DESCRIPTION OF TECHNICAL CORRECTIONS

PROPOSED TO THE

TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988, THE REVENUE ACT OF 1987, AND CERTAIN OTHER PENSION-RELATED TAX LEGISLATION

For Consideration

By the

COMMITTEE ON WAYS AND MEANS

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary description of proposed technical corrections to recent tax legislation. No description is provided for clerical or conforming changes.

Part I of the document describes proposed technical corrections to the Technical and Miscellaneous Revenue Act of 1988 (1988 Act). Part II describes proposed technical corrections to the Revenue Act of 1987 (1987 Act). Part III describes proposed pension technical corrections relating to the Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1986, and the Pension Protection Act. Part IV describes a miscellaneous technical amendment relating to the foreign tax credit.

Effective dates.--Unless otherwise specified in the description, the proposed technical correction provisions are effective as if included in the Act to which the correction is being made.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Technical Corrections Proposed to the Technical and Miscellaneous Revenue Act of 1988, The Revenue Act of 1987, and Certain Other Pension-Related Tax Legislation (JCX-27-89), June 28, 1989.

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I. AMENDMENTS TO THE TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988

A. Corporate Provisions

1. Method of computing net unrealized built-in gain or loss

For purposes of sections 382, 384, and 1374 the method of computing the amount of net unrealized built-in gain or loss is clarified. Items of income or loss that would be treated as built-in gain or loss if recognized within the recognition period are included in the computation of net unrealized built-in gain or loss, without regard to when or whether such items are actually recognized within the recognition period.

2. Modification of conforming amendment relating to S corporations engaged in banking operations

Prior to the Tax Reform Act of 1986, a corporation could not be an S corporation if the corporation's deductions for bad debts could be taken under the reserve method as a bank (under Code sec. 585) or as a thrift institution (under sec. 593) (Code sec. 1371(b)(2)(B)). The Tax Reform Act of 1986 disallowed the use of the reserve method for bad debts for large banks (Sec. 901(a)(1) of the Tax Reform Act of 1986). As a conforming amendment, the 1986 Act provided that a corporation could not be an S corporation if the corporation was a bank or thrift institution, regardless of whether or not that corporation claimed any deduction for bad debts under the reserve method (Sec. 901(d)(4)(G) of the Tax Reform Act of 1986).

The provision modifies the conforming amendment in the 1986 Act such that corporations would not be eligible to be an S corporation if the corporation could have claimed a deduction for bad debts under the reserve method as a bank if it were a small bank.

B. Minimum Tax Provisions

1. Tax benefit rule

The Tax Reform Act of 1986 provided that the Treasury Department may prescribe regulations providing proper adjustments where the taxpayer will not receive a tax benefit from an item for any taxable year. The provision clarifies that this rule applies whether the tax benefit will result in the current year or in another year. The provision also provides that under the tax benefit rule of the prior law minimum tax, the authority of the Treasury Department to prescribe tax benefit regulations includes the authority to make adjustments to items other than tax preferences. No inference is intended regarding the scope of the Treasury's authority in the absence of this provision.

2. Minimum tax credit

The provision clarifies that the minimum tax credit includes any minimum tax imposed in prior years by reason of the 90-percent limitation on the use of the alternative minimum tax foreign tax credit. This position is consistent with the position taken by the Internal Revenue Service in its forms and accompanying instructions. (Under present law, the minimum tax credit includes any minimum tax previously paid because of the 90-percent limitation on the use of net operating loss deductions.)

C. Accounting Provisions

1. Long-term contracts

a. Percentage of completion method.--In general, a portion (generally, 90 percent) of the items with respect to certain long-term contracts must be taken into account under the percentage of completion method. Under the percentage of completion method, as presently drafted, it is unclear whether all of the income under the contract must be taken into account over the contract term if not all of the total estimated contract costs are actually incurred. The provision clarifies that, except for purposes of applying the look-back method, all of the income under the contract must be taken into account no later than one year after the taxable year in which the contract is completed.

b. Treatment of costs attributable to the installation of integral components to real property.--The provision clarifies that the cost of installing any integral component to real property (e.g., a heating or air conditioning system) is to be considered a qualifying cost for purposes of the definition of home construction contract and residential construction contract.

c. Exception for certain construction contracts.--Present law provides an exception to the long-term contract rules for certain construction contracts of taxpayers whose average annual gross receipts for the prior three taxable years do not exceed $10 million. The provision clarifies that the gross receipts of any predecessor of the taxpayer (and certain related persons) are to be taken into account in determining whether this exception applies.

