[JOINT COMMITTEE PRINT]

SUMMARY
OF
H.R. 4717, THE MISCELLANEOUS REVENUE ACT OF 1982, AND
H.R. 6055, THE SUBCHAPTER S REVISION ACT OF 1982

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

OCTOBER 15, 1982

U.S. GOVERNMENT PRINTING OFFICE

★ 99-447 O WASHINGTON : 1982 JCS-37-82

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INTRODUCTION

This pamphlet, prepared by the staff of the Joint Committee on Taxation, summarizes the provisions of H.R. 4717, the Miscellaneous Revenue Act of 1982, and H.R. 6055, the Subchapter S Revision Act of 1982. The pamphlet also sets forth the legislative history and the estimated budget effects of H.R. 4717 and H.R. 6055.

The summary descriptions contained in this pamphlet are intended to be informative, rather than inclusive. The official legislative history of each Act is contained in the committee reports (and, in the case of H.R. 4717, in the Statement of Managers).

I. H.R. 4717—MISCELLANEOUS REVENUE ACT OF 1982

A. Legislative History of H.R. 4717

Initial House version

As ordered reported by the House Ways and Means Committee on December 9, 1981 (H. Rept. No. 97–405, Dec. 14, 1981), and passed by the House on December 15, 1981,[1] H.R. 4717 contained three provisions: (1) one-year postponement of effective date for LIFO reserve recapture rule; (2) modification of net operating loss rule for the Federal National Mortgage Association; and (3) requirement for filing an information return relating to transactions under the safe harbor leasing provisions in the Economic Recovery Tax Act of 1981 (P.L. 97–34).

Finance Committee action

On December 14, 1981, the Senate Finance Committee authorized a committee amendment to be offered as a floor amendment to H.R. 4717 after that bill had been passed by the House. The committee amendment included the following:

(1) provisions identical to the three provisions of H.R. 4717 as ordered reported by the Ways and Means Committee (and as subsequently passed by the House), except that the committee amendment provision on information returns relating to safe harbor leases differed from the comparable House provision;

(2) provisions identical or comparable to five of the provisions of H.R. 4961, a bill which had been ordered reported by the House Ways and Means Committee on November 19, 1981 (H. Rept. No. 97–404, Dec. 14, 1981), and which bill subsequently passed the House on December 15, 1981;[2] and

(3) certain other tax provisions.

The provisions in the committee amendment which were the same as, or comparable to, five provisions which had been ordered reported by the Ways and Means Committee in H.R. 4961 related to: (1) rental of residences to family members and other business uses of residences; (2) awarding of attorney fees in tax litigation; (3) treatment of certain lending or finance businesses for purposes of the tax on personal holding companies; (4) two-year delay in application of net operating loss rules added by the 1976 Tax Reform Act; and (5) additional refunds relating to repeal of the excise tax on buses.

The committee amendment did not include provisions identical or comparable to other provisions of H.R. 4961 (as passed by the House), relating to modification of rules for acceleration of accrual of taxes; unemployment benefits paid to ex-service members; change in SSI accounting period; treatment of unnegotiated checks under

[1] See 127 Cong. Rec. H9617–21 (daily ed., Dec. 15, 1981).
[2] See 127 Cong. Rec. H9607–17 (daily ed., Dec. 15, 1981).

the SSI program; collection of administrative costs for non-AFDC child support enforcement; technical amendments to child support enforcement provisions in P.L. 97–35; and technical amendments to social services and foster care provisions in P.L. 97–35.

Senate floor action

On December 16, 1981, the Senate passed H.R. 4717, with amendments.[3] (Since the House-passed bill was not referred to the Finance Committee, there is no Finance Committee report on that bill.) The first Senate floor amendment was a committee amendment in the nature of a substitute.[4] This floor amendment was generally the same as the committee amendment authorized by the Finance Committee on December 14, but did not include provisions of the December 14 committee amendment relating to (1) rental of residences to family members and other business uses of residences; (2) postponement of effective date for 1976 Tax Reform Act rules on net operating losses; and (3) information returns relating to safe harbor leases.[5]

