[JOINT COMMITTEE PRINT]

DESCRIPTION OF H.R. 2797: TECHNICAL CORRECTIONS ACT OF 1979

AS PASSED THE HOUSE

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE
U.S. SENATE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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I. INTRODUCTION

This pamphlet describes the technical revisions to the Revenue Act of 1978 (Public Law 95–600), the Foreign Earned Income Act of 1978 (Public Law 95–615), the Black Lung Benefits Revenue Act of 1977 (Public Law 95–488), and the Energy Tax Act of 1978 (Public Law 95–618) contained in the Technical Corrections Act of 1979 as it passed the House of Representatives (H.R. 2797).

The technical amendments made by the Technical Corrections Act of 1979 are intended to clarify and conform various provisions adopted by the acts listed above. The bill is based on a review by the staff of the Joint Committee on Taxation, taking into account the comments submitted to the Congress (in written statements and in public hearing testimony before the House Committee on Ways and Means) that concerned changes that were technical in nature. The bill was developed with the assistance of the staffs of the Treasury Department and the Internal Revenue Service.

Section II of this pamphlet is organized in three parts: Part A summarizes the technical amendments to the Revenue Act of 1978; Part B summarizes the technical amendments to the Foreign Earned Income Act of 1978; and Part C summarizes the technical amendments to the Energy Tax Act of 1978. Amendments in the bill that relate to these Acts for which no descriptions are provided are clerical in nature. All of the amendments in the bill to the Black Lung Benefits Act of 1977 are clerical in nature and, consequently, no descriptions of these amendments are provided in this pamphlet. Section III discusses the overall revenue effect of the bill.

Several of the provisions contained in the Technical Corrections Act as it passed the House of Representatives affect the 1979 tax forms. Printing of the 1979 tax forms was scheduled prior to the consideration of the bill by the Finance Committee. In order to permit the printing of correct forms, on October 2, 1979, the Finance Committee agreed to several provisions in the House-passed bill that affect 1979 tax forms. The provisions of the House-passed bill that were adopted by the Finance Committee that are described in this pamphlet are numbers 34, 53, 54, 55, and 57 of the Technical Amendments to the Revenue Act of 1978, No. 1 of the Technical Amendments relating to the Foreign Earned Income Act of 1978, and No. 1 of the Technical Amendments relating to the Energy Tax Act of 1978.

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II. DESCRIPTION OF THE BILL

A. TECHNICAL AMENDMENTS TO THE REVENUE ACT OF 1978

1. Coordination of amendments made by the Revenue Act of 1978 and the Energy Tax Act of 1978 (sec. 2 of the bill and secs. 46 and 48 of the Code)

Prior to the Revenue Act of 1978, the present investment tax credit rate of 10 percent was scheduled to decline to 7 percent (4 percent for utility property) on January 1, 1981. Under the Revenue Act of 1978, the 10-percent rate of the credit was made permanent for all taxpayers.

The provisions of the Code (sec. 46(a)(2)) which pertain to the rate of the credit also were amended and restated by the Energy Tax Act of 1978. Although the energy tax amendments were passed by the Congress before the amendments made by the Revenue Act of 1978, these two bills were signed into law by the President in reverse of the order these bills were passed by Congress.[1]

The order of enactment technically may have caused the 10-percent credit to again be temporary.

The bill would direct that, for purposes of applying the amendments made to the investment credit rate provisions by these two laws, the Energy Tax Act of 1978 will be deemed to have been enacted first. As a result, the 10-percent credit rate would be permanent as was intended by the Revenue Act of 1978.

2. Eligibility for earned income credit for persons claiming section 913 deductions (sec. 101(a)(1) of the bill and sec. 43(c)(1) of the Code)

Under present law, the earned income credit is not available to taxpayers who are entitled to exclude amounts from income under section 911 for the taxable year. This provision affects only those taxpayers who lived abroad during part of the year since the earned income credit generally is not available to those taxpayers whose principal place of abode for the taxable year is outside the United States. The Foreign Earned Income Act of 1978 established a new set of deductions under section 913 which are available generally to those taxpayers who formerly were entitled to the section 911 exclusion.

The bill would deny the earned income credit to taxpayers who claim deductions under section 913, as well as those who claim the benefits of section 911. Thus, the credit would continue to be unavailable to the same type of taxpayers who formerly were denied the credit because they qualified for section 911 exclusion. This provision would be effective for taxable years beginning after December 31, 1977.

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[1] The Revenue Act of 1978 (P.L. 95–600) was signed into law first, on November 6, 1978, and the Energy Tax Act of 1978 (P.L. 95–618) then was signed into law on November 9, 1978.

3. Treatment of earned income credit as earned income under AFDC and SSI (secs. 101(a)(2)(A) and (B) of the bill and secs. 402 and 1612 of the Social Security Act)

Prior to the Revenue Act of 1978, the earned income credit was not taken into account as income for purposes of determining eligibility for, or the amount of, benefits or assistance under any Federal program or State or local program financed in whole or in part with Federal funds. The Act repealed this provision, effective in 1980. However, conforming changes were not made to the Social Security Act.

The bill would amend the Social Security Act to provide that the earned income credit will be treated as earned income for purposes of the aid to families with dependent children (AFDC) and supplemental security income (SSI) programs, effective for payments for months beginning after December 31, 1979. This treatment would apply to any refund of Federal taxes made by reason of the earned income credit and to any advance payments made by an employer.

4. Correction of effective date for advance payment of earned income credit (sec. 101(a)(2)(C) of the bill and sec. 105(g)(2) of the Act)

The Revenue Act of 1978 contained a new provision for advance payments of the earned income credit. The effective date of the provision as written in the Act was for wages paid after June 30, 1978.

The bill would correct a typographical error in the Act to provide that the provision is effective with respect to wages paid after June 30, 1979.

5. Relationship of section 85 of the Code to railroad unemployment compensation (sec. 101(a)(3) of the bill and sec. 128(a)(8) of the Code)

Prior to the Revenue Act of 1978, unemployment compensation was not included in gross income. The Act makes all types of unemployment compensation paid under government programs includible in gross income for taxpayers with incomes above specified amounts.

The bill would modify an existing cross reference in the Code to make it clear that railroad unemployment compensation benefits may be included in gross income for certain taxpayers.

6. Extension of deferred compensation rules to certain rural electric cooperatives and their trade organizations (sec. 101(a)(4) of the bill and sec. 457(d)(9) of the Code)

The Revenue Act of 1978 provided that employees and independent contractors who provide services for a State or local government, a rural electric cooperative (described in Code sec. 501(c)(12)), or an association of such cooperatives that maintains an eligible deferred compensation plan will be able to defer the inclusion in income of compensation as long as such deferral does not exceed certain prescribed annual limitations.

The Act provision did not apply to certain rural electric cooperatives in the Tennessee Valley Authority ("TVA") area which are exempt from taxation under section 501(c)(4) (but which, generally because of TVA requirements, cannot meet all the requirements for exemption under Code sec. 501(c)(12)). In addition, the provision did not apply to certain national and State associations of rural electric

cooperatives because some of their members are not domestic rural electric cooperatives and because some of the organizations are exempt from taxation as social welfare organizations (described in sec. 501(c)(4)) rather than as trade associations (described in sec. 501(c)(6)).

The bill would provide that the types of organizations eligible for these exclusion rules include (1) any organization which is exempt from tax under section 501(a)(4) and which is engaged primarily in providing electric service on a mutual or cooperative basis and (2) any organization described in section 501(c) (4) or (6) which is exempt from tax under section 501(a) and at least 80 percent of the members of which are rural electric cooperatives which are eligible for these rules.

7. Nondiscriminatory participation requirements for cafeteria plans (sec. 101(a)(5)(A) of the bill and sec. 125(g)(3)(B) of the Code)

Prior to the Revenue Act of 1978, a participant in a cafeteria plan was taxable only to the extent he or she elected taxable benefits under the plan if the plan was in existence on June 27, 1974. The Act made this favorable tax treatment applicable to all cafeteria plans meeting certain nondiscrimination standards, including a standard regarding the maximum number of years of employment which may be required as a condition of plan participation.

The bill would make it clear that the participation standard is based on time of employment rather than time of service.

8. Effective date of cafeteria plan provisions (sec. 101(a)(5)(B) of the bill and sec. 134(c) of the Act)

A provision in the cafeteria plan rules of the Revenue Act of 1978 specifies that amounts required to be included in income by a highly-compensated participant because a cafeteria plan does not satisfy nondiscrimination standards will be treated as received or accrued in the participant's taxable year in which the plan year ends. Because the cafeteria plan rules apply to participants' taxable years beginning after 1978, amounts contributed during 1978 under a fiscal-year cafeteria plan which does not satisfy the new nondiscrimination rules might have to be included in income in 1979 by highly-compensated participants. Thus, in certain cases, the cafeteria plan rules apply retroactively to contributions made in 1978.

The bill would make the cafeteria plan provisions of the Act effective for plan years, rather than for participants' taxable years, beginning after 1978. Thus, highly-compensated participants in fiscal-year plans would not have income solely because of the new cafeteria plan rules until 1980. In addition, to comply with the cafeteria plan rules, plans would not have to be amended until the beginning of the first plan year after 1978.

9. Normalization of the investment credit for contributions to an ESOP (sec. 101(a)(6)(A) of the bill and sec. 46(f)(9) of the Code)

Prior to the Revenue Act of 1978, the Code allowed an additional investment credit of up to one and one-half percent to an employer which made contributions to an ESOP (employee stock ownership

plan). However, this credit was not available to public utilities if the agencies which regulated them did not comply with normalization rules concerning this credit.

The Act extended the additional investment credit for ESOPs for an additional three years through the end of 1983 and revised the ESOP provisions. However, cross references to the normalization provisions applicable to the ESOP credit were not changed to reflect the revisions made by the Act.

The bill would correct these cross references to clarify that the anti-flow-through rules continue to apply to investment credits attributable to an ESOP.

10. Effective dates for ESOPs and leveraged employee stock ownership plans (sec. 101(a)(6)(B) of the bill and sec. 141(g) of the Act)

The Revenue Act of 1978 made certain changes to the rules governing ESOPs and leveraged employee stock ownership plans. The Act provided that these changes generally were effective with respect to qualified investment for taxable years beginning after December 31, 1978. The application of this general effective date was unclear with respect to several of the changes relating to ESOPs and with respect to the changes relating to leveraged employee stock ownership plans.

