[JOINT COMMITTEE PRINT]

DESCRIPTION OF H.R. 3805
(TECHNICAL CORRECTIONS ACT OF 1983)

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

ON SEPTEMBER 22, 1983

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

This pamphlet describes provisions of H.R. 3805 (the Technical Corrections Act of 1983), introduced by Chairman Rostenkowski on August 4, 1983. The bill contains technical revisions to the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248), the Subchapter S Revision Act of 1982 (Public Law 97-354), the Highway Revenue Act of 1982 (Public Law 97-424), the Social Security Amendments of 1983 (Public Law 98-21), and certain other legislation. The Committee on Ways and Means has scheduled a public hearing on the bill on September 22, 1983.

The technical amendments made by the Technical Corrections Act of 1983 are intended to clarify and conform various provisions adopted by the acts listed above. The bill is based on a review by the staffs of the Joint Committee on Taxation and the Committee on Ways and Means, taking into account the comments submitted to the Congress that concerned changes that would be technical in nature. The bill was developed with the assistance of the Treasury Department, the Social Security Administration, and the Health Care Financing Administration.

Part I of the pamphlet is the description of the provisions of the bill. The bill is organized in four titles: Title I—technical corrections to the tax provisions of the Tax Equity and Fiscal Responsibility Act of 1982; Title II—technical corrections to the Subchapter S Revision Act of 1982 and certain other tax legislation enacted in 1982; Title III—technical corrections to the Highway Revenue Act of 1982; and Title IV—technical corrections to the Social Security Amendments of 1983 and related legislation. Amendments in the bill for which no descriptions are provided are clerical in nature. Finally, Part II of the pamphlet presents the overall revenue effect of the bill.

I. DESCRIPTION OF THE BILL

A. Technical Corrections to the Tax Provisions of the Tax Equity and Fiscal Responsibility Act of 1982

(Title I of the Bill)

1. Alternative minimum tax (sec. 101(a) of the bill and secs. 55-58 of the Code)

TEFRA[1] added several new tax preferences and made certain other modifications to the individual alternative minimum tax. This tax is computed at a 20-percent rate and is payable to the extent it exceeds the taxpayer's regular tax. Regular tax generally means the taxpayer's income tax liability reduced by nonrefundable credits. TEFRA also generally allowed individuals to elect to take ACRS deductions and the investment tax credit with respect to intangible drilling costs.

In order that a taxpayer may not avoid recapture of investment tax credit on disposition of investment credit property by reason of being subject to the alternative minimum tax, the bill would clarify that the amount of investment credit recapture is not included in the taxpayer's regular tax for purposes of computing alternative minimum liability. As a result, the recapture tax would be a liability in addition to the taxpayer's alternative minimum tax and regular tax.

Also, the bill would provide that the election to take ACRS deductions and the investment credit in lieu of expensing intangible drilling costs would not be available with respect to oil, gas and geothermal wells which are not located in the United States, since the investment credit is generally not allowable for property used outside the United States.

2. Casualty loss deduction (sec. 101(c) of the bill and sec. 165 of the Code)

TEFRA provided that the itemized deduction for nonbusiness casualty and theft losses is allowed only to the extent the losses exceed 10 percent of the taxpayer's adjusted gross income. In determining adjusted gross income, the deduction for capital gain (under sec. 1202) is allowed. Where a taxpayer's recognized gains from certain involuntary conversions or other casualty losses are in excess of the recognized losses for those transactions for a taxable year, the taxpayer's capital gains deduction for that year, and therefore his or her adjusted gross income, may depend on the amount of casualty loss which is allowable as a deduction (sec. 1231). Thus, in certain circumstances, the computation of the casualty loss deduc-

[1] The Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248).

tion may not be mathematically determinable because of the interrelationship with the adjusted gross income determination.

In order to break this circular computation, the bill would provide that adjusted gross income, for purposes of computing the 10-percent floor for the casualty loss deduction, is determined without regard to the application of section 1231 to gain or loss from involuntary conversions arising from casualty or theft.

3. Corporate minimum tax (sec. 102(a) of the bill and sec. 291 of the Code)

TEFRA provided a 15-percent cutback in certain corporate tax preferences. These preferences include section 1250 recapture on real estate, mining exploration and development costs, interest incurred by financial institutions to carry certain tax-exempt obligations, and intangible drilling costs of integrated oil companies.

The bill would provide that the additional gain recognized as ordinary income on the disposition of section 1250 property under the cutback provision is treated, for all purposes of the Code (such as sections 170, 341, 453B and 751), in the same manner as other section 1250 gain. Since the investment tax credit is generally not allowed for property used outside the United States, the bill would provide that no investment credit is allowed for mineral exploration and development costs with respect to mineral deposits located outside the United States. The bill would clarify that, for purposes of applying the preference cutback with respect to interest of financial institutions used to carry tax-exempt bonds, amounts paid in respect of deposits, investment certificates, or withdrawable or repurchased shares are treated as interest, whether or not designated as interest. Finally, the bill would clarify the language providing for the 36-month amortization of drilling and mining costs which are otherwise disallowed by the section.

4. Investment tax credit basis adjustment (sec. 102(b) of the bill and sec. 48(q) of the Code)

TEFRA provided a basis adjustment for property with respect to which the investment tax credit is allowed. The bill would clarify that the basis in a partnership or S corporation is adjusted to reflect adjustments to the basis of partnership or S corporation property where investment credits are either allowed or recaptured. The subsequent reduction of ACRS deductions by reason of the adjustment to the basis of the assets required by TEFRA results in a subsequent lesser reduction in the basis of the partnership interest or S corporation stock.

5. Construction period interest and taxes (sec. 102(c) of the bill and sec. 189 of the Code)

TEFRA provided that corporations must capitalize construction period interest and taxes with respect to nonresidential real property. The bill would clarify that construction period interest and taxes with respect to dwelling units in a cooperative housing corporation (as defined in sec. 216) is exempt from the capitalization requirement, since that property is residential property.

6. Partial liquidations (sec. 102(e) of the bill and sec. 543 of the Code)

TEFRA provided that distributions to corporate shareholders in a partial liquidation are excluded from the definition of personal holding company income notwithstanding that they otherwise constitute dividends under the revised treatment of partial liquidations.

In order to treat all dividends in the same manner, the bill would delete this exclusion so that dividends otherwise constituting personal holding company income will be so treated notwithstanding that they are made in a partial liquidation of the distributing corporation.

7. Distribution of appreciated property in redemption of stock (sec. 102(f) of the bill and sec. 311 of the Code)

Generally, distributions of appreciated property in redemption of a corporation's stock result in recognition of gain to the distributing corporation. TEFRA excepts from the recognition requirement distributions in partial liquidations and certain distributions of stock or obligations of a controlled corporation if made with respect to qualified stock. Qualified stock is stock held by a noncorporate shareholder who has held at least a 10-percent interest in the distributing corporation for 5 years prior to the distribution (or such lesser period as the distributing corporation or its predecessor existed). The treatment of distributions made to pass-through entities is not entirely clear under the language of TEFRA.

The bill would amend the rules relating to qualified stock to provide that, in determining whether the definition of qualified stock is satisfied, distributions to pass-through entities (S corporations, partnerships, trusts, and estates) will be treated as if made directly to the shareholders, partners, or beneficiaries in proportion to their respective interests in the entity. Thus, for example, a distribution to a partnership would not qualify as a distribution with respect to qualified stock to the extent that interests in the partnership are owned by corporations. Further, distributions would not qualify to the extent of an interest in the partnership held by any person whose interest is less than 10 percent, unless stock attributable to such interest when combined with other stock held actually or constructively by such person satisfies the 10-percent requirement. Further, regardless of how long the partnership held the stock in the distributing corporation, the distribution would not satisfy the holding period requirement to the extent it is attributable to a partner whose interest in the partnership was acquired within 5 years (or within such shorter period as the distributing corporation or its predecessor existed) prior to the distribution. Where, however, the stock was contributed to the partnership by the partner, the combined period of ownership by the partner and the partnership would constitute the holding period applicable to the partner.

8. Treatment of certain stock purchases (sec. 102(g) of the bill and sec. 338 of the Code)

a. Definition of purchase for treating certain stock purchases as asset acquisitions

A corporation making a qualified stock purchase may treat the acquisition as if the assets of the acquired corporation were purchased. Prior to TEFRA, this treatment applied only if the acquired corporation was liquidated. Under the TEFRA revision of prior law, if the purchasing corporation elects such treatment, the acquired corporation is treated as a new corporation which purchased the assets as of the beginning of the day after the date the qualified stock purchase was completed. Generally, the election may be made only if 80 percent or more of the stock (other than certain nonvoting preferred stock) of the acquired corporation is purchased within a 12-month period.

Stock owned by the acquired corporation in a third corporation is treated as purchased by the acquiring corporation if, as a result of the purchase of stock of the acquired corporation, the acquiring corporation is treated as constructively owning stock in such third corporation. When a corporation (the first corporation) purchases 80 percent of the qualifying stock of another corporation (the second corporation) which in turn owns 80 percent of the stock of a third corporation, the first corporation has not made a qualified stock purchase of the third corporation because it is treated as having purchased only 64 percent (80 percent of 80 percent) of the qualifying stock of such third corporation. However, if an election is made with respect to the qualified stock purchase of the second corporation, the second corporation will be treated as a new corporation which has purchased 80 percent of the third corporation's stock. It is not clear whether such deemed purchase is a qualified stock purchase which enables the second corporation to make an election with respect to the third corporation.