The Senate also adopted seven other floor amendments to H.R. 4717: (1) three-month delay in the effective date of certain 1980 Bankruptcy Tax Act rules relating to discharge of indebtedness in bankruptcy or insolvency; (2) provision for Medicare enrollment period for individuals formerly eligible for benefits under the Public Health Service Act; (3) limitation on the use of small-issue industrial development bonds; (4) amendments relating to use of certain amounts transferred to State unemployment funds (Reed Act), removal of age limitation for exclusion from FUTA of wages paid to student interns, and extension of exclusion from FUTA of wages paid to certain alien farmworkers; (5) amendments relating to mortgage revenue bonds; (6) reduction in the excise taxes on certain wagering; and (7) a technical amendment to the provision of the committee floor amendment relating to financing of the Reforestation Trust Fund.[6]

Also on December 16, the Senate requested a conference with the House on H.R. 4717 and appointed conferees (Senators Dole, Packwood, Wallop, Long, and Byrd of Virginia). The House did not act on H.R. 4717, as amended by the Senate, prior to the sine die adjournment of the 97th Congress, 1st Session on December 16, 1981.

House floor action on bill as amended by the Senate

On March 16, 1982, the House concurred in the Senate amendment to H.R. 4717 with an amendment in the nature of a substitute (consisting of the text of H.R. 5836).[7]

The House-passed bill included the following:

(1) five tax provisions which previously had been passed by the House as part of H.R. 4717 or H.R. 4961,[8] and which were identical or comparable to five provisions of H.R. 4717 as amended by the Senate on December 16, 1981;

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[3] See 127 Cong. Rec. S15577–15621 (daily ed., Dec. 16, 1981).

[4] The committee amendment adopted on the Senate floor was printed at 127 Cong. Rec. S15578–82 (daily ed., Dec. 16, 1981). A technical explanation of this floor amendment was printed at 127 Cong. Rec. S15587–97 (daily ed., Dec. 16, 1981).

[5] On December 16, 1981, provisions relating to these three topics were added by Senate floor amendments to H.R. 5159, the Black Lung Benefits Revenue Act of 1981 (subsequently enacted as Public Law 97–119).

[6] See 127 Cong. Rec. S15598–621 (daily ed., Dec. 16, 1981).

[7] See 128 Cong. Rec. H886–891 (daily ed., Mar. 16, 1982).

[8] See note 2, *supra*.

(2) a tax provision relating to modification of rules for acceleration of accrual of taxes, which previously had been passed by the House as part of H.R. 4961; and

(3) certain unemployment compensation and welfare provisions which previously had been passed by the House as part of H.R. 4961, and some of which had been included in H.R. 4717 as passed by the Senate.

The five tax provisions in the House-passed bill which previously had been passed by the House, and which were the same as, or comparable to, five provisions in H.R. 4717 as amended by the Senate, related to (1) one-year postponement of effective date for LIFO reserve recapture rule; (2) modification of net operating loss rule for the Federal National Mortgage Association; (3) awarding of attorney fees in tax litigation; (4) treatment of certain lending and finance businesses for purposes of the tax on personal holding companies; and (5) additional refunds relating to repeal of the excise tax on buses. The House-passed bill did not include the tax provisions of H.R. 4717 as amended by the Senate other than these five provisions.

Also on March 16, 1982, the House requested a conference with the Senate on H.R. 4717 and appointed conferees (Messrs. Rostenkowski, Gibbons, Rangel, Stark, Ford of Tenn., Conable, Duncan, and Frenzel).

Provisions enacted in P.L. 97-248

The Tax Equity and Fiscal Responsibility Act of 1982 (H.R. 4961, P.L. 97-248), enacted September 3, 1982, included provisions which were the same as, or comparable to, seven tax provisions in H.R. 4717 as passed by the House or in H.R. 4717 as amended by the Senate: (1) awarding of attorney fees in tax litigation; (2) treatment of certain lending or finance businesses for purposes of the tax on personal holding companies; (3) additional refunds relating to repeal of the excise tax on buses; (4) exclusion of certain research expenses from capital expenditure limitation for small issue industrial development bonds; (5) deferred compensation plans for State judges; (6) amendments to the Mortgage Subsidy Bond Tax Act; and (7) limitation on use of small issue industrial development bonds.