The bill would make clear the operation of the effective date provision for certain ESOP changes. The general effective date would be retained. Thus, the ESOP changes in the Act generally would apply with respect to qualified investment for taxable years beginning after December 31, 1978. In addition, special effective date provisions would apply to the ESOP provisions of the Act relating to (1) voting rights, (2) the right of an ESOP to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities), and (3) put option requirements.

The voting rights provision would apply to plans to which the new ESOP provisions generally apply beginning with the first day of such application. An ESOP would be required to follow the new voting pass-through rules with respect to all employer securities held by it if additional employer securities were acquired by the ESOP on account of qualified investment made in a taxable year beginning after December 31, 1978.

The rules relating to the right of an ESOP to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities) would apply to ESOP distributions after December 31, 1978, provided that the new ESOP rules generally have become applicable to the ESOP on account of qualified investment made after that date.

The ESOP put option requirements would apply to employer securities which are not readily tradable on an established market and which are acquired by an ESOP after December 31, 1978, on account of a qualified investment made after that date. In addition, the employer would be permitted to elect to have the new put option rules in the Act apply to all employer securities held by an ESOP which are not readily tradable on an established market. Under the bill, this election could be revoked only with the consent of the Secretary of the Treasury.

The bill also would allow taxpayers to elect irrevocably to accelerate the general effective date by a year. In such a case, the ESOP changes would apply with respect to qualified investment for taxable years beginning after December 31, 1977.

The bill also would provide effective dates for the changes made by the Act relating to leveraged employee stock ownership plans. These changes concern (1) voting rights, (2) put option requirements, and (3) the right of a leveraged employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a disrtibution in the form of employer securities).

Under the bill, in the case of employer securities acquired by a leveraged employee stock ownership plan after December 31, 1979, the plan would be required (1) to pass through voting rights to plan participants on such securities, under certain circumstances, and (2) to give employees put options on employer securities which are not readily tradable on an establish market.

The right of a leveraged employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities) would apply to distributions after December 31, 1979.

11. Definition of qualifying employer security for leveraged employee stock ownership plans (sec. 101(a)(6)(C) of the bill and sec. 4975(e)(8) of the Code)

The Revenue Act of 1978 made leveraged employee stock ownership plans subject to certain special rules with respect to employer securities held by the plans. However, under the Act, the definition of employer securities for this purpose was not made clear.

The bill would make it clear that, for purposes of the rule governing a leveraged employee stock ownership plan, the term employer securities is defined in the same manner as in the case of an ESOP. This definition generally includes readily tradable common stock of the employer and preferred stock convertible into such readily tradable common stock. This amendment would be effective for stock acquired after December 31, 1979.

12. Nonrecognition of gain on contribution to ESOP (sec. 101(a)(6)(D) of the bill and sec. 409A(m) of the Code)

Prior to the Revenue Act of 1978, it was unclear whether gain would be recognized by a corporation making a contribution to an ESOP of an employer security issued by a related corporation. The Act provided that no gain would be recognized in such circumstances. However, for technical reasons, the rule in the Act did not apply to all required contributions of employer securities to an ESOP.

The bill would correct this technical deficiency to provide that no gain or loss is recognized to an employer on the required transfer of employer securities to an ESOP which it maintains.

13. Leveraged employee stock ownership plans may distribute cash in certain cases (sec. 101(a)(6)(E) of the bill and sec. 409A(h)(2) of the Code)

Under the Revenue Act of 1978, leveraged employee stock ownership plans are required to meet certain rules also applicable to ESOPs.

However, the statute is not clear whether, under these rules, a leveraged employee stock ownership plan which meets these rules may distribute cash in lieu of employer securities to a participant entitled to a distribution from the plan.

The bill would make it clear that, like an ESOP, a leveraged employee stock ownership plan may (subject to an employee's right to require a distribution in the form of employer securities) distribute cash in lieu of employer securities to an employee entitled to a distribution from the plan.

14. Matched employer and employee contributions must stay in plan (sec. 101(a)(6)(F) of the bill and sec. 409A(d) of the Code)

Prior to the Revenue Act of 1978, matched employer and employee contributions to an ESOP generally were required to remain in the plan for an 84-month period. However, it was unclear whether the same rule continued under the Act.

The bill would make it clear that the rule requiring matched employer and employee contributions to an ESOP to remain in the plan for an 84-month period generally is still applicable.

15. Coordination of deduction for estate tax attributable to income in respect of a decedent and income tax on lump sum distributions from retirement plans (sec. 101(a)(7) of the Act and sec. 691(c)(5) of the Code)

Under present law, lump sum distributions from qualified pension, profit-sharing, and stock bonus plans are eligible for special income tax treatment rather than being taxed at the taxpayer's regular tax rates for the year the distribution is received. With respect to the portion of the distribution attributable to an employee's participation in the plan after December 31, 1973, a special 10-year forward averaging formula is provided. With respect to the portion of the distribution attributable to the employee's participation before January 1, 1974, capital gain treatment is generally allowable.

When a beneficiary receiving a lump sum distribution on account of the death of an employee elects to be taxed under the 10-year averaging rules, the distribution is includible in the deceased employee's gross estate and the amount of the distribution is subject to an estate tax. The recipient of the distribution is allowed a separate income tax deduction for the death taxes attributable to that distribution (Code sec. 691(c)).

The Revenue Act of 1978 added a provision which coordinated this deduction for estate taxes with the capital gains deduction so that the amount of any capital gain which is income in respect of a decedent is offset by the deduction for estate taxes before the capital gains deduction is computed. However, the Act failed to take into account that the recipient of a death benefit distribution from a qualified retirement plan may be able to treat the distribution (or a portion thereof) under the special 10-year averaging provisions. The Act, therefore, did not provide a rule which coordinates the use of the special 10-year averaging method with the deduction for estate taxes.

The bill would provide that the amount of a death benefit distribution subject to 10-year averaging is reduced by the amount of the

death tax deduction attributable to the distribution. This would have the effect of reducing the amount of the distribution eligible for the special 10-year averaging formula by the death tax adjustment. The amendment would be effective for estates of decedents dying after the date of enactment of the bill.

16. Exclusion of certain employees from participation in simplified employee pensions (sec. 101(a)(9)(A) of the bill and sec. 408(k)(2) of the Code)

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Employer contributions to simplified employee pensions must not discriminate in favor of employees who are officers, shareholders, or highly compensated. In testing employer contributions for discrimination, certain employees who are included in a collective bargaining unit or who are nonresident aliens may be excluded from consideration. However, the simplified employee pension rules may have required employers to include these employees in the group of employees who are entitled to share in employer contributions to simplified employee pensions.

The bill would permit certain employees who are included in a collective bargaining unit or who are nonresident aliens to be excluded from the group of employees who are entitled to share in employer contributions to simplified employee pensions.

17. Exemption from FICA and FUTA taxes for employer contributions to simplified employee pensions (sec. 101(a)(9)(B) of the bill and secs. 3121(a)(5) and 3306(b)(5) of the Code)

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under present law, employer contributions to the IRA (individual retirement account, annuity, or retirement bond) of an employee are considered remuneration subject to FICA and FUTA taxes, but employer contributions with respect to an employee to a tax-qualified plan are not subject to these taxes. The Act did not specify whether employer contributions to a simplified employee pension were subject to FICA or FUTA taxes.

Under the bill, an amount paid by an employer to an employee's individual retirement account or annuity would not be subject to FICA or FUTA taxes if the account or annuity is a simplified employee pension and there is reason to believe that the employee will be entitled to deduct the payments under the IRA rules applicable to simplified employee pensions. This amendment would be effective for payments made on or after January 1, 1979.

18. Clarification of rules relating to excess contributions to simplified employee pensions (sec. 101(a)(9)(C) of the bill and sec. 408(d)(5)(A) of the Code)

The rules relating to individual retirement accounts and annuities permit the withdrawal of an excess contribution (other than a rollover contribution) without the usual 10 percent additional income tax on early distributions to the extent no deduction was allowed for the contribution. The early distribution tax may apply, however, if the amount contributed for the year exceeds $1,750. No dollar limitation applies to an excess rollover contribution if the excess is attrib-

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utable to certain erroneous information provided by the employer. Consequently, if an excess contribution is made by an employer to an individual retirement account or annuity of an employee under the simplified employee pension rules and the amount of the contribution is greater than $1,750, the 10 percent additional tax could apply.

The bill would permit an individual to withdraw excess employer contributions to a simplified employee pension free of the 10 percent additional tax, without regard to the $1,750 limitation.

19. Contributions to simplified employee pensions after age 70½ (sec. 101(a)(9)(D) of the bill and sec. 219(b)(7) of the Code)

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under the rules for simplified employee pensions, an employer may be obligated to contribute to the individual retirement account or annuity of an employee who has attained age 70½. In the event of such a contribution, under the usual rules for individual retirement accounts and annuities, such a contribution is includible in the gross income of the employee but the contribution is not deductible by the employee and is considered an excess IRA contribution.

The bill would allow an employee who has attained age 70½ to deduct employer contributions to the employee's individual retirement account or annuity if the account or annuity is a simplified employee pension.

20. Coordination of H.R. 10 plans and subchapter S corporation plans with simplified employee pensions (secs. 101(a)(9)(E) and (F) of the bill and secs. 404(h)(4) and 408(k) of the Code)

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under the Act, if an employer maintains a defined contribution H.R. 10 plan for a self-employed individual and contributes to a simplified employee pension for that individual, the limitation on the employer's deduction for the contribution to the H.R. 10 plan is reduced by the deduction allowed for the contribution to the simplified employee pension so that the limitation on the total amount set aside for that individual is not increased. The Act, however, did not provide corresponding rules with respect to defined benefit plans for self-employed individuals or with respect to plans for certain shareholder-employees of subchapter S corporations.

Under the bill, the limitation on deductions for contributions to a defined contribution plan by a subchapter S corporation on behalf of a shareholder-employee would be reduced by the amount deducted by the employer for contributions to the simplified employee pension of that employee. Also, the bill would not allow an employer who maintains a defined benefit plan for self-employed individuals or shareholder-employees to contribute to simplified employee pensions.

