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"BLUE BOOK"
TAX LEGISLATION
ENACTED IN THE
94TH CONGRESS

OCTOBER 1976

JOINT COMMITTEE
ON TAXATION

SUMMARY
OF THE
TAX REFORM ACT OF 1976
(H.R. 10612, 94TH CONGRESS, PUBLIC LAW 94-455)

PREPARED BY THE
STAFF OF THE
JOINT COMMITTEE ON TAXATION



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(II)

LETTER OF TRANSMITTAL

OCTOBER 4, 1976.

HON. RUSSELL B. LONG, *Chairman,*
HON. AL ULLMAN, *Vice Chairman,*
Joint Committee on Taxation,
U.S. Congress, Washington, D.C.

DEAR MESSRS. CHAIRMEN: Immediately following the passage of the conference report by the House and the Senate on the Tax Reform Act of 1976 (H.R. 10612), the House and Senate also passed a House Concurrent Resolution (H. Con. Res. 751), rearranging the section numbers of the bill in a more logical sequence. In addition, the House Concurrent Resolution made corrections of printing, clerical, and technical errors.

Primarily because of the rearrangement of the section numbers, the Public Law (P.L. 94-455), or slip law on the bill, shows many provisions in a different sequence than in the conference report and in the accompanying joint explanatory statement of the committee of conference. The staff believed that this would make it difficult to use the joint statement of the conferees in examining the provisions of the public law. For that reason; it has prepared this summary which has the sections rearranged in the order in which they appear in the public law. This summary also takes into account the other changes made in the House Concurrent Resolution and corrects printing and other errors which occurred in the joint statement of the conferees.

The Joint Committee staff has customarily prepared general explanations of the larger tax acts. This summary is not intended to replace such a document. It is anticipated that the general explanation will be issued later this year.

Sincerely yours,

LAURENCE N. WOODWORTH,
Chief of Staff.

(III)

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LEGISLATIVE HISTORY OF THE ACT

The Tax Reform Act of 1976 was the result of over two years of legislative deliberations. Some of the provisions in the Act were originally considered by the House Ways and Means Committee during the 93d Congress.¹ Consideration of the Act in the 94th Congress proceeded on the following schedule:

June 23 through June 25, 1975: Panel Discussions before the House Committee on Ways and Means.

July 8 through July 31, 1975: Hearings before the House Committee on Ways and Means.

November 12, 1975: Bill (H.R. 10612) reported by the House Committee on Ways and Means (House Report 94-658).

December 3 and 4, 1975: Bill considered and passed by the House of Representatives.

March 17 through April 13, 1976; July 20 through 22, 1976: Hearings before the Senate Committee on Finance.

June 10, 1976: Bill reported by the Senate Committee on Finance (Senate Report 94-938): Supplemental report filed by Senate Committee on Finance on July 20, 1976 (Senate Report 94-938, Part 2).

June 16-18, 21-25, 28-30, July 1-2, 20-23, 26-30, and August 3-6: Bill considered and passed by the Senate.

September 13, 1976: Committee on Conference submits Conference Report (House Report 94-1515; Senate Report 94-1236).

September 16, 1976: Conference report (and House Concurrent Resolution 751) approved by the House and Senate.

October 4, 1976: Tax Reform Act of 1976 (Public Law 94-455) signed by the President.

¹ The Ways and Means Committee did not report a tax reform bill in that Congress but did hold extensive panel discussions (February 5-28, 1973) and hearings (March 5 through May 1, 1973) on the subject. In addition, H.R. 17488, The Energy Tax and Individual Relief Act of 1974, reported by that committee on November 26, 1974 (House Report 93-1502), included provisions relating to real estate investment trusts and the taxation of foreign income which were later included in the Tax Reform Act of 1976.

CROSS REFERENCE TABLE OF PUBLIC LAW AND CONFERENCE REPORT SECTION NUMBERS

The Concurrent Resolution of September 16, 1976 (H. Con. Res. 751) redesignated numerous sections of the bill (among other corrections). The following table lists the sections at which the provisions of the Act appear in the Conference Report:

Section numbers in the Act :	Section numbers in conference report :	Section numbers in the Act :	Section numbers in conference report :
101.....	101	1301.....	2101
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TITLE I—SHORT TITLE AND AMENDMENT OF 1954 CODE

Sec. 101. Short Title

The short title of the Act is the “Tax Reform Act of 1976”. It will be referred to in this summary as the “Act”.

Sec. 102. Amendment of 1954 Code

The first title also provides that unless otherwise expressly provided, all references are to sections of the Internal Revenue Code of 1954.

(1)

TITLE II—AMENDMENTS RELATED TO TAX SHELTERS

Sec. 201. Capitalization and Amortization of Real Property Construction Period Interest and Taxes

Under the Act in the case of a taxpayer other than a corporation which is not a subchapter S corporation, real property construction period interest and taxes are to be capitalized in the year in which they are paid or accrued and amortized over a 10-year period. A portion of the amount capitalized may be deducted for the taxable year in which paid or accrued. The balance must be amortized over the remaining years in the amortization period beginning with the year in which the property is ready to be placed in service or is ready to be held for sale.

Construction period interest includes interest paid or accrued on indebtedness incurred or continued to acquire, construct, or carry real property to the extent attributable to the construction period for such property. The construction period commences with the date on which the construction of a building or other improvement begins and ends on the date that the building or improvement is ready to be placed in service or is ready to be held for sale.

The provision is not to apply to any amount that is capitalized at the election of the taxpayer as a carrying charge under present law. In addition, the provision is not to apply to interest or taxes paid or accrued with respect to property that is not held (or will not be held) for business or investment purposes (e.g., the taxpayer's residence). Separate transitional rules are provided for non-residential real estate, residential real estate, and government-subsidized housing. In the case of nonresidential real estate, this provision is to apply only to property where the construction period begins after December 31, 1975. In the case of residential real estate (other than certain low-income housing), this provision is to apply to construction period interest and taxes paid or accrued in taxable years beginning after December 31, 1977, and, in the case of low-income housing to construction period interest and taxes paid or accrued in taxable years beginning after December 31, 1981. For this purpose, low-income housing means government housing entitled to the special rules relating to recapture of depreciation (under sec. 1250(a)(1)(B)).

In addition, the length of the amortization period is to be phased-in over a 7-year period. The amortization period is to be 4 years in the case of interest and taxes paid or accrued in the first year to which these rules apply. The amortization period increases by one year for each succeeding year after the initial effective date until the amortization period becomes 10 years (i.e., the 10-year period is fully phased-in for construction period interest and taxes paid or accrued in taxable years beginning in 1982, in the case of non-residential real estate; 1984, in the case of residential real estate; and 1988, in the case of government subsidized low income housing). As a transition rule for 1976,

the amount that may be deducted currently is 50 percent and the remaining 50 percent is to be amortized over a 3-year period beginning in the year the property is ready to be placed in service or is ready to be held for sale.

The application of the general transitional rules and the phase-in of the amortization period can be illustrated by the following example. Assume that \$120,000 of interest and taxes are paid or accrued in 1980 with respect to the construction of residential real estate (other than government subsidized low income housing) and that the property is ready to be placed in service in 1982. For taxable year 1980, the \$120,000 must be capitalized under this provision, but a deduction is to be allowed for \$20,000 ($\frac{1}{5}$ of the amount capitalized). The remaining \$100,000 (i.e., $\frac{4}{5}$ of the total) is to be deducted ratably over a 5-year period beginning in 1982 (the year in which the property is ready to be placed in service). Thus, \$20,000 is to be allowed as a deduction for taxable year 1982 and in each of the next 4 years.

In the case of a sale or exchange of property, the unamortized balance of the construction period interest and taxes is to be added to the basis of the property for purposes of determining gain or loss on the sale or exchange. In the case of a nontaxable transfer or exchange (i.e., a transfer to a partnership or controlled corporation, a like-kind exchange, or a gift), the transferor is to continue to deduct the amortization allowable over the amortization period remaining after the transfer.

Sec. 202. Recapture of Depreciation on Real Property

Prior to the Act, special rules were provided for the recapture of depreciation allowed (or allowable) as a deduction with respect to real estate. In the case of non-residential (commercial) real estate, any gain realized is treated or "recaptured" as ordinary income to the extent of post-1969 depreciation taken in excess of straight-line depreciation. In the case of residential property generally, this rule applied to property held during the first 100 months ($8\frac{1}{3}$ years) with a phaseout during the next 100 months; that is, there was no recapture after $16\frac{2}{3}$ years. For certain government-subsidized housing, acquired or constructed before January 1, 1976, the phaseout began at 20 months ($1\frac{2}{3}$ years) and was completed at 120 months (10 years).

The Act modifies the rules relating to the recapture of depreciation on residential real estate. (The existing treatment of non-residential real estate requiring the recapture of post-1969 depreciation in excess of straight-line depreciation is continued.) In the case of residential real estate, the Act provides for the recapture of all post-1975 depreciation in excess of straight-line, in the same manner as is presently the case for non-residential real estate. In the case of government-subsidized housing, the Act provides full recapture of post-1975 depreciation in excess of straight-line for the first 100 months ($8\frac{1}{3}$ years) and a phaseout of the amount recaptured during the second 100 months (up to $16\frac{2}{3}$ years). There will be no recapture thereafter. The Act extends the government-subsidized housing programs administered by the Farmers Home Administration.

