December 31, 2000.[83]

REASONS FOR CHANGE

The Committee believes that it is appropriate to provide a temporary extension of the present-law rule permitting an employer to make a qualified transfer of excess pension assets to a section 401(h) account for retiree health benefits as long as the security of employees' pension benefits is not threatened by the transfer. In light of the increasing cost of retiree health benefits, the Committee also believes that it is appropriate to replace the minimum benefit requirement applicable to qualified transfers under present law with a minimum cost requirement.

EXPLANATION OF PROVISION

The present-law provision permitting qualified transfers of excess defined benefit pension plan assets to provide retiree health benefits under a section 401(h) account is extended through September 30, 2009. In addition, the present-law minimum benefit requirement is replaced by the minimum cost requirement that applied to qualified transfers before December 9, 1994, to section 401(h) accounts. Therefore, each group health plan or arrangement under which applicable health benefits are provided is required to provide a minimum dollar level of retiree health expenditures for the taxable year of the transfer and the following 4 taxable years. The minimum dollar level is the higher of the applicable employer costs for each of the 2 taxable years immediately preceding the taxable year of the transfer. The applicable employer cost for a taxable year is determined by dividing the employer's qualified current retiree health liabilities by the number of individuals to whom coverage for applicable health benefits was provided during the taxable year.

EFFECTIVE DATE

The provision is effective with respect to qualified transfers of excess defined benefit pension plan assets to section 401(h) accounts after December 31, 2000, and before October 1, 2009. The modifica-

[83] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), provides that plan participants, the Secretaries of Treasury and the Department of Labor, the plan administrator, and each employee organization representing plan participants must be notified 60 days before a qualified transfer of excess assets to a retiree health benefits account occurs (ERISA sec. 103(e)). ERISA also provides that a qualified transfer is not a prohibited transaction under ERISA (ERISA sec. 408(b)(13)) or a prohibited reversion of assets to the employer (ERISA sec. 403(c)(1)). For purposes of these provisions, a qualified transfer is generally defined as a transfer pursuant to section 420 of the Internal Revenue Code, as in effect on January 1, 1995.

tion of the minimum benefit requirement is effective with respect to transfers after the date of enactment.

H. Modify Installment Method and Prohibit Its Use by Accrual Method Taxpayers

(sec. 1508 of the bill and sections 453 and 453A of the Code)

PRESENT LAW

An accrual method taxpayer is generally required to recognize income when all the events have occurred that fix the right to the receipt of the income and the amount of the income can be determined with reasonable accuracy. The installment method of accounting provides an exception to this general principle of income recognition by allowing a taxpayer to defer the recognition of income from the disposition of certain property until payment is received. Sales to customers in the ordinary course of business are not eligible for the installment method, except for sales of property that is used or produced in the trade or business of farming and sales of timeshares and residential lots if an election to pay interest under section 453(l)(2)(B)) is made.

A pledge rule provides that if an installment obligation is pledged as security for any indebtedness, the net proceeds [84] of such indebtedness are treated as a payment on the obligation, triggering the recognition of income. Actual payments received on the installment obligation subsequent to the receipt of the loan proceeds are not taken into account until such subsequent payments exceed the loan proceeds that were treated as payments. The pledge rule does not apply to sales of property used or produced in the trade or business of farming, to sales of timeshares and residential lots where the taxpayer elects to pay interest under section 453(l)(2)(B), or to dispositions where the sales price does not exceed $150,000.

An additional rule requires the payment of interest on the deferred tax that is attributable to most large installment sales.

REASONS FOR CHANGE

The Committee believes that the installment method is inconsistent with the use of the accrual method of accounting and should not be allowed in situations where the disposition of property would otherwise be reported using the accrual method. The Committee is concerned that the continued use of the installment method in such situations would allow a deferral of gain that is inconsistent with the requirement of the accrual method that income be reported in the period it is earned, rather than the period it is received.

The Committee also believes that the installment method, where its use is appropriate, should not serve to defer the recognition of gain beyond the time when funds are received. Accordingly, the Committee believes that proceeds of a loan should be treated in the same manner as a payment on an installment obligation if the loan

[84] The net proceeds equal the gross loan proceeds less the direct expenses of obtaining the loan.

is dependent on the existence of the installment obligation, such as where the loan is secured by the installment obligation or can be satisfied by the delivery of the installment obligation.

EXPLANATION OF PROVISION

Prohibition on the use of the installment method for accrual method dispositions

The provision generally prohibits the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting. The provision does not change present law regarding the availability of the installment method for dispositions of property used or produced in the trade or business of farming. The provision also does not change present law regarding the availability of the installment method for dispositions of timeshares or residential lots if the taxpayer elects to pay interest under section 453(l).

The provision does not change the ability of a cash method taxpayer to use the installment method. For example, a cash method individual owns all of the stock of a closely held accrual method corporation. This individual sells his stock for cash, a ten year note, and a percentage of the gross revenues of the company for the next ten years. The provision would not change the ability of this individual to use the installment method in reporting the gain on the sale of the stock.

Modifications to the pledge rule

The provision modifies the pledge rule to provide that entering into any arrangement that gives the taxpayer the right to satisfy an obligation with an installment note will be treated in the same manner as the direct pledge of the installment note. For example, a taxpayer disposes of property for an installment note. The disposition is properly reported using the installment method. The taxpayer only recognizes gain as it receives the deferred payment. However, were the taxpayer to pledge the installment note as security for a loan, it would be required to treat the proceeds of such loan as a payment on the installment note, and recognize the appropriate amount of gain. Under the provision, the taxpayer would also be required to treat the proceeds of a loan as payment on the installment note to the extent the taxpayer had the right to "put" or repay the loan by transferring the installment note to the taxpayer's creditor. Other arrangements that have a similar effect would be treated in the same manner.

The modification of the pledge rule applies only to installment sales where the pledge rule of present law applies. Accordingly, the provision does not apply to installment method sales made by a dealer in timeshares and residential lots where the taxpayer elects to pay interest under section 453(l)(2)(B), to sales of property used or produced in the trade or business of farming, or to dispositions where the sales price does not exceed $150,000, since such sales are not subject to the pledge rule under present law.

EFFECTIVE DATE

The provision is effective for sales or other dispositions entered into on or after the date of enactment.

I. Limitation on Use of Non-Accrual Experience Method of Accounting

(sec. 1509 of the bill and sec. 448 of the Code)

PRESENT LAW

An accrual method taxpayer generally must recognize income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy. An accrual method taxpayer may deduct the amount of any receivable that was previously included in income that becomes worthless during the year.

Accrual method taxpayers are not required to include in income amounts to be received for the performance of services which, on the basis of experience, will not be collected (the "non-accrual experience method"). The availability of this method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount charged.

A cash method taxpayer is not required to include an amount in income until it is received. A taxpayer may not use the cash method if purchase, production, or sale of merchandise is a material income producing factor. Such taxpayers generally are required to keep inventories and use an accrual method of accounting. In addition, corporations (and partnerships with corporate partners) generally may not use the cash method of accounting if their average annual gross receipts exceed $5 million. An exception to this $5 million rule is provided for qualified personal service corporations. A qualified personal service corporation is a corporation (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates or heirs. Qualified personal service corporations are allowed to use the cash method without regard to whether their average annual gross receipts exceed $5 million.

REASONS FOR CHANGE

The Committee understands that the use of the non-accrual experience method provides the equivalent of a bad debt reserve, which generally is not available to taxpayers using the accrual method of accounting. The Committee believes that accrual method taxpayers should be treated similarly, unless there is a strong indication that different treatment is necessary to clearly reflect income or to address a particular competitive situation.

The Committee understands that accrual basis providers of qualified personal services (services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting) compete on a regular basis with competitors using the cash method of accounting. The Committee believes that this competitive situation justifies the continued availability of the non-accrual experience method with respect to amounts due to be received for the performance of qualified personal services. The Committee believes that it is important to avoid the disparity of treatment between competing cash and accrual method providers of qualified personal services that could result if the non-accrual experience method were eliminated with regard to amounts to be received for such services.

EXPLANATION OF PROVISION

The bill provides that the non-accrual experience method will be available only for amounts to be received for the performance of qualified personal services. Amounts to be received for the performance of all other services will be subject to the general rule regarding inclusion in income. Qualified personal services are personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting. As under present law, the availability of the method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount.

EFFECTIVE DATE

The provision is effective for taxable years ending after the date of enactment. Any change in the taxpayer's method of accounting necessitated as a result of the proposal will be treated as a voluntary change initiated by the taxpayer with the consent of the Secretary of the Treasury. Any required section 481(a) adjustment is to be taken into account over a period not to exceed four years under principles consistent with those in Rev. Proc. 98–60.[85]

J. Deny the Exclusion of Gain on the Sale of a Principal Residence Which Was Acquired in a Like-Kind Exchange Within the Prior Five Years

(sec. 1510 of the bill and sec. 121 of the Code)

PRESENT LAW

Under present law, a taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to the sale or exchange of a principal residence that was acquired in a like-kind exchange within the prior five years.

[85] 1998–51 I.R.B. 16.

REASONS FOR CHANGE

The Committee believes that principal residences which were acquired in a tax deferred like-kind exchange should not also be eligible for the capital gain exclusion for principal residences for a period of five years after the like-kind exchange.

EXPLANATION OF PROVISION

The bill denies the principal residence exclusion (sec. 121) for gain on the sale or exchange of a principal residence if such principal residence was acquired in a like-kind exchange in which any gain was not recognized within the prior five years.

EFFECTIVE DATE

The provision is effective for sales or exchanges of principal residences after the date of enactment.

TITLE XVI. TAX TECHNICAL CORRECTIONS

Except as otherwise provided, the technical corrections contained in the bill generally are effective as if included in the originally enacted related legislation.

Amendments related to the Tax and Trade Relief Extension Act of 1998 (sec. 1601 of the bill)

Exempt organizations.—The provision clarifies that nonexempt charitable trusts and nonexempt private foundations are subject to the public disclosure requirements of section 6104(d).

Capital gains.—The provision clarifies that if (1) a charitable remainder trust sold section 1250 property after July 28, 1997, and before January 1, 1998, (2) the property was held more than one year but not more than 18 months, and (3) the capital gain is distributed after December 31, 1997, then any capital gain attributable to depreciation will be taxed at 25 percent (rather than 28 percent). Treasury has published a notice (Notice 99–17, 1999–14 I.R.B., April 5, 1999) providing that the gain is taxed at 25 percent.

Vaccine Trust Fund.—In the Tax and trade Relief Extension Act of 1998, the tax on vaccines against rotavirus gastroenteritis and the technical correction regarding the Vaccine Injury Compensation Trust Fund expenditure purposes were inadvertently included twice, once in the spending title and once in the revenue title. In addition, in the spending title, the effective date of the substantive change to the expenditure program is drafted erroneously, such that claims to the Trust Fund for this new expenditure purpose cannot be paid. The provisions clarify that the intended vaccine tax and Trust Fund provisions regarding program spending authority are those included in the revenue title, and modify the revenue title provisions as necessary to allow spending for the new purpose created elsewhere in the Act.

Amendments related to the Internal Revenue Service Restructuring and Reform Act of 1998 (sec. 1602 of the bill)

IRS restructuring.—When the Office of the Chief Inspector was replaced by the Treasury Inspector General for Tax Administration (TIGTA) under the IRS Restructuring and Reform Act of 1998, Inspection's responsibilities were assigned to the TIGTA. TIGTA personnel are Treasury, rather than IRS, personnel. TIGTA personnel still need to make investigative disclosures to carry out the duties they took over from Inspection and their additional tax administration responsibilities. However, section 6103(k)(6) refers only to "internal revenue" personnel. The provision clarifies that section 6103(k)(6) permits TIGTA personnel to make investigative disclosures.

Compliance.—Section 3509 of the IRS Restructuring and Reform Act of 1998 expanded the disclosure rules of section 6110 to also cover Chief Counsel advice (sec. 6110(i)). This is a conforming change related to ongoing investigations. The provision adds to section 6110(g)(5)(A), after the words technical advice memorandum, "or Chief Counsel advice."

Amendments Related to the Taxpayer Relief Act of 1997 (sec. 1603 of the bill)

Roth IRAs.—Code section 3405 provides for withholding with respect to designated distributions from certain tax-favored arrangements, including IRAs. In general, section 3405(e)(1)(B)(ii) excludes from the definition of a designated distribution the portion of any distribution which it is reasonable to believe is excludable from gross income. However, all distributions from IRAs are treated as includible in income. The exception was consistent with prior law when all IRA distributions were taxable, but does not account for the tax-free nature of certain Roth IRA distributions. The provision extends the exception to Roth IRAs.

Transportation benefits.—Under present law, salary reduction amounts are generally treated as compensation for purposes of the limits on contributions and benefits under qualified plans. In addition, an employer can elect whether or not to include such amounts for nondiscrimination testing purposes. The IRS Reform Act permitted employers to offer a cash option in lieu of qualified transportation benefits. The provision treats salary reduction amounts used for qualified transportation benefits the same as other salary reduction amounts for purposes of defining compensation under the qualified plan rules.

Tax Court jurisdiction.—The Tax Court recently held that its jurisdiction pursuant to section 7436 extends only to employment status, not to the amount of employment tax in dispute (*Henry Randolph Consulting* v. *Comm'r*, 112 T.C. #1, Jan. 6, 1999). The provision provides that the Tax Court also has jurisdiction over the amount.

Amendments to other acts (sec. 1604 of the bill)

Worthless securities.—Section 165(g)(3) provides a special rule for worthless securities of an affiliated corporation. The test for affiliation in section 165(g)(3)(A) is the 80-percent vote test for affiliated groups under section 1504(a) that was in effect prior to 1984. When section 1504(a) was amended in the Deficit Reduction Act of 1984 to adopt the vote and value test of present law, no corresponding change was made to section 165(g)(3)(A), even though the tests had been identical until then. The provision conforms the affiliation test of section 165(g)(3)(A) to the test in section 1504(a)(2), effective for taxable years beginning after December 31, 1984.

Work opportunity tax credit.—Section 51(d)(2) refers to eligibility for the work opportunity tax credit with respect to certain welfare recipients without taking into account the enactment of the temporary assistance for needy families ("TANF") program. The provisions conform references in the work opportunity tax credit to the operation of TANF, effective as if included in the amendments made by section 1201 of the Small Business Job Protection Act of 1996.

IRAs for nonworking spouses.—Section 1427 of the Small Business Job Protection Act of 1996 expanded the IRA deduction for nonworking spouses. The maximum permitted IRA contributions is generally limited by the individual's earned income. However, under present law, it is possible for a nonworking (or lesser earning) spouse to make IRA contributions in excess of the couple's combined earned income. The following example illustrates present law.