d. Treatment of interest under the look-back method.--Upon the completion of a contract, a taxpayer must pay interest under the look-back method to the extent that taxes in a prior contract year were underpaid due to the use of estimated contract price and costs rather than the actual contract price and costs. The provision clarifies that such interest is to be treated as an increase in tax for purposes of subtitle F of the Code (other than the estimated tax provisions).

e. Application of the discounting rules of the lookback method.--Present law provides that under the lookback method, amounts that are received or accrued after the completion of a contract are to be taken into account by discounting such amounts to their present value as of the completion of the contract. A taxpayer may elect with respect to any contract not to discount amounts recieved or accrued after the completion of the contract. The provision clarifies that costs under a contract are to be discounted in the same manner as items of income.

f. Application of regulatory authority to certain ship contracts.--The provision clarifies that the regulatory authority granted to the Secretary of the Treasury to prevent the avoidance of section 460 applies to qualified ship contracts.

2. Uniform cost capitalization rules

a. Application of section 189.--Section 189, before its repeal by the 1986 Act, required the capitalization of certain construction period interest and taxes. Such capitalized costs were generally amortized over a 10-year period. Costs were not subject to the rules of section 189 if they were capitalized under section 266. Section 263A, as enacted by the 1986 Act, also requires the capitalization of certain interest and taxes. Under section 263A(f), interest may be capitalized pursuant to a formula that takes into account all prior capitalized costs (the avoided cost method). The provision clarifies that the costs that would have been taken into account for purposes of sections 189 and 266 before the effective date of the 1986 Act will be taken into account for purposes of section 263A(f) after the effective date of the 1986 Act.

In addition, the provision clarifies that certain property that was provided transition relief under the 1986 Act is subject to the capitalization rules of section 189 (as effective before its repeal) with respect to interest and subject to the capitalization rules of section 263A with respect to other costs, including taxes.

b. Exception for free-lance authors, photographers, and artists.--The 1988 Act exempted certain free-lance authors, photographers, and artists from the uniform capitalization rules of section 263A. The provision clarifies that the exemption also applies to certain expenses incurred by certain corporations owned by such persons.

c. Exception for certain producers of animals.--Prior to the 1988 Act, producers of certain plants and animals were subject to the uniform capitalization rules unless an election was made to forego the use of accelerated depreciation. The 1988 Act exempted certain producers of animals from the uniform capitalization rules and allowed the revocation of prior elections to forego the use of accelerated depreciation. The provision clarifies that only producers of animals may revoke prior elections.

3. <u>Installment sales</u>

a. <u>Treatment of sales of personal use property by individuals</u>.--Present law provides that certain installment sales by nondealers are subject to special interest-charge and pledging rules. The provision clarifies that the sale of personal use property by an individual is not subject to these special interest-charge and pledging rules.

D. Foreign Tax Provisions

1. Source rules

Special rules for transportation income.--

i. The provision exempts from U.S. income tax gross income from the international operation of ships or aircraft derived by an individual resident of a possession, or a corporation organized in a possession, if such possession grants an equivalent exemption to U.S. individuals or corporations. In the case of any possession on the mirror code, the provision clarifies that such reciprocal exemptions exist.

ii. The provision clarifies that a foreign corporation may be exempt from U.S. tax on its income from the international operation of ships or aircraft, even if the equivalent tax exemption of the country where the foreign corporation was organized does not extend to dual resident companies that are both incorporated in the United States and also treated as residents of that country under its tax laws.

iii. Under the provision, failure to have substantially all of a taxpayer's U.S. source gross transportation income attributable to regularly scheduled transportation (or, in the case of income from the leasing of a vessel or aircraft, attributable to a fixed place of business in the United States) would not automatically prevent transportation income other than U.S. source gross transportation income from being treated as effectively connected with the conduct of a trade or business in the United States if the general rules would treat such other transportation income as so effectively connected.

2. U.S. taxation of income earned through foreign corporations

a. Exception for same-country interest.-- The provision clarifies that the exception from treatment as foreign personal holding company income for certain interest received from a related person that is organized in the same country as the recipient applies only to payments received from a related person that is a corporation.

b. Losses of foreign corporations electing to be taxed as domestic insurance companies.--The provision clarifies that any loss of a foreign corporation that makes an election to be treated as a domestic insurance company cannot reduce the taxable income of any other member of its affiliated group.