Sec. 203. Five-year Amortization for Low-income Housing

Under prior law, special rules permitted the rapid amortization of expenditures to rehabilitate low-income rental housing. In the case of

low-income rental housing, taxpayers can elect to compute depreciation on certain rehabilitation expenditures over 60 months if the additions or improvements had a useful life of 5 years or more. The aggregate rehabilitation expenditures that could be taken into account as to any housing could not exceed \$15,000 per dwelling unit and the sum of the rehabilitation expenditures for two consecutive taxable years must have been at least \$3,000 per dwelling unit. This special 5-year amortization rule for low-income rental housing expired on December 31, 1975.

The Act extends the special 5-year amortization rule for two years (until January 1, 1978). The Act provides that rehabilitation expenditures that are made pursuant to a binding contract entered into before January 1, 1978 will qualify for the 5-year amortization rule even though the expenditures are actually made after December 31, 1977. Also, the aggregate rehabilitation expenditures that can be taken into account per dwelling unit is increased from \$15,000 to \$20,000. In addition, the Act modifies the definition of families and individuals of low income by providing that the income limits will be determined in a manner consistent with those presently established for the leased housing program under section 8 of the Housing Act of 1937.

Sec. 204. Limitation on Deductions to Amount at Risk

Under prior law, the only general restriction on the amount of losses a taxpayer could claim from any investment activity was that losses were limited to the taxpayer's cost or other basis in the activity. A taxpayer's basis in an investment activity includes not only his actual cash investment and liabilities he is obligated to pay but also nonrecourse liabilities of the activity for which he has no payment obligation. The taxpayer's actual risk of economic loss might also be further limited by other contractual arrangements (such as guarantees or repurchase agreements). As a result, in many situations, a taxpayer could deduct losses which substantially exceeded the amount he was actually "at risk" in an activity.

The Act provides that the amount of any loss (otherwise allowable for the year) which may be deducted in connection with any one of certain activities cannot exceed the aggregate amount with respect to which the taxpayer is at risk in each such activity at the close of the taxable year. This "at risk" limitation applies to the following activities: (1) farming (except farming operations involving trees other than fruit or nut trees); (2) exploring for, or exploiting, oil and gas resources; (3) holding, producing, or distributing motion picture films or video tapes; and (4) equipment leasing. The limitation applies to all taxpayers (other than corporations which are not subchapter S corporations or personal holding companies) including individuals and sole proprietorships, estates, trusts, shareholders in subchapter S corporations, and partners in a partnership which conducts an activity described in this provision.¹

Under this provision, a taxpayer is generally to be considered "at risk" with respect to an activity to the extent of his cash and the adjusted basis of other property contributed to the activity, any

¹ This provision will not apply, for example, to corporations (other than subchapter S corporations and personal holding companies) either where such taxpayers engage in these activities by themselves, with other such corporations through a partnership, or with other taxpayers which are subject to this at risk limitation.

amounts borrowed for use in the activity with respect to which the taxpayer has personal liability for payment from his personal assets, and his net fair market value of personal assets which secure nonrecourse borrowings. However, a taxpayer is not at risk in an activity, even as to the equity capital he has contributed, to the extent he is protected against economic loss of all or a part of his equity capital by reason of an agreement or arrangement for compensation or reimbursement to him of any loss which he may suffer.

In general, the at risk provision applies to losses attributable to amounts paid or incurred (and depreciation or amortization allowed or allowable) in taxable years beginning after December 31, 1975. However, with respect to equipment leasing activities, the at risk rule does not apply to net leases under binding contracts finalized on or before December 31, 1975, and only to those taxpayers who held their interests in the property on such date. Also, the at risk rule does not apply to operating leases under binding contracts finalized on or before April 30, 1976, and only to those taxpayers who held their interests in the property on such date.² With respect to motion picture activities, the at risk provision does not apply to a film purchase shelter if the principal photography began before September 11, 1975, there was a binding written contract for the purchase of the film on that date, and at all times thereafter, and the taxpayer held his interest in the film on September 10, 1975. The at risk rule also does not apply to production costs, etc., if the principal photography began before September 11, 1975, and the investor had acquired his interest in the film before that date. In addition, the at risk provision does not apply to a film produced in the United States if the principal photography began before January 1, 1976, if certain commitments with respect to the film had been made by September 10, 1975.

In applying the at risk provisions to activities which were begun in taxable years beginning before January 1, 1976 (and not exempted from this provision by the above transition rules), amounts paid or incurred in taxable years beginning prior to that date and deducted in such taxable years will generally be treated as reducing first that portion of the taxpayer's basis which is attributable to amounts not at risk. (On the other hand, withdrawals made in taxable years beginning before January 1, 1976, will be treated as reducing the amount which the taxpayer is at risk.)

Sec. 205. Recapture of Intangible Drilling Costs for Oil and Gas Wells

Prior law provided for the recapture of deductions upon the sale of oil or gas property only to the extent that the deductions are attributable to the depreciation of tangible personal property (sec. 1245); amounts deducted currently for intangible drilling and development costs (under sec. 263(c)) were not subject to recapture.

The Act requires amounts deducted for intangible drilling expenses on productive wells to be recaptured upon disposition of the oil or gas property by treating those amounts as ordinary income to the extent that they exceed the amounts which would be allowed if the intangible expenses were capitalized and amortized over the useful life of the well.

² These transitional rules in the Act erroneously refer to activities "described in [Code] section 465(c)(1)(B)", that is, farming activities, including certain leases. Congress intends, however, that these transitional rules apply to equipment leasing activities described in section 465(c)(1)(C).

The provision applies with respect to costs paid or incurred after December 31, 1975.

Sec. 206. Termination of Additions to Excess Deductions Accounts (EDA)

Prior law (sec. 1251) provided, in general, that where a taxpayer had generated substantial losses from farming operations in excess of his income from farming operations (in the same or later years than the losses), he might have had to treat certain farm income he later realized as ordinary income rather than capital gain. The amount of potential recapture was measured by the farm losses in the taxpayer's excess deductions account (EDA).

The Act provides that there will be no further additions to EDA accounts in taxable years beginning after December 31, 1975. The Act also permits divisive "D" reorganizations to be undertaken without triggering EDA recapture. In these reorganizations, the entire EDA account is applied to both the transferor corporation and the transferee corporation. This provision applies to reorganizations occurring after December 31, 1975.

Sec. 207 (a) and (b). Limitations on Deductions for Farming Syndicates and Capitalization of Certain Orchard and Vineyard Expenses

The Act requires farming syndicates (1) to deduct expenses for feed, seed, fertilizer, and other farm supplies no earlier than when used or consumed; (2) to capitalize costs of poultry; and (3) to capitalize the costs of planting, cultivating, maintaining and developing a grove, orchard or vineyard which are incurred prior to the year the grove, orchard or vineyard becomes productive.

A farming syndicate includes (1) a partnership or any other enterprise (other than a corporation which has not elected to be taxed under subchapter S) engaged in the trade or business of farming if at any time interests in the partnership or other enterprise have been offered for sale in an offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale or (2) a partnership or any other enterprise (other than a corporation which has not elected to be taxed under subchapter S) engaged in the trade or business of farming if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.¹ In general, a limited entrepreneur means a person who has an interest, other than a limited partnership interest, in an enterprise and who does not actively participate in the management of the enterprise.

The determination of whether a person actively participates in the operation or management of a farm depends upon the facts and circumstances. Factors which tend to indicate active participation include participating in the decisions involving the operation or management of the farm, actually working on the farm, living on the farm, or hiring and discharging employees (as compared to only the farm manager). Factors which tend to indicate a lack of active participation include lack of control of the management and operation of the farm, having

¹ The term "partnership" is used only in a descriptive sense; it is not intended that this definition of farming syndicate operates to preclude the Internal Revenue Service from applying the regulations under section 7701 to an organization described in such definition to determine its proper classification (as a partnership or corporation) for Federal tax purposes.

authority only to discharge the farm manager, having a farm manager who is an independent contractor rather than an employee, and having limited liability for farm losses.

With respect to farming activities (other than those conducted by enterprises in which securities have been registered), the provision specifies five cases where an individual's activity with respect to a farm will result in his not being treated as a limited partner or limited entrepreneur. These cases cover the situations where an individual—

(1) has an interest attributable to his active participation for a period of not less than 5 years in the management of a trade or business of farming;

(2) lives on the farm on which the trade or business of farming is being carried on;

(3) actively participates in the management of a trade or business of farming which involves the raising of livestock (or is treated as being engaged in active management pursuant to one of the first two exceptions set forth above), and the trade or business of the partnership or any other enterprise involves the further processing of the livestock raised in the trade or business with respect to which he is (actually or constructively) an active participant;

(4) as his principal business activity, actively participates in the management of a trade or business of farming, regardless of whether he actively participates in the management of the activity in question; or

(5) is a member of the family (within the meaning of section 267(c)(4)) of a grandparent of an individual who would be excepted under any of the first four cases listed above and his interest is attributable to the active participation of such individual.