The bill generally would conform the definition of purchase to the definition of prior law (section 334(b)(2)). Under the bill, a purchasing corporation would not be treated as having purchased stock in a third corporation which it constructively owns as a result of purchasing the stock in another (the second) corporation. Instead, if a qualified stock purchase and election are made with respect to the second corporation, the deemed purchase of the third corporation's stock will (if it satisfies the 80-percent ownership requirement) be treated as a qualified stock purchase permitting an election by the second corporation, or deeming an election to be made under certain consistency of treatment requirements, with respect to the third corporation.

Generally, under the bill, an election may be made only by a corporation which has made a direct acquisition by purchase of stock satisfying the 80-percent ownership requirement. For this purpose, stock acquired (including stock acquired in a carryover basis transaction after a qualified stock purchase and election with respect to the transferor) from a related corporation, in a transaction which otherwise satisfies the "purchase" requirement, will be treated as purchased if at least 50 percent in value of the stock of the related corporation was acquired by purchase. A corporation is related if stock owned by it is owned by the acquiring corporation. The 12-month acquisition period within which a qualified stock purchase must be made commences, under the bill, not later than the date on which an acquiring corporation first constructively owns stock (other than through ownership of an option) acquired from a related corporation.

b. Limitation on nonrecognition of gain or loss in certain stock purchases treated as asset acquisitions

When an election results in treating an acquired corporation as having sold its assets, gain or loss is not recognized on such constructive sale to the same extent as gain or loss would not be recognized under the rules applicable to an actual sale of assets by, and liquidation of, the acquired corporation (under sec. 337). However, where less than all the stock of such corporation is owned by the acquiring corporation, the portion of the gain or loss not recognized is limited to the highest percentage by value of the acquired corporation's stock owned by the acquiring corporation during the 1-year period commencing with the date the qualified stock purchase is completed (the acquisition date). Nonrecognition treatment is not so limited if the acquired corporation is liquidated during such 1-year period. Nonrecognition is limited in lieu of imposing a shareholder tax on minority shareholders not disposing of their stock.

Under the bill, the highest percentage of stock held by the acquiring corporation, for purposes of limiting nonrecognition of gain or loss, would be determined by counting increases in its stock ownership after the acquisition date only to the extent such increases are attributable to purchases, or to redemptions by the target corporation to which section 302(a) applies. Further, under the bill, the exception to nonrecognition treatment for liquidations during the one-year period is not available if the liquidation is one to which sec. 333 applies. These restrictions are intended to limit nonrecognition of gain or loss to the acquired corporation resulting from transactions after the acquisition date to cases in which stock held by minority shareholders was disposed of in taxable transactions.

c. Purchases by more than one member of an affiliated group in connection with certain stock purchases treated as asset acquisitions

If there is both a direct purchase of assets and a qualified stock purchase from the same affiliated group, except as otherwise provided there is a deemed election to treat the stock purchase as a sale and purchase of assets by the acquired corporation. Similarly, if two or more qualified stock purchases are made from the same affiliated group, an election of, or failure to elect, asset sale treatment must be consistently applied to all the acquisitions. In applying these rules, an acquisition of assets or stock by a member of the same affiliated group as the purchasing corporation is treated as made by the purchasing corporation.

The bill would clarify that the aggregation of acquisitions of assets or stock by members of the purchasing corporation's affiliated group is intended to apply only for purposes of the provisions requiring consistency of treatment where assets and stock are purchased, or multiple stock purchases are made, from the same affiliated group. In applying the consistency rules, it is not necessary that the 80-percent purchase requirement be satisfied by one member. However, outside the consistency rules, no qualified stock purchase takes place where several members of an affiliated group that does not file a consolidated return, in the aggregate purchase the required 80 percent of an acquired corporation's outstanding stock but no one member separately satisfies the 80-percent purchase requirement.

d. Nonrecognition treatment on the sale or exchange of property in connection with certain stock purchases treated as asset acquisitions

Gain or loss is not recognized by a corporation on the sale or exchange of property after the adoption of a plan of complete liquidation pursuant to which its assets are all distributed within 12 months (sec. 337). Under TEFRA, these nonrecognition rules apply to the constructive sale and purchase of an acquired corporation's assets resulting from a qualified stock purchase and election. It is not clear, under present law, whether nonrecognition treatment applies to the asset sales when there is a qualified stock purchase and election with respect to an acquired corporation which has sold some of its property following adoption of a plan of liquidation.

Under the bill, if within 12 months preceding the acquisition date of a qualified stock purchase with respect to which an election is made, the acquired corporation adopted a plan of complete liquidation which was not rescinded as of such date, the nonrecognition rules of section 337 would apply to actual sales by the acquired corporation as though it had actually distributed all its assets in liquidation on the acquisition date. The same percentage of gain or loss would be recognized to the acquired corporation with respect to these sales as would be recognized on the deemed sale of its remaining assets resulting from the election. The sale of stock and the deemed distribution would have the same effect as an actual distribution in complete liquidation in applying the provisions providing exclusion from collapsible corporation treatment with respect to sales and exchanges and distributions by the acquired corporation (secs. 341(e)(1), (e)(2) and (e)(4)) and the use of the installment method by shareholders of the acquired corporation (sec. 453(h)).

e. Fair market value as deemed sale price in certain stock purchases treated as asset acquisitions

Under TEFRA, the price at which an acquired corporation's assets are treated as sold and purchased when an election is made with respect to a qualified stock purchase is the basis of the purchasing corporation's stock in the acquired corporation on the acquisition date, properly adjusted for liabilities and other items. For this purpose, the purchasing corporation's basis, if it owns less than 100 percent of the acquired corporation's stock, is "grossed up" to reflect 100-percent ownership. The price paid for the stock of the acquired corporation may be less than the fair market value of its assets to take account, for example, of tax liability resulting from the application of recapture provisions to the deemed purchase and sale of assets. Further, a qualified stock purchase and election may be made notwithstanding that a substantial portion of the value of an acquired corporation is attributable to a class of preferred stock not acquired as part of the qualified stock purchase. The recapture provisions and certain other taxable consequences were applied with reference to the fair market value of an acquired corporation's assets under the provisions applicable prior to TEFRA when a purchase and liquidation of a subsidiary corporation was treated as a purchase of its assets. It is not clear in all cases that a comparable result can be obtained under the adjusted stock basis formula prescribed under TEFRA for determining the deemed purchase price of the acquired corporation's assets.

Under the bill, in order to provide recapture and other taxable treatment comparable to that applicable when a purchased subsidiary was liquidated under prior law, the deemed sale price of the acquired corporation's assets would be their fair market value as of the acquisition date. The basis of the assets is their fair market value reduced by unrealized appreciation in the stock of the acquired corporation held by the acquiring corporation on the acquisition date. Such unrealized appreciation is the excess of the fair market value over the aggregate bases of such stock.

f. Period for making election in connection with certain stock purchases treated as asset acquisitions

An election following a qualified stock purchase must be made, except as regulations provide otherwise, within 75 days after the acquisition date.

Under the bill, the election may be made not later than the fifteenth day of the ninth month following the month in which the acquisition date occurs, except as regulations provide otherwise.

g. Treatment of certain liquidations for tax avoidance purposes

Generally on a complete liquidation of a controlled subsidiary, the acquiring corporation succeeds to its tax attributes, including carryover items. Prior to TEFRA, when an acquired subsidiary corporation was liquidated pursuant to a plan of liquidation adopted within two years following a qualifying purchase of the subsidiary's stock, the transaction was treated as a purchase of the subsidiary's assets and its net operating loss and other carryforward items and other tax attributes were terminated.

Under the TEFRA revision of prior law, the treatment of a qualified stock purchase as an asset acquisition applies on the acquisition date without liquidating the acquired corporation if an election to so treat the purchase is made by the purchasing corporation. If no election is made, the acquired corporation may be immediately liquidated following its acquisition and the acquiring corporation will succeed to its tax attributes. When control of a corporation is acquired, or a corporation acquires from another corporation not controlled by the acquiring corporation or its shareholders property with a carryover basis, carryovers and other tax benefits may be disallowed if the principal purpose of the acquisition is tax avoidance or evasion. The application of this disallowance provision in not clear when a purchased corporation with unexpired carryforward items is liquidated into the acquiring corporation.

The bill would provide an explicit rule to authorize the disallowance of carryover and other tax benefits when a subsidiary corporation, acquired in a qualified stock purchase with respect to which an election of asset acquisition treatment is not made, is liquidated pursuant to a plan adopted within two years of the acquisition date and the principal purpose of the liquidation is tax avoidance or evasion. Further, as in Treas. reg. sec. 1.269-3(b)(1), it is expected that the Treasury regulations will provide that, in the absence of evidence to the contrary, this situation is ordinarily indicative that the principal purpose of the liquidation is tax avoidance.

9. Treatment of certain holding companies (sec. 102(h) of the bill and secs. 304 and 306 of the Code)

a. Amount constituting a dividend in certain redemptions through related corporations

If one or more shareholders with 50 percent or greater stock ownership in one corporation transfer stock of that corporation to another corporation in which they have 50 percent or greater control in exchange for property, the transaction is treated as a dividend to the shareholders if it would be so treated by applying the redemption provisions (sec. 302) with reference to the ownership of the corporation whose stock is surrendered in the transaction. Under the TEFRA revision of these provisions, the determination of the amount which is a dividend is made as if the property were distributed from the issuing corporation to the acquiring corporation and then from the acquiring corporation to the shareholder.