Example: Suppose H and W retire in the middle of January, 1999. In that year, H earns $1,000 and W earns $500. Both are active participants in an employer-sponsored retirement plan. Their modified AGI is $60,000. They make no Roth IRA contributions. Before application of the income phase-out rules, the maximum deductible IRA contribution that H can make is $1,000 (sec. 219(b)(1)). After application of the income phase-out rule in section 219(g), H's maximum contribution is $200, and H contributes that amount to an IRA. Under 408(o)(2)(B), H can make nondeductible contributions of $800 ($1,000–$200). W's maximum permitted deductible contribution under section 219(c)(1)(B), before the income phase-out, is $1,300 (the sum of H and W's earned income ($1,500), less H's deductible IRA contribution ($200)). Under the income phase-out, W's deductible contribution is limited to $200, and she can make a nondeductible contribution of $1,000 ($1,300–$200). The total permitted contributions for H and W are $2,300 ($1,000 for H plus $1,300 for W). The combined contribution should be limited to $1,500, their combined earned income.

The provision provides that the contributions for the spouse with the lesser income cannot exceed the combined earned income of the spouses. The provision is effective as if included with section 1427 of the Small Business Job Protection Act of 1996 (i.e., for taxable years beginning after December 31, 1996).

Insurance.—The legislative history of section 7702A(a) (enacted in the Technical and Miscellaneous Revenue Act of 1988) indicated that if a life insurance contract became a modified endowment contract ("MEC"), then the MEC status could not be eliminated by exchanging the MEC for another contract. Section 7702A(a)((2), however, arguably might be read to allow a policyholder to exchange a MEC for a contract that does not fail the 7-pay test of section 7702A(b), then exchange the second contract for a third contract, which would not literally have been received in exchange for a contract that failed to meet the 7-pay test. The provision clarifies section 7702A(a)(2) to correspond to the legislative history, effective as if enacted with the Technical and Miscellaneous Revenue Act of

1988 (generally, for contracts entered into on or after June 21, 1988).

Insurance.—Under section 7702A, if a life insurance contract that is not a modified endowment contract is actually or deemed exchanged for a new life insurance contract, then the 7-pay limit under the new contract is first be computed without reference to the premium paid using the cash surrender value of the old contract, and then would be reduced by 1/7 of the premium paid taking into account the cash surrender value of the old contract. For example, if the old contract had a cash surrender value of $14,000 and the 7-pay premium on the new contract would equal $10,000 per year but for the fact that there was an exchange, the 7-pay premium on the new contract would equal $8,000 ($10,000–$14,000/7). However, section 7702a(c)(3)(A) arguably might be read to suggest that if the cash surrender value on the new contract was $0 in the first two years (due to surrender charges), then the 7-pay premium might be $10,000 in this example, unintentionally permitting policyholders to engage in a series of "material changes" to circumvent the premium limitations in section 7702A. The provision clarifies section 7702A(c)(3)(A) to refer to the cash surrender value of the old contract, effective as if enacted with the Technical and Miscellaneous Revenue Act of 1988 (generally, for contracts entered into on or after June 21, 1988).

Definition of lump-sum distribution.—Section 1401(b) of the Small Business Job Protection Act of 1996 Act repealed 5-year averaging for lump-sum distributions. The definition of lump-sum distribution was preserved for other provisions, primarily those relating to NUA in employer securities. The definition was moved from section 402(d)(4)(A) to section 402(e)(4)(D)(i). This definition included the following sentence: "A distribution of an annuity contract from a trust or annuity plan referred to in the first sentence of this subparagraph shall be treated as a lump sum distribution." The provision adds this language back into the definition of lump-sum distribution, effective as if included with section 1401 of the Small Business Job Protection Act of 1996. The sentence is relevant to section 401(k)(10)(B), which permits certain distributions if made as a "lump-sum distribution."

Losses from section 1256 contracts.—Section 6411 allows tentative refunds for NOL carrybacks, business credit carrybacks and, for corporations only, capital loss carrybacks. Individuals normally cannot carry back a capital loss. However, section 1212(c) does allow a carryback of section 1256 losses, if elected by the taxpayer. The provision amends section 6411(a) by including a reference to section 1212(c), effective as if included with section 504 of the Economic Recovery Tax Act of 1981.

Clerical changes (sec. 1605 f the bill)

Individual.—Section 67(f), as enacted in 1988, has a cross reference to "the last sentence of section 162(a)." Additional "last sentences" were later added at the end of section 162(a) in 1992 and 1997. The provision corrects the reference in section 67(f).

Excess contributions.—The provision modifies the heading for section 408(d)(5) to "Distributions of excess contributions after due date for taxable year and certain excess rollover contributions."

Qualified State tuition programs.—Under section 529(e)(3)(B) (enacted in the Small Business Job Protection Act of 1996), qualified higher education expenses include room and board expenses of a designated beneficiary who is enrolled at least half-time in a degree program, regardless of whether the qualified state tuition program is a prepaid (i.e., guaranteed) program or a savings program. Therefore, the provision deletes the words "under guaranteed plans" from the heading of section 529(e)(3)(B).

S corporations.—Sections 678(e) and 6103(e)(1)(D)(v) refer to "an electing small business corporation under subchapter S of chapter 1." The reference was inadvertently not changed to "S corporation" when the Subchapter S Revision Act was enacted in 1982, and the provision corrects the reference.

Foreign-Military FSCs.—The Tax Reform Act of 1976 added section 995(b)(3)(B), limiting DISC benefits relating to "military property," which is defined by reference to a list under the "Military Security Act of 1954." That Act properly was titled the "Mutual Security Act of 1954," and it had been repealed and superseded by the "International Security Assistance and Arms Export Control Act of 1976" (signed into law June 30, 1976). Section 923 (relating to FSCs) also refers to the definition in section 995(b)(3)(B). Treasury regulations correctly reference the International Security Assistance and Arms Export Control Act of 1976. The provision names the correct Act in the statute.

Private foundation excise taxes.—Section 4946 provides a definition of "government official" for purposes of determining acts of self-dealing under section 4941. In section 4946(c)(3)(B), the definition refers to "compensation at the lowest rate prescribed for GS–16 * * *." The provision changes this language so that it refers to compensation at the lowest rate prescribed for Senior Executive Service (SES) positions.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statements are made concerning the roll call votes of the Committee on Ways and Means in its consideration of the bill, H.R. 2488.

MOTION TO REPORT THE BILL

The bill, H.R. 2488, as amended, was ordered favorably reported by a roll call vote of 23 yeas to 13 nays (with a quorum being present). The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer	X	....	Mr. Rangel	....	X
Mr. Crane	X	....	Mr. Stark	....	X
Mr. Thomas	X	....	Mr. Matsui	....	X
Mr. Shaw	X	....	Mr. Coyne	....	X
Mrs. Johnson	X	....	Mr. Levin	....	X
Mr. Houghton	X	....	Mr. Cardin	....	X
Mr. Herger	X	....	Mr. McDermott.		
Mr. McCrery	X	....	Mr. Kleczka	....	X
Mr. Camp	X	....	Mr. Lewis (GA)	....	X
Mr. Ramstad	X	....	Mr. Neal	....	X
Mr. Nussle	X	....	Mr. McNulty	....	....
Mr. Johnson	X	....	Mr. Jefferson	....	X

Representatives	Yea	Nay	Representatives	Yea	Nay
Ms. Dunn	X	....	Mr. Tanner	....	X
Mr. Collins	X	....	Mr. Becerra	....	X
Mr. Portman	X	....	Mrs. Thurman	....	....
Mr. English	X	....	Mr. Doggett	....	X
Mr. Watkins	X	....			
Mr. Hayworth	X	....			
Mr. Weller	X	....			
Mr. Hulshof	X	....			
Mr. McInnis	X	....			
Mr. Lewis (KY)	X	....			
Mr. Foley	X	....			

VOTES ON AMENDMENTS

A roll call vote was conducted on the following amendment to the Chairman's amendment in the nature of a substitute.

An amendment by Mr. Stark, to provide a 50-percent refundable tax credit to Medicare beneficiaries to help pay for $2,000 per year in prescription drugs starting in 2002, rising to $5,000 by 2008, was defeated by a roll call vote of 11 yeas to 23 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer	....	X	Mr. Rangel	X	....
Mr. Crane	....	X	Mr. Stark	X	....
Mr. Thomas	....	X	Mr. Matsui	X	....
Mr. Shaw	....	X	Mr. Coyne	X	....
Mrs. Johnson	....	X	Mr. Levin	X	....
Mr. Houghton	....	X	Mr. Cardin	X	....
Mr. Herger	....	X	Mr. McDermott	....	....
Mr. McCrery	....	X	Mr. Kleczka	X	....
Mr. Camp	....	X	Mr. Lewis (GA)	X	....
Mr. Ramstad	....	X	Mr. Neal	X	....
Mr. Nussle	....	X	Mr. McNulty	....	....
Mr. Johnson	....	X	Mr. Jefferson	X	....
Ms. Dunn	....	X	Mr. Tanner	X	....
Mr. Collins	....	X	Mr. Becerra	X	....
Mr. Portman	....	X	Mrs. Thurman	....	....
Mr. English	....	X	Mr. Doggett	X	....
Mr. Watkins	....	X			
Mr. Hayworth	....	X			
Mr. Weller	....	X			
Mr. Hulshof	....	X			
Mr. McInnis	....	X			
Mr. Lewis (KY)	....	X			
Mr. Foley	....	X			

An amendment by Mr. Matsui, to prevent all provisions other than expiring provisions and revenue offsets from taking effect and to reserve all on-budget surpluses pending subsequent legislation to strengthen Social Security was defeated by a roll call vote of 13 yeas to 23 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer	....	X	Mr. Rangel	X	....
Mr. Crane	....	X	Mr. Stark	X	....
Mr. Thomas	....	X	Mr. Matsui	X	....
Mr. Shaw	....	X	Mr. Coyne	X	....
Mrs. Johnson	....	X	Mr. Levin	X	....
Mr. Houghton	....	X	Mr. Cardin	X	....
Mr. Herger	....	X	Mr. McDermott	....	....

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. McCrery	....	X	Mr. Kleczka	X	....
Mr. Camp	....	X	Mr. Lewis (GA)	X	....
Mr. Ramstad	....	X	Mr. Neal	X	....
Mr. Nussle	....	X	Mr. McNulty	....	....
Mr. Johnson	....	X	Mr. Jefferson	X	....
Ms. Dunn	....	X	Mr. Tanner	X	....
Mr. Collins	....	X	Mr. Becerra	X	....
Mr. Portman	....	X	Mrs. Thurman	X	....
Mr. English	....	X	Mr. Doggett	X	....
Mr. Watkins	....	X			
Mr. Hayworth	....	X			
Mr. Weller	....	X			
Mr. Hulshof	....	X			
Mr. McInnis	....	X			
Mr. Lewis (KY)	....	X			
Mr. Foley	....	X			

An amendment by Mr. Neal to make all provisions other than expiring provisions and revenue offsets contingent on certifications regarding social security, Medicare, and a balanced budget, was defeated by a roll call vote of 13 yeas to 22 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer	....	X	Mr. Rangel	X	....
Mr. Crane	....	X	Mr. Stark	X	....
Mr. Thomas	....	X	Mr. Matsui	X	....
Mr. Shaw	....	X	Mr. Coyne	X	....
Mrs. Johnson	....	X	Mr. Levin	X	....
Mr. Houghton	....	X	Mr. Cardin	X	....
Mr. Herger	....	X	Mr. McDermott	....	....
Mr. McCrery	....	X	Mr. Kleczka	X	....
Mr. Camp	....	X	Mr. Lewis (GA)	X	....
Mr. Ramstad	....	X	Mr. Neal	X	....
Mr. Nussle	....	X	Mr. McNulty	....	....
Mr. Johnson	....	X	Mr. Jefferson	X	....
Ms. Dunn	....	X	Mr. Tanner	X	....
Mr. Collins	....	X	Mr. Becerra	X	....
Mr. Portman	....	X	Mrs. Thurman	X	....
Mr. English	....	X	Mr. Doggett	X	....
Mr. Watkins	....	X			
Mr. Hayworth	....	X			
Mr. Weller	....	X			
Mr. Hulshof	....	X			
Mr. McInnis	....	X			
Mr. Lewis (KY)	....	X			
Mr. Foley	....	X			

An amendment by Messrs. Cardin, Stark and Levin to require a pro rata reduction in the tax reductions (other than expiring provisions) and to reserve funds for Medicare solvency and a prescription drug benefit, was defeated by a roll call vote of 13 yeas to 22 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer	....	X	Mr. Rangel	X	....
Mr. Crane	....	X	Mr. Stark	X	....
Mr. Thomas	....	X	Mr. Matsui	X	....
Mr. Shaw	....	X	Mr. Coyne	X	....
Mrs Johnson	....	X	Mr. Levin	X	....
Mr. Houghton	....	X	Mr. Cardin	X	....
Mr. Herger	....	X	Mr. McDermott	....	....

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. McCrery		X	Mr. Kleczka	X	
Mr. Camp		X	Mr. Lewis (GA)	X	
Mr. Ramstad		X	Mr. Neal	X	
Mr. Nussle		X	Mr. McNulty		
Mr. Johnson		X	Mr. Jefferson	X	
Ms. Dunn			Mr. Tanner	X	
Mr. Collins		X	Mr. Becerra	X	
Mr. Portman		X	Mrs. Thurman		
Mr. English		X	Mr. Doggett	X	
Mr. Watkins		X			
Mr. Hayworth		X			
Mr. Weller		X			
Mr. Hulshof		X			
Mr. McInnis		X			
Mr. Lewis (KY)		X			
Mr. Foley		X			

An amendment by Mr. Tanner to limit the tax reductions and to preserve 50 percent of projected non-social security surpluses for debt reduction, was defeated by a roll call vote of 13 yeas to 23 nays The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer		X	Mr. Rangel	X	
Mr. Crane		X	Mr. Stark	X	
Mr. Thomas		X	Mr. Matsui	X	
Mr. Shaw		X	Mr. Coyne	X	
Mrs. Johnson		X	Mr. Levin	X	
Mr. Houghton		X	Mr. Cardin	X	
Mr. Herger		X	Mr. McDermott		
Mr. McCrery		X	Mr. Kleczka	X	
Mr. Camp		X	Mr. Lewis (GA)	X	
Mr. Ramstad		X	Mr. Neal	X	
Mr. Nussle		X	Mr. McNulty		
Mr. Johnson		X	Mr. Jefferson	X	
Ms. Dunn		X	Mr. Tanner	X	
Mr. Collins		X	Mr. Becerra	X	
Mr. Portman		X	Mrs. Thurman		
Mr. English		X	Mr. Doggett	X	
Mr. Watkins		X			
Mr. Hayworth		X			
Mr. Weller		X			
Mr. Hulshof		X			
Mr. McInnis		X			
Mr. Lewis (KY)		X			
Mr. Foley		X			

An amendment by Mr. Kleczka for an above-the-line deduction for the prescription drug insurance coverage of Medicare beneficiaries, was defeated by a roll call vote of 13 yeas to 22 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer		X	Mr. Rangel	X	
Mr. Crane			Mr. Stark	X	
Mr. Thomas		X	Mr. Matsui	X	
Mr. Shaw		X	Mr. Coyne	X	
Mrs. Johnson		X	Mr. Levin	X	
Mr. Houghton		X	Mr. Cardin	X	
Mr. Herger		X	Mr. McDermott		
Mr. McCrery		X	Mr. Kleczka	X	
Mr. Camp		X	Mr. Lewis (GA)	X	

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Ramstad	....	X	Mr. Neal	X	....
Mr. Nussle	....	X	Mr. McNulty	....	....
Mr. Johnson	....	X	Mr. Jefferson	X	....
Ms. Dunn	....	X	Mr. Tanner	X	....
Mr. Collins	....	X	Mr. Becerra	X	....
Mr. Portman	....	X	Mrs. Thurman	....	....
Mr. English	....	X	Mr. Doggett	X	....
Mr. Watkins	....	X			
Mr. Hayworth	....	X			
Mr. Weller	....	X			
Mr. Hulshof	....	X			
Mr. McInnis	....	X			
Mr. Lewis (KY)	....	X			
Mr. Foley	....	X			

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the affects on the budget of the bill, H.R. 2488, as reported.