3. <u>Treatment of foreign taxpayers</u>

a. <u>Partnership withholding</u>.--

i. For purposes of determining the adjusted basis of an interest in a partnership, the provision generally treats withholding tax paid by a partnership on behalf of a foreign partner as a deemed distribution to such partner on the earlier of (1) the date such tax is paid to the Internal Revenue Service, or (2) the last day of the partnership's taxable year for which the tax is paid.

ii. The provision subjects a partnership to an underpayment of estimated tax penalty similar to that applicable to corporations if the partnership fails to properly pay quarterly installments of withholding tax with respect to foreign partners.

b. <u>Excise tax on insurance premiums paid to foreign persons</u>.--The provision conforms the exemption from the excise tax for premiums on life, sickness, and accident insurance policies and annuity contracts with the existing exemption from the tax for premiums on casualty insurance policies and on all reinsurance policies.

4. <u>Foreign currency</u>

<u>Foreign currency gain and loss</u>.--The provision clarifies that the character of any foreign currency gain or loss is determined under the rules of section 988 notwithstanding other gain and loss characterization rules (e.g., the rule characterizing gain and loss from trading section 1256 contracts) in the Code.

5. <u>Miscellaneous foreign provisions</u>

a. <u>Unrelated business income from DISCs</u>.--The provision clarifies that all tax-exempt DISC shareholders that are generally subject to the unrelated business income tax are equally subject to unrelated business income tax on income with respect to DISC stock.

b. <u>Treaty interaction with estate and gift tax marital deductions</u>.--The provision provides that certain estate and gift tax marital deductions available pursuant to treaties to nonresident aliens transfering U.S. property will apply notwithstanding inconsistent 1988 Act provisions.

E. Estate and Gift Tax Provisions

1. Rates and unified credit

a. Phaseout of unified credit for nonresident alien decedents.--The 5-percent phaseout of the unified credit would apply to the estate of an nonresident alien only to the extent that the estate qualified for the credit.

2. Gift tax

a. Marital deduction for gifts made by nonresident alien.--For gift tax purposes, a nonresident alien would receive the same marital deduction allowed a resident alien.

b. Annual exclusion for transfers to alien spouse.--The $100,000 annual exclusion for gifts made to an alien spouse would be allowed only for transfers of nonterminable interests. The provision would be effective for gifts made after date of committee action.

3. Marital deduction to the estate tax

a. Treatment of survivor annuity as QTIP.--A survivor annuity would be treated as qualifying terminable interest property under the marital deduction only if the annuity is includible in the estate of the decedent.

b. Availability of marital deduction for nonresident alien.--The statute would be clarified to allow property passing from a nonresident alien to an alien spouse to qualify for the marital deduction if passing in a qualified domestic trust.

c. Availability of marital deduction for property transferred to qualified domestic trust before filing of the estate tax return.--Probate property passing to an alien spouse would qualify for the marital deduction if such property is transferred or irrevocably assigned to a qualified domestic trust before the estate tax return is filed. Estates of decedents dying before the date of enactment would be allowed one year to make such a transfer or assignment.

d. Availability of marital deduction where spouse becomes U.S. citizen before the filing of the estate tax return.--The marital deduction would be allowed for property passing to an alien spouse if the spouse becomes a U.S. citizen before the date the estate tax return is filed, so long as the spouse was a U.S. resident at the date of the decedent's death and at all times before becoming a U.S. citizen.

4. Credit to estates of alien spouses for estate tax paid by estate of decedent spouse

a. Availability of credit to nonresident alien.--The credit for estate tax previously paid by the decedent spouse would be allowed to a surviving spouse who is a nonresident alien.

b. Credit for taxes imposed on qualified domestic trust not reduced by amount qualifying for marital deduction.--The credit for the estate tax imposed against a qualified domestic trust would not be reduced by the amount qualifying for the marital deduction.

5. Definition of qualified domestic trust

a. Trustees.--The rule that all the trustees of a qualified domestic trust must be U.S. citizens or domestic corporations would be modified to require only that a majority of the trustees be U.S. citizens or domestic corporations.

b. Income.--A trust would be treated as a qualified domestic trust even if the spouse did not have an income interest in the trust. To qualify for the marital deduction, the interest passing to the spouse would continue to be subject to requirements applicable to property passing to U.S. citizen spouses. To meet these requirements in particular situations, a spouse may need to have an income interest in the trust.

c. Reformation to meet QDT requirements.--A trust would meet the requirements for a qualified domestic trust if it is reformed to meet those requirements before the filing of the return or in a suit initiated before that time.

d. Regulations; Treatment of annuity as QDT.--The Secretary of the Treasury would be directed to prescribe regulations necessary or appropriate to carry out the purposes of the provision, including regulations treating an annuity as a qualified domestic trust.