This rule was intended to provide dividend treatment for property received by shareholders to the extent of the aggregate earnings and profits of both the acquiring corporation and the corporation whose stock is acquired in the transaction. However, its application is unclear because, for example, the amount treated as distributed to corporate shareholders is limited with reference to the distributing corporation's basis in the distributed property but is not so limited for shareholders who are not corporations.

In order to clarify the application of the rule adopted by TEFRA, the bill would provide that the amount which is a dividend shall be determined as if the property were distributed by the acquiring corporation to the extent of its earnings and profits and then by the corporation whose stock is acquired (the issuing corporation). The transaction would have no effect on the issuing corporation if earnings and profits of the acquiring corporation equal or exceed the amount treated as a distribution in the hands of the shareholders. If the distribution is in excess of the acquiring corporation's earnings and profits, the amount treated as distributed by the issuing corporation would not exceed the earnings and profits of such corporation.

b. Coordination of redemptions through related corporations with provisions for nonrecognition of gain or loss

Under present law, the exchange of stock in a 50 percent controlled corporation for property from another 50 percent controlled corporation is treated as a stock redemption subject to dividend treatment (under section 304). TEFRA provided that the provisions relating to transfers to 80-percent controlled corporations would generally not apply to the extent of the nonstock consideration distributed. However, the language also applies to exchanges governed by the corporate reorganization provisions. Further, redemption treatment was made inapplicable where the property received consists of indebtedness assumed by the acquiring corporation or indebtedness to which the transferred stock is subject if such indebtedness (acquisition indebtedness) was incurred by the shareholder to acquire the transferred stock. Redemption treatment was made inapplicable even if the acquisition indebtedness was assumed in a transaction to which the nonrecognition rules would not apply (one in which the transferors own less than 80 percent of the acquiring corporation). Finally, under TEFRA, stock redemption treatment does not apply to certain minority shareholders who receive securities in an exchange in which stock in a bank is transferred to a newly formed bank holding company provided those who receive property in the exchange do not have control of the bank holding company.

The bill would clarify that only the nonrecognition provision governing transfers to a corporation in which the shareholders have 80 percent control (sec. 351) would be made inapplicable to exchanges involving controlled corporations treated as redemptions. Thus, where the reorganization provisions apply, including those governing the treatment of exchanges by shareholders pursuant to a plan of reorganization, the rules of section 304(a) providing treatment as a stock redemption would not apply.

In order to prevent the "bail out" of earnings by purchasing stock from a related party with borrowed funds and later transferring the stock to a related corporation with the acquisition debt assumed, the bill would restrict the exclusion from the rules providing stock redemption treatment for acquisition indebtedness to cases in which the indebtedness is incurred to purchase stock from a person whose stock ownership is not attributable, under section 318(a), to the person transferring the stock to the acquiring corporation. Attribution resulting from ownership of an option is to be ignored in applying this rule. Finally, the bill provides that where the shareholders receive property consisting of the assumption of acquisition indebtedness in a corporation in which their control is between 50 and 80 percent, the transaction would be subject to redemption and possible dividend treatment under section 304(a).

The bill would clarify that the assumption by a bank holding company of acquisition indebtedness will not be treated as property received by shareholders in control of the bank holding company for purposes of applying the rule excluding securities received by minority shareholders from the stock redemption rules. Thus the minority shareholders would not be subject to dividend treatment on the receipt of the securities.

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c. Modification of constructive ownership rules in applying rules governing redemptions through use of related corporations

Under the constructive ownership rules, generally a shareholder is treated as owning stock held by a corporation only if the shareholder directly owns 50 percent or more in value of the stock of such corporation and only in proportion to his ownership in the corporation. Conversely, a corporation is generally treated as owning all the stock that is held by persons who are 50 percent or greater shareholders in the corporation. In applying the rules requiring redemption treatment for exchanges of stock for property involving commonly controlled corporations, these 50-percent threshold limitations on attribution of ownership do not apply. As a result, the stock redemption rules may apply when, for example, a corporation sells stock of a subsidiary to a subsidiary of another corporation if a person owns any stock in both the parent of the purchasing corporation and the selling corporation, even though such stock in each case is merely a portfolio investment. A consequence of treating the transaction under the stock redemption rules is that, under those rules, the transferred stock is treated as a contribution to the capital of the acquiring corporation. Concern has been expressed that this treatment precludes treatment of the stock acquisition as a purchase, thus disqualifying it as a qualified stock purchase for purposes of permitting elective asset acquisition treatment by the acquiring corporation (under section 338).

The bill would provide a *de minimis* rule that constructive ownership would not apply to and from a corporation and a shareholder owning less than 5 percent in value of the stock of the corporation, for purposes of determining whether or not control exists under section 304.

d. Disposition of certain preferred stock

If, in lieu of the receipt of cash or other property, shareholders who transfer stock in a controlled corporation to another controlled corporation receive in exchange preferred stock in a transaction in which gain or loss is not recognized, subsequent disposition of the preferred stock may result in ordinary income to the shareholders, if receipt of cash in lieu of stock would have been treated as a dividend. The determination of the character of the hypothetical receipt of cash is made under the rules providing for stock redemption and possible dividend treatment when stock is sold to a commonly controlled corporation. This extension of the treatment generally applicable to preferred stock dividends to preferred stock received in an exchange with a controlled corporation to which the nonrecognition rules apply was adopted by TEFRA. However, the preferred stock affected by this rule may be disposed of in a stock redemption; whether ordinary income results from such redemption is determined by treating it solely as a distribution by the acquiring corporation. The acquiring corporation may be a corporation newly formed or may have little or no earnings and profits so that the distribution would not constitute a dividend.

The bill would provide that the dividend equivalence test applied with respect to a hypothetical distribution of cash will be applicable at the time of redemption or other disposition of the preferred stock (or stock whose basis is determined by reference to the basis of the preferred stock) as well as at the time of its receipt. Under this test, treatment of the redemption of the preferred stock as a dividend to the shareholders will be determined with reference to the earnings and profits of the corporation the stock of which was acquired as well as the acquiring corporation.

10. Completed contract method of accounting (sec. 102(i) of the bill and sec. 229 of TEFRA)

TEFRA directed the Treasury Department to modify the income tax regulations relating to accounting for long-term contracts. Subsequently, on March 14, 1983, the Treasury Department issued proposed regulations in the Federal Register with respect to accounting for long-term contracts. Those regulations proposed waiving the estimated tax payment penalties for underpayments caused by certain provisions of regulations.[2] The bill would clarify that the Treasury Department has the authority to waive the penalties as proposed in the regulations.

11. Limitations on benefits and contributions under qualified plans (sec. 103(a) of the bill and sec. 415 of the Code)

TEFRA generally reduced the overall limits on contributions and benefits under qualified pension, etc., plans, tax-sheltered annuity programs, and simplified employee pensions (SEPs) of private and public employers.

The dollar limit on the annual addition under defined contribution plans was decreased under TEFRA from $45,475 to $30,000, and the dollar limit on the annual benefit payable under defined benefit plans was decreased from $136,425 to $90,000. In addition, for participants covered by both a defined contribution plan and a defined benefit plan of the same employer, the limit on the sum of the fractions of the separate limit used by each plan was reduced to the lesser of 1.25 (as applied only to the dollar limits) or 1.4 (as applied to the percentage of compensation limits).

Under TEFRA, if retirement benefits provided by a qualified defined benefit pension plan begin before age 62, the benefit generally is reduced so that it is the actuarial equivalent of an annual benefit of $90,000 beginning at age 62. Similarly, if retirement benefits under a defined benefit plan begin after age 65, the benefit may be increased so that it is the actuarial equivalent of an annual benefit of $90,000 beginning at age 65.

The TEFRA provision reducing the limits on contributions and benefits is generally effective for years ending after July 1, 1982. For plans in existence on July 1, 1982, however, the provision is effective for years beginning after December 31, 1982. A special effective date was provided for plans maintained on the date of enactment (September 3, 1982) pursuant to one or more collective bargaining agreements between employee representatives and one or more employers.

Special transition rules were applied in connection with the reduced limits. Under TEFRA, a participant's current accrued bene-

[2] Prop. Treas. reg. sec. 1.451-3(g)(5).

fit under a defined benefit pension plan is not reduced merely because TEFRA reduced the dollar limits on benefits payable under the plan. An individual's current accrued benefit is the benefit accrued as of the close of the last year beginning before January 1, 1983.

In addition, TEFRA provided a special, elective transitional rule for computing the defined contribution fraction in situations in which the employer maintains both a defined contribution plan and a defined benefit plan.

The bill would clarify that the actuarial adjustments required by TEFRA for benefits paid prior to age 62 or after age 65 would be applied to the benefit dollar limit ($90,000) rather than to the benefit.

In the case of participants in collectively bargained plans in existence on the date of enactment, the bill would provide that the current accrued benefit is the individual's accrued benefit as of the close of the last year beginning before the earlier of (1) the date on which the last of the collective bargaining agreements terminates or (2) January 1, 1986.

The bill would clarify that the special, elective transition rule for computing the defined contribution plan fraction is available only for plans that were in existence on or before July 1, 1982.