For purposes of the farming syndicate rules, activities involving the growing or raising of trees (other than fruit or nut trees) are not considered farming. Thus, this provision does not apply to forestry or the growing of timber.

The provisions relating to prepaid feed and other farm supplies and poultry expenses apply generally to amounts paid or incurred in taxable years beginning after December 31, 1975. In the case of farming syndicates in existence on December 31, 1975, these provisions apply to amounts paid or incurred in taxable years beginning after December 31, 1976 (but only if there is no change in membership in the farming syndicate between December 31, 1975, and the end of the syndicate's last taxable year beginning before January 1, 1977).² The provisions relating to orchards, groves and vineyards do not apply where the trees or vines were planted or purchased for planting prior to December 31, 1975, or where there was a binding contract to purchase the trees or vines in effect on December 31, 1975.

Sec. 207(c). Accrual Accounting for Farm Corporations

Under prior law, any taxpayer engaged in farming could use the cash method of accounting and generally could deduct preproductive period expenses.

² The "no change in membership" requirement applies to the addition of new members and the sale of interests of existing members to new members; however, it is not violated because of substitutions of members occurring by operation of law or gifts or because of withdrawals.

The Act generally requires any corporation (other than a subchapter S corporation, a family corporation, a nursery or a "small corporation") and any partnership in which a corporation is a partner to use the accrual method of accounting and to capitalize preproductive period expenses.

The exception for family corporations provides that a corporation is a family corporation if the members of one family own, directly or through attribution, at least 50 percent of the voting stock and of all other classes of stock of such corporation. Under the family corporation exception, stock ownership is attributed not only through partnerships and trusts, and (generally) one tier of corporations, but also, under certain circumstances, through two tiers of corporations.¹

The Act also provides an exception to cover small corporations. This provision exempts any corporation whose gross receipts (when combined with the gross receipts of related corporations) do not exceed \$1,000,000 per year. However, once this level of receipts is exceeded for a taxable year beginning after December 31, 1975, the corporation must change to the accrual method of accounting for subsequent taxable years and may not change back to the cash method of accounting for subsequent taxable years even if its receipts subsequently fall below \$1,000,000.

The Act provides an exception to the required accrual accounting rules for nurseries. Thus, a corporation which is engaged in the business of operating a nursery will not be required to utilize the accrual method of accounting by reason of this new provision (sec. 447). No inference is intended, however, with respect to any business operation which is required to utilize the accrual method of accounting under provisions of existing law.

For purposes of this provision, a corporation engaged in forestry or the growing of timber is not thereby engaged in the business of farming.² Consequently, this provision is not intended to affect the method of accounting (or treatment of preproductive period expenses) of corporations engaged in forestry or the growing of timber.

The Act also provides special rules which provide that if a corporation (or its predecessors) has, for a 10-year period prior to the date of enactment, used an "annual" accrual method of accounting (in which preproductive period expenses are either deducted currently or charged to the current year's crops), it may continue to use this method of accounting. Also, a taxpayer who has used, for a 10-year period, the static value method of accounting for the costs of deferred crops may change to the annual accrual method of accounting and be treated as if it had used such method of accounting for that 10-year period.

If a taxpayer is required to change its accounting method because of the application of this new provision, it will be allowed to spread the accounting adjustments required by this change over a period of 10

¹ In determining family ownership under this provision, if the trustee of a trust has discretion to distribute income or principal to family members or charities and if the trustee has made no distributions (or taken deductions for set-asides) to charities, family beneficiaries should be treated as the sole beneficiaries of the trust.

² This exclusion of forestry or the growing of timber from "farming" is consistent with the distinction drawn in regulations relating to provisions of the Code allowing taxpayers engaged in the trade or business of farming to deduct currently expenditures for soil or water conservation, fertilizer for land used in farming, and land clearing (secs. 175, 180, 182 and Regs. §§ 1.175-3, 1.180-1(b), and 1.182-2).

years. This provision applies to taxable years beginning after December 31, 1976.³

Sec. 208. Prepaid Interest

A taxpayer reporting his income on the accrual method of accounting can deduct prepaid interest only in the period or periods in which the interest represents the cost of using the funds during that period. However, a cash method taxpayer has generally been able to deduct expenses in the year he actually paid them. It was unsettled under prior law, however, whether (or under what circumstances) a cash method taxpayer could deduct prepaid interest in full in the year paid. Recent court decisions have supported the Internal Revenue Service in requiring a cash method taxpayer to allocate his deductions for prepaid interest over the period of the loan.

The Act requires a cash method taxpayer to deduct prepaid interest over the period of the loan to the extent the interest represents the cost of using the borrowed funds during each taxable year in the period. This rule applies to interest paid for personal, business or investment purposes. The Act also requires points paid on a loan to be deducted ratably over the term of the loan, except in the case of a mortgage incurred in connection with the purchase or improvement of, and secured by, the taxpayer's principal residence. However, the rule permitting current deductibility of points on a home mortgage applies only if points are generally charged in the geographical area where the loan is made and to the extent of the number of points generally charged in that area for a home loan. These new provisions apply to prepayments of interest on and after January 1, 1976, except for interest paid before January 1, 1977, pursuant to a binding contract or written loan commitment in existence on September 16, 1975 (and at all times thereafter).

Sec. 209. Limitation on Deduction of Investment Interest

Under prior law (sec. 163(d)), the deduction for interest on investment indebtedness was limited to \$25,000 per year plus the taxpayer's net investment income and long-term capital gain plus one-half of any interest in excess of these amounts.

Under the Act, interest on investment indebtedness is limited to \$10,000 per year, plus the taxpayer's net investment income. No offset of investment interest is permitted against long-term capital gain. An additional deduction of up to \$15,000 more per year is permitted for interest paid in connection with indebtedness incurred by the taxpayer to acquire the stock in a corporation, or a partnership interest, where the taxpayer, his spouse, and his children have (or acquire) at least 50 percent of the stock or capital interest in the enterprise. Interest deductions which are disallowed under these rules are subject to an unlimited carryover and may be deducted in future years (subject to the applicable limitation). Under the Act, no limitation is imposed on the deductibility of personal interest.

³ A partnership with a corporate general partner may be required to use the accrual method of accounting and may also be a farming syndicate subject to limitations on deductible expenses for prepaid feed and other farm supplies, expenses for poultry, and certain expenses of orchards, groves and vineyards. However, feed and other farm supplies are required to be inventoried under the accrual method of accounting, and the expenses (of poultry, orchards, groves and vineyards) that must be capitalized under the farming syndicate rules are also capitalizable preproductive period expenses under the accrual method of accounting (as required by this provision). Consequently, the application of both provisions is not inconsistent; the farming syndicate rules do not appear to impose any additional requirements for an organization subject to this provision.

Generally, these rules are applicable to taxable years beginning after December 31, 1975. However, under a transitional rule, prior law (sec. 163(d)) before the amendments made under the Act) continues to apply in the case of interest on indebtedness which is attributable to a specific item of property, is for a specified term, and was either incurred before September 11, 1975, or was incurred after that date under a binding written contract or commitment in effect on that date and at all times thereafter (hereinafter referred to as "pre-1976 interest"). As under prior law, interest incurred before December 17, 1969 ("pre-1970 interest") is not subject to a limitation.

Under the Act, carryovers are to retain their character. Thus, carryovers of pre-1976 interest will continue to be deductible under the limitation of prior law. Carryovers of post-1975 interest will be subject to the new rules adopted under the Act.

In a case where the taxpayer has interest which is attributable to more than one period (pre-1970, pre-1976, and post-1975), the taxpayer's net investment income is to be allocated between (or among) these periods. For example, assume a taxpayer has \$30,000 of pre-1976 interest and \$60,000 of post-1975 interest; also assume that the taxpayer has \$45,000 of investment income. Under the Act, one-third of the investment income (\$15,000) is to be allocated to the pre-1976 interest, which would be fully deductible (the \$25,000 allowance, plus the \$15,000 of net investment income—exceeds the \$30,000 of pre-1976 interest, which is therefore fully deductible). Two-thirds of the net investment income (\$30,000) is allocated to the post-1975 interest; this amount, added to the \$10,000 allowance provided under the Act, would result in a total deduction of \$40,000 for the post-1975 interest. The remaining amount (\$20,000) could be carried forward.

Sec. 210. Amortization of Production Costs of Motion Pictures, Books, Records, and Other Similar Property

The Act contains a capitalization rule which requires individuals, trusts, subchapter S corporations, and personal holding companies, to capitalize the costs of producing motion pictures, books, records and other similar property and permits them to deduct these capitalized costs over the life of the income stream generated from the production activity. These rules are only to apply to production costs (including the costs of making prints of the film for distribution) and not to distribution costs. The provision applies to amounts paid or incurred after December 31, 1975, with respect to property the principal production of which begins after December 31, 1975.

Sec. 211. Clarification of Definition of Produced Film Rents

Under present law, "produced film rents" is one category of personal holding company income. Generally, this category covers payments received by a corporation from the distribution and exhibition of motion picture films if these rents arise from an "interest" in the film acquired before the completion of production. Produced film rents are not treated as personal holding company income, however, if such rents constitute 50 percent or more of the corporation's ordinary gross income.

