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DESCRIPTION OF H.R. 6056 (TECHNICAL CORRECTIONS ACT OF 1982)

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

ON APRIL 27, 1982

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COMMITTEE ON WAYS AND MEANS
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JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This pamphlet describes the technical revisions to the Economic Recovery Tax Act of 1981 (Public Law 97–34), the Crude Oil Windfall Profit Tax Act of 1980 (Public Law 96–223), and the Installment Sales Revision Act of 1980 (Public Law 96–471) contained in the Technical Corrections Act of 1982 (H.R. 6056, introduced on April 1, 1982, by Chairman Rostenkowski and Mr. Conable). The Committee on Ways and Means has scheduled a public hearing on the bill on April 27, 1982.

The technical amendments made by the Technical Corrections Act of 1982 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 Committee on Ways and Means, taking into account the comments submitted to the Congress that concerned changes that were technical in nature. The bill was developed with the assistance of the staffs of the Treasury Department and the Internal Revenue Service.

Part I of the pamphlet is the description of the provisions of the bill. The bill is organized in three titles: Title I—technical amendments to the Economic Recovery Tax Act of 1981; Title II—technical amendments to the Crude Oil Windfall Profit Tax Act of 1980; and Title III—technical amendments to the Installment Sales Revision Act of 1980. 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 Amendments to the Economic Recovery Tax Act of 1981

(Title I of the Bill)

1. Individual rate cuts (sec. 101(a) of the bill and secs. 21 and 6428 of the Code)

ERTA [1] reduced individual income tax rates in several stages, for a total reduction of approximately 23 percent. For 1981, the rates were reduced 1¼ percent. The 1981 reduction was achieved by the use of a credit, rather than a reduction in the rate schedules. The individual rate changes made by ERTA are not prorated in the case of fiscal year taxpayers.

The bill would clarify that fiscal-year individuals and other noncorporate fiscal-year taxpayers will use the 1981 rate schedules for fiscal year 1981–1982 (i.e., they will not prorate with the 1982 rate schedules). They will be entitled to the 1¼ percent credit on their tax liability for their 1981–1982 fiscal year.[2]

The bill would clarify that the 1¼ percent credit for 1981 is not available to reduce the portion of an individual's tax determined under the 50-percent maximum rate for personal service income (sec. 1348) or the special 20-percent capital gains rate for post-June 9, 1981, gains, but is available to reduce the tax on lump sum distributions under sec. 402(e).

2. Foreign earned income exclusion (sec. 101(c) of the bill and sec. 911 of the Code)

ERTA replaced the system of deductions and exclusions for excess costs of living abroad with an exclusion for income earned abroad of up to $75,000 in 1982, increasing in annual increments of $5,000 up to $95,000 in 1986 and later years. In addition, an exclusion or deduction for certain foreign housing costs is provided.

The bill would clarify that the amount of the foreign earned income exclusion (including the exclusion for housing) plus the deduction for housing expenses cannot exceed the taxpayer's foreign earned income for the year.

3. Gain on sale of residence (sec. 101(d) of the bill and sec. 1034 of the Code)

Gain on the sale of a taxpayer's principal residence may be "rolled over" tax-free if a new principal residence is purchased within the replacement period. ERTA extended the replacement period from 18

[1] The Economic Recovery Tax Act of 1981 (P.L. 97–34).

[2] Treasury regulations allow a taxpayer to change to a calendar year accounting period in order to benefit from the lower tax rates adopted by ERTA. Reg. § 5c. 442–1.

months to 2 years. In addition, only one tax-free rollover is allowed every two years; this period also was increased from 18 months by ERTA. The effective date of this provision was generally for sales made after July 20, 1981. However, the changes were also effective for sales made on or before July 20, 1981, if the prior law 18-month rollover period had not expired by July 20, 1981. The result of these changes could deny tax-free rollover treatment in certain situations involving two sales more than 18 months, but less than two years, apart.

Under the bill, a taxpayer selling a principal residence before August 14, 1981, could elect not to have the rollover amendments made by ERTA apply to the sale. This would protect a taxpayer who had previously sold a residence within two years from losing any otherwise applicable tax-free rollover benefit.

4. Dependent care assistance exclusion (sec. 101(e) of the bill and sec. 129 of the Code)

ERTA provided an exclusion from an employee's gross income (within certain limits) for amounts paid or incurred by an employer for dependent care assistance provided to an employee under a dependent care assistance program which meets certain conditions.

The bill would provide that in order to be qualified, a dependent care assistance program can not provide benefits that discriminate in favor of officers, owners, or highly compensated employees, or their dependents.

Also, the bill would clarify that an employer is not disallowed a tax deduction for amounts employees exclude from income.[3]

5. Adoption expenses (sec. 101(f) of the bill and sec. 222 of the Code)

ERTA provided a new itemized deduction (up to $1,500) for qualified adoption expenses paid or incurred to adopt a child with special needs.

The bill would clarify that the deduction is available for the adoption of a child who the State determines is a child with special needs, as defined for purposes of the Social Security Act adoption assistance program. This is a child who the State determines cannot or should not be returned to his or her parent's home, who has a specific factor or condition which makes the child difficult to place, and who has been the object of an unsuccessful placement effort.

6. Accelerated cost recovery system (sec. 102(a) of the bill and secs. 168, 751, and 1250 of the Code)

ERTA replaced the prior law depreciation system with a new mandatory cost recovery system under which eligible property is recovered over a period of 3, 5, 10, or 15 years. Longer periods may be elected.

The bill would make a number of clarifying amendments to these provisions.