12. Loans to plan participants (sec. 103(b) of the bill and sec. 72 of the Code)

TEFRA provided that any amount received (directly or indirectly) by a participant as a loan from (1) a qualified pension etc., plan, (2) a governmental plan (whether or not a qualified plan), or (3) a tax-sheltered annuity contract is treated as a distribution to the participant unless certain requirements are met. For example, a loan that, by its terms, must be repaid within five years generally is not treated as a distribution if the amount of the loan, when added to the outstanding loan balance (principal plus interest) with respect to the employee under all plans of the employer, does not exceed the lesser of (1) $50,000, or (2) 50 percent of the present value of the employee's nonforfeitable accrued benefit under such plan (but not less than $10,000).

The TEFRA loan rules generally apply to loans made after August 13, 1982. Under a special transitional rule, however, a qualified refunding loan made after August 13, 1982, and before August 14, 1983, generally is not treated as a distribution on the date of the loan. A qualified refunding loan is a loan used to make a required principal payment on a loan that was outstanding on August 13, 1982, if that payment is required to be made before August 14, 1983.

The bill would clarify that the 50-percent rule does not reduce below $10,000 the amount of a loan to an employee that generally is not treated as a distribution under the plan.

In addition, the bill would provide that a loan to an employee from deductible employee contributions is treated as a distribution under the plan, regardless of the amount of the loan. In addition, the present value of an employee's nonforfeitable accrued benefit under the plan would not include any accrued benefit attributable to deductible employee contributions.

The bill would repeal the provision that treats a repayment of a loan to an owner-employee (*i.e.,* an individual who owns the entire interest in an unincorporated business or a partner who owns more than 10 percent of a partnership) as a contribution to the plan on behalf of the owner-employee.

Further, the bill would clarify the special transition rule for qualified refunding loans by defining a required principal payment to include an amount paid under a loan payable on demand if the loan was outstanding on August 13, 1982.

13. Repeal of special qualification requirements (sec. 103(c) of the bill and secs. 72 and 402 of the Code)

TEFRA generally eliminated distinctions in the tax law between qualified pension, etc., plans of corporations and those of self-employed individuals (H.R. 10 plans). TEFRA (1) repealed certain of the special rules for H.R. 10 plans, (2) extended other of the special rules to all qualified plans, including those maintained by corporate employers, and (3) generally applied the remainder of the special rules, with modifications, only to those plans (whether maintained by a corporate or noncorporate employer) that favor the employer's key employees (*i.e.,* a top heavy plan).

For example, TEFRA provided that a distribution to an individual who is (or was) a key employee and who has not attained age 59 1/2 or become disabled is subject to an additional 10-percent income tax. This additional tax is imposed on the taxable amount of the distribution attributable to accumulations or accruals made when the individual was a key employee in a top-heavy plan.

The bill would clarify that the additional 10 percent income tax for distributions prior to age 59 1/2 is not to apply to a distribution to an owner-employee unless it is attributable to contributions paid on behalf of the individual while a key employee in a top-heavy plan.

The bill would amend the rules relating to qualifying rollover distributions to provide that a rollover to a qualified pension, etc., plan or to a qualified annuity plan is not permitted if any part of the distribution is attributable to contributions made on behalf of the employee while a key employee in a top-heavy plan. If a distribution to a self-employed individual is not attributable to contributions made while the individual was a key employee in a top-heavy plan, however, a rollover to a qualified pension, etc., plan or a qualified annuity plan would be permitted.

14. Repeal of special limitations on deduction for self-employed individuals and subchapter S corporations (sec. 103(d) of the bill and secs. 72, 219, 401, 404, and 415 of the Code)

TEFRA generally repealed most of the special deduction limits for contributions on behalf of a self-employed individual under an H.R. 10 plan. In addition, TEFRA revised the definition of earned income of a self-employed individual so that the amount of earned income corresponds to the amount of compensation of a common-law employee. Under TEFRA, earned income is computed after taking into account contributions by the employer to a qualified plan to the extent a deduction is allowed for the contributions.

TEFRA revised the dollar limit ($30,000 for 1983) on allowable employer contributions to a simplified employee pension (SEP) to correspond to the overall limits on contributions to a defined contribution plan.

The bill would provide that, for purposes of determining the maximum allowable deduction of a self-employed individual for contributions to an H.R. 10 plan, the earned income of the self-employed individual is determined without regard to the deductions allowable for contributions to a qualified pension, etc., plan or a qualified bond purchase plan.

The bill would conform the rules relating to deductions by employees of employer contributions to SEPs to raise the dollar amount of the maximum allowable deduction to $30,000.

The bill would also repeal the following provisions relating to self-employed individuals:

(1) the rule relating to the return of excess contributions made on behalf of a self-employed individual prior to the due date of the annual return;

(2) the special rule relating to contributions by an employer on behalf of an owner-employee to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of the owner-employee issued under an H.R. 10 plan;

(3) certain special deduction rules applicable to plans benefiting self-employed individuals or shareholder-employees; and

(4) the special limitation rule applicable to certain level premium annuity contracts under plans benefiting owner-employees.

15. Allowance of exclusion of death benefit for self-employed individuals (sec. 103(e) of the bill and sec. 101 of the Code)

TEFRA provided that the exclusion from gross income of amounts received as death benefits by the beneficiary or estate of an employee is available with respect to any lump sum distribution under a qualified pension, etc., plan, a qualified annuity plan, or a tax-sheltered annuity paid on behalf of a self-employed individual.

The bill would provide that the exclusion from gross income of employee death benefits provided on behalf of a self-employed individual applies to any amount paid or distributed under a qualified pension, etc., plan or a qualified annuity plan. The bill would not change the rule providing that the exclusion is not available if (1) the employee (or self-employed individual) possessed, immediately before death, a nonforfeitable right to receive the amounts while living and (2) the distribution is not a lump sum distribution.

16. Special rules for top-heavy plans (sec. 103(f) of the bill and secs. 408 and 416 of the Code)

TEFRA provided additional qualification requirements for plans that favor an employer's key employees (top-heavy plans). These additional requirements (1) limit the amount of a participant's compensation that may be taken into account, (2) provide greater portability of plan benefits for plan participants by requiring more rapid vesting, (3) provide minimum nonintegrated contributions or benefits for plan participants who are not key employees, and (4) reduce the aggregate limit on contributions and benefits for certain key employees.

An individual is a key employee of an employer if the individual is a participant in an employer plan and, at any time during the plan year or any of the four preceding plan years, (1) is an officer (in the case of a corporate employer), (2) is one of the 10 employees owning the largest interests in the employer, (3) owns more than a 5-percent interest in the employer, or (4) owns more than a 1-percent interest in the employer and has compensation from the employer in excess of $150,000. For any plan year for which a plan is a top-heavy plan, only the first $200,000 of any employee's compensation may be taken into account under the plan. Beginning in 1986, this $200,000 limit will be adjusted for inflation in the same manner used to adjust the overall dollar limits on contributions and benefits.

Under TEFRA, a defined benefit pension plan is a top-heavy plan for a plan year if, as of the determination date, the present value of the cumulative accrued benefits for participants, who are key employees, for the plan year exceeds 60 percent of the present value of the cumulative accrued benefits for all employees under the plan. A defined contribution plan is a top-heavy plan for a plan year if, as of the determination date, the sum of the account balances of participants, who are key employees, for the plan year exceeds 60 percent of the sum of the account balances of all employees under the plan. Under a 5-year lookback rule, the present value of the cumulative accrued benefit of a participant in a defined benefit pension plan or the account balance of a participant in a defined contribution plan generally includes any amount distributed with respect to the participant under the plan within the five-year period ending on the determination date (including lump-sum distributions and distributions made before the date of enactment or before the plan became top-heavy).

The bill would revise the definition of a key employee to include any employee, rather than any participant in an employer plan, who has the requisite relationship to the employer. In addition, the bill would provide that, for purposes of determining the ten employees owning the largest interests in the employer, (1) only employees earning more than $30,000 annually are taken into account and (2) if two employees have the same interest in the employer, the employee with greater annual compensation is treated as having a larger interest. Further, the bill would clarify that the determination of the amount of an employee's interest in an employer for purposes of the top-ten owners, 5-percent owners, or 1-percent owners is determined without regard to the aggregation rules of section 414(b), (c), or (m).

Under the bill, the requirement that the employer make a minimum contribution on behalf of each participant who is not a key employee would apply to a simplified employee pension arrangement that is top-heavy.

The bill would clarify that distributions under a terminated plan, which otherwise would have been required to be included in the determination of the present value of the cumulative accrued benefit in a defined benefit plan or the account balance in a defined contribution plan, must be taken into account for purposes of the 5-year lookback rule.

The bill would provide that the $200,000 limit on compensation taken into account under SEPs will be adjusted for inflation at the same time and in the same manner as the adjustments to the overall dollar limits on contributions and benefits. In addition, the bill would clarify that no adjustment will be made to the $200,000 limit on compensation taken into account under the rules for top heavy plans until adjustments are made to the overall dollar limits on contributions and benefits.