The Act clarifies any ambiguities in present law regarding whether a qualifying "interest" in a film includes interests other than depreciable interests. Under the Act, in the case of a producer who

actively participates in producing a film, the term "produced film rents" includes an interest in the proceeds or profit from the film, but only to the extent that this interest is attributable to active participation in production activities. The provision applies to taxable years ending on or after December 31, 1975.

Sec. 212. Sports Franchise Provisions

Under prior law, depreciation taken with respect to player contracts was recaptured on a contract-by-contract basis. In addition, there were no definitive rules under prior law relating to the allocation of a portion of the purchase price for a franchise to depreciable player contracts.

The Act provides that in the case of the sale or exchange of a sports franchise, the amount allocable to player contracts by a purchaser can not exceed the amount of the sales price allocated to these contracts by the seller. However, in the case of a one-year corporate liquidation, unrecognized gain which is realized by the corporation may be taken into account for purposes of computing the adjusted basis of player contracts (but only to the extent gain is recognized by the shareholders). The Act also provides a presumption that, in the case of the sale or exchange of a sports franchise, not more than 50 percent of the consideration will be allocable to player contracts unless the taxpayer can satisfy the Secretary of the Treasury that (under the facts and circumstances of the particular case) it is proper to allocate an amount in excess of 50 percent. These new provisions apply to sales or exchanges of franchises after December 31, 1975, in taxable years ending after such date.

The Act provides special rules for the recapture of depreciation and deductions for losses taken with respect to player contracts. The special recapture rules apply only in the case of the sale or exchange of the entire sports franchise. In the case of the sale or exchange of individual player contracts recapture will continue to be determined on a contract-by-contract basis. Under these special rules, to the extent of any gain attributable to player contracts, the amount recaptured as ordinary income will be the greater of (1) the sum of the depreciation taken plus any deductions taken for losses (i.e., abandonment losses) with respect to those player contracts which are initially acquired as a part of the original acquisition of the franchise or (2) the amount of depreciation taken with respect to those player contracts which are owned by the seller at the time of the sale of the sports franchise. To the extent that depreciation taken on player contracts which were acquired as part of the original acquisition of the franchise has previously been recaptured, the amount so recaptured will reduce the aggregate amount of depreciation and losses attributable to player contracts initially acquired for purposes of determining the recapture amount under (1) above. The amount determined under (2) above with respect to player contracts held at the time the franchise is sold will be equal to the aggregate depreciation allowed or allowable for all such contracts. Thus, the amount subject to recapture will be determined for player contracts on a consolidated basis and may exceed the sum of the amounts which would otherwise be subject to recapture if determined on a contract-by-contract basis, e.g., the aggregate gain is equal to or greater than the aggregate depreciation deductions, but the gain attributable to one or more of the

contracts is less than the applicable depreciation. These new rules apply to transfers of player contracts in connection with a sale or exchange of a franchise after December 31, 1975.

Sec. 213. Partnership Provisions

(a). Dollar Limitation with Respect to Additional First-Year Depreciation for Partnerships

Under present law, an owner of certain tangible personal property is eligible to elect, for the first year the property is depreciated, a deduction for additional first-year (or "bonus") depreciation of 20 percent of the cost of the property. The maximum bonus depreciation deduction is limited to \$2,000 (\$4,000 for an individual filing a joint return). Where the owner is a partnership, the election for bonus depreciation is made by the partnership. However, under prior law, the dollar limitation described above was applied to each individual partner rather than to the partnership as a whole.

Under the Act, the amount of the additional first-year depreciation that a partnership can pass through to its partners in any taxable year is limited to \$2,000. (This provision does not affect the present overall \$2,000 or \$4,000, in the case of a joint return, limitations which apply to each individual partner.) This provision applies in the case of partnership taxable years beginning after December 31, 1975.

(b). Partnership Syndication and Organization Fees

Guaranteed payments.—Prior law (section 707(c)) provided for the deduction by a partnership of so-called "guaranteed payments" made to a partner for services or for the use of capital to the extent the payments are determined without regard to the income of a partnership, "but only for the purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses)." However, present law (section 263) generally provides that no current deduction shall be allowed for capital expenditures. Nonetheless, it has been contended that these payments under section 707(c) were automatically deductible by the partnership without regard to the "ordinary and necessary" requirements of section 162(a) or section 263.

The Act amends section 707(c) to make it clear that, in determining whether a guaranteed payment is deductible by the partnership, it must meet the same tests under section 162(a) as if the payment had been made to a person who is not a member of the partnership, and the normal rules of section 263 (relating to capital expenditures) must be taken into account. This provision applies to taxable years beginning after December 31, 1975.

Syndication and organization fees.—Until recently, it has been common for limited partnerships to claim a deduction for payments made to a general partner for services rendered by him with respect to the syndication and organization of the limited partnership. Recently, the Service ruled (Rev. Rul. 75-214, 1975-1 C.B. 185) that these payments represent capital expenditures and, as such, are not currently deductible. Moreover, in a recent case, the United States Tax Court disallowed the deduction for payments of this type made to a general partner. (*Jackson E. Cagle, Jr.*, 63 T.C. 86 (1974), on appeal to C.A. 5.)

The Act requires that fees paid in connection with the organization and syndication of a partnership be capitalized. This provision applies to taxable years beginning after December 31, 1975.

The Act allows organization fees to be amortized over a period of not less than 5 years. This provision applies to taxable years beginning after December 31, 1976.

(c). Retroactive Allocations of Partnership Income or Loss

Investments in tax shelter limited partnerships have commonly been made toward the end of the year. It has also been common for the limited partnership to have been formed earlier in the year on a skeletal basis with one general partner and a so-called "dummy" limited partner. In many cases, the limited partnership incurs substantial deductible expenses prior to the year-end entry of the limited partner-investors. In these cases, a full share of the partnership's losses for the entire year has usually been allocated to these limited partners. These are referred to as "retroactive allocations." It was not clear under prior law whether retroactive allocations were permissible, although in practice they were frequently utilized.

The Act provides that income or losses will be allocable to a partner only for the portion of the year that he was a member of a partnership. In determining the income, loss or special item allocable to an incoming partner, the partnership will either allocate on a daily basis or separate the partnership year into two (or more) segments and allocate income, loss or special items in each segment among the persons who were partners during that segment. This provision applies to partnership taxable years beginning after December 31, 1975.

(d). Partnership Special Allocations

A partnership agreement may allocate income, gain, loss, deduction, or credit (or items thereof) among the partners in a manner that is disproportionate to the capital contributions of such partners. These are referred to as "special allocations" and, with respect to any taxable year, may be made by amendment to the partnership agreement at any time up to the initial due date of the partnership tax return for that year. Under prior law, a partnership agreement special allocation of "any item of income, gain, loss, deduction, or credit" would not be recognized, however, if its principal purpose was to avoid or evade any income tax. Since this provision applied to allocations of *items* of income, gain, loss, deduction, or credit, it had been argued that the provision did not apply to, and would not preclude, allocations of taxable income or loss, as opposed to specific items of income, gain, deduction, loss or credit.

The Act provides that an allocation of taxable income or loss, as well as any item of income, gain, loss, deduction or credit, will be controlled by the partnership agreement unless it lacks substantial economic effect. If an allocation made by the partnership is set aside, a partner's share of the income, gain, loss, deduction or credit (or item thereof) will be determined in accordance with the partner's interest in the partnership. These provisions apply to partnership taxable years beginning after December 31, 1975.

(e). Treatment of Partnership Liabilities Where a Partner Is Not Personally Liable

A partner may deduct his distributive share of all the deductible items of the partnership, but not more than the amount of the adjusted basis of his interest in the partnership. Under prior law, a partner's

basis in his partnership interest was increased by a portion of any partnership liability with respect to which there was no personal liability on the part of any of the partners. Consequently, a partner was allowed to substantially increase the basis in his partnership interest, and thus the amount of partnership losses he could deduct, by a portion of the partnership liabilities with respect to which he had no personal liability. This rule enabled partners to deduct amounts exceeding the amount of investment that they had at risk in the partnership.

The Act provides that for purposes of the limitation on allowance of partnership losses (under section 704(d) of the Code), the adjusted basis of a partner's interest will not include any portion of any partnership liability with respect to which the partner has no personal liability.

It is intended that in determining whether a partner has personal liability with respect to any partnership liability, rules similar to the rules of section 465 (relating to the limitation on deductions to amounts at risk in case of certain activities) will apply. Thus, for example, guarantees and similar arrangements may be taken into account in determining whether there is personal liability.

This provision will not apply to the extent that a partnership activity is subject to the provisions of section 465 (relating to the limitation on deductions to amounts at risk in case of certain activities) nor will it apply to any partnership the principal activity of which involves real property (other than mineral property). This provision will not apply to a corporate partner (other than a subchapter S corporation) with respect to liabilities incurred in an activity to the extent that the activity is subject to the provisions of section 465. Thus, if two corporations form a partnership for an equipment leasing activity, this provision will not apply; but, if in addition to equipment leasing, the partnership invests in an activity not specified under section 465 and which does not involve real property (other than mineral property), then this provision will apply to the extent of liabilities incurred with respect to that other activity. Also, for example, if an individual and a corporation form a partnership which will engage in the raising of trees, which bear fruit and nuts this provision will not apply to the corporate partner to the extent that the tree-raising activity is subject to the provisions of section 465.