21. Special limits on benefits under certain defined benefit pension plans (sec. 101(a)(10)(A) of the bill and sec. 415(b)(7) of the Code)

Under the Code, limits are provided for benefits and contributions under tax-qualified plans, individual retirement plans, and tax-sheltered annuities. Generally, under those rules, benefits under a de-

fined benefit pension plan may not exceed 100 percent of a participant's average high 3-year compensation. An exception to the 100-percent limit was provided by the Revenue Act of 1978 for participants in certain collectively bargained plans, but the exception was not designed for situations in which an employee participates in more than one plan maintained by a single employer.

Under the bill, the exception to the 100-percent limit would be restricted to an employee who is a participant in a collectively bargained plan where the employee does not participate in any other plan (subject to the limits on benefits or contributions) maintained by an employer who maintains the collectively bargained plan.

22. Limitations for certain collectively bargained pension plans (sec. 101(a)(10)(B) of the bill and sec. 415(b)(7)(C) of the Code)

Prior to the Revenue Act of 1978, benefits under a qualified defined benefit pension plan generally were limited to the lesser of 100 percent of pay or $75,000 per year, adjusted for inflation since 1974 ($98,100 for 1979). The Act provides that the 100-percent-of-pay limit is disregarded in the case of certain large collectively bargained plans under which each employee who serves during a particular year earns the same pension credit (determined without regard to age at retirement or date of retirement).

The bill would make clear that the exception to the 100-percent-of-pay limit applies in the case of certain large collectively bargained plans where the amount of the pension credit for a particular employee is based solely on one or more of the following factors: (1) the length of service, (2) the particular years during which service was rendered, (3) the age at retirement, and the date of retirement.

23. Effective date of section 403(b) annuity rollovers and transitional rule for payments received in 1978 (secs. 101(a)(12)(A) and (B) of the bill and sec. 156(d) of the Act)

Prior to the Revenue Act of 1978, recipients of distributions under a tax-sheltered annuity purchased by an employer which is a tax-exempt organization or a public school were not eligible to defer tax on those distributions by rolling them over to an IRA (individual retirement account, annuity, or retirement bond). The Act permitted a recipient of a "lump sum distribution" from a tax-sheltered annuity to defer tax on the distribution by rolling it over within 60 days of receipt to an IRA or to another tax-sheltered annuity. Due to a clerical error, the rollover provision, as enacted, applied to distributions or transfers made after December 31, 1978, in taxable years beginning after that date.

The bill would make the tax-sheltered annuity rollover provisions effective for distributions or transfers made after December 31, 1977, in taxable years beginning after that date. In addition, the bill would provide that the recipient of a qualifying distribution in 1978 will have until December 31, 1980, to complete a rollover to either an IRA or another tax-sheltered annuity. Upon completion of the rollover, the recipient of a qualifying distribution in 1978 will be able to amend his or her 1978 income tax return to take into account the portion of the distribution originally included in income which is no longer subject to tax because of the rollover.

24. Spousal rollovers (sec. 101(a)(13)(C) of the bill and sec. 402 (a)(7)(A) of the Code)

Under the Revenue Act of 1978, a surviving spouse receiving a lump sum death benefit distribution from a tax-qualified retirement plan was, for the first time, permitted to make a rollover of the distribution to an IRA. As enacted, however, rollovers were not permitted for complete distributions to surviving spouses upon termination of tax-qualified retirement plans.

The bill would make it clear that any lump sum distribution from, or complete distribution upon termination of, a qualified retirement plan which is paid to the surviving spouse of a deceased plan participant, and which is attributable to the participant, is eligible for rollover treatment.

25. Extension of transitional rule relating to removal of five-year requirement for a rollover (sec. 101(a)(13)(D) of the bill and sec. 157(h)(3)(B) of the Act)

Prior to the Revenue Act of 1978, an individual was required to be a participant in a tax-qualified retirement plan for five full taxable years in order to qualify for a rollover to an IRA (or to another tax-qualified retirement plan) of a lump sum distribution from the plan. The Act eliminated this five-year requirement for taxable years beginning after December 31, 1977, and permitted individuals denied the opportunity for a rollover during 1978, because of the five-year requirement, to complete their rollovers at any time before January 1, 1979.

The bill would permit individuals denied rollover treatment of distributions from tax-qualified retirement plans during 1978 solely because of the five-year plan participation requirement to make such rollovers until the end of 1980.

26. Correction of attribution rules for at risk limitations (sec. 102(a)(1)(A) of the bill and sec. 465(a) of the Code)

Prior to the Revenue Act of 1978, the only types of corporations to which the at risk rules (Code sec. 465) applied were subchapter S corporations and personal holding companies. The Act extended the application of the at risk rules to certain closely held corporations (even though they would not qualify as personal holding companies and had not made subchapter S elections). The closely held corporations to which these rules were extended included any corporation in which five or fewer individuals owned 50 percent or more of the stock. However, in determining whether this ownership test was met, the attribution rules under section 318 of the Code, rather than under section 544 of the Code, were to be applied.

In general, the attribution rules of section 318 are much narrower than those of section 544, which, *inter alia*, provide for attribution of one partner's stock to another partner in the same partnership and for broader family and corporate attribution. Under section 544, stock in one corporation (the "subsidiary") owned by another corporation (the "parent") is attributed to the parent's shareholders in proportion to the shareholders' ownership in the parent. However, under section 318, the stock of a subsidiary corporation is considered as owned by a shareholder of the parent corporation only if the shareholder owns 50 percent or more in value of the stock of the parent corporation.

Also, under section 544, an individual is considered as owning stock owned directly or indirectly by his brothers and sisters, spouse, ancestors, and lineal decendants; however, under section 318, an individual is treated as owning only the stock owned directly or indirectly by his spouse, children, grandchildren, and parents.

The Act adopted the attribution rules of section 318 primarily because it was thought inappropriate to attribute one partner's stock in a corporation to another partner in the same partnership. However, in adopting the attribution rules of section 318, the Act inadvertently permitted exemption from the at risk rules where the stock ownership of the corporation warranted application of the at risk rules (e.g., where the corporation was a personal holding company but did not meet the section 318 attribution rules).

The bill would provide generally that, in determining whether five or fewer individuals own 50 percent or more of stock of a corporation under the at risk rules, the rules of section 544 which relate to attribution of stock ownership are to be applied. However, those rules of section 544 relating to attribution of stock ownership from one partner to another would not be applied.

27. Clarification of recapture rules of at risk provision (sec. 102 (a)(1)(B) of the bill and sec. 465(d) of the Code)

Under a literal interpretation of the law prior to the Revenue Act of 1978, the at risk rules may have only required the taxpayer to be at risk at the end of the taxable year for which losses are claimed. Thus, arguably, subsequent withdrawals of amounts originally placed at risk may have been made without the recapture of previously allowed losses. The Act added provisions which require the recapture of previously allowed losses when, and to the extent, the amount at risk is reduced below zero. However, the Act provides that this income is treated as income from the activity to which the at risk rule applies and thus can be used to shelter additional losses from the activity if the losses are incurred in the year in which the recapture occurs (or are suspended losses which are treated as having been incurred in such year).

In other words, because recapture income under the recapture of loss rules is considered income from the activity, any losses from the activity for the year of recapture (including losses carried over from previous years) can be offset against the recapture income without taking into account the amount of the at risk basis. Thus, notwithstanding a negative at risk basis, losses during the year of recapture, to the extent of the amount of recapture income, can be deducted. Moreover, the at risk basis is left at a negative amount, instead of being brought back up to zero by the amount of recapture income (the recapture income, instead, having been applied against the loss).

The bill would provide that such recapture income is not to be treated as income from the activity for purposes of determining whether current losses (or suspended losses) are allowable.

28. Clarification of limitation on recapture of losses under at risk provisions (sec. 102(a)(1)(C) of the bill and sec. 465(e)(2)(A) of the Code)

The Revenue Act of 1978 modified the at risk rules to provide for a recapture of losses where the amount at risk is less than zero. These re-

capture of loss rules were intended to apply only to losses relating to taxable years beginning after December 31, 1978. Because of a possible ambiguity in the provision governing the adjustments which reduce the at risk basis in an activity (Code sec. 465(b)(5)), it is unclear whether the adjustment for losses relating to a taxable year would be made as of the last day of such taxable year or as of the first day of the following taxable year. Consequently, it is unclear whether a loss relating to a taxable year beginning before December 31, 1978, but possibly reflected in an at risk basis adjustment as of the first day of a taxable year beginning after December 31, 1978, would be subject to the recapture of loss rules.

The bill would clarify the application of the recapture of loss provision (Code sec. 465(e)(2)) to indicate that it applies only to losses for taxable years beginning after December 31, 1978, and not to at risk basis adjustments possibly made after that date which relate to losses for taxable years beginning before December 31, 1978.

29. Waiver of controlled group rule where there is substantial leasing activity (sec. 102(a)(1)(D) of the bill and sec. 465(c) of the Code)

The Tax Reform Act of 1976 limited the amount of deductions in excess of income from certain types of activities to the amount the taxpayer has at risk. This specific at risk limitation (Code sec. 465) applied only to individuals, subchapter S corporations, and personal holding companies.

The Revenue Act of 1978 broadened the at risk rules to all types of activities except real estate. In addition, the Act applied the at risk limitation to closely held corporations. The Act contains an exception to the at risk limitation for closely held corporations actively engaged in equipment leasing operations. For a corporation to qualify for this exception, at least 50 percent of its gross receipts must be derived from equipment leasing. In order to prevent abuse, the Act provided that the 50-percent test is to be applied by looking at the gross receipts of all the members of a controlled group of corporations.

Despite the exception for equipment leasing, the Act applied the at risk limitations to a number of substantial active equipment leasing operations. This has occurred because the gross receipts from equipment leasing of some members of a controlled group of corporations, while substantial in an absolute sense, constitute less than 50 percent of the total gross receipts of all the members of the controlled group. In many of these situations, some of the corporations in the group have significant active leasing activities (as measured by employees, receipts, and number of transactions).

The bill would exempt certain active equipment leasing activities carried on by members of a closely held controlled group of corporations, if the following standards are met for the current taxable year and each of the two preceding taxable years:

(*1*) *Employees:* The group had at least three full time employees during the entire year who devoted substantially all of their services for equipment leasing activities only to group members that derived at least 80 percent of their gross receipts from leasing and selling equipment.