17. Required distributions for qualified plans (sec. 103(g) of the bill and sec. 401 of the Code)

TEFRA extended to all qualified plans the requirement that a participant's benefits must be distributed not later than (1) the taxable year in which the participant attains age 70-1/2, or (2) if later, the year in which the participant retires. Alternatively, distributions must begin no later than such taxable year and must be made, pursuant to Treasury regulations, over the life of the participant (or lives of the participant and the participant's spouse), or over a period not exceeding the life expectancy of the participant (or the life expectancies of the participant and the participant's spouse). In addition, a top-heavy plan must provide that distributions to an individual who is a key employee in a top heavy plan will commence not later than the taxable year in which the key employee attains age 70-1/2, whether or not the key employee separates from service or applies for benefit payment in that year.

TEFRA extended to all qualified plans certain rules for post-death distributions. If a participant or the participant's surviving spouse dies before the entire interest in the plan is distributed, amounts payable to a beneficiary who is not the participant's surviving spouse generally must be paid to the beneficiary within five years after the participant or surviving spouse dies. The required distribution rules generally apply for plan years beginning after December 31, 1983. A special transition rule, however, exempts certain distributions made pursuant to employee designations if the designation if made before Janury 1, 1984.

The bill would clarify that, for purposes of the rules requiring distributions before death, distributions may be made to the participant and a nonspouse beneficiary even though the measuring lives for a permissible payment period are those of the participant or the participant and spouse.

Under the bill, a special exception to the general rule requiring distributions to be paid within five years after the employee's or employee's surviving spouse's death would be provided. Thus, the general rule would not apply if the distribution commences not later than one year after the death of the employee or the employee's surviving spouse and is paid to a beneficiary who was a qualified dependent of the employee. Payment must be made over a qualified period (in accordance with Treasury regulations).

The bill would provide that a qualified dependent is any individual who was a dependent of the employee for income tax purposes for the taxable year in which the employee died and who either is under age 22 or is permanently and totally disabled. An individual is permanently and totally disabled if the individual is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months.

Under the bill, the qualified period over which the distribution may be paid is (1) in the case of a qualified dependent under age 22, a term certain not extending beyond the month in which the individual attains age 22 or (2) in the case of a qualified dependent who is permanently and totally disabled, the life of the individual or a term certain not extending beyond the life expectancy of the individual.

The bill would provide that the special transition rule for employee designations does not expire until the first day of the first plan year beginning on or after January 1, 1984. In addition, the bill would clarify that if a plan provides for a specific method of distribution in the absence of an employee election of another method, such a default option is treated as an employee designation under the special transition rule. Further, in the case of a collectively bargained plan, the transition period for employee designations does not expire until the first day of the first plan year beginning on or after the earlier of (1) the date on which the last of the collective bargaining agreements relating to the plan terminates or (2) January 1, 1986.

Under the bill, in the case of a government plan, the effective date is delayed until plan years beginning after December 31, 1984. Corresponding changes are made to the expiration date of the special transition rule.

18. Required distributions in case of individual retirement plans (sec. 103(h) of the bill and sec. 408 of the Code)

TEFRA revised the rules relating to distributions from an individual retirement account or annuity (IRA) after the death of the individual on whose behalf the IRA was established. In addition, TEFRA repealed the rules under which any beneficiary of an individual on whose behalf an IRA was established (or any beneficiary of the surviving spouse of such an individual) effectively could elect to treat the IRA as one established on the beneficiary's own behalf.

The TEFRA provision relating to the treatment of inherited IRAs is effective for taxable years beginning after December 31, 1983.

The bill would clarify that the provision applies with respect to individuals dying after December 31, 1983.

19. Existing personal service corporations liquidating in 1983 or 1984 (sec. 103(i) of the bill and sec. 247 of TEFRA)

TEFRA provided a transitional rule under which personal service corporations may, during 1983 or 1984, complete a one-month liquidation under section 333 without the corporation incurring tax on its unrealized receivables.

The bill would clarify that this transition rule is available only to corporations that were in existence on September 3, 1982 (the date of enactment of TEFRA).

20. Nondiscriminatory coordination of defined contribution plans with OASDI (sec. 103(j) of the bill and sec. 408 of the Code)

TEFRA extended to all defined contribution plans a prior-law H.R. 10 rule under which the tax rate and wage base applicable to employers for old age, survivors, and disability insurance (OASDI) under social security are the maximum rate and base for determining the amount by which employer contributions can be reduced under plans that are integrated with social security.

The bill would provide that, if an employer does not maintain an integrated plan at any time during the taxable year, OASDI contributions may be taken into account as contributions by the employer to an employee's simplified employee pension (SEP). This rule would apply, however, only if OASDI contributions are taken into account with respect to each employee maintaining a SEP.

21. Profit-sharing plan contributions on behalf of disabled employees (sec. 103(k) of the bill and sec. 415 of the Code)

TEFRA permitted an employer to elect to continue deductible contributions to a profit-sharing plan on behalf of an employee who is permanently and totally disabled. The contributions are deductible, however, only if contributions are nonforfeitable when contributed.

The bill would clarify that the election is available for contributions to profit-sharing and stock bonus plans. In addition, the bill would clarify that only those contributions that are the subject of the employer's election must be nonforfeitable when made under the special rule.

22. Attorney's fees (sec. 104(a) of the bill and sec. 7430 of the Code)

TEFRA added provisions allowing awards of attorney's fees to taxpayers under certain circumstances in tax cases commenced after February 28, 1983, in any United States court or the Tax Court. On October 1, 1982, (after enactment of TEFRA), the U.S. Court of Claims was reorganized, creating a new United States Claims Court as an Article I court. Because of this reorganization, the question has arisen whether the Claims Court is a "court of the United States" for purposes of the attorney's fee provisions. The bill would clarify that the attorney's fee provisions of TEFRA apply in tax cases in the Claims Court.

23. Withholding on pensions, annuities, and certain other deferred income (sec. 104(b) of the bill and secs. 31, 3405, and 6652 of the Code)

TEFRA provided that payors generally are required to withhold tax from all designated distributions (the taxable part of payments made from or under a pension, profit-sharing, stock bonus, or annuity plan, an IRA, a commercial annuity contract, or an employer deferred compensation plan if the amounts are not otherwise considered wages). Recipients may elect, for any reason, not to have the withholding rules apply to any distribution. Payors are required to notify recipients of their right to elect not to have the withholding rules apply.

The bill would provide a credit against income taxes for the amounts withheld under the pension withholding provisions. Under the bill, no amount would be required to be withheld if a distribution consists only of employer securities of the employer corporation and cash (not in excess of $200) in lieu of fractional shares of employer securities.

The bill would clarify that the taxable part of a nonperiodic distribution paid by reason of death under a qualified pension or annuity plan, or a tax-sheltered annuity, is determined by taking into account the $5,000 death benefit exclusion provided in section 101(b), whether or not allowable.

In addition, the bill would clarify that the pension withholding rules do not apply to amounts paid to nonresident aliens that are subject to the withholding of tax on nonresident aliens or would be subject to such withholding but for a tax treaty.

Further, the bill would provide a penalty for failure to give the notice to recipients required under the pension withholding rules. The penalty applies unless it is shown that the failure is due to reasonable cause and not willful neglect and equals $10 for each failure, up to a maximum during any calendar year of $5,000.

B. Technical Corrections to the Subchapter S Revision Act of 1982

(Sec. 201 of the Bill)

1. Corporate liquidations, etc. (sec. 201(a) of the bill and proposed sec. 1363(e) of the Code)

The Subchapter S Revision Act of 1982 (the "Act") provided that gain is recognized on the distribution of appreciated property by an S corporation with respect to its stock. The committee reports state that this rule does not apply in the case of a complete liquidation. The bill would add clarifying lanquage making this rule inapplicable in the case of a complete liquidation of an S corporation, or to the distribution of stock by an S corporation in a reorganization where the receipt of that stock is tax-free to the shareholder (by reason of sec. 354, 355, or 356). It is intended both that a liquidating distribution by an S corporation would be a nonrecognition transaction at the corporate level, and also that the nonrecognition provisions of section 337 would continue to apply to the sale or exchange of property after a plan of complete liquidation has been adopted by an S corporation.

As under present and prior law, gain or loss would be recognized by the shareholder with respect to his or her S corporation stock on receipt of a distribution in complete liquidation (under the rules of secs. 331 or 333). The amount of gain or loss recognized to the shareholder would not be affected by any gain or loss which is not recognized at the corporate level.

2. Treatment of discharge of indebtedness (sec. 201(b) of the bill and sec. 108 of the Code)

Generally, a taxpayer realizes income when its debts are discharged at less than the face amount of the debt. However, if the debt was incurred by a corporation, the taxpayer may elect to reduce certain tax attributes in lieu of recognizing income.

In order to treat all shareholders in the same manner, the bill would provide that the exclusion of income arising from discharge of indebtedness and the corresponding reductions in tax attributes (including losses which are not allowed by reason of any shareholder's basis limitation) are made at the corporate level. Also, the bill would provide that where a debt is contributed to an S corporation by a shareholder as a contribution to capital, corporate income would not result to the extent that the basis of the debt had previously been reduced by the pass-through of losses from the corporation.

3. Treatment of inactive subsidiaries (sec. 201(c) of the bill and sec. 1361(c)(6) of the Code)

Under present law, an S corporation may not own a subsidiary corporation other than an inactive subsidiary. An inactive subsidiary is defined as a corporation which has not begun business before the close of the taxable year and which has no taxable income for the period included within the S corporation's taxable year.