Also, Public Law 97-248 included provisions which were the same as or comparable to, or which dealt with issues involved in, the following other provisions in H.R. 4717 as passed by the House or in H.R. 4717 as amended by the Senate: (1) use of certain amounts transferred to State unemployment funds—Reed Act; (2) removal of age limitation for exclusion from FUTA of wages paid to student interns; (3) extension of exclusion from FUTA of wages paid to certain alien farmworkers; (4) change in SSI accounting period; (5) treatment of unnegotiated checks under the SSI program; (5) collection of administrative costs for non-AFDC child support enforcement; (6) technical amendments to child support enforcement provisions in Public Law 97-35; (7) technical amendments to social services and foster care provisions in Public Law 97-35; and (8) Medicare enrollment period for individuals formerly eligible for benefits under the Public Health Service Act.

Conference report

On October 1, 1982, the House and Senate agreed to the Conference Report on H.R. 4717 (H. Rept. No. 97-929).

B. Summary of H.R. 4717

Title I—Tax Provisions

1. Reduction of LIFO recapture amount with respect to certain plans of liquidation adopted during 1982 (sec. 101 of the Act)

Under present law (Code sec. 336), a corporation which distributes its LIFO inventory to its shareholders as part of a partial or complete liquidation generally must "recapture" (recognize as ordinary income) an amount equal to its LIFO reserve. (The LIFO reserve is the difference between the cost of inventory valued by the LIFO method and the cost of inventory valued by the FIFO method.) Also, a corporation which sells its LIFO inventory in the course of a 12-month liquidation must recapture an amount equal to its LIFO reserve (sec. 337(f)). These rules apply to distributions and dispositions made pursuant to plans of liquidation adopted after December 31, 1981.

Under the Act,[1] the LIFO reserve recapture rule will apply (with respect to a corporation) to distributions and dispositions made pursuant to plans of liquidation adopted after December 31, 1981 and before January 1, 1983 only to the extent that the LIFO reserve to be recaptured by that corporation is greater than $1 million. Thus, in the case of such liquidating distributions and dispositions, the amount of recapture otherwise required will be reduced by up to $1 million.[2]

In order to qualify for this exemption, the liquidation pursuant to such plan must be completed before January 1, 1984. (For this purpose, the rules under sections 333 and 337 apply in determining when a liquidation is completed.) If a corporation has more than one qualifying sale or liquidation, then the $1 million exemption applies to the sales or liquidations in the order in which the distributions, sales, or exchanges occur until $1 million is used up.

An election made in 1982 under section 338 (treating certain stock purchases as asset acquisitions) automatically qualifies for the $1 million LIFO exemption. Under this rule, the section 338 election is treated as the adoption of a plan of liquidation in 1982, followed by a sale of assets during 1982 in a transaction to which section 337 applies, and then followed by a complete liquidation in 1982.

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[1] References in section I–B of this pamphlet ("Summary of H.R. 4717") to the "Act" are to H.R. 4717, the Miscellaneous Revenue Act of 1982.

[2] For purposes of this $1 million exemption, all corporations which are members of a controlled group at any time in 1982 are treated as one corporation. A controlled group of corporations is to be determined under section 1563, except that "more than 50 percent" is substituted for "at least 80 percent". If, under this rule, a corporation is a member of more than one controlled group in 1982, the corporation will be treated only as a member of the controlled group of which it was a member on October 1, 1982, or, if it was not a member of a controlled group on October 1, 1982, then it will be treated as a member of the first controlled group of which it was a member in 1982.

2. Adjustments to NOL carryback and carryforward rules for FNMA (sec. 102 of the Act)

Under provisions enacted in the Economic Recovery Tax Act of 1981, taxpayers may carry back a business net operating loss (NOL) against income for the three taxable years preceding the loss year and carry forward any remaining unused losses to the 15 years following the loss year (Code sec. 172(b)).