It is contemplated that this provision and the specific at-risk rules of section 465 could apply to a partnership carrying on more than one activity. For example, a partnership involved in equipment leasing to which the at-risk provisions of section 465 would apply, may also be indebted on a nonrecourse basis with respect to activities which are unrelated to the equipment leasing activity of the partnership. In this instance, separate computations for purposes of allowance of losses would have to be made under both sections 465 and 704(d).

This provision applies to liabilities incurred after December 31, 1976.

Sec. 214. Scope of Waiver of Statute of Limitations in Case of Hobby Loss Elections

Present law provides generally that if an activity makes a profit in two out of five years, it is presumed not to be a hobby (which would be subject to the limitations on deductions for hobby losses). In

certain circumstances, a taxpayer may elect to have the results of certain years be relevant to the existence of this presumption for earlier years. Under prior law, a taxpayer was, in many cases, required to execute a general waiver of the statute of limitations for these earlier years if he wished to obtain the benefits of this presumption for the earlier years.

The Act provides that a taxpayer need not waive the statute of limitations for unrelated items on his return in order to take advantage of this special presumption. This provision applies to taxable years beginning after December 31, 1969, except that it does not reopen taxable years with respect to which the statute of limitations has expired and does not limit general waivers of the statute of limitations.

TITLE III—MINIMUM TAX AND MAXIMUM TAX

Sec. 301. Minimum Tax

(a). Minimum Tax for Individuals

Under prior law, individuals and corporations paid a minimum tax, in addition to their regular income tax, equal to 10 percent of their items of tax preference, reduced by a \$30,000 exemption and their regular tax liability. The tax preferences subject to the minimum tax included: (1) the excluded one-half of capital gains; (2) the excess of percentage depletion over the basis of the property; (3) accelerated depreciation on real property; (4) the bargain element of stock options; (5) accelerated depreciation on personal property subject to a net lease (excluding the acceleration resulting from use of the Asset Depreciation Range, or ADR, system); (6) the excess of amortization of on-the-job training and child care facilities over regular depreciation; (7) the excess of amortization of pollution control facilities over regular depreciation; (8) the excess of amortization of railroad rolling stock over regular depreciation; and (9) excess bad debt reserves of financial institutions. Regular taxes not used to offset preferences in the current year were allowed to be carried over for up to 7 additional years.

The Act raises the minimum tax rate to 15 percent. It reduces the exemption to \$10,000 or one-half of regular tax liability, whichever is greater, in place of the \$30,000 exemption and deduction for regular taxes under existing law. It repeals the carryover of unused regular taxes. Also, it includes an instruction to the Secretary of the Treasury to issue regulations under which there will be no minimum tax when individuals or corporations do not receive any tax benefit from a tax preference. It adds new preferences for: (1) itemized deductions (other than medical and casualty loss deductions) in excess of 60 percent of adjusted gross income; (2) intangible drilling costs in excess of the amount deductible if capitalized and amortized over 10 years; and (3) accelerated depreciation on all personal property subject to a lease (including the acceleration resulting from ADR).

The new preference for intangible drilling expenses applies to those expenses in excess of the amount which could have been deducted had the intangibles been capitalized and either (1) deducted over the life of the well as cost depletion, or (2) deducted ratably over 10 years; the taxpayer may choose whichever of these two methods of capitalization is most favorable. The calculation is made taking into account only those wells for which intangibles were paid or accrued in that taxable year. This preference does not apply to taxpayers who elect to capitalize their intangible drilling costs. Nor does it apply to nonproductive wells. For this purpose, nonproductive wells are those which are plugged and abandoned without having produced oil or gas in commercial quantities for any substantial period of time. Thus, a well which has been plugged and abandoned may have produced some relatively small amount of oil and still be considered a

nonproductive well, depending on the amount of oil produced relative to the costs of drilling.

In some cases it may not be possible to determine whether a well is in fact nonproductive until after the close of the taxable year in question. If a well is proved to be nonproductive after the end of the taxable year but before the tax return for the year in question is filed, that well can be treated as nonproductive on that return. If a well is not determined to be nonproductive by the time the return for the year in question is filed, the intangible expenses with respect to that well are to be subject to the minimum tax. However, the taxpayer may later file an amended return and claim a credit or refund for the amount of any minimum tax paid with respect to that well if the well subsequently proves to be nonproductive.

These revisions of the minimum tax for individuals apply to taxable years beginning after December 31, 1975. The amount of any tax carryover from a taxable year beginning before January 1, 1976, will not be allowed as a tax carryover for any taxable year beginning after December 31, 1975.

(b). Minimum Tax for Corporations

Under prior law, the minimum tax for corporations was the same as that for individuals, except that the capital gains preference equalled 18/48 of capital gains (rather than one-half of such gains) and the preference for accelerated depreciation on personal property subject to a net lease did not apply.

The Act raises the corporate minimum tax rate to 15 percent and reduces the exemption to \$10,000 or regular tax liability, whichever is greater. It eliminates the carryover of regular taxes. For 1976, only one-half of the increase in the minimum tax applies. Subchapter S corporations and personal holding companies are treated like individuals, not corporations. The Act does not change the items of tax preference for corporations except as noted below for timber.

The Act provides special rules for timber income of corporations, including both gains from the cutting of timber and long-term gains from the sale of timber. These rules have the effect of exempting timber income from the increase in the minimum tax for corporations. These rules provide that the item of tax preference for timber gains is to be reduced by one-third and then further reduced by \$20,000. Also, the deduction for regular taxes is to be reduced by the lesser of (a) one-third or (b) the preference reduction described above. In effect, the adjustments compensate for the general minimum tax rate increase from 10 percent to 15 percent by scaling down the entire minimum tax base, as it relates to timber, by one-third and then subjecting that lower base to a 15-percent rate. This gives the same result as subjecting the normal tax base to a 10-percent rate. The reduction in timber preferences by \$20,000 (two-thirds of \$30,000), in effect, compensates corporations with timber income for the loss of the \$30,000 exemption.

The Act also retains a regular tax carryover for corporations with timber income. Taxpayers will first have to determine how much of their corporate income tax is attributable to timber income (including both gains from the cutting of timber and long-term gains from the sale of timber). This allocation is to be made under regulations prescribed by the Secretary of the Treasury. This allocation must be made for years prior to 1976 as well as future years, in order to determine how

much of a corporation's existing regular tax carryover remains available for use in 1976 and subsequent years. The Congress does not intend that there be a carryover of regular taxes not attributable to timber income. To the extent that regular corporate income taxes attributable to timber exceed the items of tax preference in a taxable year, they may be carried forward for up to 7 additional years. The amount of the carryover that may be deducted in a subsequent year is limited to timber tax preferences in that year, reduced by the timber preference reduction described above, minus the regular tax deduction for the year (as reduced by the regular tax adjustment described above). This has the effect of permitting a carryforward of timber-related regular taxes that are not used in the current year and limiting the use of that carryforward to the part of the minimum tax base that is attributable to timber.

The effective date of the minimum tax changes is delayed for two years for financial institutions. The Secretary of the Treasury is expected to issue regulations dealing with how the minimum tax is to be computed for taxpayers who file consolidated returns with financial institutions. These will involve separating the minimum taxes of the corporations in the group for the years 1976 and 1977, and applying the new rules to preferences of corporations other than financial institutions and the old rules to financial institutions for these years.

The Act repealed the carryover of regular taxes with respect to taxable years beginning after December 31, 1975. (However, H.R. 1144, which passed the Congress on October 1, 1976, retains the carryover for taxable years beginning before July 1, 1976.)

Sec. 302. Maximum Tax

Under present law, there is a maximum marginal tax rate of 50 percent on earned income. Prior to the Act, the amount of earned income eligible for the maximum tax was reduced by the current year's tax preferences (or, if greater, one-fifth of the tax preferences for the past five years) in excess of \$30,000.

The Act eliminates the \$30,000 exemption to the preference offset and the 5-year averaging provision. It adds the new minimum tax preferences to the preference offset. It also extends the maximum tax to pensions, annuities and deferred compensation. These changes apply to taxable years beginning after December 31, 1976.

TITLE IV—EXTENSIONS OF INDIVIDUAL INCOME TAX REDUCTIONS

Sec. 401(a). General Tax Credit

The Revenue Adjustment Act of 1975 included a credit equal to the greater of \$35 per capita or 2 percent of the first \$9,000 of taxable income. This applied for the first 6 months of 1976.

The Act extends the general tax credit in the Revenue Adjustment Act for the second 6 months of 1976 and for calendar 1977.

Sec. 401(b). Standard Deduction

The Revenue Adjustment Act of 1975 raised the minimum standard deduction to \$1,700 for single returns and \$2,100 for joint returns; the percentage standard deduction to 16 percent; and the maximum standard deduction to \$2,400 for single returns and \$2,800 for joint returns. These changes applied only to the first 6 months of 1976.

The Act makes permanent these increases in the standard deduction.

Sec. 401(c). Earned Income Credit

Under prior law, the earned income credit equaled 10 percent of the first \$4,000 of earnings. The credit was phased out as adjusted gross income rose from \$4,000 to \$8,000 and was refundable. The credit was also available only to people who maintain a household for a dependent child who is either under 19 or a student and for whom they are entitled to claim a personal exemption. This credit applied to 1975 and to the first 6 months of 1976.