The bill would clarify that recovery allowances for real property for the year the property is placed in service or disposed of will be

[3] Sec. 127 (relating to educational assistance programs) contains a similar disallowing amounts excluded from income. The IRS has interpreted that rule as not applying to the employer.

based on the number of months the property is in service during the year regardless of the length of the taxpayer's taxable year.

The bill would allow the Treasury Department to prescribe rules relating to the treatment of recovery allowances where property is transferred in certain related party transfers, sale-leasebacks, and tax-free transfers.

The bill would allow the Treasury Department to prescribe rules to determine recovery allowances where the use of the property changes.

The bill would clarify that qualified coal utilization property in the 10-year recovery class means only property which otherwise would be 15-year public utility property.

The bill would clarify that the straight-line recovery method for 15-year real property in the year the property is placed in service is to be based on the number of months during the year the property is in service.

The bill would clarify that a partner's gain on a sale of a partnership interest will be ordinary income to the extent that the partnership would have realized ordinary income if it disposed of its "section 1245 recovery property" in the year the partner sold its interest.

The bill would clarify that straight-line depreciation, for purposes of determining recapture on section 1250 property, would be based on straight-line depreciation over the recovery period applicable to the particular property.

7. Minimum tax preferences (sec. 102(b) of the bill and secs. 57–58 of the Code)

Under ERTA, as under prior law, accelerated recovery on personal property leased by individuals and accelerated recovery on real estate are items of tax preferences for purposes of the minimum tax (and for 1981, the maximum tax on personal service income).

The bill would clarify that the tax preference for accelerated recovery deductions on real estate continues to apply to corporations (including REITs) as under prior law.

The bill would clarify that the minimum tax is inapplicable where property is recovered over periods longer than the period prescribed under the minimum tax provisions.

8. Carryovers (sec. 102(d) of the bill and sec. 172 of the Code)

Generally, ERTA extended the carryover period for net operating loss carryovers and credit carryovers to 15 years.

The bill would clarify that the NOL carryover period for all unexpired NOL carryovers to 1981 of former REITs would be 15 years.

The bill would clarify that NOL or credit carryovers which expired prior to 1981 are not revived by ERTA.

9. Investment tax credit (section 102(e) of the bill and secs. 46–48 of the Code)

Under ERTA, three-year class property is eligible for a 6-percent investment tax credit, and other property is eligible for a 10-percent credit. Additional credits continue to apply to energy property, and additional credits were made applicable to certain rehabilitation expenditures for buildings. ERTA also extended the investment tax credit to certain storage facilities used in connection with the distribution of petroleum products.

The bill would clarify that eligible property such as elevators and escalators get full investment credits.

The bill would clarify that a building or structural component (such as a warehouse) used as a storage facility in connection with the distribution of petroleum products is not eligible for the investment credit (and would not automatically be subject to section 1245 recapture).

10. Rehabilitation expenditures (sec. 102(f) of the bill and secs. 46(a) and 48(g) of the Code)

ERTA provided a 15-percent investment tax credit for the rehabilitation of nonresidential buildings at least 30 years old, as a 20-percent credit for nonresidential buildings at least 40 years old, and a 25-percent credit for certified historic buildings. The prior law provision permitting 5-year amortization of the costs of rehabilitating historic structures was repealed.

The bill would clarify that a building on which a rehabilitation began before 1982 and which is not eligible for the new investment credit will not lose its eligibility for 5-year amortization (under sec. 191), whether or not the rehabilitation was eligible for the prior law credit.

The bill would clarify that the end of the 24-month period with respect to which the substantiality of a rehabilitation project is measured may be set at any time during the taxable year rather than only on the last day of the taxable year.

The bill would clarify that a basis adjustment for any allowable investment credit would be required for certain rehabilitation regardless of whether the credit is used or carried forward.

To obtain the credit under ERTA, the taxpayer must elect the straight-line method for the rehabilitated portion of the building. To elect straight-line for improvements under ACRS, the taxpayer must have elected straight-line for the building shell, unless the rehabilitation occurs more than 3 years after the property is placed in service. The bill would clarify that taxpayers may elect the straight-line method for the building shell at any time within 3 years after the shell is placed in service. This would enable taxpayers to elect straight-line for the rehabilitated portion of the building, and thus claim the credit.

The bill would clarify that only a qualified rehabilitated building is eligible for the rehabilitation credit.

The bill would clarify that the basis of land is not taken into account in determining whether a rehabilitation is substantial.

11. Investment tax credit for used property (sec. 102(g) of the bill and sec. 48(c) of the Code)

ERTA increased the used property limitation from $100,000 to $150,000 ($125,000 in taxable years beginning in 1981, 1982, 1983, and 1984).

The bill would clarify that the increased used property limitation for the investment credit applies to taxable years beginning after 1980.

12. Credit for increasing research expenditures (sec. 102(h) of the bill and sec. 44F of the Code)

ERTA added a 25-percent income tax credit based on the amount by which a taxpayer's qualified research expenditures for the taxable

year exceed the average qualified research expenditure, in a base period (generally, the preceding three taxable years). Qualified research expenses include "in-house research expenses" and "contract research expenses". In-house research expenses means amounts paid or incurred for certain research wages, research supplies, or the right to use personal property in research.

The bill would provide that in-house research expenses do not include payments for the right to use personal property in research paid or incurred after March 31, 1982, other than payments for the use of computer time by a person who is not the principal user of the computer.

The bill would add the research credit to the list of income tax credits which may be reduced under Code section 108(b)(2) where a taxpayer has income from discharge of indebtedness excluded from gross income by reason of bankruptcy or insolvency.