6. Estate tax on qualified domestic trust

a. Definition of income.--The Secretary of the Treasury would be granted regulatory authority to modify the definition of income not subject to the estate tax on qualified domestic trusts.

b. Definition of distribution.--The payment of the estate tax on qualified domestic trusts itself would be a distribution subject to the estate tax.

c. No tax when surviving spouse becomes U.S. citizen.--The estate tax on qualified domestic trusts would no longer be imposed if the surviving spouse subsequently becomes a U.S. citizen if either (1) no previous taxable distributions were made from the trust, or (2) the spouse was a U.S. resident at the date of the decedent's death and at all times before becoming a U.S. citizen.

d. Multiple qualified domestic trusts.--If there is more than one qualified domestic trust, the tax rate on each trust would be the highest estate tax rate in effect at the date of the decedent's death unless there is one U.S. citizen or domestic trustee responsible for filing the returns and paying the tax on all qualified domestic trusts.

e. Interest on tentative tax.--The tentative tax refunded upon final determination of estate tax on a qualified domestic trust would bear interest.

f. Availability of estate tax benefits--The charitaple and marital deductions, capital gains treatment of redemptions of stock to pay estate tax, special use valuation, and extension of time to pay estate tax would be would be allowed against the estate tax on qualified domestic trusts if allowable to the estate of the surviving spouse.

g. Basis for estate tax on lifetime distributions.--The basis of property distributed as corpus from the trust would be increased by the amount of the tax.

h. Due date for tax on deathtime transfers.--The return for the estate tax on imposed on a qualified domestic trust by reason of the death of the surviving spouse would be due on the same date as the estate tax return for that spouse.

i. Exclusion from tax on distributions.--The rule excluding income distributions from the tax on distributions would be modified to exclude at least $100,000 in distributions, even if made from trust corpus. The $100,000 exclusion would not be available if there is more than one qualified domestic trust unless there is one U.S. citizen or domestic corporation responsible for filing the returns and paying the tax on all qualified domestic trusts.

7. Generation-skipping transfer tax

a. Basis adjustment.--The total basis adjustment for property subject to the generation-skipping transfer tax would be limited to its fair market value.

b. Double deduction of expenses.--Administrative expenses would not be simultaneously deductible against both the generation-skipping transfer tax and the income tax.

c. Valuation date for transfers for which gift tax return not required.--Generation skipping transfers would be valued as of the date of transfer if an allocation of exemption is made on a timely filed gift tax return, even if such return is not required for gift tax purposes.

8. Estimated taxes of trusts and estates

a. Exception from estimated taxes for two years following decedent's death.--If the decedent has no will, a grantor trust with primary responsibility for paying taxes, debts and administrative expenses of a decedent would not be required to pay estimated taxes for taxable years ending within two years of the decedent's death.

F. Application of 2-Percent Floor on Itemized Miscellaneous Deductions to Indirect Deductions Through Pass-Through Entities

1. 2-percent floor and publicly offered mutual funds

Under present law, the Secretary of the Treasury is required to prescribe regulations prohibiting the indirect deduction through pass-through entities of amounts that would not be deductible under the 2-percent floor on miscellaneous itemized expenses if paid or incurred directly by an individual. These regulations would prohibit indirect deductions through partnerships, mutual funds, real estate mortgage investment conduits, and certain trusts and estates. A shareholder's share of expenses of publicly offered mutual funds are permanently exempt from the prohibition. The 1988 Act inadvertently sunseted the prohibition for taxable years beginning after December 31, 1989.

Under the provision, the prohibition on indirect deduction through pass-through entities would be made permanent and the exemption for publicly offered mutual funds would sunset on December 31, 1989. Thus, the provision would apply the 2-percent floor to shareholder expenses of publicly offered mutual funds for taxable years beginning after December 31, 1989.

G. Insurance Provisions

1. Treatment of modified endowment contracts

a. Treatment of qualified additional benefits.--The provision clarifies that an increase in the charge for a qualified additional benefit is not a material change in the benefits under a contract, and, consequently, the 7-pay test is not to be reapplied at such time. An addition of, or an increase in, a qualified additional benefit, however, is to be considered a material change in the benefits under the contract and requires a reapplication of the 7-pay test.

b. Increase in benefits based on cost-of-living index.--The provision clarifies that, to the extent provided in regulations, a material change does not include any cost-of-living increase based on an established broad-based index if the increase is funded ratably over the remaining period during which premiums are required to be paid under the contract (rather than over the remaining life of the contract).

c. Treatment of contracts with a negative 7-pay premium.--The committee report to the bill would clarify that a contract which is materially changed is not to be considered a modified endowment contract if the calculation of the 7-pay premium after the material change is a negative amount provided that no additional premiums are paid during the first 7 years after the material change.

d. Timing of death benefit increases under the material change rules.--The committee report to the bill would clarify that a death benefit increase that occurs before the payment of a premium that is not necessary to fund the lowest death benefit payable during the first 7 contract years may be considered a material change in the benefits provided under a contract, and, in such case, the material change would be considered as occurring on the date that such premium is paid.