(2) *Number of transactions:* The group members that derived at least 80 percent of their gross receipts from leasing and selling equipment had, in the aggregate, entered into at least five separate equipment leasing or sales transactions.

(3) *Gross receipts:* The group members that derived at least 80 percent of their gross receipts from leasing and selling equipment had, in the aggregate, at least $1,000,000 of gross receipts from leasing and selling equipment.

If all these standards are met, the "controlled group" rule would not be applicable. Instead, the active business test (based on gross receipts) currently in the statute would be applied to the members on a corporation-by-corporation basis, and the 50-percent gross receipts requirement would be increased to 80 percent for each member.

30. Clarification of normalization provisions for purposes of investment tax credit (sec. 103(a)(1)(A) of the bill and sec. 312(c)(2) of the Act)

The Revenue Act of 1971 added rules to provide for the normalization of the investment tax credit for public utility property which qualified for the investment credit after the credit was restored in 1971. The Revenue Act of 1978 repealed the rules relating to the restoration of the credit in 1971 as "deadwood." As a result, it is not clear whether the normalization rules apply to public utility property placed in service before 1971.

The bill would clarify the application of the normalization rules to public utility property so that the normalization provisions would apply to public utility property only for the period to which the restored investment credit applies.

31. Coordination of investment credit rules for pollution control equipment (sec. 103(a)(2) of the bill and sec. 46(c)(5)(B) of the Code)

The Energy Tax Act of 1978 provides a 10-percent investment credit for investments in certain energy property acquired after September 30, 1978 and before January 1, 1983. This credit is in addition to the 10-percent regular investment credit for which energy property also may qualify. Qualifying energy property includes pollution control equipment which is required to be installed in connection with certain other energy property. However, where energy property, including pollution control equipment, is financed in whole or in part by tax-exempt industrial development bonds, a reduced credit of 5-percent is allowed on qualified investment.

The Revenue Act of 1978 revised the rules concerning investment credits for pollution control facilities where the taxpayer elects to amortize the cost of pollution control facilities over 5 years. Under these rules, where 5-year amortization is elected for pollution control facilities which also are financed with tax-exempt industrial development bonds, the taxpayer's qualified investment for purposes of investment credits is one-half of the investment which is subject to the 5-year amortization election.

Where pollution control equipment which is energy property is subject both to the generally applicable rule which limits qualified investment and to the reduction in the energy credit percentage, the effective rate of the energy credit will be only 2.5 percent.

The bill would correct this unintended result of the changes made by the two 1978 tax acts so that pollution control equipment in this situation will be allowed an energy investment credit of 5 percent.

32. Treatment of noncorporate lessors for purposes of the investment credit for rehabilitation expenditures (sec. 103(a)(3)(A) of the bill and sec. 46(e)(3) of the Code)

Under the investment credit provisions generally, a limitation exists concerning the availability of the credit for noncorporate lessors. Under this limitation, the credit generally is not available to a noncorporate lessor of qualified leased property unless either (1) the noncorporate lessor produced the property or (2) the lease term is less than 50 percent of the useful life of the property and the lessor's ordinary and necessary business expenses in connection with the property are more than 15 percent of the rental income produced by the property during the first 12 months of the lessee's use. This limitation was designed to deal with equipment leasing tax shelters which often involve long-term leases on a net basis (i.e., the lessee pays all expenses incident to the maintenance and operation of the leased property).

The Revenue Act of 1978 makes the investment credit generally available to expenditures incurred after October 31, 1978, for rehabilitating older business and commercial buildings (except those used for residential purposes). However, newly rehabilitated buildings, which may have had only marginal usefulness before they were rehabilitated, often will be leased under long-term or net leases in order to enhance the lessor's ability to recover the substantial costs of rehabilitation. The application of the noncorporate lessor limitation will deny the investment tax credit in many situations where taxpayers have incurred substantial expenditures in rehabiliating older buildings.

The bill would make the noncorporate lessor limitation inapplicable for purposes of the investment credit on rehabilitation expenditures.

33. Coordination of regular investment credit for rehabilitation expenditures with energy investment credit (sec. 103(a)(3)(B) of the bill and sec. 48(g)(2)(B) of the Code)

The Revenue Act of 1978 made the regular investment credit available to rehabilitation expenditures for certain buildings which are at least 20 years old. One of the provisions of the Act excludes from the definition of qualified rehabilitation expenditures those expenditures for property which qualify as investment credit property under other investment credit rules. This provision would exclude from the regular investment credit certain rehabilitation expenditures which also qualify as expenditures for energy property eligible for the energy investment credit.

The bill would make both the energy investment credit and the regular investment credit available where rehabilitation expenditures also qualify as expenditures for energy property.

34. Rules for work incentive credit and jobs credit for cooperatives (sec. 103(a)(4) of the bill and secs. 50B(f) and 52(f) of the Code)

Prior to the Revenue Act of 1978, special rules applied for purposes of determining the amounts of the work incentive (WIN) credit and

the general jobs credit which could be used by cooperatives. These special rules applied the same rules under which the amount of investment credit for cooperatives was determined. The Act revised the rules pertaining to the investment credit for cooperatives but no change was made to the rules pertaining to the WIN and jobs tax credits for cooperatives.

The bill would extend the new rules for the investment credit for cooperatives to the WIN and jobs credits.

This amendment already has been adopted by the Finance Committee. This amendment affects the 1979 tax forms which were printed prior to the time consideration of H.R. 2797 was scheduled by the Finance Committee. The Finance Committee adopted the amendment on October 2, 1979, in order that this amendment could be reflected in the 1979 tax forms.

35. Correction of expiration date of targeted jobs credit (sec. 103 (a)(5)(A) of the bill and sec. 51(c)(4) of the Code)

The Revenue Act of 1978 provided for a targeted jobs credit which allows employers a tax credit for employing certain categories of individuals. Due to a clerical error, the Act provides that the targeted jobs credit is to expire for wages paid after December 31, 1980.

The bill would correct the clerical error to provide that the credit may be claimed for wages paid or incurred up to and including December 31, 1981.

36. Clarification of effective date for election of jobs credit (sec. 103(a)(5)(B) of the bill and sec. 321(d) of the Act)

The Revenue Act of 1978 provides that the jobs credit is elective, rather than mandatory as under prior law. However, the Act did not contain a special effective date for this provision to permit taxpayers to retroactively revoke the election.

The bill would correct this error in the Act to provide that the election provision is effective for taxable years ending after December 31, 1976.

37. Clarification of effective date for newly targeted groups under jobs credit (sec. 103(a)(5)(C) of the bill and sec. 321(d)(2)(A) of the Act)

The Code, prior to the Revenue Act of 1978, provided a jobs credit to encourage employers to expand their workforces and an extra credit was provided for hiring persons referred under vocational rehabilitation programs. The Act amended the jobs credit to provide that, effective for amounts paid or incurred after December 31, 1978, the credit would be available only for the employment of specific target groups of individuals. For individuals in newly targeted groups (i.e., all individuals in target groups except persons referred under vocational rehabilitation programs for whom the taxpayers claimed credit under prior law), the credit is available only for persons first hired by the employer after September 26, 1978.

The bill would make clear that the effective date provision of the Act which relates to newly targeted groups applies only for purposes of the amendments made by the Act. Thus, with respect to a member of a newly targeted group who first begins work for an employer before January 1, 1979, the employer would be allowed whatever credit was

available under prior law for wages paid or incurred before January 1, 1979. For the purpose of amounts paid or incurred on or after that date, the credit will be allowed with respect to such an individual only if he or she was first hired after September 26, 1978, and this individual would be treated as beginning work on January 1, 1979, or the date hired, whichever is later.

38. Clarification of transitional rule for fiscal year taxpayers claiming jobs credit (sec. 103(a)(5)(D) of the bill and sec. 321(d)(3) of the Act)

The Revenue Act of 1978 includes a transitional rule to coordinate the effective date of the targeted jobs credit for 1979 with the expiration of the prior general jobs tax credit at the end of 1978 for fiscal year taxpayers.

The bill would clarify that, under the transitional rule, a taxpayer with a fiscal year beginning in 1978 will compute his total credit for that fiscal year by (1) determining his general jobs credit under prior law (but without regard to the 100 percent of tax liability limitation) for wages paid in 1978 and his targeted jobs credit under the Act (also without regard to the 100 percent of tax liability limitation) for wages paid or incurred in 1979, (2) adding the two amounts together, and then (3) applying the 100 percent of tax liability limitation to the sum.

39. Clarification that FUTA wages are to be treated as including remuneration of youths participating in cooperative education programs (sec. 103(a)(5)(E) of the bill and secs. 51(d)(8)(D) and 51(c) of the Code)

Under present law, one of the targeted groups for purposes of the targeted jobs credit is youth participating in a qualified cooperative education program. In general, wages eligible for the targeted jobs credit are Federal Unemployment Tax Act (FUTA) wages. Section 3306(c)(10)(C) excludes services performed by cooperative education students under the age of 22 from coverage under FUTA. Thus, although cooperative education students of ages 16 through 18 comprise an eligible target group, employers are not able to claim a credit with respect to the wages paid to them.

The bill clarifies that wages paid to youths participating in cooperative education programs, although not FUTA wages, are eligible for the targeted jobs credit.

40. Clarification of effective date for WIN-Welfare recipient tax credit for fiscal year taxpayers (secs. 103(a)(6)(A) of the bill and sec. 322(e)(1) of the Act)

Prior to the Revenue Act of 1978, the amount of WIN credit available to any employer was limited to $50,000 of tax liability plus one-half of tax liability in excess of $50,000. The Code contained rules for allocating amount between married individuals filing separately, among members of a controlled group, and between an estate or trust and its beneficiaries. The Act increased the limitation on the credit amount to 100 percent of tax liability, effective for taxable years beginning after December 31, 1978. Under the Act, it is unclear whether

the related rules for apportioning the $50,000 amount are effective during the entire taxable year of fiscal year 1978–79 taxpayers.

The bill specifies that for purposes of applying the prior law tax liability limitation to a taxable year beginning before January 1, 1979, the prior law rules relating to the apportionment of the $50,000 amount shall apply.