13. Qualified subchapter S trusts (sec. 102(i) of the bill and sec. 1371(g) of the Code)

The provisions of subchapter S allow certain closely held corporations to have their income and loss taxed directly to the shareholders. Prior to ERTA, trusts other than grantor trusts, voting trusts, and certain testamentary trusts could not be shareholders in a subchapter S corporation. ERTA also allowed certain trusts which distribute all their income currently to the sole income beneficiary to be a shareholder in a subchapter S corporation.

The provision would clarify that a trust required to distribute all its income currently (i.e., a "simple" trust), as well as a trust which actually does distribute all its income currently to a sole income beneficiary may qualify to be a shareholder in a subchapter S corporation. Also, the bill would clarify that the distribution requirement applies with respect to income within the meaning of section 643(b), i.e., the local law definition of income.

14. Incentive stock options (sec. 102(j) of the bill and sec. 422A of the Code)

ERTA added provisions to allow all income with respect to certain employee stock options ("incentive stock options") to be taxed at capital gains rates when the stock received on the exercise of the option is sold. The amount of stock with respect to which incentive stock options may be granted in any year after 1980 is limited to $100,000 (determined at the time of grant) plus a partial carryover of any previously unused amount.

The bill would clarify that if the option stock is sold or exchanged in a recognition transaction prior to the end of the required holding period (two years from the grant of the option and one year from the exercise of the option), the amount of ordinary income to be recognized is is limited to the excess of the amount realized over the adjusted basis.

The bill would clarify that the dollar limits with respect to options which may be granted in any year applies only to incentive stock options and that the limit is not affected by nonqualified options.

The bill would allow a good faith valuation to be used in applying the maximum dollar limit and the carryover of any unused limit, under regulations prescribed by the Treasury.

The bill would provide that the early disposition of stock acquired pursuant to the exercise of a statutory stock option to acquire other stock in connection with the exercise of an incentive stock option will not be treated as a nonrecognition transaction under section 1036. Thus, such a disposition results in ordinary income treatment (under section 421(b)) with respect to the stock disposed of.

15. Restricted property (sec. 101(k) of the bill and sec. 83(c) of the Code)

ERTA provided that if stock received by a taxpayer is subject to the "insider" trading restrictions of section 16(b) of the Securities Exchange Act of 1934, the time the income with respect to that stock is taken into account under section 83 is postponed.

The bill would clarify that the new rules apply to transfers after December 31, 1981, without regard to the recipient's taxable year.

The bill would correct the reference in the Code to the name of the Securities Exchange Act of 1934.

16. Targeted jobs credit (sec. 102(l) of the bill and sec. 51 of the Code)

ERTA extended the targeted jobs credit through 1982, revised the definition of certain eligible target groups, changed the certification rules, and made other technical changes.

The bill would clarify that wages paid to cooperative education students would continue to be eligible wages even if the income of the student's family increased after the initial determination that the family was economically disadvantaged.

The bill would clarify that the WIN credit is not available for amounts paid to any employee in taxable years beginning after December 31, 1981.

The bill would clarify that certifications on the day the individual begins work would be valid.

The bill would clarify that individuals participating in work incentive demonstration programs authorized under P.L. 97–35 could be members of a targeted group.

17. Increase in deduction for charitable contributions by corporations (sec. 102(m) of the bill and sec. 170 of the Code)

ERTA increased the charitable deduction limit for corporations from 5 percent to 10 percent of the corporation's taxable income (computed with certain adjustments).

The bill would conform several provisions of the Code, including provisions relating to insurance companies and tax-exempt organizations, to reflect the limit increase from 5 percent to 10 percent made by ERTA.

18. Motor carrier operating authorities (sec. 102(n) of the bill and section 266 of ERTA)

ERTA allowed taxpayers holding motor carrier operating authorities on July 1, 1980, to deduct the basis of the authorities over a 60-month period.

The bill would clarify that motor carrier amortization deductions may carry over in corporate acquisitions to which section 381 applies.

19. Qualified tax-exempt savings certificates (sec. 103(a) of the bill and sec. 128 of the Code)

ERTA provides a lifetime exclusion of $1,000 ($2,000 in the case of a joint return) of interest earned on qualified tax-exempt savings certificates.

The bill would clarify that interest paid on credit union share accounts is eligible for the exclusion.

20. Net interest exclusion (sec. 103(b) of the bill and sec. 128 of the Code)

ERTA provides an exclusion of 15 percent of net interest up to $3,000 of net interest ($6,000 on a joint return), starting in 1985.

The bill would clarify that an individual who does not itemize deductions would not be required to reduce interest income eligible for the net interest exclusion by interest expense, and that a person itemizing deductions would be required to reduce such interest income by no more than the amount of his or her excess itemized deductions. The bill would also provide that for the purposes of determining the amount of exclusions, itemized deductions, and credits, adjusted gross income would not be reduced by the amount of the net interest exclusion.

21. Individual retirement savings (sec. 103(c) of the bill and secs. 72, 219, 402, 403, 2039, and 4972 of the Code)

ERTA generally allows individuals an annual deduction for contributions to an individual retirement account, annuity, or bond (IRA) limited to the lesser of $2,000 ($2,250 for a spousal IRA) or 100 percent of compensation. In lieu of the deduction for IRA contributions, an employee is allowed a deduction (subject to the IRA limit) for qualified voluntary employee contributions to an employer's retirement plan. Accumulated deductible employee contributions under an employer's plan generally are subject to IRA-type rules.