The bill would eliminate the taxable income test and instead would provide that a subchapter S election would terminate, by reason of the subsidiary's becoming active, on the day during the S corporation's taxable year the subsidiary first has gross income. This rule would prevent a termination of the subchapter S election from occurring retroactively to the beginning of the taxable year (which is generally prohibited) by reason of the subsidiary's having any taxable income. For purposes of applying this gross income test, contributions to the corporation's capital by a shareholder would not be treated as gross income.

4. Treatment of worthless debt (sec. 201(d) of the bill and sec. 1367(b) of the Act)

The Act provided that corporate losses which pass through to the shareholders are to be taken into account prior to taking into account the deduction for worthless stock.

The bill would provide the same rule where the shareholder's debt in the corporation becomes worthless. Thus, for example, where a shareholder has no basis in his or her S corporation stock but has basis in debt owed by the corporation and that debt becomes worthless, corporate losses for the year would be allowed to the shareholder; these losses would reduce the shareholder's basis in the debt, which in turn would reduce the amount of the short-term capital loss (under sec. 166(d)) for the worthless debt.

5. Investment tax credit recapture (sec. 201(e) of the bill and sec. 1371(d) of the Code)

The Act provided that the recapture of the investment tax credit for credits claimed in years prior to becoming an S corporation is to be made at the corporate level. The bill would clarify that an S corporation's accumulated earnings and profits would be reduced by the amount of investment credit recapture tax (sec. 47) imposed on the corporation with respect to these credits, since the earnings and profits were not previously reduced by the amount of tax savings attributable to the credit.

6. Qualified subchapter S trusts (sec. 201(f) of the bill and sec. 1361(d) of the Code)

Present law allows certain trusts which distribute, or are required to distribute, income currently to elect to be treated as a "qualified subchapter S trust" which may be a shareholder in an S corporation. This election may be retroactive for up to 60 days.

The bill would increase this period to 75 days, to conform to the time provided the corporation to make a subchapter S election. Also, the bill would require that, in order for a trust to qualify to make the election, the trust, by the terms of its governing instrument, must be required to distribute its income currently. (This would prevent a retroactive revocation from occurring where there is a failure by the trust to distribute income currently.) The amended distribution requirement would not apply to any trust which elected to be a qualified subchapter S trust prior to the date of enactment of the bill.

7. Coordination with section 338 (sec. 201(g) of the bill and sec. 1362 of the Code)

Under present law, the items of income, loss, etc. for the entire taxable year in which a subchapter S election is terminated are pro-rated between the short subchapter S year and the short regular corporate year on a daily basis, unless all persons who are shareholders at any time during the year consent to closing the corporate books at the end of the subchapter S year.

Under the bill, if a corporation makes a qualified stock purchase of the stock of an S corporation and makes an election under section 338, all the recapture income resulting from the election will be reported in the corporation's subchapter C return. As a result, the selling shareholders would not take this recapture into account on their individual returns.

8. Passive income rules for 1982 (sec. 201(h) of the Code and sec. 6(b) of the Act)

Under the Act, the amendments to the passive income rules, preventing a subchapter S election from terminating by reason of excess passive income for any single taxable year, were made effective for taxable years beginning after December 31, 1981.

The bill would provide that a corporation could elect to have the new passive income rules apply only for taxable years beginning after December 31, 1982, the general effective date for the Act. Thus, a corporation with excess passive income under the rules of prior law for its taxable year beginning in 1982 could elect to terminate its subchapter S election rather than paying both a corporate and shareholder tax on that income. If an election under this provision is made causing the termination of the subchapter S election, the corporation could not re-elect subchapter S status within 5 years without the consent of the Internal Revenue Service.

9. Attribution (sec. 201(i) of the Act and sec. 318 of the Code)

Under present law, in applying attribution of ownership rules under section 318, a partnership is deemed to own proportionately stock owned by the partnership, and the partnership is deemed to own all the stock owned by the partners. In the case of a corporation, attribution to and from shareholders occur only with respect to shareholders owning 50 percent or more in value of the corporation's stock.

The bill would provide that the attribution of stock to or from an S corporation and its shareholders would apply in the same manner as if the S corporation (and its shareholders) were a partnership (with partners). Thus, attribution would occur to and from shareholders owning less than 50 percent of the corporation's stock.

10. Certain short taxable years (sec. 201(k) of the bill and sec. 1362(b) of the Code)

Under present law, a subchapter S election for a taxable year may be made during the first 2 1/2 months of the taxable year (sec. 1362(b)(1)(B)). The bill would provide that a corporation could make the election within 2 1/2 months from the beginning of a taxable year although the taxable year is of less than 2 1/2 months duration.

C. Technical Corrections to Miscellaneous Provisions

(Sec. 202 of the Bill)

1. Tax preference for low-income housing (sec. 202(a)(1) of the bill and sec. 57 of the Code)

The Technical Corrections Act of 1982 added a provision to clarify that the amortization of low-income housing under section 167(k) remained a tax preference, but erroneously added that provision to subparagraph (A) of section 57(a). This bill would move that provision to subparagraph (B) of section 57(a), relating to the tax preference for 15-year real property.

2. Foreign currency contracts (sec. 202(a)(2) of the bill and sec. 1256(g) of the Code)

The Technical Corrections Act of 1982 provided that certain foreign currency contracts would be treated as regulated futures contracts and therefore be taxed on the marked-to-market system with a maximum tax rate of 32 percent. In order for a contract to qualify as a foreign currency contract, the contract must require delivery of a foreign currency which is a currency in which positions are also traded through regulated futures contracts.

Certain contracts may call for a cash settlement by reference to the value of the foreign currency rather than actual delivery of the currency. The bill would provide that the delivery of a foreign currency requirement is met where the contract provides for a settlement determined by reference to the value of the foreign currency.

3. Effective date of corporation acquisition provision (sec. 202(a)(3) of the bill and sec. 306(a)(8) of TEFRA)

The Technical Corrections Act of 1982 clarified that any recapture income required to be reported as the result of an election to treat the purchase of corporate stock as the sale and purchase of the corporate assets generally is not reported on a consolidated return. Instead, the income is reported on the target corporation's separate return. The new TEFRA provision allowing an election to treat stock purchases as asset purchases was effective for purchases on or after September 1, 1982. A transitional rule was provided by the Technical Corrections Act to require reporting of the recapture income on the selling corporation's consolidated return in circumstances where the contract was negotiated on the contemplation that the recapture income would be reported on the selling corporation's consolidated return, and where the stock was purchased pursuant to a binding contract entered into on or after the date of enactment of TEFRA (September 3, 1982) and before the date of enactment of the Technical Corrections Act. The transitional rule is inapplicable where the contract was entered into before September

3, 1982, notwithstanding that it was contemplated that the new TEFRA rules would apply.

The bill would make the special transitional rule requiring recapture income to be reported on a selling corporation's consolidated return applicable to contracts entered into on or after September 1, 1982 (the effective date of the TEFRA election provision), rather than on or after September 3, 1982 (the date TEFRA was enacted into law).

4. Coordination of certain amendments made by the Highway Revenue Act of 1982 and Public Law 97–473 (sec. 202(b) of the bill)

The Highway Revenue Act of 1982 revised Code section 103(m) to clarify that interest on certain obligations is tax exempt under section 103 and that therefore the shareholders of regulated investment companies holding those obligations qualify for tax-free treatment on the distributions of the interest on those obligations. Public Law 97-473 also revised old section 103(m) to provide cross references. Because the Highway Act was signed prior to P.L. 97-473, the question arises whether the provision relating to Code section 103(m) contained in the Highway Act was repealed by the later-signed law. The bill would clarify that the later-signed law did not repeal the provision added by the Highway Revenue Act.

D. Technical Corrections to Highway Revenue Act of 1982

(Title III of the Bill)

1. Application of retail truck and trailer excise tax to vehicles including used parts (sec. 301 of the bill and sec. 4052 of the Code)

The Highway Revenue Act repealed the prior 10-percent manufacturers excise tax on certain trucks and trailers and imposed the tax as a retail excise tax. The new tax is imposed at a 12-percent rate on the first retail sale of taxable trucks and trailers.

The bill would clarify that the value of any used component included in a taxable truck or trailer (if furnished by the first user of the taxable vehicle) is excluded in determining the retail price of (and thereby the excise tax on) the truck or trailer.

2. Application of gasoline excise tax to gasohol (sec. 302 of the bill, sec. 521 of the Highway Revenue Act, and sec. 4081 of the Code)

The Highway Revenue Act provides a 5-cents-per-gallon exemption for gasohol from the 9-cents-per-gallon gasoline excise tax.

The bill would clarify that the exemption applies to the gasohol mixture, and not solely to the gasoline component of the mixture. A conforming amendment would be made to the floor stocks tax imposed on certain gasohol held for sale on January 1, 1983.

3. Floor stocks refunds for tax-reduced tires (sec. 303(a) of the bill and sec. 523(b) of the Highway Revenue Act)

The Highway Revenue Act provides for refund of certain previously-paid manufacturers excise taxes on articles on which tax is repealed.

The bill would clarify that floor stocks refunds also are available with respect to tires on which the excise tax is reduced, but not repealed, on January 1, 1984. The refund would be limited to the reduction in tax.

4. Other technical and conforming changes (secs. 303(b)–(f) and 304 of the bill, secs. 513(c) and 521(c) of the Highway Revenue Act, and secs. 4051, 4053, 4061, 4063, 4071, 4073, 4216, 4218, 4221, 4227, 4481, 6412, and 6416 of the Code)

The bill would restate as part of the new truck and trailer retail excise tax the exemptions previously provided by cross-reference to the repealed manufacturers excise tax.