The bill is estimated to have the following effects on budget receipts for fiscal years 1999–2009:

ESTIMATED BUDGET EFFECTS OF THE ''FINANCIAL FREEDOM ACT OF 1999,'' AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS

[Fiscal years 1999–2009, in millions of dollars]

Provision	Effective	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2004	1999–2009
Title I. Family Tax Relief Provisions														
A. 10% Across-the-Board Income Tax Rate Cut—reduce regular income tax and AMT rates by: 2.5% for 2001 through 2004, 5.0% for 2005 through 2007, 7.5% in 2008, and 10% in 2009 and thereafter.	tyba 12/31/00	....	....	−13,167	−19,360	−20,156	−21,131	−40,369	−50,237	−52,821	−76,361	−111,551	−73,814	−405,153
B. Marriage Penalty Relief														
1. Adjust the standard deduction for married couples filing joint returns to twice that of a single taxpayer; phase-in ratably over 3 years beginning in 2001.	tyba 12/31/00	....	....	−1,266	−3,125	−5,153	−5,854	−5,713	−5,838	−5,976	−6,003	−5,599	−15,398	−44,527
2. Adjust student loan interest deduction income limits for married couples filing joint returns to twice that of a single taxpayer; repeal 60-month rule (for everyone) beginning in 2000.	tyba 12/31/99	....	−36	−149	−173	−199	−231	−237	−239	−247	−253	−254	−787	−2,017
3. Increase the Roth IRA conversion income limit for married couples filing joint returns to $160,000 beginning in 2000.	tyba 12/31/99	....	205	536	370	89	−183	−374	−675	−547	−326	−90	1,018	−994
C. Repeal the Individual Minimum Tax—make permanent the present-law provision to allow nonrefundable personal credits fully, effective for 1999 and thereafter; repeal 90% limit on foreign tax credits effective for taxable years beginning after 12/31/01; phaseout the individual AMT by paying the following percent of AMT liability: 80% in 2003, 70% in 2004, 60% in 2005, 50% in 2006 and 2007; repeal in 2008; unused AMT credit carryovers as of repeal may be used to offset 90% of regular tax (repeal eliminates AMT marriage penalty).	tyba 12/31/98 & tyba 12/31/02	....	−980	−989	−1,348	−2,458	−4,158	−6,007	−8,388	−11,016	−18,798	−27,406	−9,933	−81,548
Total of Family Tax Relief Provisions	....	....	811	−15,035	−23,636	−27,877	−31,557	−52,700	−65,377	−70,607	−101,741	−144,900	−98,914	−534,239
Title II. Savings and Investment Tax Relief Provisions														
1. Exclusion of interest and dividend income ($200 joint returns)/$100 (all others) for 2001 and 2002; $400 (joint returns)/$200 (all others) for 2003 and thereafter; apply to all interest and dividends (other than tax-exempt interest, capital gain dividends, cooperative patronage dividends, and ESOP dividends).	tyba 12/31/00	....	....	−353	−1,771	−2,083	−3,245	−3,315	−3,335	−3,428	−3,424	−3,064	−7,452	−24,018

2. Reduce individual capital gains rates from 20%/10% to 15%/7.5% (same assets and 1-year holding period as under present law); reduce recapture rate from 25% to 20%; 28% rate remains as under present law; repeal mark-to-market and 18%/8% rates for 5-year holding period.	giiia /6/30/99 [1]	....	−731	−3,784	−5,804	−5,773	−5,828	−5,884	−5,978	−5,948	−5,953	−5,962	−21,920	−51,645
3. Reduce tax on capital gains of designated settlement funds to individual capital gains rates under the bill.	tyba 12/3/99	....	−12	−59	−67	−75	−85	−96	−110	−123	−137	−153	−298	−917
4. Suspend 5-year holding period requirement relating to gain on sale of principal residence for members of the uniformed services and the foreign service serving outside the area in which the residence is located.	sa DOE	....	−5	−12	−13	−13	−14	−14	−15	−15	−16	−16	−57	−133
5. Suspend 5-year holding period requirement (for a maximum of 5 years) relating to gain on sale of principal residence by employee who is sent out of the United States by an employer.	sa DOE	....	−18	−26	−28	−29	−30	−31	−32	−33	−34	−35	−131	−296
6. Modify treatment of worthless securities of certain financial institutions.	sbwi tyba 12/31/99	....	−8	−12	−12	−11	−11	−10	−10	−10	−10	−10	−58	−108
7. Clarify the tax treatment of income and losses from derivatives.	DOE	....	([2])	1	1	1	1	1	1	1	1	1	4	9
Total of Savings and Investment Tax Relief Provisions.	....	....	−774	−4,245	−7,694	−7,983	−9,212	−9,349	−9,479	−9,556	−9,573	−9,239	−29,912	−77,108
Title III. Business Investment and Job Creation Provisions														
1. Reduce tax on capital gains of corporations to 34.1% in 2000, 33.9% in 2001, 32.7% in 2002, 31.7% in 2003, 30.8% in 2004, 29.8% in 2005, 29.2% in 2006, 28% in 2007, 27.4% in 2008, 26.2% in 2009, and 25% in 2010 and thereafter; apply same rate for all gains includible in income in the taxable year.	tyba 12/31/99	....	−47	−119	−247	−511	−825	−1,222	−1,645	−2,198	−2,863	−3,633	−1,749	−13,310
2. Corporate AMT: repeal 90% limit on foreign tax credits, effective for taxable years beginning after 12/31/01; allow AMT credit carryovers to offset current year's minimum tax liability: 20% in 2003, 30% in 2004, 40% in 2005, 50% in 2006 and 2007; repeal in 2008: unused AMT credit carryovers after repeal may be used to offset 90% of regular tax.	tyba 12/31/01	....	....	....	−138	−1,121	−2,024	−1,916	−1,517	−1,121	−2,037	−2,644	−3,283	−12,519
Total of Business Investment and Job Creation Provisions.	....	....	−47	−119	−385	−1,632	−2,849	−3,138	−3,162	−3,319	−4,900	−6,277	−5,032	−25,829

ESTIMATED BUDGET EFFECTS OF THE "FINANCIAL FREEDOM ACT OF 1999," AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS—Continued

[Fiscal years 1999–2009, in millions of dollars]

Provision	Effective	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2004	1999–2009
Title IV. Education Tax Relief Provisions														
1. Education savings accounts (formerly "Education IRAs")—increase the annual contribution limit to $2,000; expand the definition of qualified education expenses to include elementary and secondary education expenses (and after-school programs); allow ESAs to be used for special needs beneficiaries; allow corporations and other entities to contribute to ESAs; allow contributions until April 15 of following year; and allow taxpayer to exclude ESA distribution from gross income and claim HOPE or Lifetime Learning credit as long as they are not used for same expenses.	tyba 12/31/00	....	....	−46	−152	−230	−311	−394	−475	−566	−651	−726	−739	−3,552
2. Qualified tuition plans—permit private institutions to establish tax-deferred prepaid tuition plans beginning in 2001; allow tax-free distributions from State plans beginning 2001 and tax-free distributions from private plans in 2004; permit one tax-free rollover every 12 months for benefit of same beneficiary; and allow taxpayer to exclude plan distributions from income and claim HOPE or Lifetime Learning credit as long as not used for same expenses.	tyba 12/31/00	....	....	−11	−37	−56	−82	−114	−146	−181	−211	−239	−186	−1,078
3. Exclude from tax awards under the following programs: National Health Corps Scholarship program, beginning in 1994; F. Edward Hebert Armed Forces Health Professions Scholarship program, beginning in 1994; National Institutes of Health Undergraduate Scholarship Program, beginning in 1994; and similar State-sponsored scholarship programs, beginning in 2000.	tyba 12/31/93 & tyba 12/31/99	....	−3	−3	−3	−3	−3	−4	−4	−4	−4	−5	−16	−36
4. Increase the school construction small issuer arbitrage rebate exception from $10 million to $15 million.	cya 1999	....	(3)	−2	−4	−5	−13	−14	−14	−15	−16	−17	−25	−102
5. Provide new 4-year expenditure schedule for bonds for public school construction under the arbitrage rebate rules.	bia 12/31/99	....	−13	−120	−236	−274	−292	−307	−310	−305	−300	−293	−935	−2,450
Total of Education Tax Relief Provisions	....	....	−16	−182	−432	−568	−701	−833	−949	−1,071	−1,182	−1,280	−1,901	−7,218

Title V. Health Care Tax Relief Provisions														
1. Provide an above-the-line deduction for health insurance expenses for which the taxpayer pays at least 50% of the premium, phased in as follows: 25% in 2001, 40% in 2002, 50% in 2003 through 2006, 75% in 2007, and 100% in 2008 and thereafter; for purposes of the 50% payment rule, all health plans for a single employer are combined; health insurance deduction does not apply to any month in which the taxpayer is enrolled in Medicare, Medicaid, Champus, VA, Indian Health Service, Children's Health Insurance or Federal Employees Health Benefits (non-COBRA) programs.	tyba 12/31/00	....	....	−416	−1,567	−2,447	−3,035	−3,241	−3,460	−4,379	−6,834	−8,848	−7,466	−34,228
2. Provide an above-the-line deduction for long-term care insurance expenses for which the taxpayer pays at least 50% of the premium, phased in as follows 25% in 2001, 40% in 2002, 50% in 2003 through 2006, 75% in 2007, and 100% in 2008 and thereafter.	tyba 12/31/00	....	....	−40	−306	−555	−745	−801	−857	−991	−1,573	−2,146	−1,646	−8,014
3. Allow long-term care insurance to be offered as part of cafeteria plans [4].	typa 12/31/00	....	....	−99	−133	−137	−151	−173	−197	−218	−228	−247	−519	−1,582
4. Expand medical savings accounts (MSAs)—make the program permanent and repeal the 750,000 cap on taxpayer participation; allow any employer to offer MSAs to its employees; lower the minimum deductible to $1,000 for individual coverage ($2,000 for family coverage); allow MSA contributions equal to 100% of the deductible under the policy; allow both employer and employee contributions; allow MSAs to be part of a cafeteria plan.	tyba 12/13/00	....	....	−109	−326	−370	−414	−458	−502	−546	−590	−634	−1,217	−3,947
5. Provide an additional dependency deduction to caretakers of elderly family members.	tyba 12/31/99	....	−180	−276	−275	−283	−304	−324	−350	−394	−418	−428	−1,317	−3,231
6. Increase the time period for measuring eligible expenses qualifying for the orphan drug tax credit.	eia 12/31/99	....	−5	−8	−9	−10	−10	−11	−12	−13	−14	−15	−42	−107
7. Include the Streptococcus Pneumoniae vaccine to the list of taxable vaccines in the Federal vaccine insurance program; study of program.	([5])	....	4	7	9	10	10	10	10	10	10	11	39	91
8. Above-the-line deduction for prescription drug insurance coverage of Medicare beneficiaries if certain Medicare and Low-Income Assistance provisions in effect.	tyba DOE							No Revenue Effect						
Total of Health Care Tax Relief Provisions	....	....	−181	−941	−2,607	−3,792	−4,649	−4,998	−5,368	−6,531	−9,647	−12,307	−12,168	−51,018

ESTIMATED BUDGET EFFECTS OF THE "FINANCIAL FREEDOM ACT OF 1999," AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS—Continued

[Fiscal years 1999–2009, in millions of dollars]

Provision	Effective	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2004	1999–2009
Title VI. Death Tax Relief Provisions														
1. Phase in repeal of estate, gift, and generation-skipping transfer taxes: beginning in 2001, convert the unified credit into a true exemption, repeal the 5% "bubble" (which phases out the lower rates and part of the unified credit), and repeal rates in excess of 50%; in 2002 through 2004, reduce all rates by 1 percentage point a year; in 2005 through 2008, reduce all rates by 2 percentage points a year but do not go below the lowest and highest income tax rates under the bill's broad-based income tax relief; for 2002 through 2008, proportionately reduce Stte tax credit rates; beginning in 2009, repeal all of these taxes; beginning in 2009, carryover basis applies to nonspouse transfers by gift or by death after 12/31/08; estates with total assets of fair market value of $2 million or less and spouse transfers continue to receive step up in basis.	dda & gma 12/31/00	....	....	....	−5,140	−6,142	−6,964	−7,901	−9,567	−11,266	−13,039	−15,238	−18,246	−75,257
2. Simplification of generation-skipping transfer tax rules.	generally DOE	....	−3	−5	−7	−10	−10	−10	−10	−10	−10	−10	−35	−85
Total of Death Tax Relief Provisions	....	....	−3	−5	−5,147	−6,152	−6,974	−7,911	−9,577	−11,276	−13,049	−15,248	−18,281	−75,342
Title VII. Distressed Communities and Industries Provisions														
1. Designate 20 Renewal Communities; provide various incentives (zero capital gains tax on certain 5-year investments; special deduction for real estate revitalization expenditures; special expensing for certain business property; work opportunity tax credit; Brownfield remediation expenses; family development accounts) beginning 1/1/01 and ending 12/31/07 [6].	DOE	....	....	−130	−256	−293	−296	−308	−335	−426	−109	−18	−975	−2,172
2. Provide that Federal farm production payments are taxable in the year of receipt (override constructive receipt if farmer has an election to take the payments in an earlier year).	DOE	Negligible Revenue Effect												
3. Allow 5-year carryback of oil and gas net operating losses.	lii tyba 12/31/98	....	−46	−28	−24	−21	−20	−20	−21	−21	−22	−23	−139	−246
4. Increase maximum reforestation expenses qualifying for amortization and credit from $10,000 to $25,000; remove cap on amortization of reforestation costs in 2000 through 2003.	epoii tyba 12/31/98	−4	−10	−17	−25	−31	−36	−38	−39	−37	−33	−29	−122	−298