The bill would clarify the rules for spousal IRAs to insure that an employee is not denied a deduction for contributions to an IRA for the benefit of a spouse having no compensation merely because the employee is also allowed a deduction for employer contributions to an IRA which qualifies as a simplified employee pension (SEP). In addition, the bill makes it clear that a deduction is allowable for IRA contributions for the benefit of a spouse who has no compensation and who has not attained age 70½ before the close of the taxable year, even if the spouse having compensation is age 70½ or older.

The bill would delete simplified employee pensions from the definition of qualified employer plan. (Except for the limits on contributions, SEPs are generally subject to the tax rules applicable to IRAs).

The bill would clarify the rules allowing a deduction for individual retirement savings by providing that, for a self-employed individual, compensation includes net earnings from self-employment reduced by any amount allowable as a deduction to the individual for contributions made on behalf of the individual to a tax-qualified plan (an "H.R. 10" plan or "Keogh" plan). In addition, the bill would clarify that compensation, for this purpose, does not include pension and annuity payments or other deferred compensation.

The bill would clarify the rule allowing deductions for certain voluntary employee contributions made to a qualified employer or government plan after the close of the taxable year by providing that such contributions must be made on account of that taxable year.

The bill would clarify that a 10-percent additional income tax is imposed on early withdrawals (generally, before age 59½) of accumulated deductible employee contributions from either the plan to which the contributions were made or from a plan to which the accumulated contributions were rolled over or otherwise transferred.

The bill would revise the rules relating to lump sum distributions and rollover amounts under qualified plans and tax-sheltered annuity programs to clarify that partial (as well as total) distributions of accumulated deductible employee contributions are eligible for tax-free rollover treatment.

The bill would clarify that accumulated deductible employee contributions payable to a beneficiary of a deceased employee under a tax-qualified plan are eligible for the estate tax exclusion only if any lump sum distribution also payable to the beneficiary under the plan is eligible for the exclusion.

The bill would clarify that an owner-employee (a sole proprietor, or a partner whose partnership interest exceeds 10 percent) is permitted to make deductible employee contributions to a tax-qualified plan (an "H.R. 10" plan or "Keogh" plan) notwithstanding the rules which may preclude nondeductible employee contributions by the owner-employee.

The bill would clarify effective date provisions for the estate tax and gift tax provisions relating to individual retirement savings.

22. Retirement plan deduction for self-employed individuals (sec. 103(c) of the bill and secs. 401 and 408 of the Code)

ERTA increased from $7,500 to $15,000, the maximum annual deduction limit for employer contributions to defined contribution H.R. 10 plans, defined contribution plans maintained by subchapter S corporations and simplified employee pensions (SEPs). Conforming changes were made to the limits on benefit accruals in defined benefit H.R. 10 plans. In addition, ERTA permitted a plan to increase the amount of compensation which may be taken into account from $100,000 to $200,000 provided the plan provides specified minimum contribution or benefit levels for common-law employees.

The bill would amend the minimum contribution rule applicable to simplified employee pensions to permit the exclusion of self-employed individuals. This change would conform the minimum contribution rule for SEPs to that for H.R. 10 plans and plans maintained by subchapter S corporations.

The bill would increase the limit on contributions to an IRA to which an employer makes contributions under a SEP from $15,000 to $17,000, to allow the IRA to accept employee contributions of $2,000 in addition to employer contributions of $15,000.

The bill would clarify the effective date provision to apply to all plans, whether or not they cover a self-employed individual.

23. Public utility dividend reinvestment plans (sec. 103(e) of the bill and sec. 305(e) of the Code)

ERTA added a provision which allows public utility corporations to set up dividend reinvestment plans under which shareholders electing to receive distributions in the form of common stock, rather than money or other property, may exclude up to $750 per year ($1,500 in the case of a joint return) of the stock distribution from income.

The bill would clarify that a corporation is a qualified public utility, if during the 10 years prior to its taxable year in which the distribution is paid, at least 60 percent of the cost of all tangible property described in subparagraphs (A) and (B) of section 1245(a)(3) (i.e., personal property and certain other tangible property) placed in service (whether or not purchased or self-constructed) by the corporation during the 10-year period was qualified long-life public utility property. Qualified long-life public utility property means any tangible property described in subparagraph (A) or (B) of section 1245(a)(3), which has a present class life of more than 18 years and which is public utility property (as defined in section 167(1)(3)(A)). Thus, property excluded from the definition of "recovery property" under ACRS may nevertheless meet the definition of qualified long-life public utility property.

24. Employee stock ownership provisions (secs. 103 (f), (g), and (h) of the bill and secs. 44G, 401, and 409A of the Code)

Under ERTA, the additional investment tax credit allowed an employer for contributions to an employee stock ownership plan (ESOP) is terminated with respect to qualifying investments made after December 31, 1982. For taxable years ending after that date, an electing employer is allowed an income tax credit for ESOP contributions limited to a prescribed percentage of the aggregate compensation of all employees covered by the plan.

The bill would add provisions relating to regulated public utilities which would conform the rules for the payroll-based tax credit for ESOP contributions to the rules for the investment-based tax credit for ESOP contributions.

The bill would clarify that the tax-qualified status of an ESOP is not affected merely because employer contributions are determined solely by reference to the payroll-based tax credit allowable to the employer for the contributions.

The bill would clarify that certain cash distribution provisions, if provided under a tax credit ESOP of an employer whose stock generally is required to be held only by employees, will not affect the plan's status either under the qualified plan rules or those additional rules applicable to tax credit ESOPs.