e. Aggregation rules for modified endowment contracts and annuity contracts.--The provision clarifies that contracts under qualified pension plans are not subject to the aggregation rules which generally apply to modified endowment contracts and annuity contracts.

f. Special effective date provision where death benefit increases by more than $150,000.--The committee report to the bill would clarify that if the death benefit under a contract increases by more than $150,000 over the death benefit under the contract as of October 20, 1988, then the contract would be subject to the material change rules as of the date that the death benefit exceeds the threshold. In addition, the committee report would provide that in determining whether the death benefit increase constitutes a material change, the death benefit payable under the contract as of October 20, 1988, increased by $150,000 is to be taken into account rather than the lowest death benefit payable during the first 7 contract years.

g. Exception to special effective date provisi where death benefit increases by more than $150,000.--The provision clarifies that the exception to the $150,000 death benefit increase provision applies to any contract that, as of June 21, 1988, required at least 7 level annual premium payments and under which the policyholder makes at least 7 level annual premium payments.

h. Treatment of contracts that are considered entered into on or after the effective date.--The committee report to the bill would clarify the treatment of an insurance contract that is entered into before June 21, 1988, and that is exchanged on or after such date for another contract or that is otherwise treated under the effective date provisions as entered into on or after such date. The committee report would provide that the 7-pay premium for such a contract is to be reduced by the cash surrender value of the contract in the same manner as a contract that is materially changed.

2. Special estimated tax payments

a. Deduction allowed only if tax benefit results.--The provision clarifies that a deduction is allowed for unreversed discount only to the extent that the deduction results in a tax benefit for the taxable year of the deduction or a prior taxable year.

b. Due date of special estimated tax payments.--The provision clarifies that special estimated tax payments are to be made on or before the due date (determined without regard to extensions) for filing the return for the taxable year for which the deduction is allowed.

c. Special loss discount account.--The provision clarifies that any amount added to the special loss discount account must be subtracted from such account and included in gross income no later than the 15th year after the year for which the amount was added to the account.

d. Treasury regulatory authority.--The provision clarifies that the authority granted to the Secretary of the Treasury to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 847 shall include the authority to prescribe rules that apply in cases where the deduction allowed for any year is less than the unreversed discount as of the close of such year.

e. Effective date.--The provision clarifies that the effective date of section 847 is the same as the effective date of section 846 (*i.e.*, section 847 applies to losses incurred in taxable years beginning after December 31, 1986).

H. Pension Provisions

1. Treatment of churches under certain deferred compensation programs

The provision clarifies the exemption from the application of section 457 for church plans. Under the provision, churches would be exempt from the definition of eligible employer.

2. One time election with respect to elective deferrals

The provision clarifies the regulatory authority in the exception to the definition of elective deferrals (sec. 402(g)(3)) to provide that a contribution is not treated as an elective deferral if, under the salary reduction agreement, the contribution is made pursuant to (1) a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the agreement or (2) a similar arrangement involving a one-time irrevocable election specified in regulations.

3. Effective date with respect to deductibility of certain contributions by self-employed individuals

The provision clarifies that the effective date of the 1988 Act rule relating to the deduction rules for self-employed individuals is effective as if included in the Tax Reform Act of 1986, rather than as if included in the Pension Protection Act of 1987.

4. Transfer of interest in individual retirement accounts

The rule relating to transfers of interests in an IRA incident to a divorce is amended to conform to the treatment generally of such transfers under qualified plans pursuant to the Retirement Equity Act of 1984. Present law permits a transfer of an interest in an IRA to be treated as a nontaxable transfer if the transfer is to a former spouse pursuant to a divorce decree. The provision permits a transfer of an interest in an IRA to be treated as a nontaxable transfer if the transfer is to a spouse or former spouse under a decree of divorce or legal separation. This provision is effective for transfers after the date of enactment in taxable years ending after the date of enactment.

5. Deduction for payments relating to standard terminations

The deduction rule relating to employer liability payments treated as contributions to qualified plans is amended to clarify that the rule applies in the case of standard terminations, effective for payments made after January 1, 1986, in taxable years ending after that date.

I. Excise Tax Provision

1. Undenatured distilled spirits

The provision corrects the exemption for educational institutions from the distilled spirits occupational tax to apply to procuring less than 25 gallons of undenatured distilled spirits, instead of specially denatured distilled spirits.