5. Allow steel manufacturers to use alternative minimum tax credit carryovers to reduce 90% of AMT liability.	tyba 12/31/98	18	−83	−36	−22	−13	−7	−4	−2	−1	(3)	(3)	−181	−187
6. Suspend the 65% of taxable income limit on percentage depletion for 6 years.	tyba 12/31/98 & tybb 1/1/05		−10	−12	−15	−17	−20	−10					−74	−84
7. Allow geological and geophysical costs to be deducted currently.	cpoii tyba 12/31/99		−16	−25	−26	−27	−27	−28	−29	−29	−30	−31	−121	−268
8. Allow delay rental payments to be deducted currently.	tyba 12/31/99		−3	−4	−4	−4	−4	−4	−4	−3	−4	−5	−19	−39
9. Modify the refining threshold in section 613(d)(4) from "on any given day".	tyba 12/31/99		−1	−2	−2	−2	−2	−2	−2	−2	−2	−2	−9	−19
10. Section 631(b) treatment of sales of timber	sa DOE	Negligible Revenue Effect												
Total of Distressed Communities and Industries Provisions.		−22	−169	−254	−374	−408	−412	−414	−432	−519	−200	−108	−1,640	−3,313
Title VIII. Small Business Tax Relief Provisions														
1. Accelerate 100% self-employed health insurance deduction.	tyba 12/31/99		−245	−1,007	−1,040	−657							−2,949	−2,949
2. Increase section 179 expensing to $30,000	tyba 12/31/99		−790	−880	−189	−95	2	−31	−90	−142	−157	−160	−1,954	−2,533
3. Accelerate repeal of the FUTA surtax	yba 12/31/04							−1,029	−421	−21	−1,058	−413		
4. Restore 80% business meals deduction (excluding entertainment expenses)—increase 5 percentage points a year.	tyba 12/31/04							−293	−899	−1,594	−2,376	−3,247		−8,409
Total of Small Business Tax Relief Provisions			−1,035	−1,887	−1,229	−752	2	−1,353	−1,410	−1,757	−1,475	−2,994	−4,903	−13,891
Title IX. International Competitiveness Provisions														
1. Allocate interest deduction on worldwide basis (including controlled foreign corporations).	tyba 12/31/01				−850	−2,722	−2,972	−3,146	−3,383	−3,636	−3,909	−4,202	−6,499	−24,775
2. Accelerate look-through treatment for dividends of 10/50 companies and for separate basket excess credit carryovers.	tyba 12/31/01				−116	−451	−172	−63	−32	−22	−17	−12	−739	−885
3. Exception from subpart F treatment for certain pipeline transportation and electricity transmission income.	tyba 12/31/01				−3	−10	−13	−15	−17	−20	−23	−25	−26	−126
4. Recharacterize overall domestic loss	tyba 12/31/04							−206	−444	−471	−494	−529		−2,144
5. Repeal FSC 50% limitation for military property	tyba 12/31/01				−45	−108	−121	−136	−153	−173	−194	−215	−274	−1,145
6. Treatment of regulated investment companies	mf tyba 12/31/04							−82	−153	−162	−171	−182		−750
7. Repeal special foreign tax credit rules for foreign oil and gas income.	tyba 12/31/04							−351	−922	−1,024	−1,136	−1,259		−4,692
8. Treasury study on treating the European Union as one country for purposes of same-country exceptions under subpart F.	DOE	No Revenue Effect												
9. Authorize the President to waive the denial of the foreign tax credit under certain circumstances.	DOE	No Revenue Effect												
10. Prohibit disclosure of advance pricing agreements (APAs) and related information; require the IRS to submit to Congress an annual report of such agreements; APA user fee.	DOE	Negligible Revenue Effect												

ESTIMATED BUDGET EFFECTS OF THE ''FINANCIAL FREEDOM ACT OF 1999,'' AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS—Continued

[Fiscal years 1999–2009, in millions of dollars]

Provision	Effective	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2004	1999–2009
11. Increase the section 911 exclusion by $3,000 per year starting in 2003 until it reaches $95,000; index for inflation in 2008, for inflation occurring after 2006.	1/1/03	....	....	....	....	−24	−48	−80	−107	−131	−155	−184	−72	−729
Total of International Competitiveness Provisions.	....	....	....	....	−1,014	−3,315	−3,281	−4,079	−5,211	−5,639	−6,099	−6,608	−7,610	−35,246
Title X. Tax-Exempt Organization Provisions														
1. Provide a tax exemption for organizations created by a State to provide property and casualty insurance coverage for property for which such coverage is otherwise unavailable.	tyba 12/31/99	....	−2	−4	−4	−4	−5	−5	−6	−7	−8	−8	−18	−53
2. Modify special provision for a permanent university fund.	tyba 12/31/99	....	(3)	−1	−1	(3)	(3)	(2)	(3)	−1	(3)	(3)	−2	−3
3. Deny deduction and impose excise tax with respect to charitable split-dollar life insurance arrangements.	(7)							Negligible Revenue Effect						
4. Authorize the Secretary of the Treasury to grant waivers from section 4941 prohibitions.	DOE							Negligible Revenue Effect						
5. Extend declaratory judgment remedy to certain organizations seeking determinations of tax-exempt status.	DOE							Negligible Revenue Effect						
6. Modify section 512(b)(13) to exempt income received by a tax-exempt organization from certain subsidiaries when fair market value pricing is used, excess of fair market value subject to UBIT and 20% penalty tax, and extension of transition relief for certain binding contracts.	DOE & proaa 12/31/99	....	−7	−9	−11	−11	−11	−11	−12	−12	−12	−13	−49	−110
Total of Tax-Exempt Organization Provisions	....	....	−9	−14	−16	−15	−16	−16	−18	−20	−20	−21	−69	−166
Title XI. Real Estate Tax Relief Provisoions														
1. Real estate investment trust (REIT) provisions:														
a. Impose 10% vote or value test	tyba 12/31/00	....	....	2	8	8	8	9	9	9	10	10	26	73
b. Treatment of income and services provided by taxable REIT subsidiaries.	tyba 12/13/00	....	....	60	158	53	23	−9	−45	−84	−127	−173	294	−145
c. Special foreclosure rule for health care REITs	tyba 12/31/00							Negligible Revenue Effect						
d. Conformity with RIC 90% distribution rules	tyba 12/31/00	....	....	1	1	1	1	1	1	1	1	3	5	
e. Clarification of definition of independent operators for REITs.	tyba 12/31/00							Negligible Revenue Effect						
f. Modification of earnings and profits rules	da 12/31/00	....	....	−6	−3	−3	−3	−4	−4	−4	−4	−16	−35	
2. Modify at-risk rules for publicly traded securities	diia 12/13/99	....	(3)	−2	−4	−5	−6	−8	−10	−12	−14	−16	−19	−78
3. Amend section 110 to eliminate 15-year limitation	−apa 12/31/99	....	−8	−16	−22	−28	−34	−40	−42	−43	−44	−46	−108	−323

4. Amend section 118 to clarify the tax treatment of certain construction allowances or contributions received by retail operators.	apa 12/31/99	....	−1	−2	−6	−10	−14	−18	−22	−27	−31	−36	−32	−166
5. Low-income housing tax credit—increae per capita credit by $0.10 per year through 2004; thereafter COLA; change stacking; change credit allocation rules.	tyba 12/31/99	....	−4	−21	−63	−132	−231	−357	−504	−664	−836	−1,021	−450	−3,833
Total of Real Estate Tax Relief Provisions	....	....	−13	16	69	−116	−256	−426	−617	−824	−1,045	−1,285	−302	−4,502
Title XII. Pension Reform Provisions														
A. Provisions for Expanding Coverage														
1. Increase contribution and benefit limits:														
a. Increase defined benefit dollar limit to $160,000.	yba 12/31/00	....	....	−18	−31	−40	−45	−48	−50	−53	−55	−57	−134	−396
b. Lower early retirement age to 62; lower normal retirement age to 65.	yba 12/31/00	....	....	−3	−4	−4	−4	−5	−5	−5	−5	−5	−16	−40
c. Increase annual addition limitation for defined contribution plans to $40,000 [8].	12/31/00	....	....	−6	−11	−13	−14	−15	−16	−16	−17	−18	−44	−125
d. Increase qualified plan compensation limited to $200,000 [8].	yba 12/31/00	....	....	−40	−69	−78	−83	−89	−95	−101	−107	−113	−270	−776
e. Increase limitation on exclusion for elective deferrals to $11,000 in 2001, $12,000 in 2002, $13,000 in 2003, $14,000 in 2004, $15,000 in 2005; index in $500 increments thereafter [8].	yba 12/31/00	....	....	−127	−307	−454	−559	−630	−680	−726	−757	−781	−1,448	−5,021
f. Increase limits on deferrals under deferred compensation plans of State-local governments and tax-exempt organizations to $11,000 in 2001, $12,000 in 2002, $13,000 in 2003, $14,000 in 2004, $15,000 in 2005; index in $500 increments thereafter (twice the dollar limit in 3 years before retirement) [8].	yba 12/31/00	....	....	−51	−90	−104	−115	−123	−130	−138	−143	−146	−360	−1,039
g. Increase limitation on SIMPLE elective contributions to $7,000 in 2001, $8,000 in 2002, $9,000 in 2003, $10,000 in 2004; index in $500 increments thereafter [8].	yba 12/31/00	....	....	−5	−14	−22	−27	−29	−29	−30	−32	−33	−67	−220
2. Plan loans for subchapter S owners, partners, and sole proprietors.	yba 12/31/00	....	....	−20	−30	−32	−35	−37	−39	−41	−44	−46	−117	−325
3. Modification of top-heavy rules	yba 12/31/00	....	....	−3	−7	−9	−10	−11	−13	−14	−15	−17	−29	−99
4. Elective deferrals not taken into account for purposes of deduction limits.	yba 12/31/00	....	....	−38	−71	−81	−85	−89	−93	−97	−101	−104	−275	−759
5. Reduce PBGC premium for new plans of small employers; additonal PBGC premium relief for plans with 25 or fewer employees [9].	pea 12/31/00	....	....	−([10])	−([10])	−([10])	−([10])	−([10])	−([10])	−([10])	−([10])	−([10])	−15	−40
6. Phase-in of additonal PBGC premium for new plans [9].	pea 12/31/00	....	....	−1	−1	−1	−2	−2	−2	−2	−2	−2	−4	−12

ESTIMATED BUDGET EFFECTS OF THE "FINANCIAL FREEDOM ACT OF 1999," AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS—Continued

[Fiscal years 1999–2009, in millions of dollars]

Provision	Effective	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2004	1999–2009
7. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations.	yba 12/31/00	....	....	−16	−22	−22	−22	−22	−23	−24	−25	−26	−82	−202
8. Elimination of user fee for determination requests regarding small employer pension plans [9].	rma 12/31/00	....	....	−17	−8	−8	−9	−9	−9	−9	−10	−10	−42	−88
9. Definition of compensation for purposes of deduction limits [8].	yba 12/31/00	....	....	−1	−2	−3	−3	−3	−3	−3	−3	−3	−9	−24
10. Option to treat elective deferrals as after-tax contributions.	tyba 12/31/00	....	....	50	100	131	144	89	−2	−104	−218	−345	426	−155
11. Increase minimum benefit under defined benefit plans from $10,000 to $40,000 in $10,000 increments, and repeal limitation relating to defined contribution plans.	yba 12/31/00	....	....	−2	−5	−7	−7	−7	−8	−8	−8	−8	−22	−61
Subtotal of Provisions for Expanding Coverage.	....	....	....	−297	−575	−780	−878	−1,033	−1,200	−1,374	−1,545	−1,717	−2,508	−9,382
B. Provisions for Enhancing Fairness for Women														
1. Additional salary reduction catch-up contributions.	yba 12/31/00	....	....	−60	−122	−109	−77	−65	−64	−66	−66	−66	−368	−694
2. Equitable treatment for contributions of employees to defined contribution plans [8].	yba 12/31/00	....	....	−50	−75	−81	−87	−92	−97	−103	−107	−110	−294	−804
3. Faster vesting of certain employer matching contributions.	pyba 12/31/00	Negligible Revenue Effect												
4. Simplify and update the minimum distribution rules by modifying post-death distribution rules, reducing (to 10%) the excise tax on failure to make minimum distributions, and directing the Treasury to simplify and finalize regulations relating to the minimum distribution rules.	yba 12/31/00	....	....	−118	−212	−239	−268	−297	−330	−366	−402	−441	−837	−2,673
5. Clarification of tax treatment of division of section 457 plan benefits upon divorce.	tdapma 12/31/00	Negligible Revenue Effect												
Subtotal of Provisions for Enhancing Fairness for Women.	....	....	....	−228	−409	−429	−432	−454	−491	−535	−575	−617	−1,499	−4,171
C. Provisions for Increasing Portability for Participants														
1. Rollovers allowed among governmental section 457 plans, section 403(b) plans, and qualified plans.	dma 12/31/00	....	....	−7	−11	−12	−12	−12	−13	−13	−13	−14	−41	−106