The bill would clarify the rules permitting a distribution to a participant under a tax credit ESOP in the event of the participant's transfer from one employer to another incident to a sale of assets by the former employer to the new employer.

25. Unlimited marital deduction (sec. 104(a) of the bill and secs. 2044, 2056, 2519, and 2523 of the Code)

ERTA removed the quantitative limits on the marital deduction for both estate and gift tax purposes. Thus, unlimited amounts of property

(other than certain terminable interests) may be transferred between spouses without estate or gift tax.

Under the Act, certain transfers of qualified terminable interest property qualify for the marital deduction. If certain conditions are met, a surviving spouse's income interest in qualified terminable interest property is not treated as a terminable interest. The entire property subject to such interest is treated as passing to the spouse and no interest in such property is considered to pass to any person other than the spouse. Accordingly, the entire property qualifies for a martial deduction.

The Act also provided that the entire value of property subject to an election to be treated as a qualified terminable interest will be subject to transfer taxes at the earlier of (1) the date on which the donee spouse disposes (either by gift, sale, or otherwise) of all or any part of the qualifying income interest or (2) upon the donee spouse's death.

The bill would clarify that qualified terminable interest property ("QTIP property") included in the estate of a deceased donee-spouse (under sec. 2044) is eligible for a "step-up" in basis.

The bill would clarify that QTIP property included in a deceased donee spouse's estate is treated as passing from that spouse, for purposes of the estate tax, such as, the charitable or marital deduction.

In order to insure that there is not a double deduction as a marital deduction and a charitable deduction for charitable remainder interests, the bill would clarify that the value of any interest in property may be deducted only once in computing the estate tax or gift tax liability.

The bill would clarify that the special rule providing for a constructive gift as a result of a lifetime transfer by the donee spouse of an income interest in QTIP property, applies only to the remainder interest in QTIP property. The treatment of the life estate in QTIP property is governed by the rules generally applicable to any life estate held by the surviving spouse.

The bill would clarify that the lifetime QTIP election must be made no later than April 15 of the calendar year following the year the gift is made (i.e., the due date of the annual gift tax return).

The bill would clarify that a transfer by the donor spouse of any retained interest in QTIP property after the transfer of the life interest to the donee spouse is not treated as a transfer for estate and gift tax purposes. This rule would not apply after a subsequent disposition by the donee spouse or the death of the donee spouse.

The bill would clarify that an annuity does not qualify as a qualifying income interest.

26. Current use valuation (sec. 104(b) of the bill and sec. 2032A of the Code)

If certain requirements are satisfied, an executor of an estate comprised largely of real property used in farming or other closely held businesses may elect to value the property at its current use value, rather than at its full fair market value. If, within a prescribed period after the death of the decedent (and before the death of the qualified heir), specially valued property is disposed of to nonfamily members or ceases to be used for the farming or other closely held business purpose on the basis of which it was valued in the decedent's estate, all or a

portion of the Federal estate tax benefits obtained by virtue of the reduced valuation are recaptured by means of a special "additional estate tax" or "recapture tax" imposed on the qualified heir.

The provision, as amended by ERTA, requires material participation for periods aggregating five years of the eight-year period ending on the earliest of (1) death (2) continuous disability lasting until death or (3) retirement lasting until death. ERTA also amended the provision to deem the material participation requirement to be satisfied if a surviving spouse of a decedent whose estate was eligible to value the property based upon its current use engages in "active management" of the business operation. Active management means the making of business decisions other than daily operating decisions, and requires a lesser standard of involvement than material participation.

The bill would allow "tacking" of material participation by a retired spouse with active management by the surviving spouse to qualify property for current use valuation in the surviving spouse's estate.

Four changes made by ERTA apply retroactively to certain estates of decedents dying after December 31, 1976, as well as prospectively. These four changes apply retroactively to (1) estates of decedents for which the estate tax return was due and timely filed on or before July 28, 1980 (the date on which the final Treasury regulations under section 2032A were adopted), provided that the estate timely elected current use valuation on the decedent's estate tax return (even if the election was subsequently revoked), and (2) estates of decedents for which an estate return was due and timely filed after July 28, 1980, whether or not the estate originally elected the current use valuation provision.

Estates which were eligible to reinstate (or make) elections because of these retroactive changes were required to do so on or before the date which was six months after the date of enactment of ERTA.

The bill would clarify that the only retroactive amendment made by ERTA with respect to the rules of cessations of qualified use is the provision of section 2032A(c)(7)(A) permitting a qualified heir a 2-year grace period to begin using the property in a qualified use.

The bill would clarify that the period to reinstate current use valuation by reasons of the retroactive amendments in no event expired before the close of February 16, 1982.

The bill would clarify that the right to make a late initial election is available only if one of ERTA's retroactive amendments applies to the estate.

The bill would clarify that recapture on certain tax-free exchanges occurs only to the extent nonqualified property is received.

27. Deferred estate tax payments (sec. 104(c) of the bill and sec. 6166 of the Code)

ERTA amended the Code provisions which permitted an estate to make installment payments of estate taxes attributable to interests in a closely held business. Under the Act, if the value of an interest in a closely held business exceeds 35 percent of the value of the adjusted gross estate, the estate tax attributable to the value of that interest may be paid in installments for up to 14 years. Unpaid installments are accelerated if certain dispositions occur.

The bill would correct a reference to the 35-percent requirement of section 6166 and would make conforming amendments relating to the relationships between acceleration of the tax and section 303 redemptions.