In an exception to this general carryover rule, present law provides a 10-year carryback and a 5-year carryforward for NOL's of banks and certain other financial institutions. Since the Federal National Mortgage Association (FNMA) is not such a financial institution, it is not eligible for the 10-year carryback treatment, and thus must use a three-year carryback and a 15-year carryforward.

The Act provides a 10-year carryback and 5-year carryforward of the NOL of the FNMA to the extent the amount of the NOL exceeds the FNMA mortgage disposition loss.[3] This provision is effective for NOL's incurred in taxable years of the FNMA beginning after 1981.

3. Rollover of gain on certain sales under FCC order where newspapers are bought (sec. 103 of the Act)

Under present law, gain realized on the sale or exchange of property is not recognized if the sale or exchange is certified by the FCC as necessary because of a change in policy and the taxpayer elects to treat the sale or exchange as an involuntary conversion (Code sec. 1071). The Internal Revenue Service has ruled (in a private letter ruling) that nonrecognition treatment is not available under this provision when a corporation, in an FCC-certified sale or exchange, divests itself of a television station and reinvests in stock of a corporation operating a newspaper.

The Act provides nonrecognition treatment on the reinvestment in the stock of a newspaper corporation under certain specified conditions. This provision is effective on the date of enactment.

4. Treatment of certain oil shale property as energy property (sec. 104 of the Act)

The Energy Tax Act of 1978 provided a 10-percent energy investment tax credit for shale oil equipment, defined for this purpose to mean equipment for producing or extracting oil from oil-bearing shale rock (Code sec. 48(l)(7)). Under present law, the statute expressly excludes equipment for hydrogenation, refining, or other processes subsequent to retorting from the definition of qualifying shale oil equipment.

The Act expands the definition of shale oil equipment for purposes of the energy investment tax credit to include equipment used in hydrogenation or other similar processes subsequent to retorting that are necessary to bring about the chemical change in the hydrocarbons necessary to make the shale oil less viscous and to remove contami-

[3] The FNMA mortgage disposition loss is the net loss from the sale or exchange of mortgages, securities (not including stock), and other evidences of indebtedness to the extent that such net loss is not greater than the NOL for the taxable year. Gains and losses attributable to mortgage foreclosures will not be taken into account in determining the amount of an FNMA disposition loss, which will continue to have a three-year carryback and a 15-year carryforward.

nants such as sulphur and arsenic.[4] Only equipment for processes located within the vicinity of the property from which the shale was extracted (i.e., within 50 miles) qualifies for the credit, provided that such processes are applied to bring the shale oil to a grade and quality suitable for transportation to and processing in a refinery.

The provision applies to periods beginning after December 31, 1980, and before January 1, 1983.

5. Annuities for survivors of Tax Court judges (sec. 105 of the Act)

The Act generally increases annuity amounts payable pursuant to the survivors annuity plan for U.S. Tax Court judges (Code sec. 7448). Also, subject to certain limitations, the Act increases those annuities to reflect cost-of-living adjustments based on salary increases (including, for those in pay status on the date of enactment, adjustments based on post-1963 salary increases).

6. Tax Court procedures (sec. 106 of the Act)

Under present law, the chief judge of the U.S. Tax Court may assign "small tax cases" (i.e., certain cases in which the deficiency is not more than $5,000) and certain declaratory judgment actions to commissioners (special trial judges) for hearing and decision. Special procedural rules apply to small tax cases.

Present law requires that in any Tax Court case, the findings of fact and opinion must be reported in writing (sec. 7459).

Under the Act, special trial judges may hear and decide regular cases (i.e., cases that are not small tax cases) if the deficiency is not more than $5,000. In addition, subject to the $5,000 limitation, the category of small tax cases is expanded to include cases involving certain excise taxes and the crude oil windfall profit tax.

The Act also provides that in appropriate cases, a Tax Court judge may state orally, and record in the transcript of the proceedings, the findings of fact or opinion in the case. In such cases, the Court must provide to the petitioner(s) in the case and to the Internal Revenue Service, free of charge, either (1) a copy of those pages of the transcript which record such findings or opinion or (2) a written summary of such findings or opinion. If a summary is provided, the summary must be of all findings of fact or opinion, not merely the Court's final determination in favor of the taxpayer or the Internal Revenue Service. These provisions generally are effective on enactment.