41. Clarification of transitional rule for AFDC recipients and WIN registrants hired after September 26, 1978 (sec. 103 (a)(6)(B) of the bill and sec. 322(e)(2) of the Act)

The Code, prior to the Revenue Act of 1978, provided a credit to employers who hired certain AFDC recipients and WIN registrants. The Act amended the credit in several respects, and the amendments generally are effective for work incentive program expenses paid or incurred after December 31, 1978. Under the Act, eligible employees hired after September 26, 1978, are to be treated as having first begun work for the employer no earlier than January 1, 1979. However, it is unclear whether an employer is entitled to whatever credit was available under prior law for wages paid or incurred before January 1, 1979, with respect to AFDC recipients and WIN registrants.

The bill clarifies that the effective date provision which relates to AFDC recipients and WIN registrants hired after September 26, 1978, applies only for purposes of the amendments made by the Act. Thus, with respect to such an employee who first begins work for an employer before January 1, 1979, the employer would be allowed whatever credit was available under prior law for wages paid or incurred before January 1, 1979. For the purpose of amounts paid or incurred on or after January 1, 1979, such an employee would be treated as beginning work on January 1, 1979, and any wages paid or incurred after December 31, 1978, with respect to this employee would be considered to be attributable to services rendered after that date.

42. Effective date for limit on ordinary loss deduction for small business corporation stock (sec. 103(a)(7) of the bill, sec. 1244 of the Cole, and sec. 345(e) of the Act)

Prior to the Revenue Act of 1978, the Code provided that, if certain individual shareholders realized a loss on the disposition of certain stock (sec. 1244 stock), it would be treated as an ordinary loss. Under prior law, the maximum amount of ordinary loss from the disposition of section 1244 stock that could be claimed in any taxable year was $25,000, except for married taxpayers filing joint returns, in which case ordinary loss treatment was limited to $50,000.

In general, the Act increased the amount of section 1244 stock that a qualified small business corporation could issue, simplified and liberalized some of the conditions which must be satisfied for stock to qualify as section 1244 stock, and increased the amount of loss that certain shareholders could treat as an ordinary loss rather than as a capital loss. Under the Act, the maximum amount that could be treated as an ordinary loss was increased to $50,000; in the case of a husband and wife filing a joint return for the taxable year in which the loss is incurred, the maximum amount that may be treated as an ordinary loss was increased to $100,000.

Under the Act, these provisions applied to common stock issued after the date of enactment. This effective date is appropriate for the

changes in requirements for qualifying stock; however, as drafted, the Act did not increase the limitation on the amount of loss on previously issued section 1244 stock which could be treated as an ordinary loss in a taxable year. Rather, it created two separate limitations, one for common stock issued prior to the date of enactment and another for stock issued after the date of enactment (November 6, 1978).

The bill would amend the effective date of the provisions relating to the limitations on the amount of loss on section 1244 stock which may be treated as an ordinary loss by providing that the amendments relating to the ordinary loss limitations for individuals are applicable to taxable years beginning after December 31, 1978, whether or not the stock was issued before or after the effective date of the Act.

The bill also provides that, for taxable years beginning before December 31, 1978, the increased dollar limitations apply only with respect to losses on section 1244 stock issued after November 6, 1978.

43. Clarification of the club dues limitation on the nondeductibility of entertainment facility expenses (sec. 103(a)(8) of the bill and sec. 274(a)(2)(C) of the Code)

Prior to the Revenue Act of 1978, expenses incurred with respect to entertainment facilities were deductible if they were ordinary and necessary, the facility was used primarily for the furtherance of the taxpayer's business (i.e., more than 50 percent of the time that it was used), and the expense in question was related directly to the active conduct of the taxpayer's business. For this purpose, entertainment facility expenses included dues or fees paid to any social, athletic, or sporting club or organization.

The Act provided generally that no deduction was allowable for any entertainment facility expense. Contrary to the intent of the conferees, the Act provided an exception only for country club dues which meet the business test from this disallowance rule.

The bill would modify the exception from the facility expense deduction disallowance rule provided in the Act so that the exception would apply to all social, athletic, and sporting club dues which meet the business test.

44. Application of withholding tax to medical reimbursements (sec. 103(a)(10)(A) of the bill and sec. 3401(a)(19) of the Code)

Prior to the Revenue Act of 1978, medical reimbursements paid to, or on behalf of, an employee under a self-insured medical reimbursement plan of an employer generally were excluded from the employee's gross income and were not subject to withholding tax. Under the Act, such payments may be fully or partly includible in an employee's gross income for a year if the medical reimbursement plan discriminates in favor of highly compensated individuals for that year. In some cases, it may not be possible to make a determination as to the amount which is includible in gross income until after the year has ended.

The bill would clarify present law by continuing the withholding tax exclusion for reimbursements to an employee under a self-insured medical reimbursement plan, if it is reasonable to believe that the employee will be able to exclude the payment from gross income under the rules applicable to such plans.

45. Clarification of nondiscriminatory eligibility classification for medical reimbursement plans (sec. 103(a)(10)(B) of the bill and sec. 105(h)(3)(A) of the Code)

Prior to the Revenue Act of 1978, self-insured medical reimbursement plans were not subject to statutory nondiscrimination rules. Under the Act, nondiscrimination rules regarding eligibility were added, but it was not made clear whether the group in whose favor discrimination was prohibited consists of all highly compensated individuals employed by an employer or of only those who are plan participants.

The bill would make it clear that the nondiscrimination rule regarding eligibility for self-insured medical reimbursement plans takes into account all highly compensated individuals employed by the employer.

46. Clarification of excess reimbursement test under medical reimbursement plans (sec. 103(a)(10)(C) of the bill and sec. 105(h)(7)(A) of the Code)

Prior to the Revenue Act of 1978, medical reimbursements paid to, or on behalf of, an employee under a self-insured medical reimbursement plan of an employer generally were excluded from the employee's gross income. Under the Act, such payments may be fully or partly includible in an employee's gross income for a year if the medical reimbursement plan discriminates in favor of highly compensated individuals for that year. However, under the Act, the discrimination tests for measuring the amount of reimbursements under a particular benefit are not the same as the tests for determining whether that particular benefit is discriminatory.

The bill would conform the rules for measuring excess reimbursements under a self-insured medical reimbursement plan to the rules prohibiting discrimination in favor of highly compensated individuals under such plans.

47. Clarification of effective date for medical reimbursement plans (sec. 103(a)(10)(D) of the bill and sec. 366(b) of the Act)

Under the rules provided by the Revenue Act of 1978 for medical reimbursement plans, excess reimbursements made during a plan year are includible in the gross income of a highly compensated individual for the taxable year in which (or with which) the plan year ends. Because the rules apply for taxable years beginning after December 31, 1979, excess reimbursements made during 1979, in a plan year beginning after December 31, 1978, and ending after December 31, 1979, will be includible in the 1980 gross income of a highly compensated individual whose taxable year is the calendar year.

The bill would provide that the medical reimbursement plan rules apply only to reimbursements paid after December 31, 1979. However, in determining the taxability of reimbursements made in that plan year during 1980, the employee coverage and benefits provided by a plan for its plan year beginning in 1979 and ending in 1980, as well as reimbursements made in that plan year during 1979, will be taken into account.

48. Clarification of the effective date of the increased capital gains deduction (sec. 104(a)(2)(A) of the bill and sec. 1202(c) of the Code)

The Revenue Act of 1978 increased the capital gains deduction from 50 to 60 percent effective for sales or exchanges after October 31, 1978. The Act, however, was unclear as to the amount of the deduction which was to be allowed in the case of post-effective date receipts of payments attributable to pre-effective date transactions, e.g., installment sales.

The bill would clarify that post-effective date receipts of payments attributable to pre-effective date transactions are entitled to the increased capital gains deduction where the income is properly taken into account during a period after October 31, 1978.

49. Clarification of the alternative tax for noncorporate capital gains (sec. 104(a)(2)(B) of the bill and sec. 1201 of the Code)

Prior to the Revenue Act of 1978, a noncorporate taxpayer generally deducted from gross income 50 percent of any net capital gain, and the balance of the gain was taxed at the regularly applicable ordinary income rates. However, a partial alternative tax of 25 percent on the first $50,000 of net capital gain could apply, in lieu of taxing 50 percent of the gain at the regular rates, if it resulted in a lower tax than that which was produced by the regular method.

The Act repealed the noncorporate alternative tax for taxable years beginning after December 31, 1978. However, the Act inadvertently failed to conform the computation of each partial tax (for periods prior to its repeal) to reflect the increase in the capital gains deduction.

The bill would conform the calculation of the alternative tax to reflect the Act's increase in the capital gains deduction.

50. Clarification of the application of the effective date of the capital gains changes to amounts received from certain conduits (sec. 104(a)(2)(C) of the bill and secs. 1201(c)(2) and 1202(c)(1) of the Code)

The Revenue Act of 1978 increased the net capital gains deduction for noncorporate taxpayers from 50 to 60 percent, and decreased the corporate alternative tax rate from 30 to 28 percent. The former provision was effective with respect to post-October 31, 1978, gains and losses, and the latter provision was effective for post-December 31, 1978, gains and losses. However, the Act was unclear as to the applicability of these provisions to the capital gains of certain conduits whose income is taxed to another party where the date that the gains are includible in income by such other party is on or after the Act's effective date.

The bill would provide that, in applying the increased capital gains deduction or the reduced corporate alternative tax rate, the determination of the period for which gain or loss is properly taken into account must be made at the entity level. Therefore, in the case of pass-through entities, the proper capital gains deductions of an individual will be determined with reference to the time when those gains were taken into account by an entity rather than when a distribution was made, or was deemed to be made, by the entity to that individual. For purposes of applying this rule, "pass-through entities" are regulated investment

companies, real estate investment trusts, electing small business corporations, partnerships, estates, trusts, and common trust funds. This entity level determination would apply to taxable years of the recipient beginning before November 1, 1979 (or January 1, 1980, in the case of a corporation).

51. Clarification of the effective date of the reduced corporate alternative capital gains rate (sec. 104(a)(3)(A) of the bill and sec. 1201(c) of the Code)

The Revenue Act of 1978 reduced the corporate alternative tax rate for capital gains from 30 to 28 percent effective for sales or exchanges after December 31, 1978. The Act, however, was unclear as to the rate which was to apply in the case of post-effective date receipts of payments attributable to pre-effective date transactions, e.g., installment sales.