28. Transfers made within three years of death (sec. 104(d) of the bill and sec. 2035 of the Code)

Prior to ERTA, gifts made by the decedent within 3 years of death generally were includible in the decedent's gross estate (sec. 2035(a)). ERTA provided generally that gifts made by the decedent prior to death are not included in the decedent's gross estate. However, the Act contained exceptions which continue the application of the three year rule to interests in property included in the value of the gross estate pursuant to section 2036, 2037, 2038, 2041 or 2042.

The Act also included transfers within three years of death in the estate for purposes of determining eligibility for special redemptions, valuation, and installment payment purposes.

The bill would clarify that the special 3-year rule would apply for purposes of section 6166 only to determine eligibility for deferred payment treatment.

The bill would apply the 3-year inclusion rule to interests which would have been includible in the decedent's estate under section 2036, 2037, or 2038, whether or not a gift tax return was required with respect to the transfer.

The bill would make the 3-year rule inapplicable to exercises of general powers of appointment.

The bill would allow the executor of a decedent's estate to make an irrevocable election to have the estate and gift tax amendments made by ERTA not apply in any case where the decedent had made a gift before August 13, 1981, and within 3 years of death, on which a gift tax had been paid before April 16, 1982.

29. Postponement of recognition of certain straddle losses (sec. 105(a) of the bill and sec. 1092 of the Code)

ERTA requires the deferral of losses from positions constituting part of a straddle where there are unrealized gains on offsetting positions (sec. 1092(a)(1)). Unrealized gains on offsetting positions are defined as gains which would be taken into account if the positions were sold on the last day of the taxable year at their fair market value (sec. 1092(a)(3)(A)). Under tax accounting rules, gains from sales of property by a taxpayer on the cash method of accounting are not taken into account until the sale proceeds are actually or constructively received. In the case of year-end sales, consummation of the sales contract and receipt of the sales proceeds may not take place until the following year. Losses, however, are generally taken into account for tax purposes on the date the sales contract is executed. Prior to ERTA, these tax accounting rules permitted losses to be taken into account in one year and offsetting gains to be deferred into the following year in some cases. ERTA was intended to preclude this possibility.

The bill would clarify that the loss deferral rules of section 1092 would apply in the case of unrecognized gain, whether or not realized.

The bill would delete certain language of sections 1092(a)(1)(A) and 1092(d)(4) as redundant.

30. Regulated futures contracts (sec. 105(b) of the bill and sec. 1256 of the Code)

ERTA adopted the marked to market system of domestic exchanges to determine the tax consequences of holding regulated futures contracts (sec. 1256). Gains and losses reflected in such contracts held by the taxpayer at the close of his or her taxable year and which constitute capital assets are treated as short-term gain or loss to the extent of 40 percent of gains and losses and as long-term gain or loss to the extent of 60 percent of gains and losses. Section 1256(c) requires gains and losses to be taken into account at other relevant dates during the taxable year, such as the date a contract is closed by making or taking delivery under a regulated futures contract.

The bill would require expressly that gains and losses be taken into account when a taxpayer's rights in a regulated futures contracts are transferred. Thus section 1256(a) would apply when transfers of regulated futures contracts are made to and from partnerships and other flowthrough entities.

Section 1223(8) includes the period a commodity futures contract was held in determining the holding period of a commodity acquired by performance of the contract. Prior to ERTA, taking delivery under a futures contract was not a taxable event.

The bill would clarify that the holding period rule of section 1223(8) is to be inapplicable to commodities acquired through satisfaction of a regulated futures contract to which section 1256 applies.

Mixed straddles are straddles composed in part of regulated futures contracts and in part of other positions. Taxpayers may elect, under section 1256(d), to exclude the regulated futures contracts forming part of such straddles from the treatment provided by section 1256. Each position forming part of such a straddle must be identified as being part of such straddle before the close of the day on which it is acquired. If the regulated futures contract is acquired and identified before other positions included in such a straddle, failure to identify the subsequently acquired positions results in a failure to satisfy the definition of a mixed straddle in section 1256(d)(4).

The bill would amend section 1256(d)(4) defining mixed straddles to require identification of all positions constituting such straddle not later than the close of the day on which the first regulated futures contract forming part of the straddle is acquired. This amendment would clarify that an election whether section 1256 will apply to a regulated futures contract included in a mixed straddle may not be deferred beyond the date that contract is acquired.

Hedging transactions are excepted from the marked to market treatment of section 1256(a) as well as the rules of section 1092 and section 263(g). Certain syndicates, losses from which flow to limited partners or limited entrepeneurs, are excluded from the hedging exception (sec. 1256(e)(3)). The Treasury is authorized to determine that certain interests will not be treated as limited interests under these rules where it determines that an interest is held by an individual activity participating in management and that neither such interest nor the entity are used for tax-avoidance purposes. It is not clear whether this authority may be exercised through the promulgation of regulations or must be exercised on a case by case basis.

The bill would provide expressly that the Treasury may prescribe regulations to determine that interests will not be treated as held by limited partners or limited entrepreneurs in applying the syndicate rule.

31. Stripper oil (sec. 106(b) of the bill and sec. 4994 of the Code)

Under ERTA, the independent stripper oil exemption is not available for production from property which, at any time after July 22, 1981, is held by an integrated producer. The bill would clarify that this limitation applies only if the property is transferred after July 22, 1981. Therefore, a property held by a taxpayer who is currently an independent producer but who was integrated for a period of time in the past could be eligible for the exemption.

32. Penalty for valuation overstatement (sec. 107(a) of the bill and sec. 6659 of the Code)

ERTA added a valuation overstatement penalty if applicable the value of any property, or the adjusted basis of any property, claimed on a return exceeds 150 percent of the amount determined to be the correct valuation or basis. A $1,000 de minimis exception applies.