7. Withholding statements for terminated employees (sec. 107 of the Act)

Under present law, an employee whose employment terminates during the year generally must be furnished a Form W–2 with his or her final wage payment (Code sec. 6051(a)). Treasury Regulations provide, however, that the employer may furnish a Form W–2 to an employee whose employment terminates prior to the close of the calendar

[4] Under present law, the energy investment credit for shale oil equipment generally is available after 1982 and before 1991 if specified affirmative commitments are undertaken with respect to qualified property that involves long-term projects of two years or more. This special affirmative commitment rule under present law does not apply to hydrogenation equipment made eligible as oil shale property under the Act. Thus, the credit for hydrogenation equipment under the Act will not apply to any construction or acquisition after December 31, 1982.

year at any time after the termination, but not later than January 31 of the following year, unless the employee requests earlier receipt.

The Act provides that if an employee whose employment terminates during the year makes a written request for a Form W–2, the employer generally must furnish the form within 30 days after receiving the request. Absent such a request, the terminated employee must be furnished a Form W–2 at the same time as all other employees (i.e., no later than January 31 of the year following the calendar year in which services were performed). This provision applies to employees whose employment is terminated after the date of enactment.

8. Withholding of State income tax from the wages of certain seamen (sec. 108 of the Act)

Present law generally permits employers to withhold State income taxes from wages paid to employees. However, Federal law prohibits employers from withholding State income taxes from the wages of seamen or fishermen (46 U.S.C. sec. 601).

Under the Act, seamen or fishermen who are employed in the coastwise trade between ports in the same State may enter into voluntary withholding agreements with their employers for withholding from wages of amounts as State income taxes. This provision is effective on enactment.

9. Reduction in excise taxes on wagers and wagering permitted under State law (sec. 109 of the Act)

Present law imposes a two-percent excise tax on the amount of certain wagers which are placed (1) with a person in the business of accepting wagers on the outcome of a sports event or contest, (2) with respect to a sporting event or contest, in a wagering pool conducted for profit, or (3) in certain lotteries conducted for profit. The tax applies whether or not such wagering is authorized by State law.

An occupational tax of $500 per year is imposed on each person who is in the business of accepting wagers and on each person who is engaged in receiving wagers for or on behalf of such person.

The Act reduces the two-percent excise tax on certain wagers to 0.25 percent for wagers authorized by State law. The $500 occupational tax is reduced to $50 in the case of persons authorized by State law to accept wagers in a wagering business authorized by State law. In States where wagering is illegal, the two-percent excise tax and $500 occupational tax will continue to apply.

The reduction in the excise tax on certain wagers will be effective on January 1, 1983, and the reduction in the occupational tax will be effective on July 1, 1983.

Title II—Other Provisions

1. Unemployment benefits paid to ex-service members (secs. 201–202 of the Act)

Section 2405 of the Omnibus Budget Reconciliation Act of 1981 (P.L. 97–35) established new requirements for the payment of benefits to former military personnel under the unemployment compensation for ex-service members (UCX) program. Under P.L. 97–35, benefits are limited to individuals who (1) have 365 or more days of military service; (2) were discharged or released under honorable conditions; (3) did not resign or voluntarily leave the service (i.e., they were not eligible for reenlistment); and (4) were not released or discharged "for cause" are defined by the Department of Defense. These new requirements apply to individuals who left Federal military service on or after July 1, 1981, but only for weeks of unemployment that began on or after August 13, 1981, the date of enactment of P.L. 97–35.

The Act substitutes for the requirements enacted in P.L. 97–35 new Federal unemployment compensation eligibility requirements for individuals separated from the military. Under the Act, up to 13 weeks of Federal unemployment benefits, following a four-week waiting period after separation, could be provided to unemployed ex-service members who (1) had completed the initial term of active service they agreed to serve, (2) were separated under honorable conditions, and (3) meet the qualifying requirements of the State in which they file for benefits.