J. Tax-Exempt Bond Provisions

1. Disregard of certain financings in determination of qualification for small-issue exception

The provision amends Code section 148(f)(4)(C)(ii)(II) as enacted by section 6183 of the 1988 Act to clarify that bonds issued by a governmental unit "to make loans to," rather than "on behalf of," other qualifying governmental units do not count in the determination of whether the issuing governmental unit has exceeded $5 million in total annual bond issuance.

2. Application of future legislation to transitioned bonds

The provision clarifies that generally in the case of any bond to which the amendments made by section 1301 of the Tax Reform Act of 1986 do not apply by reason of any provision of the Tax Reform Act of 1986, any amendment of the 1986 Code (and any other provision applicable to such Code) included in any law enacted after the date of enactment of the Tax Reform Act of 1986 shall be treated as included in section 103 and section 103A (as appropriate) of the 1954 Code with respect to such bond. Exceptions are provided (1) if such law expressly provides that such amendment (or other provision) shall not apply to such bond, or (2) if such amendment (or other provision) applies to a provision of the 1986 Code for which there is no corresponding provision in section 103 and 103A (as appropriate) of the 1954 Code and which is not otherwise treated as included in such sections 103 and 103A with respect to such bond.

The provision is effective as if included in the Tax Reform Act of 1986.

K. Research Tax Credit Provision

1. Election of reduced credit

Present law, as amended by the 1988 Act, provides that the section 174 deduction is reduced by 50 percent of the research tax credit determined for the year. Present law permits a taxpayer to avoid a reduction of the section 174 deduction for a taxable year by electing to forgo entirely its section 41 credit for the year. The provision would permit a taxpayer to avoid a reduction of the section 174 deduction by electing to reduce its section 41 credit by the amount of tax saved (assuming the taxpayer is in the highest corporate tax bracket) by not making a reduction of its section 174 deduction. Thus, under the present tax rate schedule, a taxpayer making this election would be entitled to a credit determined at the rate of 16.6 percent and would not be subject to a reduction of the section 174 deduction.

II. AMENDMENTS TO THE REVENUE ACT OF 1987

A. Accounting Provisions

1. Installment sales

Present law provides an interest charge on certain deferred tax liabilities arising from certain installment sales. The provision clarifies that such interest is not to be treated as a payment of regular tax for purposes of determining whether the alternative minimum tax applies. Another provision clarifies that the interest charge described in section 453A(c) (relating to nondealer sales) shall be treated as interest for purposes of computing the deductions allowable to a taxpayer.

2. Required payments for certain entities

Partnerships and S corporations may elect a taxable year other than a required taxable year if certain required payments are made. The amount of the required payments generally are phased-in over a 4-year period. The provision clarifies that the phase-in rule is not to apply for taxable years beginning after 1988 unless more than 50 percent of the net income of the partnership or S corporation for the short taxable year that otherwise would have resulted had the election not been made is allocable to partners or shareholders who would have been eligible to include such income over a 4-year period.

B. Corporate Provision

1. Adjustments to earnings and profits and to basis of stock of a subsidiary

The provision clarifies that the rules requiring certain adjustments to earnings and profits and to the basis of stock of a subsidiary, for purposes of determining gain or loss on disposition of such stock, apply where the corporation disposing of the stock of a former member of an affiliated group is itself a former member of the group. The provision is not intended to apply to the extent such adjustments have already been made with respect to a prior disposition.

III. AMENDMENTS RELATED TO OTHER PENSION PROVISIONS[2]

A. Amendments Related to the Tax Reform Act of 1986

1. Vesting rules

a. Class-year vesting.--The Tax Reform Act of 1986 repealed class-year vesting. The provision includes a special vesting rule for plans that had class-year vesting so that the elimination of class-year vesting does not adversely affect the vesting status of plan participants.

b. Matching contributions.--The provision clarifies that a matching contribution is not treated as forfeitable merely because the contribution is forfeitable if the contribution it matches is an excess contribution, an excess deferral, or an excess aggregate contribution.

2. Reversions

In the case of a jointly administered collectively bargained qualified pension plan and a welfare benefit plan providing retiree health benefits under which the qualified pension plan has assets in excess of liabilities on a termination basis, and under which the welfare benefit plan has assets which are less than the present value of benefits, then, notwithstanding any other provision of law, after termination of the pension plan, the excess assets may be distributed and transferred to the welfare benefit plan for retiree health benefits. Any amount transferred is includible in the employer's income and subject to the 15-percent tax on reversions.

3. Time for plan amendments

The Tax Reform Act of 1986 generally allowed plans that operated in compliance with the employee benefit provisions of the Act to delay the corresponding plan amendments to a specified time. The provision generally provides the same delayed amendment rules with respect to the plan amendments required by the technical corrections title of the 1986 Act, the technical corrections to the 1986 Act, or the provisions under this amendment.