2. Rollovers of IRAs to workplace retirement plans.	dma 12/31/00	Negligible Revenue Effect												
3. Rollovers of after-tax retirement plan contributions.	dma 12/31/00	Negligible Revenue Effect												
4. Expand rollover opportunities for surviving spouses by providing that the surviving spouse may make a rollover into an employer plan, not just an IRA.	dma 12/31/00	Negligible Revenue Effect												
5. Waiver of 60-day rule	dma 12/31/00	Negligible Revenue Effect												
6. Treatment of forms of qualified plan distributions.	yba 12/31/00	Negligible Revenue Effect												
7. Rationalization of restrictions on distributions.	da 12/31/00	Negligible Revenue Effect												
8. Purchase of service credit in governmental defined benefit plans.	ta 12/31/00	Negligible Revenue Effect												
9. Employers may disregard rollovers for cash-out amounts.	da 12/31/00	Negligible Revenue Effect												
Subtotal of Provisions for Increasing Portability for Participants.	....	....	....	−7	−11	−12	−12	−12	−13	−13	−13	−14	−41	−106
D. Provisions for Strengthening Pension Security and Enforcement														
1. Phase-in repeal of 150% of current liability funding limit; extend maximum deduction rule.	yba 12/31/00	....	....	−7	−21	−33	−36	−36	−38	−38	−39	−41	−98	−290
2. Missing plan participants	(11)	Negligible Revenue Effect												
3. Excise tax relief for sound pension funding [9]	yba 12/31/00	....	....	−2	−3	−3	−3	−3	−3	−3	−3	−3	−11	−26
4. Notice of significant reduction in plan benefit accruals.	pateo/a DOE	Negligible Revenue Effect												
Subtotal of Provisions for Strengthening Pension Security and Enforcement.	....	....	....	−9	−24	−36	−39	−41	−41	−42	−44	−109	−316	
E. Provisions for Reducing Regulatory Burdens														
1. Repeal of multiple use test	yba 12/31/00	Considered in Other Provisions												
2. Flexibility in nondiscrimination and line of business rules [12].	DOE	Negligible Revenue Effect												
3. Modification of timing of plan valuations	pyba 12/31/00	Negligible Revenue Effect												
4. Rules for substantial owner benefits in terminated plans [9].	noitta 12/31/00	Negligible Revenue Effect												
5. ESOP dividends may be reinvested without loss of dividend deduction.	tyba 12/31/00	....	....	−19	−44	−56	−61	−63	−66	−69	−71	−74	−180	−523
6. Notice and consent period regarding distributions.	yba 12/31/00	No Revenue Effect												
7. Repeal transition rule relating to certain highly compensated employees.	pyba 12/31/00	....	....	−2	−3	−3	−3	−3	−3	−4	−4	−4	−10	−28
8. Employees of tax-exempt entities [12]	DOE	Negligible Revenue Effect												
9. Treatment of employer-provided retirement advice.	yba 12/31/00	Negligible Revenue Effect												
10. Provisions relating to plan amendments	DOE	No Revenue Effect												
11. Pension plan reporting simplification [12]	DOE	No Revenue Effect												

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Provision	Effective	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2004	1999–2009
12. Model pension plans for small businesses [12].	DOE	No Revenue Effect												
13. Intermediate sanctions [12]	DOE	Negligible Revenue Effect												
Subtotal of Provisions for Reducing Regulatory Burdens.				−21	−47	−59	−64	−66	−69	−73	−75	−78	−190	−551
Total of Pension Reform Provisions				−562	−1,066	−1,286	−1,425	−1,604	−1,814	−2,036	−2,250	−2,470	−4,347	−14,526
Title XIII. Miscellaneous Provisions														
1. Tax exclusion for certain foster care payments	tyba 12/31/99		−6	−14	−21	−29	−37	−44	−52	−61	−70	−80	−106	−414
2. Tax exclusion for mileage reimbursements by public charities not in excess of standard business mileage rate.	tyba 12/31/99		(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	−1	−2
3. Repeal 0.1 cent per gallon LUST tax on railroads (10/1/99); consolidate Superfund and LUST trust funds; repeal 4.3-cents-per-gallon tax on railroad fuel and inland waterway fuel currently paid into the General Fund (10/1/03).	10/1/99 & 10/1/03		−2	−2	−2	−2	−117	−125	−128	−131	−134	−137	−125	−780
4. Repeal 10% excise tax on fishing tackle boxes [13]	30da DOE		−3	−3	−3	−3	−3	−3	−3	−3	−3	−3	−15	−30
5. Equalize the tax treatment of "clean fuel" vehicle and oversized electric vehicles.	1/1/00	(3)	(3)	(3)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(3)	(2)
6. Nuclear decommissioning costs: one-time transfer of non-qualified funds, with amortization over remaining useful life beginning in 2002; modify section 468A to eliminate cost of service requirement in determining nuclear decommissioning costs and clarify treatment of funds transfers.			−24	−51	−89	−126	−128	−130	−131	−132	−132	−132	−418	−1,075
7. Accelerate increase private activity bond volume cap.	cya 1999		−22	−89	−186	−277	−345	−384	−398	−387	−360	−331	−919	−2,779
8. Repeal 5-year limitations relating to life insurance companies filing a consolidated tax return with an affiliated group of nonlife insurance companies.	tyba 12/31/04							−102	−206	−210	−214	−217		−949
9. Allow income from publicly traded partnerships to be qualifying income for regulated investment companies.	mf tyba 12/31/00			−4	−9	−13	−17	−20	−23	−25	−28	−30	−43	−170
10. Exempt from tax distributions from Alaska Native Corporations to Alaska Native Settlement Trusts; income earned by the trust treated as under present law; distribution of principal to beneficiaries taxed as ordinary income.	da 12/31/99		(3)	−1	−2	−2	−2	−2	−2	−1	−1	−1	−7	−13
11. Increase the Joint Committee on Taxation refund review threshold from $1 million to $2 million.	DOE	Negligible Revenue Effect												
12. Tax Court provisions [9]	DOE	Negligible Revenue Effect												

13. Modification to Form W–2 to report employer's share of Social Security and Medicare taxes.	rpa 12/31/99	No Revenue Effect												
14. Add inserts and outserts to arrow excise tax; reduce excise tax rate on "broadhead" arrow points.	fcqb 30da DOE	Negligible Revenue Effect												
15. Public safety officer survivors	(15)	....	−1	−2	−2	−2	−2	−2	−1	−1	−1	−1	−8	−15
16. Allow wholesale dealers with sales of distilled spirits in excess of $10 million to receive distilled spirits in bond; with additional 1.5% tax on tax liabilities.	DOE	....	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(3)	(3)
17. Specialized small business investment companies.	sa & tybo/a DOE	....	(3)	(3)	(3)	(3)	−1	−1	−1	−2	−2	−2	−1	−9
18. Clarification of depreciation study	....	No Revenue Effect												
Total of Miscellaneous Provisions	....	....	−58	−166	−314	−454	−652	−813	−945	−953	−945	−934	−1,643	−6,236
Title XIV. Extension of Expired and Expiring Provisions														
1. Research credit, and increase in AIC rates by 1 percentage point (through 6/30/04).	(17)	....	−1,657	−1,853	−2,226	−2,537	−2,238	−1,340	−707	−433	−127	....	−10,510	−13,115
2. Exemption from Subpart F for active financing income (through 12/31/04).	tybi 2000	....	−187	−827	−992	−1,190	−1,369	−1,156	....	....	....	....	−4,565	−5,721
3. Suspension of 100% net income limitation for marginal properties (through 12/31/04).	tyba 12/31/99	....	−23	−35	−36	−36	−37	−13	....	....	....	....	−167	−180
4. Work opportunity tax credit (through 12/31/01)	wpoifibwa 6/30/99	....	−229	−321	−293	−151	−58	−19	−3	....	....	....	−1,053	−1,074
5. Welfare-to-work tax credit (through 12/31/01)	wpoifibwa 6/30/99	....	−49	−77	−79	−47	−19	−7	−2	....	....	....	−271	−280
Total of Extension of Expired and Expiring Provisions.	....	....	−2,145	−3,133	−3,626	−3,961	−3,721	−2,535	−712	−433	−127	....	−16,566	−20,370
Title XV. Revenue Offset Provisions														
1. Information reporting on cancellation of indebtedness by non-bank financial institutions.	coda 12/31/99	....	....	7	7	7	7	7	7	7	7	7	28	63
2. Extension of IRS user fees (through 9/30/99) (9)	9/30/03	....	....	....	....	....	50	53	56	59	61	64	50	343
3. Impose limitation on pre-funding of certain employee benefits.	pmo/a 6/9/99	22	93	141	147	149	140	129	118	105	90	74	693	1,209
4. Increase to 15% (from 10%) optional withholding rate for nonperiodic payments from deferred compensation plans.	dma 12/31/99	....	51	1	1	1	1	1	1	1	1	1	54	58
5. Modify treatment of closely-held REITs, with incubator REIT exception.	tyea 7/12/99	....	2	5	5	5	6	6	6	6	7	7	23	55
6. Prevent the conversion of ordinary income or short-term capital gains into income eligible for long-term capital gain rates.	teio/a 7/12/99	....	15	45	47	49	51	54	58	62	66	70	207	517
7. Allow employers to transfer excess defined benefit plan assets to a special account for health benefits of retirees (through 9/30/09).	tmi tyba 12/31/00	....	....	19	38	39	40	41	42	42	43	44	136	348
8. Repeal installment method for most accrual basis taxpayers; adjust pledge rules.	iseio/a DOE	....	477	677	406	257	72	8	21	35	48	62	1,889	2,063
9. Limit use of non-accrual experience method of accounting to amounts to be received for the performance of qualified professional services.	tyea DOE	....	77	60	33	28	10	12	14	16	18	20	208	288

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[Fiscal years 1999–2009, in millions of dollars]

Provision	Effective	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	1999–2004	1999–2009
10. Exclusion of like-kind exchange property from nonrecognition treatment on the sale of a personal residence.	seopra DOE	....	3	7	8	9	10	11	12	13	14	15	37	102
Total of Revenue Offset Provisions	....	22	718	962	692	544	387	322	335	346	355	364	3,325	5,046
Title XVI. Tax Technical Correction Provisions	....							No Revenue Effect						
Net Total	....	....	−4,543	−25,545	−46,779	−57,767	65,316	−89,847	−104,736	−114,195	−151,898	−203,307	−199,963	−863,958
Addendum: Tax Cut Target (Updated as a Result of the July 1, 1999, Congressional Budget Office Revision).	....	....	−5,000	−29,000	−68,000	−45,000	−54,000	−70,000	−116,000	−141,000	−155,000	−182,000	−200,000	−864,000

[1] Estimate assumes that effective date includes prior installment sales.

[2] Gain of less than $500,000.

[3] Loss of less than $500,000.

[4] Estimate assumes concurrent enactment of the above-the-line deduction for health and long-term care insurance (item 1, under Health Care Tax Relief Provisions).

[5] Effective for vaccine sales the date after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugate Streptococcus Pneumonia vaccines to children.

[6] Estimate does not include outlay effects of renewal community provision.

[7] Effective for transfers made after 2/8/99 and for premiums paid after the date of enactment.

[8] Proposal includes interaction with other provisions in Provisions for Expanding Coverage.

[9] Estimate provided by Congressional Budget Office.

[10] Loss of less than $5 million.

[11] Effective for distributions from terminating that occur after the PBGC has adopted final regulations implementing provision.

[12] Directs the Secretary of the Treasury to modify rules through regulations.

[13] The Congressional Budget Office estimates that this provision would reduce outlays by $11 million from 1999 thorough 2004 and by $32 million from 1999 through 2009.

[14] Generally effective for taxable years beginning after 12/31/99. The provision relating to transfer of non-qualified funds is effective for taxable years beginning after 12/3/01.

[15] Effective for payments received after 12/31/99 with respect to all officers.

[16] Negligible revenue effect.

[17] Extension of credit effective for expenses incurred after 6/30/99; increase in AIC rates effective for taxable years beginning after 6/30/99.

Legend for ''Effective'' column; apa = amounts paid after; bia = bonds issued after; coda = cancellation of indebtedness after; cpoii = costs paid or incurred in; cya = calendar year after; da = distributions after; dda = decedents dying after; diia = debt instruments issued after; dma = distributions made after; DOE = date of enactment; eia = expenses incurred after; epoii = expenses paid or incurred in; fcqb = first calendar quarter beginning at least; giiia = gains includible in income after; gma = gifts made after; iseio/a = installment sales entered into on or after; lii = losses incurred in; mf = mutual funds; noitta = notice of intent to terminate after; pateo/a = plan amendments taking effect on or after; pea = plans established after; pmo/a = payments made on or after; proaa = payments received or accrued after; pyba = plan years beginning after; ma = requests made after; rpa = remuneration paid after; sa = sales after; sbwi = stock becoming worthless in; soeopra = sales or exchanges of personal residences after; ta = transfers after; tdapma = transfer, distributions, and payments made after; teio/a = transactions entered into on or after; tmi = transfer made in; tyba = taxable years beginning after; tybb = taxable years beginning before; tybi = taxable years beginning in; tybo/a = taxable years beginning on or after; tyea = taxable years ending after; wpoifibwa = wages paid or incurred for individuals beginning work after; yba = years beginning after; and

Note.—Details may not add to total due to rounding.

Source: Joint Committee on Taxation.

B. Statement Regarding New Budget Authority and Tax Expenditures

Budget authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority.

Tax expenditures

In compliance with clause 2(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the revenue-reducing income tax provisions (other than the individual tax rate reduction, the increased standard deduction for married taxpayers, and the foreign tax credit provisions) involve increased tax expenditures, and the revenue-increasing income tax provisions (other than information reporting on cancellation of indebtedness by non-bank financial institutions and optional withholding for nonqualified deferred compensation) involve reduced tax expenditures. (See amounts in table in Part IV.A., above.)

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the Congressional Budget Office (CBO), the following statement is made: The Committee estimate of the budgetary effects of the bill, prepared by the Joint Committee on Taxation, appears above. The letter from CBO was not received in a timely manner, and therefore, will need to be provided in a supplemental report.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was a result of the Committee's oversight review concerning the tax burden on individuals, families, small businesses, and others, education savings incentives, investment incentives, incentives for distressed communities and industries, international tax relief, treatment of certain tax-exempt organizations, real estate tax relief, pension reforms, certain miscellaneous tax provisions, extension of tax provisions expiring in 1999, certain revenue offsets, and necessary technical corrections to recent tax legislation, and the Fiscal Year 2000 Budget Resolution tax reduction instructions, that the Committee concluded that it is appropriate and timely to enact the revenue reconciliation provisions included in the bill as reported.

B. Summary of Findings and Recommendations of the Committee on Government Reform

With respect to clause 3(c)(4) of rule XII of the Rules of the House of Representatives, the Committee advises that no oversight findings or recommendations have been submitted to this Committee by the Committee on Government Reform with respect to the provisions contained in the bill.

C. CONSTITUTIONAL AUTHORITY STATEMENT

With respect to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 8 ("The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises . . ."), and from the 16th Amendment to the Constitution.

D. INFORMATION RELATING TO UNFUNDED MANDATES

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the following provisions of the bill contain Federal mandates on the private sector (for amounts, see table in Part IV.A., above): (1) add certain vaccines against streptococcus pneumoniae to the list of taxable vaccines, (2) impose 10 percent vote or value test, (3) treatment of income and services provided by taxable REIT subsidiaries, (4) impose 1.5 percent surtax on distilled spirits wholesale dealers and control State entities, (5) information reporting on cancellation of indebtedness by non-bank financial institutions, (6) impose limitation on prefunding of certain employee benefits, (7) modify treatment of closely held REITs, with incubator REIT exception, (8) prevent the conversion of ordinary income or short-term capital gains into income eligible for long-term capital gains rates, (9) repeal installment method for most accrual basis taxpayers, (10) limit use of nonaccrual experience method of accounting to amounts to be received for the performance of qualified professional services, and (11) exclusion of like-kind exchange property from nonrecognition treatment on the sale of a personal residence.