Ex-service members who were separated prior to completing their initial term of active service could qualify for unemployment benefits if they were separated early, under honorable conditions, (a) for the convenience of the Government under an early release program, (b) because of medical disqualification, pregnancy, parenthood, or any service-incurred injury or disability, (c) because of hardship, or (d) if they had served for at least 365 continuous days, because of personality disorders or inaptitude. The provision is effective for separations on or after July 1, 1981, but only for benefits payable after the date of enactment.

Also, effective October 1, 1983, the Act requires that Federal unemployment benefits paid to ex-service members be charged to the Department of Defense in the same manner as Federal benefits paid to former civilian Federal employees are charged to other Federal agencies.

2. Extension of exclusion from FUTA for certain fishing boat services (sec. 203 of the Act)

Services performed by members of the crew on boats engaged in catching fish or other forms of aquatic animal life are exempt from the social security tax (FICA) if their remuneration is a share of the boat's catch (or cash proceeds from the sale of a share of the catch)

and if the crew of such boat normally is made up of fewer than ten individuals. In addition, the remuneration received by those fishing boat crew members whose services are exempt for purposes of FICA is not considered to be wages for purposes of income tax withholding. Furthermore, the Economic Recovery Tax Act of 1981 (P.L. 97–34) provided that wages paid during 1981 to certain fishing boat crew members who are self-employed for purposes of FICA are not subject to FUTA taxes.

The Act extends for one year (through 1982) the FUTA tax exemption for wages paid to fishermen whose remuneration is exempt for purposes of FICA. This provision applies to remuneration paid during 1982.

3. Eligibility requirements for trade adjustment assistance (sec. 204 of the Act)

Under prior law, workers could be certified eligible to apply for benefits under the trade adjustment assistance program if increased imports "contributed importantly" to worker layoffs and production or sales declines of the firm. Pursuant to the Omnibus Budget Reconciliation Act of 1981 (P.L. 97–35), the causation standard was modified to require that increased imports be a "substantial cause" of such layoffs and declines, defined as a cause which is "important and not less than any other cause." The new test applied to petitions filed on or after February 9, 1982.

The Act restores the standard applicable prior to February 9, 1982, for certification by the Department of Labor of workers for benefits under the trade adjustment assistance program. The provision requires that increased imports "contribute importantly" to, rather than be a "substantial cause" of, worker layoffs and sales or production declines of the firm. The provision applies retroactively to petitions filed on or after February 9, 1982, until statutory termination of the program on September 30, 1983.

C. Estimated Budget Effects of H.R. 4717

Estimated Budget Effects of H.R. 4717 as Passed by the House and Senate, Fiscal Years 1983–1986

[In millions of dollars]

Provision	1983	1984	1985	1986
A. *Tax Provisions:*				
Reduction of LIFO recapture amount with respect to certain liquidations	−56	([2])	([2])	([2])
Adjustments to NOL rules for FNMA	−14	+14	--	--
Rollover of gain on FCC-ordered disposition of broadcast property	([1])	([1])	--	--
Treatment of certain oil shale property as energy property	([2])	--	--	--
Annuities for survivors of Tax Court judges (outlays)	([3])	([3])	([3])	([3])
Tax Court procedures	--	--	--	--
Withholding statements for terminated employees	--	--	--	--
Withholding of State income tax from wages of certain seamen	--	--	--	--
Reduction in excise taxes on wagers and wagering permitted under State law	−8	−14	−16	−17
Total, tax provisions*	−86	−8	−19	−20
B. *Other Provisions:*				
Unemployment benefits paid to ex-service members (outlays)**	90	70	60	55
Eligibility requirements for trade adjustment assistance (outlays)	([4])	([4])	([4])	([4])
Extension of exclusion from FUTA for certain fishing boat services	([5])	--	--	--

[1] Loss of less than $10 million.
[2] Loss of less than $5 million.
[3] Increases outlays by less than $50,000.
[4] Increases outlays by indeterminate amount.
[5] Revenue loss of less than $1 million.

*For budget scorekeeping purposes, totals include $3 million for each figure shown as "less than $5 million" and $5 million for each figure shown as "less than $10 million."