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[2] These provisions are the same as those contained in H.R. 4845 (introduced in the 100th Congress on June 16, 1988, by Chairman Rostenkowski) as reported by the Committee on Ways and Means on July 27, 1988. For a complete discussion of the provisions, see H. Rept. 100-801, Part I.

4. Health care continuation rules

a. Covered employee.--Under the provision, the definition of a covered employee for purposes of the health care continuation rules (Code sec. 4980B) includes any individual who is (or was) provided coverage under a group health plan by virtue of the performance of services by the individual for one or more persons maintaining the plan. Thus, the term covered employee could include an individual by virtue of the individual's performance of services as, for example, an independent contractor for a third party or as a partner for his or her partnership. The provision would apply to plan years beginning after December 31, 1988.

b. Duration of continued coverage.--The provision would delete the provision allowing continuation coverage to be terminated upon the coverage of the qualified beneficiary under the group health plan of an employer other than the employer providing the continuation coverage. The provision would apply to plan years beginning after December 31, 1988.

c. Premiums.--The provision would clarify that a plan may not require the payment of any premium for continuation coverage before the day which is 45 days after the day on which the qualified beneficiary made the initial election for continuation coverage.

d. Multiple events.--Under the provision, if an individual obtains health care continuation rights by virtue of a reduction of hours, and then separates from service within 18 months, his or her health care continuation rights with respect to the separation from service would exist for no more than 18 months (rather than 36 months as under present law) from the date of reduction of hours. The provision is effective for plan years beginning after December 31, 1988.

5. Technical corrections to the Retirement Equity Act of 1984

Under present law, a plan is required to notify participants of their right to decline a qualified preretirement survivor annuity before the applicable election period. Under the provision, the notification period in the case of a participant who separates from service before age 35 would be a reasonable period after separation. The provision would be effective for distributions after the date of enactment. The provision also corrects a date in a previously enacted transition rule relating to the Retirement Equity Act.

6. Miscellaneous

The provision corrects a date in a previously enacted effective date relating to the Multiemployer Pension Plan Amendments Act of 1980.

B. Amendment Related to the Omnibus Budget Reconciliation Act of 1986

Under the provision, normal retirement age is defined to mean the later of (1) age 65, or (2) the 5th anniversary of the time a plan participant commenced participation in the plan.

C. Amendments Related to the Pension Protection Act

1. Modification of minimum funding standard

a. Deficit reduction contribution.--The provision would provide that unfunded new liability is the unfunded current liability of the plan determined without regard to (1) the unamortized portion of the unfunded old liability, (2) the unamortized portion of the unfunded existing benefit increase liability, and (3) the liability with respect to any unpredictable contingent event benefits (without regard to whether or not the event has occurred). The provision would provide that the funding rule for unpredictable contingent event benefits added by the Act applies to such benefits with respect to which the event on which the benefit is contingent occurs in a plan year beginning after December 31, 1988.

b. Current liability.--The amendment would provide that the rule disregarding certain preparticipation service is elective and does not apply with respect to a participant who does not, at the time of becoming a participant, have years of service in excess of the years required for plan eligibility. The provision would provide that assets are to be reduced by any credit balance in the funding standard account for purposes of the funding requirements added by the Act (Code sec. 412(l)), and that, in other places where the term "unfunded current liability" is used, the Secretary of the Treasury may provide for such a reduction.

c. Valuations.--The provision would provide that plan valuations are to be made not less frequently than annually.

d. Steel employee plans.--For purposes of calculating the funded current liability percentage under the Act's funding rule for steel employee plans, the provision would provide that unpredictable contingent event benefit liability, contributions relating to such liability, and income on such contributions are disregarded.

2. Time for contributions

a. Applicable plan.--Under the provision, the installment payment requirement of the Act would apply only to defined benefit plans (other than multiemployer plans) that are subject to the minimum funding requirements.

b. Unpredictable contingent event benefits.--The provision would modify the special installment payment rule with respect to unpredictable contingent event benefits to conform the rule to the funding rule for such benefits.

c. Notification.--The provision would add a sanction for failure to notify plan participants and beneficiaries of the failure to make required contributions, and would clarify that the notice requirement is effective with respect to plan years beginning after December 31, 1987.

d. Interest rate.--The provision would clarify that the interest rate on underpayments of required installments is the greater of (1) 175 percent of the applicable Federal mid-term rate, or (2) the rate of interest used under the plan to determine costs (including any adjustments required for plans subject to the new funding rules under Code sec. 412(l)).