The costs required to comply with each Federal private sector mandate generally are no greater than the estimated budget effects of the provision. Benefits from the provisions include improved administration of the Federal tax laws and a more accurate measurement of income for Federal income tax purposes.

The provision that adds Streptococcus Pneumoniae vaccine to the list of taxable vaccines for purposes of the vaccine excise tax and the 1.5 percent surtax on distilled spirits wholesale dealers and control State entities impose Federal intergovernmental mandates on State, local, and tribal governments. The staff of the Joint Committee on Taxation estimates that the direct costs of complying with these Federal intergovernmental mandates will not exceed $50,000,000 in either the first fiscal year or in any of the 4 fiscal years following the first fiscal year. The Committee intends that these Federal intergovernmental mandates be unfunded because (1) the net revenues from the Federal vaccine excise tax are used to finance the Federal Vaccine Injury Compensation Trust Fund and (2) as with other excise taxes, it is expected that the 1.5 percent surtax on distilled spirits will not be borne by the States, but rather will be passed on to the consumers of alcoholic beverages. Since these Federal excise taxes are imposed on the private sector and on State, local, and tribal governments, they do not affect the competitive balance between such governments and the private sector.

E. Applicability of House Rules XXI5(b)

Rule XXI5(b) of the Rules of the House of Representatives provides, in part, that "No bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase shall be considered as passed or agreed to unless determined by a vote of not less than three-fifths of the Members." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increase within the meaning of the rule.

F. Tax Complexity Analysis

The following tax complexity analysis is provided pursuant to section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998, which requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service ("IRS") and the Treasury Department) to provide a complexity analysis of tax legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or a Conference Report containing tax provisions. The complexity analysis is required to report on the complexity and administrative issues raised by provisions that directly or indirectly amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided, along with an estimate of the number and the type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS regarding each of the provisions included in the complexity analysis, including a discussion of the likely effect on IRS forms and any expected impact on the IRS.

1. Broad-based tax relief provision (sec. 101 of the bill)

Summary description of provision

The broad-based tax relief provision reduces the regular income tax rates by 10 percent over a ten-year period (2000–2009). Each rate is reduced by a total of 2.5 percent for taxable years beginning in 2001, 5 percent in 2005, 7.5 percent in 2008 and 10 percent in 2009. The provision does not apply to the tax rates applied to capital gains. The tax rates which are reduced are rounded up annually to the nearest one-tenth of a percent.

Number and type of affected taxpayers

It is estimated that the reduction of the regular income tax rates will affect approximately 99 million individual income tax returns. It is estimated that, of this number, approximately 80 million individual tax returns have incomes less than $75,000.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. The rate reduction should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. In addition, the provision should not increase individuals' tax preparation costs. For taxpayers with incomes of $100,000 or less, the tax liability is generally determined from tax tables. For those taxpayers, the new rates will be incorporated into the tax tables; i.e., individuals who use those tables will not be required to perform additional calculations.

2. Marriage penalty relief relating to the basic standard deduction for married couples filing a joint return (sec. 111 of the bill)

Summary description of provision

This provision increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual in each taxable year. This increase is phased in over three years (2001–2003).

Number and type of affected taxpayers

It is estimated that increasing the basic standard deduction for joint filers will affect approximately 23 million individual income tax returns. It is estimated that, of this number, approximately 20 million individual income tax returns have incomes less than $75,000.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. The higher basic standard deduction should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. In addition, the provision should not increase individuals' tax preparation costs.

Some taxpayers who currently itemize deductions may respond to the provision by claiming the increased standard deduction in lieu of itemizing. Such taxpayers will no longer have to file Schedule A to Form 1040 or need to engage in the record keeping inherent in itemizing below-the-line deductions. This reduction in complexity and record keeping may also result in a decline in the number of individuals using a tax preparation service (or a decline in the cost of using such a service). It may also reduce the number of disputes between taxpayers and the IRS regarding substantiation of itemized deductions.

3. Partial exclusion of interest and dividend income (sec. 201 of the bill)

Summary description of provision

The provision provides individuals with an exclusion from income for most types of interest and dividends. The maximum exclusion from income for individuals is $100 of combined interest and dividends ($200 for married couples filing jointly) for taxable years

2001 and 2002. The maximum exclusion is increased to $200 of combined interest and dividends ($400 for married couples filing jointly) for taxable years 2003 and thereafter.

Number and type of affected taxpayers

It is estimated that providing a partial exclusion for interest and dividend income will affect approximately 65 million individual income tax returns. It is estimated that, of this number, 44 million have incomes less than $75,000.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision, nor should the provision result in an increase in disputes with the IRS. It is not expected that the provision will increase individuals' tax preparation costs. Individuals with interest and dividend income in excess of the exclusion amount will have to perform one additional calculation, i.e., subtracting the amount of excludable interest and dividend income.

The effect of the provision on filing requirements will depend on how the IRS responds to the provision. The legislative history to the provision encourages the IRS to implement the provision so as to simplify the process of completing tax forms to the greatest extent practicable, for example, by raising the administratively-established dollar thresholds for filing Schedule B or for being able to use the Form 1040EZ. For example, if the IRS raises the threshold by the amount of the exclusion, then taxpayers with only a small amount of taxable interest or dividend income (taking into account the exclusion) will not have to file Schedule B.

4. Individual capital gains rates (sec. 202 of the bill)

Summary description of provision

The provision reduces the present-law individual capital gain rates of 10, 20, and 25 percent to 7.5, 15, and 20 percent respectively, effective for transactions on or after July 1, 1999. The provision also repeals certain reduced rates for property held more than 5 years which would otherwise apply beginning after 2000.

Number and type of affected taxpayers

It is estimated that reducing the tax rates on capital gains will affect approximately 19 million taxpayers. It is estimated that, of this number, approximately 12 million individual income tax returns have incomes of less than $75,000.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision, because the provision is only a rate change. To the extent that a lower capital gains rate encourages more taxpayers to attempt to convert ordinary income into capital gains, the provision may result in an increase in disputes with the IRS. Additional regulatory guidance should not be necessary to implement the provision. The provision should not increase the tax preparation cost of individuals using a tax preparation service, expect possibly for the 1999 year when two rate schedules will be in effect (i.e., for sales on or after July 1, 1999, and for sales before July 1, 1999).

The change in rates will not create additional complexity compared to the present-law rate structure, except in the 1999 tax year, when two different rate structures apply depending on the date of the transaction. Because the provision repeals the reduced rate for five-year property that was scheduled to take effect after 2000, it will simplify the forms and record keeping requirements with respect to capital gains in the years after 2000.

5. Repeal of the temporary federal unemployment "FUTA" surtax (sec. 803 of the bill)

Summary description of provision

Under present law, in addition to the regular FUTA tax of 0.6 percent of taxable wages, a temporary surtax of 0.2 percent of taxable wages applies through 2007. The provision repeals the temporary FUTA surtax after December 31, 2004.

Number and type of affected taxpayers

It is estimated that the repeal of the FUTA surtax will affect over six million small businesses.

Discussion

It is not anticipated that small businesses will need to keep additional records due to this provision, nor is it anticipated that this provision will result in an increase in disputes with the IRS. Additional regulatory guidance should not be necessary to implement this provision. The provision should not increase the tax preparation cost of small businesses using a tax preparation service.

6. Restore 80-percent meals deduction (sec. 804 of the bill)

Summary description of provision

The provision phases in an increase from 50 percent to 80 percent in the deductible percentage of business meal (food and beverage) expenses. The increase in the deductible percentage is phased in according to the following schedule:

Taxable years beginning in—	*Deductible percentage*
2005	55
2006	60
2007	65
2008	70
2009	75
2010 and thereafter	80

The provision is effective for taxable years beginning after 2004.

Number and type of affected taxpayers

It is estimated that almost all small businesses will be affected by the provision.

Discussion

Because the provision increases the percentage deduction only with respect to meals and not entertainment, small businesses may have to keep additional records to distinguish between the two types of expenditures. The provision may lead to additional disputes between small businesses and the IRS regarding the nature of an expenditure, particularly in business situations where the meal and entertainment is provided as a package for a single price. No new regulatory changes would be needed to implement the provision (although a conforming change to regulations to reflect the increasing percentage would be appropriate). The provision may increase complexity because the percentage of the deduction is phased in.

7. Expand employer reporting of annual wage and tax statements (sec. 1303 of the bill)

Summary description of provision

Under present law, an employer must provide certain information annually to each employee in the form of a wage and tax statement ("Form W–2"), including the employee's portion of Social Security and Medicare taxes. The provision requires the Form W–2 to separately state the employer's share of Social Security and Medicare taxes.

Number and type of affected taxpayers

It is estimated that almost all small businesses will be affected by the expansion of the reporting requirements on the Form W–2.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision, nor is it anticipated that this provision will result in an increase in disputes with the IRS.

The provision will impose an additional administrative burden on small employers, because they will need to report additional information. However, this information is generally readily available; the amount of payroll taxes imposed on the employer is generally the same amount the employer is withholding and reporting with respect the employee's share of payroll taxes.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC, July 15, 1999.

MS. LINDY I. PAULL,
Chief of Staff, Joint Committee on Taxation,
Washington, DC.

DEAR MS. PAULL: Attached are the Internal Revenue Service's (IRS) comments on the seven provisions from the Committee on Ways and Means markup of the "Financial Freedom Act of 1999" that you identified for complexity analysis in your letter of July 13, 1999. The comments are based on the Joint Committee on Taxation staff description (JCX–42–99) of the provisions and the statutory language for the Act published in the *Daily Tax Report* of the Bureau of National Affairs for Wednesday, July 14, 1999.

Due to the short turnaround time, our comments are provisional and subject to change upon a more complete and in-depth analysis of the provisions.

Sincerely,

CHARLES O. ROSSOTTI.

Attachment.

IRS COMMENTS ON SEVEN TAX PROVISIONS IDENTIFIED FOR COMPLEXITY ANALYSIS

10-percent reduction in regular income tax rates over ten years

Tax rate changes mandated by the provision would be incorporated in the tax tables and tax rate schedules during IRS' annual update of these items. Changes to the tax rates shown in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, and 1041, and on Forms 1040–ES, 1041, W–4V, 6251, 8801, and 8814 would be required for the 2001, 2005, 2008, and 2009 forms. Other forms (e.g., Form 8752) would also be affected. No new forms would be required. Programming changes to the tax computation process would be required to reflect the new rates.

Applying a three-digit tax rate percentage (as opposed to currently applying a two-digit percentage, most often) would cause math errors by some taxpayers who use the tax rate schedules or who figure estimated tax payments. Forms 1040 with incorrect tax calculations would have to be sent to Error Resolution for correction. This could result in delays in processing returns and in issuing refunds, as well as additional telephone inquiries. Manual processing of these erroneous returns would increase IRS' processing costs.

Marriage penalty tax relief

This provision would require changes to the standard deduction amount for married taxpayers filing jointly shown on Forms 1040, 1040A, 1040EZ, and 1040–ES and in the instructions for Forms 1040, 1040A, and 1040EZ for each year over the three-year phase-in period (2001–2003). No new forms would be required. Programming changes to the tax computation process would be required to reflect the increased standard deduction for married taxpayers filling jointly.

Reduction in individual capital gains tax rates

Tax forms

Applying the reduced rates to gains from 1999 sales after June 30 (as opposed to all 1999 sales) would require the following major changes to the 1999 Schedule D (Form 1040) and the worksheets in its instructions:

—In Part I of Schedule D, a new column (g) with 5 lines for gain or loss after June 30 would be added.

—In Part II, column (g) would be redesignated for gain or loss after June 30. The determination of 28% rate gain or loss would be moved to a new 5-line worksheet in the Schedule D instructions.

—In Part IV, 10 additional lines would be added to figure the gains subject to new rates (7.5%, 15%, and 20% for unrecaptured section 1250 gain). One line would be removed because of the new 28% rate gain worksheet.

—The worksheet for unrecaptured section 1250 gain would be expanded to add a new 9-line column for gain or loss after June 30.

It would also preclude the IRS from adding a new simplified 15-line worksheet that the IRS planned to include in the 1999 Form 1040 instructions for most taxpayers with no capital gains other than capital gain distributions. These taxpayers would have used this worksheet in lieu of completing Schedule D to figure their tax.

The mid-year 1999 effective date would also require conforming changes for the following 1999 forms: Schedule D–1 (Form 1040); Schedule D for Forms 1041, 1065, and 1120S; and Forms 2439, 4797, 6251, and 6781. In addition, the 1999 Schedules K–1 for Forms 1041, 1065, and 1120S would need to be revised to add lines for gain or loss after June 30, 1999, for short-term gain or loss, long-term gain or loss, and section 1231 gain or loss. Finally, the 1999 Forms 1099–DIV and 1099–B should be revised, but since they have already been distributed, the IRS would probably issue an announcement explaining how to report post-June 30, 1999, transactions to recipients on a substitute or separate statement. No new forms would be required.

Generally, the above changes apply only to the 1999 forms and instructions. The forms and instructions for 2000 and later years would revert to the 1998 format, except that they would reflect the reduced capital gains tax rates. However, fiscal year 1998–99 taxpayers with a taxable year ending after June 30, 1999, may also be affected by the mid-year 1999 effective date. These taxpayers file 1998 tax forms for their 1998–99 fiscal year. Because the 1998 forms are already in print, the IRS would issue an announcement similar to Announcement 97–109, 1997–45 I.R.B. 12, which was issued to reflect new reporting requirements necessitated by the 1997 capital gains tax rate changes. The announcement would explain how taxpayers must complete the 1998 forms to reflect the reduced rates for gains after June 30, 1999. The 1998 forms include Schedules D for Forms 1040 and 1041 and Schedules K–1 for Forms 1041, 1065, and 1120S.

If the reduced rates were made applicable to all transactions during a calendar year (instead of transactions after June 30), and section 202(c)(5) of the bill were struck, most of the major changes described above could be eliminated.

Processing and programming

The above changes to the 1999 forms caused by the mid-year effective date would require extensive revision of computer programs for processing those returns. While revisions of this kind late in the calendar year always pose difficulties, the problem is especially severe this year because of the special requirements in preparing for the Century Date Change. By August 1, 1999, the IRS will have already completed nearly all programming in preparation for the 2000 filing season. By October 1, 1999, all systems must be frozen in order to allow for final end-to-end testing of IRS systems. The IRS also must work with independent vendors of tax preparation software to test their systems so that it can correctly receive electronically filed returns beginning shortly after January 1, 2000.