The bill would clarify that post-effective date receipts of payments attributable to pre-effective date transactions generally are subject to the reduced corporate alternative tax rate where the income is properly taken into account during a period after December 31, 1978.

52. Undistributed capital gains of regulated investment companies (sec. 104(a)(3)(B) of the bill and sec. 852(b) of the Code)

Under present law, regulated investment companies (commonly called "mutual funds") are allowed a deduction for income and capital gains that are distributed to its shareholders if certain requirements are met. In the case of capital gains, present law allows an alternative treatment that does not require the distribution of the capital gain to shareholders. Under the alternative treatment, the regulated investment company pays the regular corporate tax on the capital gain; the shareholder includes the capital gain in his income, is given credit for the capital gains taxes paid by the regulated investment company, and increases his basis in his shares of the regulated investment company by a specified percentage of the capital gain. The specified percentage under present law is 70 percent and is designed to be the excess of the capital gain taken into income by the shareholder over the amount of credit given the shareholder for the capital gains taxes paid by the regulated investment company. When the rate of tax on capital gains of corportions was decreased in the Revenue Act of 1978 from 30 percent to 28 percent, no corresponding adjustment was made to the specified percentage of basis adjustment.

The bill would increase the specified percentage of basis adjustment to stock in a regulated investment company to reflect undistributed capital gains from 70 percent to 72 percent.

53. Clarification that carryovers may not reduce alternative minimum taxable income (sec. 104(a)(4)(A) of the bill and sec. 55(b)(1) of the Code)

The Revenue Act of 1978 imposed an alternative minimum tax which is payable by an individual to the extent the gross alternative tax exceeds the regular tax as increased by the "add on" minimum tax. The alternative minimum tax base is generally the sum of an individual's gross income, adjusted itemized deductions, and capital gains, reduced by deductions allowed for the taxable year. In certain circum-

stances, it is possible that a deduction may reduce the alternative minimum taxable income base for a taxable year and still be available as a carryback or carryover to reduce taxable income in another taxable year.

The bill would deny the use of a deduction against the alternative minimum taxable income base if the deduction is available as a carryover or carryback to another taxable year.

This amendment already has been adopted by the Finance Committee. This amendment affects the 1979 tax forms which were printed prior to the time consideration of H.R. 2797 was scheduled by the Finance Committee. The Finance Committee adopted the amendment on October 2, 1979, in order that this amendment could be reflected in the 1979 tax forms.

54. Foreign tax credit allowable against alternative minimum tax (secs. 104(a)(4) (B) and (C) of the bill and secs. 55(c) and (b) of the Code)

The Revenue Act of 1978 imposed an alternative minimum tax but allowed a foreign tax credit against the tax.

The bill would revise the foreign tax credit rules to provide greater clarity, but no substantive changes are made. The bill would make it explicit that the credit may not exceed the amount of the alternative minimum tax. In addition, the definition of alternative minimum taxable income from sources without the United States would be revised to define more clearly the adjustments to be made to gross income.

This amendment already has been adopted by the Finance Committee. This amendment affects the 1979 tax forms which were printed prior to the time consideration of H.R. 2797 was scheduled by the Finance Committee. The Finance Committee adopted the amendment on October 2, 1979, in order that this amendment could be reflected in the 1979 tax forms.

55. Clarification of alternative minimum taxable income to taxpayers not itemizing deductions (sec. 104(a)(4)(D) of the bill and sec. 55(b) of the Code)

The Revenue Act of 1978 imposed an alternative minimum tax which is payable by an individual to the extent the gross alternative tax exceeds the regular tax as increased by the "add on" minimum tax. The alternative minimum tax base is generally the sum of an individual's gross income, adjusted itemized deductions, and capital gains, reduced by deductions allowed for the taxable year.

In the case of a taxpayer who does not elect to itemize deductions, no itemized deductions are allowed for the taxable year. In computing the regular income tax, a bracket is included in the tax tables to provide the taxpayer the benefit of a "standard deduction." No comparable provision is included in the computation of the alternative minimum tax.

The bill would provide that a taxpayer who does not elect to itemize deductions will be entitled to a deduction equal to the zero bracket amount (formerly the "standard deduction") in computing the alternative minimum tax.

This amendment already has been adopted by the Finance Committee. This amendment affects the 1979 tax forms which were printed prior to the time consideration of H.R. 2797 was scheduled by the

Finance Committee. The Finance Committee adopted the amendment on October 2, 1979, in order that this amendment could be reflected in the 1979 tax forms.

56. Exclusion of foreign taxes as an adjusted itemized deduction for purposes of the alternative minimum tax (sec. 104(a)(4)(E) of the bill and sec. 57(b) of the Code)

The Revenue Act of 1978 added a provision that, for purposes of the computation of the tax preference for "adjusted itemized deductions" for purposes of the alternative minimum tax, deductible State and local taxes, in effect, shall be treated as an "above the line" deduction. No corresponding provision was made in the case of deductible foreign taxes, although the Act provided that the foreign tax credit is allowable against the alternative minimum tax.

The bill would clarify that deductible foreign taxes are treated in the same manner as State and local taxes in computing the tax preference for adjusted itemized deductions.

57. Adjusted itemized deductions of estate or trust and the alternative minimum tax (sec. 104(a)(4)(F) of the bill and sec. 57(b)(2)(A) of the Code)

The Tax Reform Act of 1976 broadened the minimum tax on preferences to include a preference for adjusted itemized deductions. The Revenue Act of 1978 made the preference for adjusted itemized deductions subject to the new alternative minimum tax and clarified the application of the adjusted itemized deduction preference to trusts and estates. Generally, the preference for adjusted itemized deductions is equal to the amount by which itemized deductions exceed 60 percent of adjusted gross income. In the case of estates and trusts, the preference is the amount by which all deductions other than deductions allowable in arriving at adjusted gross income and certain other deductions exceed 60 percent of the estate or trust's adjusted gross income reduced by all deductions. However, under the Act, deductions allowable in arriving at adjusted gross income were subtracted twice.

The bill would modify the computation of the preference for adjusted itemized deductions of a trust or estate to clarify that deductions allowable in arriving at adjusted gross income are taken into account only once.

This amendment already has been adopted by the Finance Committee. This amendment affects the 1979 tax forms which were printed prior to the time consideration of H.R. 2797 was scheduled by the Finance Committee. The Finance Committee adopted the amendment on October 2, 1979, in order that this amendment could be reflected in the 1979 tax forms.

58. Carryover of residential energy credit in connection with alternative minimum tax (sec. 104(a)(4)(G) of the bill and sec. 55(c)(3) of the Code)

The Revenue Act of 1978 imposed a new alternative minimum tax. Generally, credits are not allowed against the alternative minimum tax. However, the Act contained special rules that would allow the carryover of the jobs credit, the work incentive credit, and the investment credit that otherwise would have been lost because of the alternative minimum tax. No comparable rule was provided for the residential energy credit.

The bill would provide a rule similar to the rules applicable to the jobs, work incentive, and investment credits for the residential energy credit that will allow the carryover of the residential energy credit where the taxpayer is subject to the alternative minimum tax.

59. Clarification of the treatment of post-October 1978 capital gains for purposes of the maximum tax (sec. 104(a)(5) of the bill, sec. 1348 of the Code, and sec. 441(b)(2) of the Act)

Prior to the Revenue Act of 1978, the amount of personal service income eligible for the 50 percent maximum tax rate was reduced dollar-for-dollar by an individual's items of tax-preference, including capital gains, for the year. The Act increased the net capital gains deduction from 50 to 60 percent, and provided that post-effective date capital gains would not reduce the amount of personal service income eligible for the 50 percent maximum tax rate. These changes were effective for sales or exchanges after October 31, 1978. However, it was possible that, in certain situations, gains after October 31, 1978, would reduce the amount eligible for the 50 percent maximum tax rate.

In the case of taxable years which begin before November 1, and end after October 31, 1978, the bill would clarify that the amount of personal service income which is eligible for the 50 percent maximum tax rate is to be reduced only by 50 percent of the lesser of: (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year before November 1, 1978.

60. Power of the chief judge of the Tax Court to assign small tax cases to commissioners (sec. 105(a)(1) of the Act and secs. 7456(c) and 7463(g) of the Code)

Prior to the Revenue Act of 1978, an action for a declaratory judgment could, under certain circumstances, be instituted in the United States Tax Court. Such an action could be brought to determine the tax status of an organization, the qualification of certain pension plans, and the tax consequences of certain transfers of property from the United States. Each of the three provisions which conferred declaratory judgment jurisdiction on the Tax Court provided that the chief judge of the Tax Court could assign those proceedings to be heard by commissioners of the Court and could authorize a commissioner to make the decision with respect to such proceedings.

Section 336(a) of the Act provided that an action for declaratory judgment could be brought in the Tax Court to determine the tax status of certain governmental obligations. In order to avoid duplication of provisions in the Code, the Act repealed the separate provisions which allowed the chief judge of the Tax Court to assign commissioners to hear declaratory judgment proceedings and enter decisions in such proceedings. In place of these provisions, the Act added a single provision relating to the power of the chief judge to assign to commissioners proceedings brought under various provisions of the Code.

The Act also provided that tax controversies involving disputes of less than $5,000 could be tried as small tax cases. That provision also provided that the chief judge could assign these proceedings to be heard by commissioners.

In order to avoid duplication in the provisions of the Code, the bill would repeal the specific provision granting the chief judge the power to assign small tax cases to be heard by commissioners. In place of this provision, the bill would add "small tax cases" to the types of proceedings the chief judge may assign to be heard by commissioners.

61. Refund adjustments for amounts held under claim of right (sec. 105(a)(2) of the bill and sec. 6411(d)(2) of the Code)

If a taxpayer receives income under a claim of right and restores it in a later year, he may, under a special method for computing his tax liability, be treated as having made an overpayment of tax on the last day prescribed by law for payment of tax for the year the income is restored. The Revenue Act of 1978 establishes a procedure for a quick refund of the overpayment.

The bill would clarify the time within which the Treasury Department ordinarily must act on the taxpayer's refund application. It also would clarify the extent to which the processing of the application is to be similar to the processing of quick refund claims resulting from net operating loss or other carrybacks.