The Act extends the earned income credit through the rest of 1976 and calendar 1977. Also, it extends eligibility for the credit to people with adult disabled dependents and to people who maintain a household for a child who is either a student or under age 19 but who are not entitled to claim a personal exemption for the child.

Sec. 402. Disregard of Earned Income Credit

The Act extends the provision of prior law that refunds resulting from the earned income credit were to be disregarded in determining eligibility for any benefits under Federal or federally assisted aid programs if the recipient is a beneficiary in the month prior to the refund.

TITLE V—TAX SIMPLIFICATION FOR INDIVIDUALS

Sec. 501. Revision of Tax Tables for Individuals

Under prior law, the tax tables were used by taxpayers who claimed the standard deduction and who had adjusted gross incomes below \$10,000 (\$15,000 for 1975 only). The Act adopts new tax tables based on taxable incomes of \$20,000 or less to be used by both itemizers and those using the standard deduction, effective for taxable years beginning after December 31, 1975.

Sec. 502. Deduction for Alimony

Under prior law, taxpayers claiming a deduction for alimony payments had to claim them as an *itemized* deduction. The Act changes the alimony deduction from an itemized deduction to a deduction in arriving at adjusted gross income. The change applies to taxable years beginning after December 31, 1976.

Sec. 503. Revision of Retirement Income Credit

Under prior law, for taxpayers age 65 or over, and for taxpayers under 65 who received a public retirement system pension, a tax credit was provided equal to 15 percent of retirement income up to \$1,524 for a single person and \$2,286 for a married couple. The maximum amount of retirement income was reduced on a dollar-for-dollar basis for social security and other types of exempt pension income. For taxpayers age 62 or over and under age 72, these base amounts for the credit were also reduced by one-half of the annual amount of earned income over \$1,200 and under \$1,700, and by the entire amount of earned income in excess of \$1,700.

The Act simplifies the rules on eligibility for the credit and increases the maximum base for the credit for a single person to \$2,500 and for a married couple to \$3,750. It also eliminates the parallel to social security by making the credit available for earned income as well as retirement income and renames the credit "credit for the elderly." The Act reduces the maximum amount of the credit base by one-half of adjusted gross income in excess of \$7,500 for a single person and \$10,000 for a married couple filing a joint return (which they are generally required to do in order to use this provision). The maximum amount is also reduced by exempt social security and exempt retirement income. Similarly, for public retirement system retirees under age 65, the base for the credit is increased to the same amounts as for those age 65 or over but no change is made in the definition of retirement income. (In the case where one spouse is under 65 and has public retirement income and one is over 65, they may elect the public retirement income rules or the new provision.) These changes are effective for taxable years beginning after December 31, 1975.

Sec. 504. Credit for Child Care Expenses

Under prior law, taxpayers could claim as an itemized deduction certain expenses incurred for the care of a child or disabled dependent

or spouse up to \$4,800 a year. The maximum deduction was reduced by one dollar for every two dollars of income in excess of \$35,000. Payments to relatives were not deductible.

The Act converts the deduction to a tax credit of 20 percent of eligible expenditures. It limits the maximum eligible expenses to \$2,000 for one dependent and \$4,000 for two or more and eliminates the \$35,000 income limit. It also eliminates the distinction between expenses for services inside and outside the home for children. The Act extends the credit to married couples where one spouse works part-time or is a student and to a divorced or separated parent who has custody of a child. The Act also makes payments to relatives who are not dependents of the taxpayer eligible for the credit if the services which the relatives perform is considered employment for Social Security purposes. These changes apply to taxable years beginning after December 31, 1975.

Sec. 505. Sick Pay and Certain Disability Pensions

Under prior law, an employee could exclude from income up to \$100 a week received under wage continuation plans when he was absent from work on account of injury or sickness. Military personnel could exclude from income pensions for personal injuries or sickness paid by the Department of Defense (as well as all Veterans Administration disability compensation).

The Act repeals the sick pay exclusion for temporary absences from work and continues the exclusion of up to \$5,200 a year for retirees under age 65 only in the case of those who are permanently and totally disabled. The Act reduces this \$5,200 exclusion dollar-for-dollar for adjusted gross income (including disability income) in excess of \$15,000. It also eliminates the exclusion for non-combat related disability pensions for those who joined the armed forces after September 24, 1975, but continues the exemption for disability payments for combat related injuries, V.A. disability compensation, or an equivalent amount paid by the Department of Defense.

The Act also allows disability payments for injuries to civilian government employees resulting from acts of terrorism the same exclusion granted military disability payments for combat-related injuries.

In the case of an individual who retired on disability and was permanently and totally disabled, for purposes of section 72 his annuity starting date shall be age 65 (or earlier only if he makes an irrevocable election not to make use of the disability income exclusion). The same rule also applies to partially disabled individuals who retired on disability before January 1, 1976, and were entitled on December 31, 1975, to a sick pay exclusion.

These changes generally apply to taxable years beginning after December 31, 1975. The provision for injuries resulting from terrorist acts applies to taxable years beginning after December 31, 1976.

Sec. 506. Moving Expenses

Under prior law, a taxpayer could deduct expenses of up to \$2,500 for house-hunting, the sale of a residence, and temporary lodging, related to moving to a new place of work which was 50 miles farther from his former residence than was his former place of work. As a result of the lapse of the moratorium (provided by legislation) on the application of the Tax Reform Act of 1969 with respect to the

1969 moving expense rules in the case of the military, in-kind moving services and moving expense reimbursements for members of the armed forces were to be includible (after 1975) in income and deductible under the same rules as civilians.

The Act increases the \$2,500 maximum deduction to \$3,000 and decreases the 50-mile test to 35 miles. It exempts in-kind services or reimbursed moving expenses for members of the armed forces on active duty moved by military orders. The Act also exempts military moves from the time and mileage requirements and excludes from income cash reimbursements or allowances to the extent of expenses actually paid or incurred, as well as all in-kind services provided by the military. The Armed Services are exempted from the reporting requirements under section 82 with regard to in-kind moving services, reimbursements and allowances provided to members. In addition, the Act provides that when a military member is required to relocate and the member's spouse and dependents cannot accompany the member but because of military orders must move to a different location, all in-kind moving and storage expenses, and reimbursements and allowances (to the extent of moving expenses actually paid or incurred) provided by the military to move the member and the spouse and dependents both to and from their separate locations are excluded from income. In cases where the military moves the member and the member's spouse and dependents to or from separate locations and they incur unreimbursed expenses, their moves are treated as a single move to a new principal place of work for purposes of the deduction (section 217).

These changes apply generally to taxable years beginning after December 31, 1976, except that the military provisions apply for years after 1975.

Sec. 507. Tax Simplification Study by Joint Committee

Present law (sec. 8022 of the Code) provides that the Joint Committee on Taxation is to investigate the operation and effects of the Federal system of internal revenue taxes, including studies for the simplification of the income tax. The Joint Committee is to publish its proposals and report the results and any recommendations to the Senate Finance Committee and House Ways and Means Committee.

The Act retains the duties under section 8022 and adds a specific requirement that the Joint Committee conduct a study on "simplifying and indexing the tax laws" (including whether tax rates can be reduced by repealing any or all tax deductions, exemptions or credits). A report is to be submitted to the Senate Finance and House Ways and Means Committees by June 30, 1977.

TITLE VI—BUSINESS-RELATED INDIVIDUAL INCOME TAX PROVISIONS

Sec. 601. Disallowance of Certain Expenses

(a). Deductions for Expenses Attributable to Business Use of Homes

The Act provides definitive rules relating to deductions for expenses attributable to the business use of homes. Under the Act, a taxpayer is not permitted to deduct any expenses attributable to the use of his home for business purposes except to the extent attributable to the portion of the home used exclusively on a regular basis: (a) as the taxpayer's principal place of business, (b) as a place of business which is used for patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of business, or (c) in the case of a separate structure which is not attached to a dwelling, in connection with the taxpayer's trade or business. Further, in the case of an employee, the business use of the home must be for the convenience of his employer. An exception to the exclusive use test is provided where the dwelling unit is the sole fixed location of a trade or business which consists of selling products at retail or wholesale and the taxpayer regularly uses a separate identifiable portion of the residence for inventory storage. An overall limitation is provided which limits the amount of the deductions to the gross income generated by the business activity of the taxpayer in his home. The provision applies to taxable years beginning after December 31, 1975.

(b). Deductions for Expenses Attributable to Rental of Vacation Homes

Under prior law, there were no definitive rules relating to how much personal use of vacation property would result in the disallowance of deductions because the rental activities are not engaged in for profit. The Act provides a limitation on deductions for expenses attributable to the rental of a vacation home if the home is used by a taxpayer for personal purposes in excess of the greater of 2 weeks or 10 percent of the actual business use (that is, its rental time) during a year. In this case, the deductions allowed in connection with a vacation home cannot exceed the gross income from the business use of the vacation home, less expenses which are allowable in any event (such as interest and taxes). In addition, if a vacation home is actually rented for less than 15 days during the year, then no business deductions nor income derived from the use of the vacation home are to be taken into account in the taxpayer's return for the year. The provision applies to taxable years beginning after December 31, 1975.