**Preliminary estimate supplied by the Congressional Budget Office.

II. H.R. 6055—SUBCHAPTER S REVISION ACT OF 1982

A. Legislative History of H.R. 6055

House bill

H.R. 6055, the Subchapter S Revision Act of 1982, was reported with amendments by the Subcommittee on Select Revenue Measures to the House Committee on Ways and Means on July 15, 1982. The bill was reported with further amendments by the Committee on Ways and Means on September 16, 1982 (H. Rept. No. 97–826). The House passed the bill, without amendment, on September 20, 1982.[1]

Senate bill

The Senate Committee on Finance reported the bill, with amendments, on September 29, 1982 (S. Rept. No. 97–640). The bill was passed by the Senate without further amendment on September 30, 1982.[2] On October 1, 1982, the House agreed to the Senate amendments.[3]

B. Summary of H.R. 6055

In general, H.R. 6055 (the Subchapter S Revision Act of 1982) is intended to simplify and modify the tax rules relating to eligibility for subchapter S status and the operation of subchapter S corporations. This is accomplished by removing eligibility restrictions that appear unnecessary and by revising the rules relating to income, distributions, etc., that tend to create traps for the unwary. The principal changes from present law made by the Act[4] are summarized below.

Eligibility

With respect to initial and continued eligibility of a corporation for subchapter S treatment, the Act makes the following changes:

(1) The number of permitted shareholders will be increased from 25 to 35;

(2) Differences in voting rights in common stock will not violate the one-class-of-stock requirement;

(3) The present law rule which results in the termination of an election if the corporation derives more than 80 percent of its gross receipts from sources outside the United States will be repealed;

(4) The present law rule which automatically terminates a corporation's subchapter S election if more than 20 percent of a corporation's gross receipts for any taxable year is passive investment income will be eliminated for corporations which do not have subchapter C accumulated earnings and profits at the close

[1] See 128 Cong. Rec. H7193–7202 (daily ed., Sept. 20, 1982).
[2] See 128 Cong. Rec. S12725–12727 (daily ed., Sept. 30, 1982).
[3] See 128 Cong. Rec. H8414–8417 (daily ed., Part II, Oct. 1, 1982).
[4] References in section II–B of this pamphlet ("Summary of H.R. 6055") to the "Act" are to H.R. 6055, the Subchapter S Revision Act of 1982.

of the taxable year, and will be modified for corporations with subchapter C accumulated earnings and profits by raising the 20 percent test to 25 percent, by imposing a corporate level tax on the excess passive income, and by terminating the election only where the corporation has excess passive income for three consecutive taxable years;

(5) A person who becomes a shareholder of a subchapter S corporation after the initial election of subchapter S status will not have the power to terminate the election by affirmatively refusing to consent to the election. Accordingly, the new shareholder will be bound by the initial election until the election is otherwise terminated; and

(6) A safe harbor will be provided for a debt instrument which is not convertible into stock and which consists of an unconditional promise to pay on demand or on a specified date a sum certain in money with respect to which the interest rate and payment date are fixed (straight debt). Straight debt will not be classified as a second class of stock when held by a person eligible to hold subchapter S stock. The classification of instruments outside the safe harbor rule as stock or debt will be made under usual tax law classification principles applicable to subchapter S corporations.

Elections, revocations, and terminations

The Act provides that an election made on or before the fifteenth day of the third month of the taxable year will be effective for the entire taxable year if all persons who held stock in the corporation during the pre-election portion of that year were individuals, estates, and qualified trusts, and if all persons who held stock in the corporation at any time during the year up to the time the election is made consent to the election. If these requirements are not met, or if the election is made later than the fifteenth day of the third month of the taxable year, it will not be effective until the subsequent taxable year.

An event occurring during the taxable year which causes a corporation to fail to meet the definition of an eligible corporation will terminate the election as of the day on which the event occurred (rather than as of the first day of the taxable year in which the event occurred, as under present law). To minimize the effect of an inadvertent termination, the Act provides that the Internal Revenue Service may waive the terminating event so that the corporation may continue to be a subchapter S corporation notwithstanding that event.