62. Reduction of estate tax value of jointly held property where spouse of decedent materially participated in farm or other business (sec. 105(a)(3)(A) of the bill and sec. 2040(c)(2) of the Code)

The Revenue Act of 1978 contained a provision (Code sec. 2040(c)) which permitted the efforts of a decedent's spouse to be taken into account in determining the amount of jointly held property used in a farm or other business included in the decedent's gross estate. Generally, under this provision, the value of the gross estate could be reduced by the sum of (1) by the adjusted consideration of the surviving spouse and (2) by 2 percent of the excess of the value of the property over the total adjusted consideration provided by both spouses for each year that the decedent's spouse materially participated in the operation of the farm or other business in which the property was used. The adjusted consideration is the consideration furnished by a spouse plus interest computed at 6 percent per year from the date the consideration was furnished until the date of the decedent's death.

Under this formula, it was possible that less than the decedent's adjusted consideration, or the portion of the value attributable to the decedent's adjusted consideration, would be included in the decedent's gross estate where the total appreciation in the property was less than the assumed 6 percent increase in the original consideration.

The bill would correct this result by providing that the special rule would not apply if the sum of the adjusted consideration provided by both spouses equals or exceeds the value of the property on the date of the decedent's death.

63. Distribution from estate prior to 1980 of farm valuation property (sec. 105(a)(5) of the bill and sec. 1040 of the Code)

Under present law, the distribution of property by an estate or trust in satisfaction of a pecuniary bequest is treated as a taxable transaction resulting in the recognition of gain or loss to the estate or trust.

The Revenue Act of 1978 added a provision to clarify that where property is subject to special farm or other business use valuation, the tax will be measured by the difference between the fair market value of the property on the date of distribution (determined without regard to special use valuation) and the fair market value of the property on the date of the decedent's death (also determined without regard to special use valuation). However, the postponement of the carryover basis provisions, until 1980, inadvertently resulted in a postponement of this provision.

The bill would clarify that the provision added by the Act concerning the distribution of special use valuation property in satisfaction of a pecuniary bequest is effective for estates of decedents dying after December 31, 1976.

64. Clarification of tax treatment of cooperative housing corporations where stock is acquired in a tax-free transaction (sec. 105(a)(6) of the bill and sec. 216(b)(6) of the Code)

In general, a tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid to such a corporation to the extent such amounts represent his or her proportionate share of allowable real estate taxes and interest relating to the corporation's land and buildings (Code sec. 216). In general, for a corporation to qualify as a cooperative housing corporation (which can pass through these deductions to tenant stockholders), 80 percent or more of the gross income of the cooperative housing corporation must have been derived from individual tenant-stockholders.

Under the Revenue Act of 1978, if a person who conveys a house, apartment building, or leasehold therein to a cooperative housing corporation acquires stock in the corporation by *purchase or foreclosure*, together with a lease or right to occupy the house or apartment, such person would be treated as a tenant-stockholder for up to three years from the date of acquisition (even if such person were not an individual). The general intent of this provision was to allow corporate promoters to form cooperative housing corporations and to own the shares in such corporations during a reasonable period while the shares were being sold to individuals who would qualify as tenant-stockholders under the general rules of section 216. The requirement that the stock be acquired "by purchase or foreclosure" may well be interpreted as precluding situations where the corporate promoter acquires the stock in a tax-free transaction (such as a transfer to a controlled corporation pursuant to the provisions of Code sec. 351).

The bill would amend the provisions added by the Act to provide that, if an original seller (e.g., a corporate promoter) acquires stock of the cooperative housing corporation either from the corporation or by foreclosure, the original seller shall be treated as a tenant-stockholder for a period not to exceed three years from the date of the acquisition of the stock. However, except in the case of an acquisition of stock of a cooperative housing corporation by foreclosure, this rule only would apply to stock acquired from the cooperative housing corporation which occurs not later than one year after the date on which the apartments or houses (or leaseholds therein) are transferred by the original seller to the corporation.

65. Amendment relating to exclusion of certain cost-sharing payments (sec. 105(a)(7) of the bill and secs. 126 and 1255 of the Code)

The Revenue Act of 1978 provided an exclusion from gross income for all or a portion of certain payments received under a number of Federal and State cost-sharing conservation programs. Under these provisions, no deduction or credit could be claimed with respect to amounts excluded under the Act, and the basis of any property acquired or improved with these payments would not reflect the excluded amounts. Also, under the Act, a special rule was provided for the recapture (that is, treatment as ordinary income rather than capital gains) of excluded amounts if the property, or improvements, purchased with the payments are disposed of before the expiration of 20 years.

Since the provisions of the Act automatically applied to the excludible portion of all cost-sharing payments, there are some circumstances under which a taxpayer could be worse off under this provision than under prior law. Generally, this results from the fact that, under some circumstances, at least some of the payments received under certain of these programs are reimbursements for costs for which a current deduction would otherwise be allowable. Thus, under prior law, a taxpayer would have had a wash (that is, deductions offsetting income) and the recapture rule would not have applied to him. Under the provisions of the Act, such a taxpayer would have the same effect of a wash (by the exclusion of the income and the disallowance of any corresponding deduction) but would be subject to recapture. Also, there are certain other circumstances where, even though the amounts attributable to reimbursement under these cost-sharing programs were not currently deductible, the taxpayer might (by reason of the application of the investment credit, net operating loss limitations, etc.) be better off under prior law than under the exclusion rule.

The bill would provide that the exclusion for cost-sharing payments and the recapture provision do not apply to any portion of any payment which is properly attributable to an amount which is allowable as a deduction for the taxable year in which the amount is paid or incurred. Also, the bill would provide that, if a taxpayer makes an election, the exclusion provision and the recapture provision would not apply to the excludible portion of any government cost-sharing payment. Such an election would be made not later than the due date (including extensions) for filing the taxpayer's income tax return for the taxable year in which the payment was received or accrued.

Also, an amendment is made to the recapture provision (Code sec. 1255) to coordinate this provision with the other recapture provisions which could potentially result in ordinary income from the disposition of property acquired or improved with excluded cost-sharing payments. (These provisions are section 1251 (relating to recapture of amounts in so-called "Excess Deduction Accounts") and section 1252 (relating to recapture of previously deducted soil and water conservation expenses or land clearing expenses).)

66. Computations of adjusted itemized deductions in case of estates and trusts (sec. 107(a)(1)(A) of the bill and sec. 57(b)(2)(C) of the Code)

Under the Revenue Act of 1978, the alternative minimum tax is imposed on the adjusted itemized deductions preference. The charitable contributions deduction is an itemized deduction that normally may result in the adjusted itemized deductions preference. However, the Act provided an exception in the case of certain charitable deductions of trusts and estates. One exception arises where all the unexpired interests in the trust are devoted to religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals (i.e., the purposes described in section 170(c)(2)(B) of the Code). Another exception arises where all of the income interests in the trust are devoted to religious, charitable, etc., purposes (i.e., purposes described in section 170(c)(2)(B) of the Code) and the grantor had a power to revoke the trust at his death. Neither of the two exceptions applies where the interests in the trust are for purposes other than religious, charitable, etc., purposes (i.e., those purposes described in section 170(c)(2)(B) of the Code) but for which a charitable deduction is nonetheless allowable (i.e., those purposes described in sections 170(c)(1),(3),(4), and (5)).

The bill would modify the exceptions so that they apply to all interests in the trust devoted for purposes for which a charitable deduction is allowed to the trust.

67. Estate tax treatment of gifts within 3 years of death (sec. 107(a)(2)(F) of the bill and sec. 2035 of the Code)

Prior to the Tax Reform Act of 1976, the gross estate of a decedent included all gifts made in contemplation of death that occurred less than 3 years before the date of the decedent's death. Under this rule, the Internal Revenue Service required that only gifts in excess of $1,000 need be disclosed in the estate tax return.

The 1976 Act provided that all gifts made within 3 years of the decedent's death are to be included in the gross estate of the decedent, regardless of whether the gift was made with death time motives. However, the 1976 Act contained an exception to this inclusion rule for gifts to which the annual $3,000 gift tax exclusion applied. While somewhat ambiguous, the legislative history could be read to state that this exception resulted in the inclusion of only the excess of the death time value of all gifts made within 3 years of death over $3,000.

The Revenue Act of 1978 clarified the exception so that it applied only to gifts (other than life insurance) which were not required to be included in a gift tax return. Under this rule, the entire amount of the gift (and not just the excess of the value of the gift over $3,000) is includible in the gross estate where the gift is in excess of $3,000. This clarification in rules was made to apply to gifts made after December 31, 1976.

Since the change in the exception was not adopted by the Ways and Means Committee until October, 1977, it is possible that gifts could have been made in excess of $3,000 based upon the assumption that only the excess of the value over $3,000 was included in the gross estate.

The bill would allow executors of decedents to elect with respect to all gifts made in 1977 (other than life insurance) to all donees to include in the decedent's gross estate only the excess of the death time value over $3,000.

B. TECHNICAL AMENDMENTS RELATING TO THE FOREIGN EARNED INCOME ACT OF 1978

1. Use of tax tables by individuals excluding foreign earned income (sec. 108(a)(1)(A) of the bill and sec. 3 of the Code)

Prior to the Tax Reform Act of 1976, certain individuals working abroad were allowed to exclude from gross income up to $20,000 annually ($25,000 in some cases). The Tax Reform Act of 1976 amended this provision so that these individuals were taxed on their other income at the higher rate brackets which would have applied if the excluded earned income were not so excluded (i.e., the exclusion was "off the bottom"). This amendment made the use of tax tables inappropriate for these individuals and, under the Tax Reduction and Simplification Act of 1977, they are not permitted to use the tables.

The Foreign Earned Income Act of 1978 made a number of changes in the foreign earned income exclusion. Among these is a rule that the excluded income is not taken into account in computing the tax on the taxpayer's other income (i.e., the exclusion is "off the top"). Thus, use of the tax tables no longer would be inappropriate.

The bill would permit individuals who exclude foreign earned income to use the tax tables.

This amendment already has been adopted by the Finance Committee. This amendment affects the 1979 tax forms which were printed prior to the time consideration of H.R. 2797 was scheduled by the Finance Committee. The Finance Committee adopted the amendment on October 2, 1979, in order that this amendment could be reflected in the 1979 tax forms.