Sec. 602. Deductions for Attending Foreign Conventions

Generally, in order for traveling expenses (domestic and foreign) to be deductible under present law, they must be ordinary and necessary in the conduct of the taxpayer's business and directly

attributable to the trade or business. If a trip is primarily related to the taxpayer's business, the entire traveling expenses (including food and lodging) to and from a destination are deductible. If a trip is primarily personal in nature, the traveling expenses to and from the destination are not deductible even if the taxpayer engages in business activities while at the destination. With respect to expenses incurred in attending a convention or other meeting, the deductibility of expenses depends upon the facts and circumstances of each case.

The Act modifies the facts and circumstances test under present law and provides definitive rules for the deductibility of expenses incurred in attending certain foreign conventions or similar meetings. Deductions may be allowed for expenses incurred in attending not more than two conventions, educational seminars, or similar meetings outside the United States, its possessions and the Trust Territory of the Pacific.

The amount of the deduction for transportation expenses outside the United States to and from these foreign conventions cannot exceed the cost of airfare based on coach or economy class charges. Transportation expenses will be deductible in full only if more than one-half of the total days of the trip (excluding the days of transportation to and from the site of the convention) are devoted to business-related activities. If less than one-half of the total days of the trip are devoted to business-related activities, a deduction will be allowed for transportation expenses only in the ratio of the business time to total time.

In addition, deductions for subsistence expenses, such as meals, lodging, and other ordinary and necessary expenses, paid or incurred while attending the convention will be limited to the fixed amount of per diem allowed to government employees at the location where the convention is held. However, in order to deduct subsistence expenses up to this limitation for a day, there must generally be at least 6 hours of business-related activities scheduled daily (or 3 hours for a deduction for one-half day) and the taxpayer must attend two-thirds of these activities.

The Act provides that no deduction is to be allowed unless the taxpayer complies with certain reporting requirements in addition to the substantiation requirements of present law. Under these reporting requirements, the taxpayer must furnish information indicating the total days of the trip (exclusive of the transportation days to and from the convention), the number of hours of each day that he devoted to business activities (and a brochure describing the convention, if available), and furnish any other information required by regulations. In addition, the taxpayer must attach a statement signed by an appropriate officer of the sponsoring organization to his income tax return which must include a schedule of the business activities of each convention day, the number of hours of business-related activities that the taxpayer attended each day and any other information required by regulations.

The provision applies to conventions, seminars and similar meetings which take place after December 31, 1976.

Sec. 603. Qualified Stock Options

Under prior law, no income was recognized on the grant to a corporate employee, or on his exercise of, a "qualified" option to receive stock in the employer corporation. The stock acquired by the exercise

of the option was a capital asset in the hands of the employees and the income realized from the eventual sale of the stock was generally treated as long-term capital gain or loss.

Under the Act, the qualified stock option provisions are repealed. Thus, for the future, all options are to be governed under the rules which apply under present law for nonqualified stock options. This means that if the option has a "readily ascertainable fair market value" at the time it is granted, then the value of the option will constitute ordinary income to the employee at that time, but any gain later realized by the employee upon the sale of any stock acquired under the option will generally be treated as capital gain. On the other hand, if the option does not have a readily ascertainable fair market value at the time it is granted, it will not constitute income to the employee at that time, but if the option is subsequently exercised, and if the fair market value of the stock exceeds the option price, this excess will constitute ordinary income to the employee at the time the option is exercised.

It is intended that in applying these rules for the future, the Internal Revenue Service will make every reasonable effort to determine a fair market value for an option (i.e., in cases where similar property would be valued for estate tax purposes) where the employee irrevocably elects to have the option valued at the time it is granted (particularly in the case of an option granted for a new business venture). It is intended that the Service will promulgate regulations and rulings setting forth as specifically as possible the criteria which will be weighed in valuing an option which the employee elects to value at the time it is granted.

Under these rules, the value of an option will be determined under all the facts and circumstances of a particular case. Among other factors that will be taken into account will be the value of the stock underlying the option (to the extent that this can be ascertained), the length of the option period (the longer the period, the greater the chance the underlying stock might increase in value), the earnings potential of the corporation, and the success (or lack of success) of similar ventures. Corporate assets, including patents, trade secrets and knowhow will also have to be taken into account.

It is anticipated that under the Service's rules, certain options, such as those traded publicly, will be treated as having a readily ascertainable fair market value, regardless of whether the employee makes an election. However, the regulations can provide that in certain other cases the option will ordinarily not be valued at the time it is granted unless the employee so elects.

These rules apply generally to options granted after May 20, 1976, but the Act contains certain transitional rules for options granted after that date under preexisting plans. In interpreting the transitional rules, the Congress intends that if a corporation adopted an option plan in 1974 and is reorganized in 1977 into a holding company with one or more operating subsidiaries, the holding company may adopt the 1974 option plan and continue to grant qualified stock options to the extent permissible had the reorganization not occurred.

Sec. 604. Deduction for State Legislator's Travel Expenses Away From Home

The tax home of a State legislator was determined under prior law by taking into account a number of factors, such as: (a) the total time

ordinarily spent by the taxpayer at each location, (b) the degree of business activity at each location, and (c) the amount of income ordinarily earned by the taxpayer at each location, etc.

The Act provides that for taxable years beginning before January 1, 1976, the tax home of a State legislator is his place of residence within the legislative district that he represents and he may elect to be treated for that period as having expended for living expenses an amount equal to the daily per diem allowed U.S. Government executive branch employees multiplied by the number of days the State legislature was in session. The definition of a legislative day includes any day in which the State legislature was not in session for a period of 4 consecutive days or less. However, the total amount of deductions allowable cannot exceed the amount already claimed on the legislator's tax return (or amended return) filed before May 21, 1976, for the year in question.

Sec. 605. Nonbusiness Guarantees of Bad Debts

In the case of a noncorporate taxpayer, business bad debts are deductible as ordinary losses. Nonbusiness bad debts are treated as short-term capital losses. However, under prior law, where the noncorporate taxpayer's loss results from a situation where he guaranteed the debt of a noncorporate person, the guarantor could treat a payment under the guaranty as a business bad debt (even though the guaranty did not arise out of the guarantor's trade or business) if the proceeds of the loan were used by the borrower in his trade or business and the debt was worthless when paid by the guarantor.

Under the Act, where a taxpayer has a loss arising from the guaranty of a loan, he will receive the same treatment as where he has a loss from a loan which he makes directly. If the guaranty arose out of the guarantor's trade or business, the loss will be treated as an ordinary loss. If the guaranty were a transaction entered for profit by the guarantor (but not as part of his trade or business), the loss will be treated as a short-term capital loss. This provision applies to losses for taxable years beginning after December 31, 1975, in connection with guaranties made after that date.

TITLE VII—ACCUMULATION TRUSTS

Sec. 701. Accumulation Trusts

Distributions by a trust of previously accumulated income are taxed substantially the same as if they were distributed when earned, i.e., “thrown back” to the year earned. Under prior law, the tax on the distribution of previously accumulated income was computed under either the “exact method” or the “short-cut” method. Under the “exact method”, the tax on the accumulation distribution was the sum of the additional taxes that would have been payable by the beneficiary if the income had been distributed when earned and if the tax on the beneficiary had been entirely recomputed. Under the “short-cut” method, the tax on the accumulation distribution was computed by averaging the accumulation distribution over the number of years during which the accumulated income was earned by the trust, including this average amount in the beneficiary’s income for each of the 3 immediate prior years, and then multiplying the average additional tax for those years by the number of years during which the accumulated income was earned. Under both methods, the beneficiary was entitled to a credit for taxes paid by the trust on the accumulation distribution. The “throw-back” rules also applied to distributions of accumulated capital gains.

The Act repeals the “exact method” of computing the tax on accumulation distributions. It also modifies the “short-cut” method by throwing back the average accumulation distribution to 3 of the 5 preceding years, excluding those years with the highest and lowest incomes. It does not permit refunds of excess taxes paid by the trust. In addition, the Act provides that income accumulated prior to the beneficiary’s attaining the age of 21 and the years a beneficiary was not in existence are not subject to the throw-back rule. The Act also provides special rules for multiple trusts. Finally, the Act repeals the capital gain throw-back rules, but taxes the trust at the grantor’s rate brackets on “built-in” gain on sales or exchanges occurring within 2 years of the transfer to the trust. These modifications apply to distributions made in taxable years beginning after December 31, 1975. The special rule for gain on property transferred to a trust applies to transfers made after May 21, 1976.

TITLE VIII—CAPITAL FORMATION

Sec. 801. Extension of \$100,000 Limitation on Used Property for the Investment Credit

Prior to 1975, up to \$50,000 of the cost of used property could be taken into account as qualified investment for purposes of the investment tax credit for a taxable year. The Tax Reduction Act of 1975 increased the amount to \$100,000 for taxable years beginning in 1975 and 1976.

The Act extends the increased limit of \$100,000 on used property for 4 additional years, taxable years beginning before January 1, 1981.