The bill would provide that refunds of tax paid on articles used as components in the manufacture of another article on which the retail excise tax is later imposed generally are to be made to the person paying later tax rather than to the person who paid tax on the component.

The bill would clarify that the liability of installers for the truck and trailer retail excise tax on certain parts and accessories installed on taxable vehicles within six months of their purchase is secondary to the liability of the truck or trailer owners.

The bill would clarify that penalties applicable to the highway excise taxes also apply to the floor stocks taxes imposed by the Highway Revenue Act.

The bill would clarify two provisions relating to the heavy vehicle use tax. First, the bill would clarify that owner-operators eligible for a one-year delay in the increased heavy vehicle use tax rates will be subject to a full year's tax at the present law rates during 1984 (rather than a partial year's tax because of the previously scheduled expiration date of September 30, 1984). Second, the bill would provide that no inference is to be drawn from the 1982 amendments with respect to the taxation of trailers based on their "customary use" for periods before the effective date of those amendments.

Further, the bill would repeal provisions of the Code made obsolete by the Highway Revenue Act.

E. Technical Corrections to the Social Security Amendments of 1983 and Related Legislation (Title IV of the Bill)

1. Social Security coverage of Federal workers (sec. 401(h) and 403(3)(1)(B) of the bill and sec. 210(a) of the Social Security Act and sec. 3121(b)(5)(B) of the Code)

The Social Security Amendments of 1983 (P.L. 98-21) provided social security coverage for newly hired Federal civilian employees effective January 1, 1984. Persons continuously in the employ of the United States since December 31, 1983 (or with a break in such employment of 365 days or less) will not be covered.

Due to a drafting oversight, it is possible under this provision for a Federal employee who is covered under social security and who has a break in service of 365 days or less to be excluded from coverage upon return to Federal employment. For example, a person who is in the military service (which is covered under social security) as of December 31, 1983 who leaves the service and within 365 days assumes a position under the civil service retirement system would be exempt from social security coverage in the new Federal job. This result is unintended and inconsistent with the intent of the provision which is to expand the coverage of Federal employees by the social security system.

In order to prevent Federal employees who had been previously covered under social security from losing coverage as a result of a break in service of 365 days or less, the bill would provide that only continuous noncovered Federal employment since December 31, 1983 is a basis for exclusion from social security coverage.

2. Basis for calculation of alternate annual cost-of-living adjustments (secs. 401(i) (2) and (3) of the bill and sec. 205(i)(5) of the Act)

The Social Security Amendments of 1983 provided for alternative basis for the calculation of the annual cost-of-living adjustment to be paid in years when the trust fund balance is below a given percentage (15 percent at the beginning of years from 1985 through 1988, 20 percent thereafter). In any such year, the adjustment would be based on the lower of the CPI increase or the increase in average wages. The provision also requires that a "catch-up" payment be made at the point the trust funds again accumulate a reserve of at least 32 percent, to increase overall benefit levels to the extent necessary in order to compensate for losses resulting from the lower adjustment being paid. These payments can be made only to the extent that a fund ratio of at least 32 percent is maintained.

Due to a drafting oversight, the provision does not provide the authority necessary to round these catch-up payments in the same manner as all other social security benefits are rounded. The provision also could be interpreted as basing the calculation of the amount of the catch-up increase on a period of years including the year of the catch-up itself, rather than on the period ending with the year prior to the catch-up, as was intended and is stated elsewhere in the provision. Finally, the provision could be interpreted to allow a much higher catch-up payment than intended for persons who are eligible for retirement benefits long after the year of a lower benefit increase, but who were eligible for disability benefits during the year the lower increase was paid.

In order to clarify these ambiguities, the bill would provide the necessary authority to round benefits, specify that the catch-up payment will be based on the period of years preceding the year of the catch-up payment, and specify that the calculation for an individual's entitlement to a catch-up payment is to be based on the year of eligibility for the benefit on which the catch-up increase is paid.

3. Benefits of persons receiving pensions from noncovered employment (sec. 401(i)(1) of the bill and sec. 215(a) of the Act)

The Social Security Amendments of 1983 provided for a different benefit formula to be used in computing social security benefits for persons receiving pensions from employment not covered by social security. Because of a drafting oversight, the language of the provision may result in exemption from the "windfall" formula of anyone who was eligible for any type of social security benefit at any time prior to eligibility for retirement benefits (e.g., during a brief period of disability.)

The bill, therefore, would clarify the definition of eligibility for the windfall benefit formula to make certain that all those becoming eligible for social security benefits after 1985 (provided they had not become eligible for their noncovered pension prior to that time) will have the new formula applied to them.

4. Gender-based distinction concerning entitlement of divorced husbands (sec. 401(j)(1) of the bill and sec. 216(f) of the Act)

Under present law, a divorced woman is deemed to be divorced throughout the month in which she becomes divorced. Divorced husbands are not so deemed.

While the Social Security Amendments of 1983 sought to eliminate all gender-based distinctions in the Social Security Act, this gender-based distinction was not eliminated by those Amendments. Consistent with this goal, the bill would deem a divorced husband to be divorced throughout the month in which he becomes divorced.

5. Financing of noncontributory military wage credits (sec. 401(k) of the bill and sec. 229(b) of the Act)

The Social Security Amendments of 1983 changed the method of financing post-1956 noncontributory military wage credits by providing for a lump-sum payment to be made to the OASDHI trust funds from the general fund based on an amount estimated to be equivalent to the OASDHI employer-employee taxes attributable to such wage credits for the period 1957-83, accumulated with interest.

The law also provides that within 1 year after the date of the lump-sum transfer (which occurred on May 20, 1983), the amount is to be revised based on data which become available during that year. However, due to the timing of annual wage reporting, the actual amount of 1983 deemed military service wage credits will not become available until early in 1985 and, therefore, cannot be used to adjust the lump-sum amount.

The 1983 amendments also provided that in the future the trust funds would be paid annually for the OASDHI employer-employee taxes on deemed wage credits attributable to military service in years after 1983. These annual payments may be adjusted in subsequent years to account for actual experience but not for years before 1984. Thus, under current law, there will be no opportunity to revise the payment based on estimates of the amount of 1983 deemed wage credits in order to reflect actual experience.

In order to ensure that the OASDHI trust funds are paid the correct amount for employer and employee taxes attributable to deemed military service wage credits for 1983, the bill would delay the final adjustment of the estimated amount transferred to the trust funds based on deemed military service wage credits for 1983 by providing that the yearly authorizations of appropriations to the Social Security trust funds from the general fund may include adjustments of prior estimates for wages deemed to have been paid in 1983.

6. Effective date for elimination of gender-based distinction concerning divorced husbands (sec. 402(c) of the bill and sec. 202(c) of the Act)

The Social Security Act Amendments of 1983 provided that divorced spouses could become entitled to benefits without regard to the entitlement of their former spouses. Due to a drafting error, the provision applies to divorced husbands who become entitled to benefits after April 1983 and divorced wives who become entitled after December 1984.

The bill would correct this discrepancy and would eliminate this newly created gender-based distinction since P.L. 98-21 sought to eliminate all gender-based distinctions in the Act.

7. Effective date for treatment of non-qualified deferred compensation (sec. 402(f)(2) of the bill, secs. 3121 and 3306 of the Code, and sec. 209 of the Act)

Under the Social Security Amendments of 1983, amounts deferred under nonqualified deferred compensation plans generally are included in an employee's FICA and FUTA base when the services for which the amounts are payable are performed or, if later, when there is a lapse of a substantial risk of forfeiture of the employee's right to those amounts.

In general, the provision relating to nonqualified deferred compensation is effective for remuneration paid after December 31, 1983 (for FICA and social security benefit purposes), and after December 31, 1984 (for FUTA purposes). In the case of any agreement, in existence on March 24, 1983, between a nonqualified deferred compensation plan and an individual, the provision applies only with respect to remuneration paid that is attributable to services performed after December 31, 1983 (December 31, 1984, for FUTA purposes). As drafted, the treatment for FICA and social security purposes is not clear for deferred compensation under an agreement not in existence on March 24, 1983, for services performed in 1983 and for which there is no substantial risk of forfeiture at some point during 1983.

In order to eliminate this ambiguity and to provide employers sufficient time to prepare to administer the new provision, the bill would provide that remuneration, which would have been included in the FICA definition of wages before January 1, 1984 (January 1, 1985, for FUTA purposes) if the provisions of the Social Security Amendments of 1983 had applied before that date, is included in the definition of wages when the remuneration is paid. Thus, for example, if an individual enters into a nonqualified deferred compensation arrangement after March 24, 1983, and before January 1, 1984, with respect to services performed before January 1, 1984, the bill would include amounts, the payment of which is deferred under the arrangement until after December 31, 1983, in the definition of wages for FICA tax purposes when the amounts are paid. Of course, the rule for certain agreements in existence on March 24, 1983, would still apply to insure that remuneration attributable to services performed before January 1, 1984, and paid under these agreements continues to be subject to prior law.