2. Definition of "earned income" for purposes of deduction for excess foreign living costs (sec. 108(a)(1)(B) of the bill and sec. 913(e) of the Code)

The Foreign Earned Income Act of 1978 established a deduction for excess foreign living costs for Americans working abroad. The aggregate amount deductible under this provision cannot exceed the taxpayer's foreign "earned income." In addition, earned income also is relevant in the calculation of the excess housing costs, one element of the deduction. For purposes of determining earned income under present law, amounts generally are considered received, and thus earned income, in the year in which the taxpayer performed the services to which those amounts relate. However, this rule does not apply to amounts received more than one year after the year in which the services were performed.

First, for purposes of computing the housing element of the deduction, the bill provides that deferred compensation is taken into account in the year it is included in income, not the year in which the services giving rise to the compensation were performed. Second, the bill provides a new recapture rule to deal with situations where a taxpayer

defers compensation from a year in which he claims a deduction under section 913 for excess foreign housing costs (the "performance year") to a year in which he does not have an excess housing cost deduction. This recapture rule only applies where the compensation ("after-received compensation") is deferred for no more than 3 years after the year in which the services are performed.

3. Disallowance of deductions attributable to excluded foreign earned income (sec. 108(a)(1)(D) of the bill and sec. 911(a) of the Code)

Under prior law, an individual who excluded foreign earned income could not claim any deductions, or take a credit for any foreign income taxes, to the extent properly allocable to, or chargeable against, the excluded income. This provision was carried over under the Foreign Earned Income Act of 1978, but the wording was changed in a way which makes it less clear that deductions, as well as foreign tax credits, allocable to excluded foreign earned income are to be disallowed.

The bill would change the wording to clarify that deductions attributable to excluded amounts will continue to be disallowed.

4. Definition of "qualified home leave expenses" for purposes of the deduction for excess foreign living costs (sec. 108(a)(1)(F) of the bill and sec. 913(g) of the Code)

The 1978 Foreign Earned Income Act allows certain Americans working abroad to deduct reasonable costs of transportation of the individual, his spouse, and dependents from his tax home (generally, his principal place of work) outside the United States to (i) his present (or if none, most recent) principal residence in the United States or (ii), if the preceding rule does not apply to the individual, to the nearest U.S. port of entry (excluding Alaska and Hawaii).

It is not clear how this limitation applies to departures from locations other than the individual's foreign tax home. Also, it is not clear that a taxpayer could ever take a deduction for the cost of round-trip transportation to Alaska or Hawaii.

The bill would make it clear that the taxpayer may deduct the cost of home-leave transportation from a point other than his tax home abroad, but that his deduction will be limited to the lesser of the cost of transportation from (a) his tax home, or (b) the other point abroad from which he departs to (i) his present (or, if none, most recent) U.S. residence, if he actually goes there, or (ii) the nearest U.S. port of entry, if he does not. The nearest port of entry would generally exclude Alaska and Hawaii. However, an individual could elect not to have that exclusion apply, thus permitting deduction of the cost of round-trip travel to Alaska or Hawaii, if nearer than the nearest port of entry in the other states.

C. TECHNICAL AMENDMENTS RELATING TO THE ENERGY TAX ACT OF 1978

1. Repayment of tax on gasoline used in commercial fishing vessels (sec. 108(c)(1) of the bill and sec. 6421(d)(2) of the Code)

Prior to the Energy Tax Act of 1978, a direct refund of 2 cents a gallon was permitted for the excise tax on gasoline, 2 or 4 cents a gallon for the excise tax on diesel fuels, and the special motor fuels, and 6 cents a gallon for the excise tax on lubricating oil used for certain nonhighway uses. The Energy Tax Act of 1978 removed the direct refund provisions where the products were not used in a trade or business but did not affect provisions allowing the tax-free purchase or indirect credits or refunds for these items where the items are to be used on a commercial fishing vessel. However, the tax-free purchase (or indirect credit or refund) often cannot be obtained because the producer is not selling directly to the operator of a commercial fishing vessel or the final seller does not want to go through the paperwork to obtain the credit or refund.

The bill would allow the 2-cent and 6-cent direct refunds permitted under prior law where the item is used on a commercial fishing vessel.

This amendment already has been adopted by the Finance Committee. This amendment affects the 1979 tax forms which were printed prior to the time consideration of H.R. 2797 was scheduled by the Finance Committee. The Finance Committee adopted the amendment on October 2, 1979, in order that this amendment could be reflected in the 1979 tax forms.

2. Technical corrections with respect to fuels tax exemption for gasohol (sec. 108(c)(2) of the bill and secs. 4081(c) and 6416 (b)(2) of the Code)

Under the Energy Tax Act of 1978, gasohol (i.e., fuel which is a blend of gasoline, or other motor fuel, and alcohol) that is at least 10 percent alcohol (other than alcohol derived from petroleum, natural gas, or coal) is exempted from the Federal excise taxes on motor fuels on or after January 1, 1979, and before October 1, 1984. The Act provides that gasoline may be sold free of tax if it is to be used in the production of gasohol. Since motor fuels other than gasoline are taxed on the retail sale or use, a similar tax-free provision is not necessary in such cases. The Act also provides that, if the gasohol for which an exemption from the tax is obtained is later separated into gasoline and alcohol, the person doing such separation is to be treated as the producer of the gasoline (and thus would ordinarily be liable for the 4-cents-a-gallon tax). No provision is made for refund of the tax on gasoline if tax-paid gasoline is mixed with alcohol to produce gasohol.

The bill makes two technical changes. First, the bill amends the provision of present law which allows a refund for tax-paid fuel used for

certain exempt purposes by treating as an overpayment of tax any fuel excise tax paid on gasoline used or sold for use in the production of gasohol. This provision ensures that gasohol can be produced free of any ultimate tax burden (through a credit or refund approach) even though excise taxes had been paid on the gasoline by the producer or importer. Second, the bill amends the provision (Code sec. 4081(c)) which treats a person who separates an exempted gasoline-alcohol mixture into gasoline and alcohol as the producer of such gasoline (and therefore subject to the 4-cents-a-gallon tax) by providing that this treatment applies not only if the gasoline was originally acquired free of tax but also if a credit or refund of excise taxes had been obtained.

3. Tires used in the manufacture of buses (sec. 108(c)(3) of the bill and secs. 4071(e), 6416(b)(3)(C), and 6416(b)(4)(B) of the Code)

Prior to the Energy Tax Act of 1978, a 10-percent manufacturers excise tax was imposed on the sale of buses having a gross vehicle weight of more than 10,000 pounds, with certain exceptions (Code sec. 4061(a)). Another provision (Code sec. 4071) imposes excise taxes on tires, inner tubes, and tread rubber. These taxes generally apply to tires and inner tubes used on buses (as well as other tires, inner tubes, and tread rubber).

The Energy Tax Act repealed the excise tax on buses. In the case of excise taxes on highway tires, inner tubes, and tread rubber, the Energy Tax Act also provided an exemption for sales by a manufacturer, producer, or importer of such items "sold for use" by the purchaser on or in connection with an intercity, local, or school bus. Tires and inner tubes also may be purchased tax free by a vehicle manufacturer to be placed on a chassis which is to be sold (among other things) to a State or local government or a private nonprofit school. If purchased tax-paid and then so used, a credit or refund of tax is available to the vehicle manufacturer. However, if a manufacturer purchases tires or inner tubes to be placed on a bus which is for domestic use by other than a State or local government or by a nonprofit school, the excise taxes on tires and inner tubes are imposed, and there is no provision for credit or refund of such taxes.

The bill provides that if tires or inner tubes are sold on a tax-paid basis to a manufacturer of bus chasis or bodies, the tire tax is to be credited or refunded to the bus manufacturer upon the sale of the bus chassis or body.

4. Refund of tax on lubricating oil used in producing rerefined oil (sec. 108(c)(4) of the bill and sec. 6416(b)(2) of the Code)

Under present law, a 6-cent-per-gallon manufacturers excise tax is imposed on lubricating oil (other than cutting oils) sold in the U.S. by a manufacturer or producer, or used by a manufacturer or producer. The sale of recycled oil is not subject to the tax. However, the excise tax is imposed on the new lubricating oil mixed with the used oil.

The Energy Tax Act of 1978 exempted the sale of new lubricating oil from the excise tax where the oil is sold for use in a blend with previously used or waste lubricating oil which has been cleaned, renovated, or rerefined. Such a blend is designated as "rerefined oil."

The exemption applies if the blend contains 25 percent or more of waste oil. All of the new oil in a mixture is exempt from the tax if the blend contains 55 percent or less of new oil. If it contains more than 55 percent new oil, the exemption applies only to so much of the new oil as does not exceed 55 percent of the blend. However, no provision was made for refunds of the excise tax where tax-paid new oil is mixed with waste oil.

The bill provides for credit or refund of tax paid with respect to new oil in rerefined oil to the extent that the blend of new and waste oil would be exempt from the manufacturers excise tax. As a result, refunds will be available for the tax paid on up to 55 percent of a blend of new and waste lubricating oil which contains at least 25 percent of waste oil. However, refunds would not be available until the blend is used or sold.

5. Credit or refund of tax on truck bodies or chassis used in the manufacture of buses (sec. 108(c)(5) of the bill and sec. 6416 (b)(3) of the Code)

Prior to the Energy Tax Act of 1978, a 10-percent manufacturers excise tax was imposed on the sale of buses or trucks having a gross vehicle weight of more than 10,000 pounds with certain exceptions (Code sec. 4061(a)). The Energy Tax Act repealed the excise tax on buses (but not the excise tax on trucks). However, no provision was made for a credit or refund of tax in situations where a person produces a bus from a truck body or chassis (on which tax has been paid) to a bus.

The bill would permit the producer of the bus to obtain a credit or refund of the tax on the truck chassis or body.

III. REVENUE EFFECT

It is estimated that the provisions contained in the bill ("Technical Corrections Act of 1979", H.R. 2797) will not have any overall revenue impact. It should be noted that certain individual provisions may appear to result in a minor revenue increase or decrease. However, the revenue effects which were included in the various acts took into account the basic Congressional policy contained in the revisions made by this bill.

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