The Act provides that an election can be revoked by those shareholders holding a majority of the corporation's voting stock (as contrasted with the current rule which requires all shareholders to consent to a revocation). The present law rule allowing a revocation filed during the first month of the taxable year to be effective for that entire taxable year is modified so that such a retroactive revocation may be filed on or before the fifteenth day of the third month of the taxable year.

Passthrough of income, etc.

The Act provides that the character of items of income, deduction, loss, and credits of the corporation will pass through to the shareholders in the same general manner as the character of such items of a partnership passes through to partners. Thus, for example, such items

as tax-exempt interest, capital gains and losses, percentage depletion, the source or allocation of foreign income or loss, and foreign income taxes will pass through and retain their character in the hands of shareholders.

As is the case under present law with respect to losses, income will be passed through and allocated to shareholders on a per-share, per-day basis.

Selection of taxable year

Under the Act, rules generally similar to those applicable to partnerships will apply to the selection of a taxable year for a subchapter S corporation. The taxable year of a corporation which makes a subchapter S election will be required to be either the calendar year, or any other accounting period for which the corporation establishes a business purpose to the satisfaction of the Treasury Department. These rules also apply to corporations currently operating under subchapter S. However, a corporation with a subchapter S election in effect on December 31, 1982, may continue its current taxable year so long as 50 percent or more of the outstanding stock in the corporation on that date continues to be owned by the same shareholder. For purposes of this transitional rule, transfers of stock to family members pursuant to certain existing agreements, by gift to family members, or through inheritance will not be considered changes in ownership.

Carryforward of loss

Under the Act, a subchapter S shareholder will be entitled to carry forward a loss to the extent that the amount of the loss passed through for the year exceeds the aggregate amount of the basis in this subchapter S stock and loans to the corporation. The loss carried forward can be deducted only by that shareholder if and when the basis in his or her stock of, or loans to, the corporation is restored.

Distributions

The rules relating to distributions from subchapter S corporations are substantially revised by the Act.

Under the new rules, a corporation will not have earnings and profits attributable to any taxable year beginning after the date of enactment if a subchapter S election is in effect for that year. For corporations with no earnings and profits, the amount of the distribution (generally cash plus the fair market value of property) will be tax-free and will reduce the shareholder's basis in his or her stock. To the extent that the amount of the distribution exceeds the amount of the basis in the stock, capital gains generally will result.

For corporations with accumulated earnings and profits, the distribution will be treated as a distribution by a corporation without earnings and profits to the extent of the shareholder's portion of the undistributed amount of subchapter S gross income less deductible expenses (an "accumulated adjustment account"). Any amount in excess of the accumulated adjustment account will be treated under the usual corporate rules, first as a distribution out of accumulated earnings and profits to the extent thereof.

Under the Act, both taxable and nontaxable income and deductible and nondeductible expenses will serve, respectively, to increase and decrease the subchapter S shareholder's basis in his or her stock of,

and loans to, the corporation. These rules are generally analogous to those provided for partnerships. Also, unlike present law, basis will be restored to debt obligations as well as stock. Restoration of basis will be made first to debt (to the extent of prior reductions) and then to stock. Under the Act, gain will be recognized by a subchapter S corporation upon nonliquidating distributions of appreciated property.

Fringe benefits

Under the Act, rules similar to the partnership tax rules will apply to employee fringe benefits. For this purpose, persons owning two percent or more of the corporate stock will be treated as partners.

Treatment of transactions between corporation and related parties

Under the Act, amounts accruing to any cash-basis shareholder owning two percent or more of the corporation's stock will be deductible only when paid.

Administrative provisions

The Act provides that the items of subchapter S income, deductions, and credits will be determined in audit and judicial proceedings at the corporate level rather than separately with each shareholder. Shareholders are to be given notice of, and the opportunity to participate in, Internal Revenue Service proceedings with the corporation.

Effective date

The Act is generally effective for taxable years beginning after December 31, 1982. The new passive income rules are effective for taxable years beginning after December 31, 1981.

C. Estimated Budget Effects of H.R. 6055

It is estimated that the provisions of H.R. 6055 will reduce budget receipts by less than $10 million annually.

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