The bill would clarify that the $1,000 de minimis exception to the valuation overstatement penalty applies to the aggregate of all overstatements of the taxpayers for the taxable year. Also, a clarification would be made that the penalty applies where the stated value is exactly 150 percent of the actual value.

33. Individual estimated tax payments (sec. 107(b) of the bill and sec. 6654 of the Code)

ERTA provided that an individual is not subject to a penalty for failure to pay estimated taxes if the tax due is less than $500. (This amount is phased up in $100 increments beginning with $100 in 1981).

The bill would clarify that the underpayment penalty does not apply if the tax liability reduced by any income tax withheld is less than the specified amounts ($500 in 1985 and thereafter).

34. Prepaid legal services (sec. 108(a) of the bill and secs. 120 and 501 of the Code)

ERTA extended through 1984 the provisions of prior law allowing an exclusion from income for benefits provided under a qualified group legal services plan which is exempt from income tax under section 501(c)(20).

The bill would clarify that the section 501(c)(20) exemption provision, as well as the exclusion provision relating to group legal service plans, will terminate after 1984.

B. Technical Corrections to the Crude Oil Windfall Profit Tax Act of 1980

(Title II of the Bill)

1. Net Income Limitation—Taxable periods for computing cost depletion (sec. 201(a) of the bill and sec. 4988(b)((3)(C) of the Code)

In applying the net income limitation, producers must recompute their taxable income as if cost depletion had been claimed for "all taxable periods" (sec. 4988(b)(3)(C)). These periods were intended to include all periods during which the producer owned the property.

The bill would change "taxable periods" to "taxable years." This is necessary since the definition of taxable periods, which was changed in the conference report, does not include periods before March 1980.

2. Inflation adjustments (sec. 201(b) of the bill and sec. 4989(b)(3) of the Code)

Under section 4989(b), the inflation adjustment for any quarter is based on the difference between the GNP deflator for the second preceding quarter and that for the second quarter of 1979. The second revision of the GNP deflator is used for this purpose.

The bill would clarify that the GNP deflator for the second quarter of 1979 is to be measured using the revision most consistent with the second revision of the GNP deflator for the second quarter preceding the current quarter.

3. National Petroleum Reserve (sec. 201(c) of the bill and sec. 4991(d)(1) of the Code)

Federal production from the U.S. owned petroleum reserves at Elk Hills and Beuna Vista, California, and Teapot Dome, Wyoming, is taxed as tier two oil.

The bill would correct the reference to these reserves as "National Petroleum Reserve" in section 4991(d) to "Naval Petroleum Reserve."

4. Definition of independent producer (sec. 201(d) of the bill and sec. 4992(b) of the Code)

Under section 4992(b), an independent producer eligible for lower rates on tier 1 or tier 2 oil and for the stripper well exemption generally is a producer who is not integrated during the calendar quarter.

The bill would change the quarterly test of independent producer status to an annual test like that used for depletion purposes. The amendment would take effect starting in 1983.

5. Allocation of independent producer production (sec. 201(d) of the bill and sec. 4992(c)(2) of the Code)

In general, if an independent's production exceeds 1,000 barrels a day, the 1,000 barrel amount must be allocated between tiers one and two in proportion to the producer's production in those tiers.

The bill would provide that only taxable production eligible for lower rates is to be considered in making this allocation.

6. Small producers transfers (sec. 201(d) of the bill and sec. 4992 (d)(3)(B) of the Code)

Section 4992(d)(3)(B) refers to both "interests in property" and to "property."

The bill would conform these references.

7. Incremental tertiary project beginning date (sec. 201(e) of the bill and sec. 4993(c)(2) of the Code)

Section 4993(c)(2)(B) requires qualified tertiary recovery projects to have a beginning date after May 1979. A project's beginning date is the latter of the date injection begins or the date of certification.

The bill would clarify that projects in fact started before June 1979 cannot qualify through a post-May 1979 certification.

8. Refunds for tertiary projects (sec. 201(f) of the bill and sec. 4994(c)(2) of the Code)

Section 4994(c)(2) refers to the same person as both the taxpayer and the producer. The bill would make both references to the producer.

9. Alaskan exemption (sec. 201(f) of the bill and sec. 4994(e) of the Code)

A literal reading of section 4994(e) would result in taxing noncommercial quantities of oil produced north of the Arctic Circle and within 75 miles of the Trans-Alaska pipeline.

The bill would provide that all oil produced north of the Arctic Circle (other than Sadlerochit Oil) is exempt from tax.

10. Liberalization of withholding adjustments (sec. 201(g) of the bill and sec. 4995(a)(3)(A) and (C) of the Code)

Under present law, any error in the amount withheld by the first purchaser with respect to a producer's windfall profit tax liability can be corrected by future withholding adjustments. Such adjustments cannot be required (1) in excess of the windfall profit element of any payment, or (2) beyond the close of the calendar year of removal. These rules were designed to protect small producers such as small royalty owners who are now generally exempt from the windfall profit tax.

The bill would streamline the withholding adjustment provisions of current law by striking the windfall profit limitation and by granting the Secretary authority to require adjustments after the close of the calendar year of removal. It is anticipated that the Treasury would place a limitation on how long after the original error a correction can be made. Similarily, the reports would indicate agreement with the current cut off date for voluntary withholding adjustments. The amendment would be effective upon enactment.

11. Deemed payment date (sec. 201(g) of the bill and sec. 4995(a)(4) of the Code)

Present law provides that withheld windfall profit taxes are deemed paid on the last day of the first February following the close of the calendar year in which oil is removed from the premises.