If the mid-year effective date is retained, the IRS would be forced to complete testing of computer programs for processing during the 2000 filing season using the existing law and would be unable to process 1999 returns reporting capital gains under the new law until later in the filing season, possibly not until March 2000. At a minimum, this means that those taxpayers who have capital gains and who are due refunds would not be able to receive them until late in the filing season. In addition, since about 25 million returns include Schedule D and since these returns would not be processed until late in the season during the peak period, this might delay processing of some other returns. With these delays for so many returns, the IRS would expect an increased number of taxpayer phone calls concerned about delays in refunds thereby reducing the opportunity for other taxpayers to get assistance.

The added complexity of Schedule D would lead to increased taxpayer error. During processing, these returns would have to be sent to Error Resolution for correction. This could cause additional delay in return processing and in the issuance of refunds. It also would increase the IRS' processing costs.

Customer Service would need to issue a Taxpayer Education Bulletin Board item soon after enactment and subsequently incorporate this change into several sections of IRM Part 21. Customer Service would also need to train the Customer Service Representatives in the provision prior to the year 2000 filing season.

Partial exclusion for interest and dividend income

To implement this provision, the IRS would add one box to Form 1099–DIV for 2001 (for nonqualifying dividends). The IRS would also add to Forms 1040 and 1040A three lines—total interest and dividends, exclusion, and taxable amount. The IRS would add to Form 1040–EZ (and the TeleFile Record) two lines—exclusion (for interest) and taxable amount—which could impact the scanability of the 1040EZ. Also, the IRS would add a deduction line on page 1 of Form 1041 to allow estates and trusts to claim the dividend and interest exclusion. No new forms would be required.

Repeal of FUTA surtax

The provision would require a change to the FUTA tax rate on Forms 940, 940–EZ, and 940–PR for 2005. The rate would be reduced from 6.2% to 6.0%. No new forms would be required. Programming changes to the FUTA tax computation process would be necessary to reflect the reduced rate.

Restoration of 80-percent deduction for meal expenses

This provision would require the addition of a new 5-line column on Form 2106 and a new line on Form 2106–EZ to account for the different limits on meal expenses and entertainment expenses. Currently, the same 50% limit generally applies to both types of expenses. Minor changes to the instructions for Schedules C, C–EZ, E and F of Form 1040; Form 1065; and the Form 1120 series would also be required. No new forms would be required.

Inclusion of employer Social Security taxes on W–2

The following forms would have to be reformatted to allow for two extra boxes for calendar year 2000: Form W–2, Form W–2VI (U.S. Virgin Islands), Form W–2AS (American Samoa), Form 499 R–2/W–2PR (Puerto Rico), Form W–2GU (Guam), and Form W–2CM (Commonwealth of the Northern Mariana Islands).[1] No new forms would be required.

The IRS proposed a major format revision of Form W–2 for 2000, but industry groups and our advisory group asked us to delay the revision until 2001 because of Y2K computer problems. In Announcement 99–34, 1999–15 I.R.B. 8, the IRS announced it would not make major changes to Form W–2 until 2001, unless legislation requires it.

These two new boxes would impose added burden on employers for information that is not used by the IRS or the Social Security Administration (SSA). These boxes also would have the potential to confuse taxpayers who currently use the existing social security and Medicare tax withheld boxes to complete other worksheets and forms, such as Form 8812, Additional Child Tax Credit. Because space is at a premium on Form W–2, the IRS prefers to require only information actually needed by the IRS, SSA, and taxpayers.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL AS REPORTED

In the opinion of the committee, in order to expedite the business of the House of Representatives, it is necessary to dispense with

[1] Form 499 R–2/W–2PR is revised by Puerto Rico, and Form W–2CM is revised by the Commonwealth of the Northern Mariana Islands.

the requirements of clause 3(e) of rule XIII of the Rules of the House of Representatives (relating to showing changes in existing law made by the bill as reported).

VII. DISSENTING VIEWS

I. Misplaced priorities

The Republicans on this Committee have made their budget priorities clear. They are willing to risk the future of Social Security and Medicare and to reject the budgetary discipline that has resulted in low interest rates and contributed to the current economic expansion. They refuse to enter into serious bipartisan discussions with the President of the United States. Their only priority is a reckless tax bill based on uncertain economic projections and on unrealistic assumptions about draconian cuts in future government spending for law enforcement, defense, education, veterans, farm programs, environmental protection, and other general government functions.

The Democratic members of the Committee on Ways and Means are united in opposing the Republican budget priorities. Unfortunately, the votes in the Committee clearly indicate that the Republican members of this Committee have embraced their Leadership's reckless budget priorities. The Republicans on the Committee voted en bloc:

1. To defeat an amendment that would have reduced the tax cuts by half and devoted the savings to paying off the National debt. The only sure way to promote economic growth is to pay down the National debt. Otherwise we leave our children and grandchildren with a huge burden.

2. To defeat an amendment that would have reserved the funds necessary for the Social Security solvency plan proposed recently by Chairman Archer and Congressman Shaw. By defeating this amendment, the Committee Republicans turned their back on the Chairman's own Social Security plan because, with the tax cuts, his plan would require a $1.1 trillion increase in the public debt. It is not credible to pretend that the Committee tax bill and the Chairman's Social Security plan are compatible.

3. To defeat an amendment to put the tax cuts on hold until Social Security and Medicare solvency is ensured and until there is a Medicare prescription drug benefit. Voting for tax cuts is easy. We should first accomplish the difficult task of protecting these vital programs.

4. To defeat an amendment that would have reserved the funds necessary to preserve the solvency of the Medicare system until 2027 and to provide a prescription drug benefit for Medicare beneficiaries.

5. To defeat an amendment that would have provided a prescription drug benefit for Medicare beneficiaries comparable to that provided in the President's plan announced in June, but without the payment of premiums by beneficiaries.

This tax cut is premature, given that no non-Social-Security surpluses have yet materialized. The Republicans assert that their tax bill will leave sufficient resources to ensure the solvency of both the Social Security and Medicare programs. They point to the $2 trillion set-aside in the House-passed Social Security lockbox and argue that those funds will be sufficient for both programs. That assertion is so fraudulent that it must embarrass many of the members of the Republican Party. Devoting that $2 trillion to the Social Security system does not extend the solvency of the Social Security system by one day. If any of that money is used to extend the solvency of the Medicare program, it will accelerate the date on which the Social Security system becomes insolvent. The Republicans hope that the public will ignore a basic economic fact: you cannot spend the same dollar more than once.

The Republicans have attempted to cloak their reckless tax bill in moral terms. They have been unsuccessful in that effort. Our Federal government's debt has grown by $3 trillion since 1980. We have all enjoyed the government services and consumption that was funded by that debt increase. The responsible and moral course of action would have the generation of Americans who ran up that debt bear the burden of paying it off. Instead, the Republican majority on the Committee has decided that the debt burden should be passed onto our children and their children. No matter how hard the Republicans may try to obfuscate this issue, their fiscally irresponsible tax bill will require the issuance of an additional $1 trillion in public debt obligations over the next 10 years and approximately an additional $3 trillion over the following 10 years. Congressman John Tanner has quite accurately described the Republican's budgetary strategy as equivalent to "an intergenerational mugging."

The burden of that increase in the National debt will also be borne by consumers, home purchasers, farmers, and small businesses in the form of higher interest rates. The Republicans cannot avoid the basic rule of supply and demand. The more the Federal government has to borrow, the higher the interest rates will be. Federal Reserve Board Chairman Alan Greenspan has stated that eliminating a substantial portion of the National debt could result in a reduction in interest rates. Taxpayers will benefit in two ways from debt reduction—lower Federal expenditures for interest payments and lower interest rates for the economy. The only guaranteed way to reduce the Federal spending is to pay down the National debt.

The Republicans have argued that their tax bill is necessary to protect against higher Federal spending. If an outside observer had watched the Committee's consideration of the bill, that observer would have come away with the strong impression that the Republican Party did not control both Houses of Congress. They do, and if they choose not to spend the money, it will not be spent. They spent an entire day arguing strenuously that their tax bill is necessary to protect the public from the Republican-controlled Congress.

The experience of the 1980's indicates that reckless tax reductions do not ensure equivalent reductions in spending, they only ensure large deficits. The Republicans like to blame the deficits of the 1980's on the Democratic Congresses and not on the Republican Presidents that presided over that deficit spending. The fact is that the Democratic Congresses, for virtually every fiscal year during the 1980's, appropriated no more money than what was recommended in the Republican President's budget requests. After the Republican tax cut bill of 1981, Democratic Congresses constantly reduced Federal spending in relationship to the total economy.

The procedures for considering this bill reflect its true, fiscally irresponsible nature. The Committee consideration of this 400-page bill that will cost nearly a $1 trillion lasted only about 15 hours. The details of that bill were not released until midnight of the day before the Committee consideration began—even though press releases on its provisions were released during the prior week. New provisions were added by the Chairman minutes before the markup began. The refusal to release the details of the bill in a timely and fair manner denied both Democratic and Republican members an opportunity to analyze its impact. The Chairman's actions reflect an uneasy recognition that the details of the bill could not bear scrutiny.

Our form of government requires a respect for both institutions of government and procedures. The procedures followed for the consideration of this bill did not bring credit to the Committee, and we hope that they will not be repeated in the future.

II. Reducing the Federal debt

This Country has an historical opportunity to reduce our $3.6 trillion debt. Tax cuts at this time are for the "me" generation. Reducing the debt is for the future—our children, grandchildren and their families.

The lesson of recent outstanding economic performance is not that it is time to abandon efforts to reduce Federal debt. Reductions in debt have, and will, make it possible to restrain interest rates, which is good for families with mortgages, not just businesses. Reducing debt means that after two decades of draining away the Nation's savings, the Federal government now can put money back into the national savings bank. Instead of impeding capital formation, the government can encourage it.

Reducing Federal debt is good for the economy. This tax bill does the opposite. In contrast, the President's budget updated this July would retire Federal debt held by the public by the year 2015 and budget interest costs would fall from $229 billion to zero.

Chairman Alan Greenspan testified before the Committee earlier this year that the wise course would be to let these budget surpluses run to see if they are real. He stated that his preference that the surpluses be allowed to run for a while and unwind a good deal of the debt which has accumulated over the years. It is hardly necessary to try to tax-cut stimulate an economy that has been growing rapidly and which has the lowest unemployment rate in 29 years.

Without a doubt, debt reduction would promote long-term economic growth by increasing national saving and freeing up capital to expand the Nation's productive capacity. Consequently, debt reduction would ensure that more real economic resources are available to meet the needs of future generations in retirement, the true test of successful Social Security and Medicare reform. Moreover, budget surpluses are uncertain in nature (and become more so the more distant in the future they are expected to occur), but tax cuts are fixed in law. Thus, in the event that budget surpluses are smaller than anticipated (or do not materialize at all), tax cuts could force the Congress to dip into Social Security surpluses. This is an outcome Democrats and Republicans alike sought to prevent by passing Social Security lock box legislation earlier this year. A policy of debt reduction not only avoids this possibility but, by reducing the amount of interest paid on the debt, allows the Congress to redirect budget dollars to Social Security or Medicare, much as the President has suggested.

III. Social Security first

Since the emergency of Federal budget surpluses, the question has been asked again and again: Should the Congress cut taxes before it acts to strengthen Social Security and Medicare? The Republicans' tax bill offers the wrong answer to this vitally important question about our Nation's priorities. They would spend virtually all projected non-Social Security surpluses to cut taxes before such surpluses have been realized, without the support of the American people and within a month of the Federal Reserve's decision to raise interest rates to restrain growth. As a result, the bill fails to set aside the resources necessary to strengthen Social Security and Medicare—the Nation's premier domestic programs—and to keep our Nation's promises to future retirees.

The United States currently is enjoying a period of incredible economic and fiscal prosperity. However, due to long-term demographic trends, major challenges await. The twin pillars of retirement security in the United States—Social Security and Medicare—will encounter financing shortfalls in the first few decades of the next century. Together, these two programs, in one way or another, touch the lives of all Americans. Together, Social Security and Medicare provide a dependable source of income and health care for all elderly Americans and form a bulwark against poverty in old age. Together, Social Security and Medicare represent what is best about our Country.

In this context, the Congress should act responsibly, not expediently. The Congress should address these challenges squarely and resolutely and should place them ahead of any other priority on its agenda. The Congress should act now to strengthen Social Security and Medicare, while it has budget surpluses ahead of it and the American people behind it. Instead, the Republicans proposed a massive tax cut that not only disproportionately benefits the wealthy, but also denies Social Security and Medicare the resources they needed to meet our Nation's obligations to future retirees.

In a time of great prosperity, why would we want to shirk our responsibilities to the people who count on Social Security and Medicare being there when they retire? Why would we want to pass up a historic opportunity to strengthen Social Security and Medicare?

The Democrats offered an amendment to make the Congress' priorities consistent with those of the American people and to make tax cuts contingent on extended solvency for Social Security and Medicare. The amendment would not have eliminated the tax cuts contained in the bill. Rather, it would have postponed those tax cuts until the Congress reaches an agreement on how best to meet the challenges that Social Security and Medicare will face in the decades ahead. Republicans unanimously rejected this fiscally responsible amendment, confirming that they are concerned more about the wealthiest members of our society than they are about America's working families.

The bill would preclude the President's Medicare plan, as well as any number of Social Security plans. During two days of hearings in the Committee last month, Members of Congress described an array of plans to resolve Social Security's projected financing shortfall. No fewer than six of the solvency plans relied on large infusions of general revenues to accomplish their goal. In fact, both of the plans suggested by Members of this Committee—one by Congressman Stark and the other by Chairman Archer and Congressman Shaw—would depend on annual transfers of general revenues equal to about 2 percent of taxable payroll into the Social Security system. However, since both parties agree on the desirability of locking-up Social Security surpluses strictly to pay for previously-promised Social Security benefits, the only budget surpluses available to finance the transfers under either the Archer-Shaw plan or the Stark bill are on-budget surpluses. Yet, the combination of the Republicans' tax cut and the funds necessary for either of these plans would exceed available on-budget surpluses by upwards of $200 billion per year. Thus, it is fiscally irresponsible to cut taxes to the extent envisioned by the Republicans and to address Social Security's financing shortfall through either the Archer-Shaw plan or the Stark bill. It is clear that this would quickly bring back the budget deficits the Congress struggled for years to eliminate.