8. Codification of Rowan decision (sec. 402(g) of the bill, secs. 3121 and 3306 of the Code, and sec. 209 of the Act)

The Social Security Amendments of 1983 provided that, with the exception of the value of certain meals and lodging provided for the convenience of the employer, the determination of whether or not amounts are includible in the social security and FUTA wage bases is to be made without regard to whether such amounts are treated in regulations as wages for income tax withholding purposes. This provision thus prevents the application to compensation, other than meals and lodging, of the Supreme Court's reasoning in *Rowan Companies Inc. vs. United States*, 452 U.S. 247 (1981). In this case, the Supreme Court held that, because the treatment of employer meals and lodging excluded from income under section 119 for income tax withholding and for FICA purposes was not dealt with in the statutes governing these provisions, Treasury regulations defining wages for purposes of these two provisions had to be consistent. Thus, because one Treasury regulation excluded from wages for income tax withholding purposes the value of meals and lodging excluded from gross income under section 119, another regulation including these amounts in wages for FICA purposes was held to be invalid.

The provision in the Amendments applies to remuneration paid after December 31, 1983, for FICA and social security benefit purposes and to remuneration paid after December 31, 1984, for FUTA purposes. Thus, it is possible that this provision could be cited as demonstrating Congressional intent that the reasoning of the *Rowan* decision should generally apply before these dates, e.g., to contributions under a salary reduction agreement to tax-sheltered annuities (sec. 403(b). These contributions have been held by the Treasury Department to be taxable for FICA purposes (Revenue

Ruling 65-208) even though they are exempt by regulation from income tax withholding.[1] (The applicability of the *Rowan* decision to these salary reduction contributions is unclear because of specific statutory language relating to retirement payments applicable to FICA but not to income tax withholding.) If the 1965 revenue ruling were determined to be invalid, then employers and employees would be eligible for refunds for open years because taxable wages would be lower. In addition, wages for benefit computation purposes would be reduced, leading in some cases to reduction of social security benefits being paid to current beneficiaries and recoupment of a portion of benefits which have been paid in recent years on the basis of wage records which included the salary reduction contributions.

In order to avoid the inferences which this provision could raise, the bill would clarify the effective date of the provision overriding the *Rowan* decision so that the provision applies for all purposes both to remuneration paid after March 4, 1983, and to remuneration paid on or before March 4, 1983, which the employer treated as wages when paid. For example, if an employer treated as wages, for FICA or FUTA purposes (or both), the amounts contributed during 1982 to an employee's tax-sheltered annuity pursuant to a salary reduction agreement, the FICA or FUTA taxes (as the case may be) paid by the employer and employee may not be refunded or credited.

9. Exclusion from coverage of foreign agricultural workers under the Agricultural Act of 1949 (secs. 403(a)(6)(A) and 403(e)(1)(A) of the bill and sec. 210(a)(1) of the Act and sec. 3121(b)(1) of the Code)

Under present law, service performed by foreign agricultural workers under contracts entered into in accordance with title V of the Agricultural Act of 1949, as amended, are excluded from coverage under the Social Security Act and taxation under the Internal Revenue Code.

In light of the fact that the provision of the Agricultural Act which provides for such contracts expired on December 31, 1964, the bill would strike the references in the law to the Agricultural Act of 1949, as amended.

10. Gender-based distinction concerning the penalty for fraud (sec. 403(c)(1) of the bill and sec. 1107(b) of the Act)

Under present law, any person who, with the intent of eliciting information about the birth, employment, wages or benefits of any individual, falsely represents that he is either that individual or the husband, wife, widow, widower, divorced wife, child or parent of that individual is subject to the penalty for fraud set out in the law. However, a person who falsely represents himself as a divorced husband is not subject to the penalty.

[1] The Social Security Amendments provide explicitly that contributions to tax-sheltered annuities under a salary reduction agreement are included in the wage base for social security and FUTA purposes, effective for remuneration paid after December 31, 1983 (December 31, 1984, for FUTA).

While the Social Security Amendments of 1983 sought to eliminate all gender-based distinctions in the Social Security Act, this gender-based distinction was not eliminated by those amendments. In order to assure that the Social Security Act provides the same penalty for fraud regardless of sex, the bill would provide that the penalty for fraud would also apply to an individual who falsely represents that he is the divorced husband of a worker or beneficiary.

11. Peer review organizations (sec. 411(a) of the bill and sec. 1866 of the Act)

The Social Security Amendments of 1983 required hospitals to enter into an agreement with a Utilization and Quality Control Peer Review Organization (also known as a Peer Review Organization or PRO) as a condition of payment under the medicare program. The costs of such review are reimbursed through the medicare trust fund. A full transition from the Professional Standards Review Organization (PSRO) program to the PRO program has not yet been made.

The bill would treat PSRO's in a manner similar to that applied to PRO's under the Social Security Amendments while the transition is being made from PSRO's to PRO's. Hospitals would be required to enter into an agreement with a PSRO (which was in existence on July 1, 1983) before January 1, 1984 as a condition of medicare payment. The costs of the review would be paid from the medicare trust fund.

12. Medicare prospective payment (sec. 411(b) of the bill and secs. 1866, 1878 and 1886 of the Act)

The Social Security Amendments of 1983 established a new system of payor hospitals under medicare, known as the prospective payment system.

The bill would clarify that the percentage of payment to be made under the target reimbursement method and the diagnosis related groups (i.e., the phase-in of the DRG payment system from a cost-based system) is based on cost reporting periods, and that the "combined adjusted" DRG payment rates are based on discharges occurring on or after a specific date.

The bill would require that State hospital cost control systems must prevent gaming and "unbundling" of services and inappropriate admissions practices in order to be provided a medicare waiver.

The bill would clarify that public comment is required only on proposed determinations issued with respect to annual indexing of DRG's on June 1 of each year, beginning with fiscal year 1986.

The bill would also require that hospitals exempt from the DRG-payment system have agreements with PRO's or PSRO's; it would amend section 1878 of the Social Security Act to provide prospectively for consolidated judicial review of Provider Reimbursement Review Board (PRRB) determinations of group petitions; and it would correct a reference error in section 1818(c) of the Act.

13. Normalizing credit of medicare taxes to the Hospital Insurance Trust Fund (sec. 411(c) of the bill and sec. 1817 of the Act)

The Social Security Amendments of 1983 revised the accounting procedures of the Old Age and Survivors, Disability, and Hospital Insurance Trust Funds to provide that the Treasury would credit to the trust funds, at the beginning of each month, the amount of payroll taxes estimated to be received during the month. Under prior law, amounts were paid to the trust fund from "time to time."

The bill would repeal these "normalization" provisions with respect to the Hospital Insurance Trust Fund. Thus, funds would be transferred from the Treasury to the HI Trust Fund as under prior law. The provision does not affect the OASDI Trust Funds.

14. Effective dates relating to certain medicare changes (sec. 411(d) of the bill and secs. 1878 and 1886 of the Act)

The Social Security Amendments of 1983 made certain changes with respect to group appeals under the Provider Reimbursement Review Board. In addition, the Amendments required the Secretary of Health and Human Services to issue regulations with respect to prospective payment by a certain date.

The bill would clarify that the PRRB changes only apply to appeals and action brought after April 20, 1983. It also would clarify that the regulations for implementing all the medicare-related amendments (not merely those directly related to DRG payments) are to be made on an interim-final basis.

15. Enrollment and premium penalty with respect to working aged provision (sec. 412 of the bill and sec. 1839 of the Act)

The Tax Equity and Fiscal Responsibility Act of 1982 requires employers to offer to their employees age 65 through 69 the same group health plan which is offered to their employees under 65. Where the employee chooses the employer plan, medicare becomes the secondary payor.

Under present law, a penalty equal to 10 percent of the part B premium is assessed against an individual for every year in which he or she fails to enroll in medicare part B after he or she becomes eligible for benefits. Further, an individual who does not enroll when initially eligible at 65, may enroll in medicare only during the January through March enrollment period.

The bill would eliminate any penalty for late enrollment in medicare for any individual 65 through 69 for any month in which the individual can demonstrate that he or she was enrolled as an employee (or a spouse of an employee) in an employer group health plan which is a primary payor to the medicare program.

A special enrollment period would be provided to individuals in such age group who did not elect coverage under medicare during their initial enrollment period because of coverage at the time under an employer plan and who lose such employer coverage or turn 70 years of age. In addition, there is also a special enrollment period for those who were enrolled during periods in which they were not covered under an employer plan, who have not terminated medicare enrollment other than at a time when they were covered under such a group health plan or turn 70. These special enrollment periods begin either three months before the individual turns 70 and last seven months, or begin with the month in which the individual loses coverage under the employer plan and last four months, whichever begins earlier. Where the individual has such a special enrollment period, because the individual turns 70 or the employer coverage terminates, medicare coverage begins in the same manner as under current law for individuals turning 65; for example, if the individual enrolls in the month in which he or she turns 70, the coverage period begins with the following month.

16. Miscellaneous corrections (sec. 413 of the bill)

The bill would make certain corrections of spelling, punctuation, and cross-references in title XVIII of the Social Security Act and in cross-references to the Internal Revenue Code.

F. Effective Dates

The amendments made by H.R. 3805 (the Technical Corrections Act of 1983) would take effect as if included in the original legislation to which each amendment relates.

II. REVENUE EFFECT OF THE BILL

It is estimated that the provisions contained in H.R. 3805 (the Technical Corrections Act of 1983) would not have any overall revenue impact. While certain individual provisions may appear to result in a minor revenue increase or decrease, these revenue effects were taken into account in estimating the revenue effects of the original bills.