3. Funding waivers

a. Interest rate.--The provision would provide that, for purposes of determining the interest rate on waived contributions, adjustments required for plans subject to the funding rules added by the Act are taken into account in calculating the plan's interest rate.

b. Frequency of waivers.--Under the provision, the reduction in the number of waivers than can be granted within a 15-year period is effective with respect to waivers for plan years beginning after December 31, 1987.

4. Limitations on interest rate

To reflect the legislative history, the provision would provide that certain special interest rate rules apply for purposes of determining current liability and for purposes of determining a plan's required contribution under the funding rules applicable to plan with assets less than current liability. The bill would also conform the special rules in ERISA to the Code rules.

5. Effective dates of changes relating to amortization periods

The provision would provide that the change in the amortization period for experience gains and losses applies to gains and losses established in years beginning after December 31, 1987, and would also provide a special transition rule for any experience gain or loss determined by a valuation occurring as of January 1, 1988.

6. Employer access to plan assets; limitations on employer reversions upon plan termination

The Act provides that a plan amendment or provision providing for or increasing a reversion to the employer is not effective before the end of the fifth calendar year following the date the provision or amendment is adopted. The provision clarifies the effective date of the 5-year rule, clarifies a transition rule under the 5-year rule, and clarifies that other changes in the Act relating to distribution of assets also apply to standard terminations.

7. Elimination of section 4049 trust

Under the act, the employer's entire liability following plan termination is to be paid to the PBGC, which then pays benefits to plan participants and beneficiaries. The amount of nonguaranteed benefits to be paid depends on the applicable recovery ratio. The provision clarifies terminations that are taken into account in determining the recovery ratio for small plans, and provides that the transition rule for small plans is not limited to situations where the recovery ratio is finally determined as of December 17, 1990. The provision also clarifies that the Act's provisions relating to the elimination of the section 4049 trust apply to all termination where notice of intent to terminate is provided after December 31, 1987, and makes additional conforming changes to reflect the elimination of the section 4049 trust.

8. Standards for termination

The provision provides that, in a distress termination, the distress criteria must be satisfied as of the proposed date of plan termination, and clarifies that the plan asset and benefit information required to be provided to the PBGC is to be provided as of the proposed termination date and, if applicable, the proposed distribution date.

9. PBGC premiums

Under the provision, no additional PBGC premium is required with respect to a year if deductible contributions to a plan could not be made the prior year due to the full funding limitation.

10. Miscellaneous

a. Security rules for underfunded plans.--Under the Act, a sponsor of a defined benefit plan is required to provide security to the plan if a plan amendment is adopted and the plan's funded current liability percentage is less than a certain amount. The provision (1) clarifies that, in determining the amount of security that must be provided, the increase in current liability attributable to the plan amendment and all plan amendments after December 22, 1987, are taken into account, (2) provides that the security rules do not apply to plans that are not subject to the minimum funding requirements, (3) conforms the provisions of ERISA to the provisions of the Code, (4) provides that a contributing sponsor that is required to provide security is to notify the PBGC of the plan amendment, (5) with respect to the special effective date for collectively bargained plans, provides that extensions, amendments, or modifications of the bargaining agreement on or after December 22, 1987, are disregarded, and (6) clarifies the penalty for failure to notify the PBGC of the failure to make required contributions.

b. Reporting requirements.--The provision conforms the statute to legislative history by providing that the annual report must contain additional information regarding the funded status of the plan if the value of plan assets is less than 70 percent of current liability. In such cases, the annual report is also to include the percent which the value of plan assets is of current liability. The provision authorizes the Secretary of Labor to bring a civil action to collect the penalty for failure to file an annual report, and clarifies that the plan administrator is liable for the penalty.

c. Coordination of provisions of the Code with provisions of ERISA.--The provision deletes section 403(c)(3) of ERISA.

d. Plan investment in employer securities.--The provision clarifies that the definition of qualifying employer security added by the Act applies only to plans that are not individual account plans.

e. Interest rate on accumulated contributions.--Under the provision, the rules on attributing income to employee contributions under a defined benefit plan would be modified as follows: (1) employee contributions plus income would not be limited by the employee's accrued benefit under the plan's benefit formula; and (2) the conversion of the employee's contributions plus income to an annuity would be performed under the plan's interest rate. A transition rule would apply so that a plan amendment to conform to this rule would not be a cutback in an employee's accrued benefit.

IV. MISCELLANEOUS TECHNICAL AMENDMENT

Foreign tax credit with respect to lump sum distributions.--The provision clarifies that foreign income tax paid with respect to a lump sum distribution from a qualified pension plan is creditable against the separate U.S. tax imposed on such a distribution using 5 year averaging, and provides that the credit with respect to such a distribution is subject to a separate foreign tax credit limitation. The provision is effective for all open taxable years.