The Democrats also attempted to resolve this particular shortcoming but were blocked by the Republicans. Democrats offered an amendment to reserve projected on-budget surpluses for Social Security reform. Therefore, when the Congress decided to pursue substantive Social Security reform, whether through the Archer-Shaw plan, the Stark bill, or some other legislative vehicle, it would have the resources necessary to put Social Security on sound financial footing for the next 75 years. The amendment made clear how much violence a mammoth tax cut would do to efforts to strengthen Social Security and Medicare. Nonetheless, Republicans ignored reality and voted unanimously against the solution.

IV. Save Medicare and assist those with medical needs

The Republicans have refused to save Medicare, provide a Medicare drug benefit, or help those who really need help in meeting the costs of health insurance and caring for a family member. Their priorities are clear and will be judged by the public.

The Republicans defeated the Democrats' efforts to save Medicare. The Republicans defeated an amendment to extend the life of the Medicare Hospital Insurance Trust Fund from its current exhaustion date of 2015 to the year 2027, well into the retirement of the "baby boom" generation. They also defeated efforts to provide immediate and meaningful prescription drug help for Medicare beneficiaries. The Republicans lost a major chance to save Medicare and to begin a substantial prescription drug benefit through the easiest step possible—the dedication of 15% of the surplus to

Medicare. In accommodating a parade of special interests, Medicare beneficiaries are left facing a difficult future, with no help in obtaining prescription drugs.

The Republicans rejected the Democrats' effort to save Medicare for the "baby boomers." The Republicans defeated an amendment to adopt President Clinton's plan to save the Medicare Hospital Insurance Trust Fund and to provide for an essential modernization—a pharmaceutical benefit for beneficiaries. By the simple act of transferring 15% of the projected surplus to Medicare, the Democrats' amendment would have achieved 12 more years of solvency and started an annual prescription drug benefit of $1000 in 2002, rising to $2500 by 2008.

There are only three ways to save Medicare for the future. As the number of beneficiaries grows from today's 39 million to about 75 million in 2030, we can (1) cut payments to hospitals and doctors, (2) increase costs on beneficiaries by making them pay more, or (3) add new resources. We believe that any honest policymaker will admit that we need a combination of all three steps to ensure the survival of a program that continues to offer quality care.

By rejecting the Democrats' efforts to save resources for Medicare, the Republicans are setting the stage for future massive cuts in benefits to seniors and the disabled, crippling cuts to hospitals, nursing homes, and home health agencies, or a massive future tax increase at a time when the economy may not be able to handle such an increase. The choice seems obvious: Save resources for Medicare today, or face impossible choices in the future.

No one can dispute the need for more resources in the future. The number of Medicare beneficiaries will roughly double from about 39 million now to about 75 million in 2030. More of these seniors will be living longer, with those over 85 making up the fastest growing group.

Also, as the number of beneficiaries doubles, total Medicare spending as a percent of Gross Domestic Product will roughly double over the next 30 years from 2.55% in 1999 to 4.88% in 2030. Again, we clearly will need more resources. We should save surpluses now to meet this growth.

In addition, the number of workers per Medicare beneficiary will fall from 3.9 in 1998 to 2.3 in 2030. We must make it easier now for those fewer workers of the year 2030 to pay taxes to support retirees and the disabled. That means dedicating additional revenues or surpluses now by retiring debt.

Other options for extending the life of the Hospital Trust Fund are unacceptable. The Medicare Hospital Trust Fund runs out of money in 2015. The Medicare Trustees estimate that to bring the HI program into actuarial balance, over just the next 25 years, would require either that outlays be further reduced by 11% or that income be increased 12%. By voting not to save 15% of the surplus for Medicare, thus extending the Trust Fund to 2027, Republicans are in effect voting for additional major hospital cuts or future tax increases. The option of shifting more costs to seniors and the disabled also is unacceptable to Democrats. Medicare is already one of the lowest value retiree benefit plans in the industrialized world and worth less than the value of the average private insurance/employer plan. This is why the Democrats believe a prescription drug benefit is critical at this time. Under the Balanced Budget Act of 1993, costs are already being shifted to seniors. We should not shift more, especially when so many seniors are still low income and the median per capita income of those over 65 was $13,324 in 1998. For all these reasons, it is essential that we provide more resources for Medicare over the long-run. There will never be an easier way to do that than to dedicate a portion of the current surpluses to Medicare in lieu of excessive tax cuts today.

The early passage of a prescription drug benefit is essential. You can not have a modern health insurance program without pharmaceutical coverage. Many drugs reduce other expenses, such as hospitalization and surgery.

Over one-third of Medicare beneficiaries (about 15 million people) have no prescription coverage. Those who often do have very poor coverage. For example, Medigap plans are very limited and cost more than the value of the insurance they provide. Five million beneficiaries who have some drug coverage in an HMO are facing sharp cutbacks or cancellations being announced daily. Medicaid coverage is often severely limited. Employer-provided retiree drug coverage has been cut about 20% between 1993 and 1997 and is steadily decreasing. The average Medicare beneficiary spends about $942/year on drugs, about half paid by third parties, but 14% spend more than $1000 out of pocket, and 4% (about 1.5 million) spend more than $2000/year.

The Democrats offered its version of the President's prescription benefit proposal, because we believe that a drug benefit should be available for all as a social insurance program. Medicare is not a welfare or Medicaid program. The benefit should be available universally, not just for the low-income.

Finally, the Republicans tax deductions for health insurance do little or nothing to solve the problem of the uninsured. The Republican's provisions to provide deductions for the cost of buying health insurance and long term care insurance, an extra personal exemption for caregivers, and an expansion of Medical Savings Accounts will only help people in upper-income brackets. These are the people most likely to already have health insurance and savings for long term care. Republicans seem to forget the simple fact that people tend not to have health insurance because they don't have enough family income. Those with low family income do not pay much in taxes, and are little helped by tax deductions.

The fair approach would be to provide tax credits for the cost of health and long-term care insurance and the cost of caring for a disabled family member. The President has proposed a $1000 tax credit for some of the expenses of caring for a disabled family member, and Democrats have introduced his bill; providing for a refundable tax credit. That would be a true help to families, many of whom have had to give up jobs and income to take care of a family member. In contrast, the Republican bill would provide a tax benefit worth at most $400 for taxpayers in the 15% bracket. The benefit would rise to $1000 for those few individuals whose income after all deductions exceeds $250,000. This provision indicates clearly which income class the Republicans wish to benefit. In addition, about 6 million people who were uninsured or purchased individual insurance did not file tax returns in 1996. Obviously, the Republican health proposals do nothing for those people.

V. Fairness to all Americans

The Republican's fiscally irresponsible tax cuts are skewed to the affluent and just plain unfair to most Americans. The Joint Committee on Taxation (JCT) has estimated the distribution of tax cuts in this bill in the year 2004. Taxpayers with incomes over $200,000 get 32.4% of the tax cuts in the year 2004, but they comprise only 1.9% of all taxpayers and pay 24.9% of all Federal taxes. Although this 24.9% tax share may be impressive, their share of the Republican's tax cut is larger. Republicans typically cite the share of income taxes paid by the wealthy, but they ignored the payroll and other taxes that fall disproportionately on those who are not so affluent. The JTC estimates also show that those with incomes over $100,000 get 51.8% of the tax cuts, but they comprise only 8.8% of all taxpayers and pay 46.1% of all Federal taxes. In contrast, the lower- and middle-income groups get smaller shares of the huge tax cut in relation to their share of the population and their share of current Federal taxes.

The tilt in the year 2004 distribution of tax cuts, in fact, is even greater than shown by the JCT methodology. The JCT does not "distribute" the effects of the estate/gift tax repeal nor the cuts in corporate income taxes. And the benefits of the capital gains tax cut are understated. While a tax cut of 5 percentage points in the capital gains tax rate is, for example surely worth $2500 to a taxpayer with $50,000, in capital gains, the JCT builds a "realizations response" into its revenue estimates which reduce the potential revenue loss. Only the revenue loss is measured in the JCT distribution tables, not what the tax cut is worth to the affected taxpayers.

Tens of millions of tax-paying households will not benefit from a 10% cut in income tax rates. After Budget Chairman Kasich proposed a 10% rate cut earlier this year, the JCT estimated that, in the year 2000, forty-eight million households would not get any benefit from the proposal. The major reason for left-out households is that most do not owe income tax under current law. Although they may not owe any income tax, most of them pay Federal payroll and other Federal taxes.

The Republican's 10% tax rate cut is skewed to the affluent because it cuts only the progressive Federal tax, while leaving the regressive Federal taxes unchanged. It is easiest to understand the unfairness of the Republican's tax cut by illustrating its effects as though it would be immediately effective, even though this bill phases in the tax cuts over ten years. According to earlier JCT estimates, households with incomes between $20,000 and $30,000 would get an average tax cut of $120 in a year; households with incomes above $200,000 would get an average tax cut of $9221. Households with incomes between $20,000 and $30,000 would get a 3.3% cut in Federal taxes; households with incomes above $200,000 get a 6.1% cut in taxes. (The JCT calculates the percentage cut in taxes relative to total Federal taxes, not just the income tax.) Households with incomes between $20,000 and $30,000 would get a 3.5% share of the tax cut; households with incomes above $200,000 get a 31.5% share of the tax cut.

The share of this tax cut for a high income group exceeds the group's share of current-law Federal taxes, according to the JCT. The share of this tax cut for a middle- or lower-income group is less that the group's share of current-law Federal taxes.

The capital gains tax cuts are especially unfair. The Republican's bill cuts capital gains tax rates again, after they were cut in 1997. The tax rates on long-term capital gains would be cut from the current 20 percent and 10 percent to 15 percent and 7.5 percent, respectively. These are 25% reductions from the current rates. However, capital gains tax cut favor the affluent because a huge proportion of capital gains are realized by a small fraction of very affluent taxpayers.

According to the JCT, taxpayers with incomes over $100,000 account for only 8% of all taxpayers. But they account for 36% of all income and for 88% of all long-term capital gains in 1999. Taxpayers with incomes over $200,000 account for only 2% of all taxpayers. But they account for 20% of total income and 76% of all long-term capital gains. Accordingly, the Republican's capital gains tax cut is worth much more to affluent taxpayers than to middle-income taxpayers. Furthermore, a much higher proportion of affluent taxpayers have capital gains.

Seventy-five percent of taxpayers with incomes over $200,000 have capital gains, according to the JCT. Their average taxable gain is $137,000. A reduction in the capital gains tax rate from 20% to 15% is worth an average of $6850 (0.05 x 137,000) for these top income taxpayers. In contrast, only 14% of taxpayers with incomes between $40,000 and $50,000 have capital gains. Their average capital gain is $2600. Their capital gains tax cut is worth $130 or less.

Whatever ones views might be about the fairness of cutting individual tax rates, rather than relieving regressive Federal tax, this bill makes middle-income taxpayers wait ten years for the full 10% rate cut, while the very affluent with large capital gains get the capital gains tax cut right away (particularly since the effective date is retroactive to July 1, 1999.)

Two supporting tables based on JTC estimates are attached to this statement.

V. Conclusion

It is a sad day in America when Republican Representatives are willing to go through the motions of crafting the "tax cut of the Century" knowing that their actions are nothing but a joke. There are factions of the Republican party that must be satisfied before the elections. This bill allows them to say they did. But did what? All they have done is promote a huge tax cut for some of their constituency (who we believe know full well the folly of their actions) and told the public with a straight face that the tax benefits will be realized by all. Worse, they have betrayed the public's hope and expectation that Social Security and Medicare solvency would be addressed by this Congress. In the end, they have betrayed future generations by refusing to pay down any of our government's outstanding debt.

DISTRIBUTION OF TAX CHANGES UNDER ARCHER TAX PROPOSAL—YEAR 2004

Income group	Change in Federal taxes (Millions)	Percent Distribution of—			Percent change in taxes	Average tax cut per household
		Tax cut	Taxpayers	Current law taxes		
Less than $10,000	−$17	0.0	14.4	0.4	−0.2	−$1
$10,000 to $20,000	−$364	0.9	17.8	2.0	−1.0	−$14
$20,000 to $30,000	−$1,332	3.2	14.8	5.0	−1.5	−$62
$30,000 to $40,000	−$2,163	5.1	11.7	6.5	−1.9	−$127
$40,000 to $50,000	−$2,729	6.5	9.3	7.3	−2.1	−$201
$50,000 to $75,000	−$7,155	17.0	15.1	17.6	−2.3	−$325
$75,000 to $100,000	−$6,545	15.5	8.1	15.1	−2.4	−$554
$100,000 to $200,000	−$8,137	19.3	6.8	21.1	−2.2	−$818
$200,000 and over	−$13,663	32.4	1.9	24.9	−3.1	−$4,835
Total, all taxpayers	−$42,105	100.0	100.0	100.0	−2.4	−$289

Source: Joint Committee on Taxation, Distributional Effects of the Financial Freedom Act of 1999, July 13, 1999, JCX–44–99 and background on the distribution of numbers of taxpayers from JCT table #D–99–15, Feb. 12, 1999.

Table prepared from JCT estimates by Ways and Means Committee Democratic Staff.

DISTRIBUTION OF LONG-TERM REALIZED CAPITAL GAINS

Income group	Percent of—			Total capital gains (millions)	Percent of total gains	Average capital gain among—	
	Total taxpayers	Total income	Taxpayers within income group with gains			Those with gains	All taxpayers
Less than $10,000	$16.1	1.4	1.2	$444	0.1	$1,626	$20
$10,000 to $20,000	19.0	5.9	2.6	1,071	0.3	1,582	41
$20,000 to $30,000	14.6	7.6	5.7	2,244	0.7	1,926	111
$30,000 to $40,000	11.5	8.4	10.3	4,227	1.2	2,579	266
$40,000 to $50,000	9.4	8.9	13.9	4,795	1.4	2,630	367
$50,000 to $75,000	14.3	18.4	20.8	14,638	4.3	3,544	738
$75,000 to $100,000	7.2	13.1	29.7	14,855	4.3	4,982	1,479
$100,000 to $200,000	6.1	16.8	47.5	42,082	12.2	10,463	4,974
$200,000 and over	1.8	19.5	75.0	259,958	75.5	137,181	102,872
Total, all taxpayers	100.0	100.0	13.4	$344,314	100.0	$18,507	$2,480

Source: Joint Committee on Taxation, July 9, 1999, table #D–99–49 and computations from this data.

C.B. RANGEL.
WILLIAM J. JEFFERSON.
SANDER M. LEVIN.
WILLIAM J. COYNE.
RICHARD E. NEAL.
BEN CARDIN.
JOHN LEWIS.
LLOYD DOGGETT.
JERRY KLECZKA.
ROBERT T. MATSUI.
JOHN TANNER.
XAVIER BECERRA.
PETE STARK.
JIM McDERMOTT.