The bill would clarify that this deemed payment date rule applies only for windfall profit tax and administrative purposes.

12. Treatment of net profits interests (sec. 201(h) of the bill and sec. 4996(a) of the Code)

Under section 4996(a), the producer responsible for payment of the windfall profit tax on oil is defined by reference to the income tax concept of economic interests. This concept determines which persons are entitled to the allowance for depletion with respect to the production of oil and gas. In the case of a net profit interest, oil production is shared by first allowing the working interest owner to recover specified costs from production and by then allocating the remaining net profit between the working interest owner and the net profits interest owner. Under the depletion rules, the working interest owner is treated as the owner of the economic interest in the crude oil allocated for the recovery of costs as well as his share of the net profits. Under present law, the windfall profit tax obligations on such oil are allocated in the same manner, thus, the working interest owner is responsible for the windfall profit tax on all of the cost recovery oil.

The bill would require allocation of cost recovery oil for windfall profit tax purposes in proportion to the shares of net profits for net profits agreements entered into after March 31, 1982.

13. Definition of crude oil (sec. 201(h) of the bill and sec. 4996(b) of the Code)

Under present law, crude oil subject to the windfall profit tax is defined by reference to the June 1979 Energy Regulations. Thus, crude oil includes condensate recovered from associated or non-associated production by mechanical separators.

The bill would amend the definition of crude oil to remove any doubt that condensate from oil and gas wells is taxable whether recovered before or after removal from the premises on which it is produced. Thus, condensate that normally could be recovered by mechanical separation will be taxed when removed from the premises even though it is not in fact recovered from the natural gas stream. It is anticipated that the Treasury will describe in regulations the circumstances under which the amount of condensate actually recovered prior to application of post-separation recovery processes such as adsorption and absorption may be used to determine the amount of condensate that should have been treated as recoverable.

14. Penalty for failure to file returns (sec. 201(i) of the bill and sec. 4997(a), etc. of the Code)

The bill would add a penalty for failure to file returns and make statements required under section 4997(a). This amendment would apply to returns the due dates for which are after the date of enactment.

15. Interrelation of overpayments of windfall tax to estimated income tax (sec. 201(j) of the bill and secs. 6015, 6154, 6654, and 6655 of the Code)

The bill would permit overpayments of windfall profit tax to be taken into account in the payment of estimated income tax to the extent provided for by the Treasury.

16. Tertiary injectants (sec. 202(b) of the bill and sec. 193(b)(1) of the Code)

The phrase "during the taxable year" would be deleted from section 193(b)(1). The phrase is redundant in light of the taxable year reference in section 193(a).

17. Transfers to corporations (sec. 202(d) of the bill and sec. 613A(c)(10)(E) of the Code)

Under section 613A(c)(10), depletion is not lost on property transferred to a corporation by an individual if certain conditions are satisfied. One of these is that the stock of the corporation be issued solely in exchange for oil and gas properties.

The bill would clarify that oil and gas property includes necessary production equipment such as production casing and pumps. The amendment would apply to transfers after 1974 with respect to production after 1979.

C. Technical Corrections to the Installment Sales Revision Act of 1980

(Title III of the Bill)

1. Sales of depreciable property between related parties (sec. 301 of the bill and sec. 1239 of the Code)

The Installment Sales Revision Act of 1980 provides that sales or exchanges of depreciable property between certain related parties are denied both capital gains treatment (sec. 1239) and installment sales reporting (sec. 453(g)). Related parties include a husband and wife, a taxpayer and a corporation or partnership which is 80-percent owned by the taxpayer, or two entities (corporations or partnerships) each of which is 80-percent owned by a taxpayer. Stock or partnership interests held by one spouse are treated as also held by the other spouse.

Under the Act, because of the application of "back attribution" rules, two entities could be treated as related even though there is no common 80-percent owner of the entities. For example, if Corporation X is owned 100 percent by A and Corporation Y is a publicly traded corporation in which A owns one share of stock, X and Y would be treated as related, since Y would be treated as owning 100 percent of X through "back attribution" of A's ownership of X.

The bill would correct the application of "back attribution" constructive ownership rules under section 1239 for cases where the entities are not considered 80-percent owned by the same person. Thus, in the case of commonly-owned corporations, if no one person owns, directly or indirectly, 80 percent or more of the stock of both corporations, the corporations would not be subject to the ordinary income rules of section 1239 with respect to any sale of depreciable property between them. For example, if Corporation X is owned 100 percent by A, and Corporation Y is owned 79 percent by A and 21 percent by a person unrelated to A, then X and Y would not be treated as related parties for purposes of section 1239.

Under the bill, if Corporation X owns at least 80 percent (by value) of the stock of Corporation Y, the corporations are related parties and section 1239(a) will continue to apply to sales of depreciable property between them. If the corporations file a consolidated return, the rules applicable to sales between X and Y will continue to be governed by the consolidated return regulation (Reg. § 1.1502–13).

2. Receipt of like-kind property (sec. 303 of the bill and sec. 453 (f) of the Code)

The Act provided that property permitted to be received without recognition of gain in certain like-kind exchanges would not be treated as a payment for purposes of reporting income under the installment method. The bill would clarify that recipt of like-kind property will qualify as a "payment" for purposes of determining whether a transaction is an installment sale.

II. REVENUE EFFECT OF THE BILL

It is estimated that the provisions contained in H.R. 5056 (the Technical Corrections Act of 1982) would not have any overall revenues 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.

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