Sec. 802. Extension and Treatment of Investment Credit

(a). Extension of 10-Percent Investment Credit

Prior law provided a permanent investment credit of 7 percent (4 percent for certain utility property) for investment in qualified property. The Tax Reduction Act of 1975 increased the credit to 10 percent for all qualified property (including utility property) placed in service after January 21, 1975 and before January 1, 1977.

The Act extends the 10-percent investment credit for 4 additional years to apply generally to property placed in service before January 1, 1981.

(b). First-in-First-out Treatment of Investment Credits

In general, the amount of investment credit used in any year cannot exceed \$25,000 of tax liability plus 50 percent of any liability in excess of \$25,000. A 3-year carryback and 7-year carryforward is then applied to credits which are not used because of the tax liability limitation. (A 10-year carryforward is available for pre-1971 credits.) Generally, under prior law, investment credits earned in a particular year were applied first to the tax liability for that year, after which carryovers and carrybacks of unused credits from other years were applied.

Under the Act, credits carried over are used first and then credits earned currently are used; after that, any carryback credits may be applied. If there is more than one carryforward or carryback to a particular year, the oldest credit is generally used first. The provision applies to taxable years beginning after December 31, 1975.

Sec. 803. ESOP Investment Credit Provisions

(a). General

Under prior law, if a qualified investment were made before January 1, 1977, an extra percentage point of investment credit (11 percent rather than 10 percent) was allowed where the additional credit amount was contributed to an employee stock ownership plan (ESOP).

The Act extends the additional one-percent credit program to qualified investments made before January 1, 1981. Also, if an employer supplements its contributions under the one percent credit program by matching employee contributions to the ESOP, beginning in

1977 the Act allows an extra investment credit (up to an extra one-half percentage point) for the employer's supplementary contributions which are matched by employee contributions. Under the Act, separate accounting is required for matching employee and employer contributions. Continuing present law treatment, an employer contribution for a taxable year in excess of the amount attributable to the additional credit allowed for such year is deductible for that year, subject to the usual rules for deduction of contributions to employee plans.

Under the Act, employee contributions are subject to the overall benefit and contribution limitations applicable to employee plans. (The Act continues prior law under which employer contributions to investment credits ESOPs were subject to these limitations.) The limitations may restrict the amount of the additional one-half percent investment credit allowable.

The Congress intends that employee contributions can be taken into account for the additional credit if they are contributed to the plan before the end of the year in which the credit is allowed or if the contributions are pledged by the employees to be paid within 2 years after the close of that year and the pledge is made before the return for the year is filed. If employee contributions are made in excess of the amount pledged and are matched with employer contributions, additional credit can be claimed by the employer for the year the property giving rise to the credit was placed in service. Under the Act, employee contributions made under the matching rules are to be invested in employer securities under the same rules that apply to employer contributions.

If the plan provides, the Act permits funds contributed by the employer to be withdrawn from an investment credit ESOP (1) to refund employer contributions which are not matched by employee contributions within the period specified, or (2) to permit the employer to recover from the ESOP any portion of the employer's contribution which is recaptured from the employer under the investment credit rules (for example, where the property for which the credit is claimed is disposed of prematurely). The Act provides that the withdrawal of employer contributions made under the one-half percent credit rules because they are not matched by employee contributions, or a recovery of employer contributions under the recapture rules, will not cause the plan to be considered as other than for the exclusive benefit of employees and that employee rights to employer-derived benefits under the plan will not be considered forfeitable merely because employer contributions of investment credit may be withdrawn under the matching or recapture rules. The Act does not permit an employer to recover recaptured investment credit unless the employer contributions for each year are separately accounted for (all contributions made before enactment of the Act can be aggregated for this purpose).

Under the Act, employee funds contributed to an investment credit ESOP are subject to employee withdrawal unless they are matched by employer contributions under the one-half percent credit rules. For example, if matching employer or employee contributions cannot be made because of the overall limitations on benefits and contributions

(sec. 415 of the Code), the unmatched employee contributions would be refunded to the employee (unless he instructs the plan to the contrary).

Also, under the Act, employee contributions to an investment credit ESOP are subject to the same antidiscrimination rules as apply to employee contributions under a tax-qualified pension plan, and matched employee contributions are subject to the same restrictions on distribution as employer contributions of investment credit (generally, no withdrawal is permitted for 84 months).

Employee contributions cannot be compulsory; that is, employee contributions may not be made a condition of employment or a condition of participation in the plan. Of course, the level of employer-derived benefits under the matching rules may depend upon employee contributions.

In addition, the Act: (1) prevents flow-through of the investment credit contributed by a public utility to an ESOP with respect to credits claimed for taxable years after 1975; (2) permits employer securities to be contributed to an ESOP as the credit is allowed rather than when it is claimed; (3) provides that future contributions under the investment credit program rules may be reduced if investment credits which have been contribution to an ESOP are recaptured or disallowed and provides that, as an alternative, recaptured or disallowed credits may be deducted or, as a further alternative in the case of recaptured credits, that the credits may be recovered from the ESOP; (4) permits use of stock of "brother-sister" corporations, "second-tier" subsidiaries and corporations which would be affiliates except for nonvoting preferred stock to be contributed to an ESOP under the investment credit rules; (5) excludes employer stock held by an ESOP for purposes of determining whether corporations are sufficiently affiliated to permit the filing of consolidated returns; (6) permits ESOPs to be considered permanent plans even though contributions are contingent upon the availability of the additional investment credit; (7) doubles the dollar amount of the overall limitation on contributions permitted to be made to certain ESOPs and provides that employee compensation for purposes of the investment credit ESOP rules is the same as that under the overall limitations; (8) permits a limited amount of "start up" and administrative expenses to be charged against the additional investment credit contributed to an ESOP; (9) allows contributions to be made to a plan contingent upon an Internal Revenue Service determination that the plan qualifies under the investment credit and employee plan rules; and (10) provides that no penalties are to be imposed for underpayment of estimated income tax where the underpayment is caused by the taxpayer's inability to avail itself of the grace period or anti-flow through provisions (effective for 1975).

These 10 provisions are generally effective for taxable years beginning after December 31, 1974 (except for (1), as indicated above).

(b). Employee Stock Ownership Plan Regulations

These 10 provisions are generally effective for taxable years beginning with stock ownership plans and expresses concern that administrative rules and regulations may frustrate Congressional intent. In this connection, it has come to the attention of the Congress that proposed

regulations issued by both the Department of the Treasury and the Department of Labor on July 30, 1976, may make it virtually impossible for ESOPs, and especially leveraged ESOPs, to be established and function effectively. The following areas are of specific concern to the Congress.

(1) *Independent third party.*—The proposed rules would prohibit loans (or loan guarantees) by fiduciaries to employee stock ownership plans unless the loans are arranged and approved by an independent third party. These rules would, for example, prevent a bank which serves as trustee for an ESOP from making a loan to the plan and would prevent the employer-fiduciary who established the plan from providing a loan guarantee.

In view of other rules presently in effect, which require that the interest rate for any such loan be reasonable, that the loan be primarily for the benefit of participants or their beneficiaries, and that the only collateral the plan can give the lender is the employer's stock purchased with the loan proceeds, the requirement of an independent third party is unduly burdensome. Consequently, the Congress believes that the regulations should deal directly with possible abuses which may occur in the administration of plans rather than attempting to require a plan to incur the burden of dealing through an independent third party. Similarly, the Congress believes that an independent third party should not be required to arrange and approve a sale of stock between an employer (or shareholder of the employer) and an ESOP. The Congress has not considered whether the principles applicable to ESOPs in connection with loans to the plan or sales of employer stock should apply in the case of other exemptions from the prohibited transaction rules and, accordingly, no inference should be drawn regarding those other exemptions.

(2) *Put option.*—The proposed regulations would require that an employer provide each employee who receives stock from a leveraged ESOP or an investment credit ESOP with a 2-year "put option" if the stock is not listed on an exchange.

Although the Congress agrees that a market should be provided for employer stock distributed by an ESOP to an employee, the Congress believes that a put option for a period considerably shorter than two years will properly protect employees and that a put under which the employer must pay for tendered stock over too short a period would effectively deny the employer the benefits of capital formation the Congress sought to provide under an ESOP. On the contrary, the Congress believes that the payment by the employer could be made in substantially equal installments over a reasonable period, taking into account the need to protect the interests of employees and the need of the employer for capital.

(3) *Stock purchased with loan proceeds.*—Under the proposed regulations, if an ESOP holds employer stock which it purchased with the proceeds of a loan, the stock is to be placed in a suspense account from which it is to be released under a formula. The formula provided by the proposed regulations, however, is not in accordance with the common business practice under which the stock is released from the account as loan principal is amortized.

The Congress believes that the regulations should allow the stock to be released as the loan principal is repaid if (a) the principal is amortized over a reasonable period (taking into account the facts and circumstances, including the interests of plan participants and the employer's need for capital), and (b) the employees are adequately informed regarding their rights to employer stock held by the plan.

(4) *Allocation of stock.*—Under the proposed regulations, employer stock acquired by an ESOP with loan proceeds must be allocated to plan participants as it is released from the suspense account discussed in (3) above. The Congress believes that the regulations should permit the allocation of stock to be made in accordance with a formula more similar to that provided for ESOPs in the Trade Act of 1974 (19 U.S.C. § 2373(f)(4)).

(5) *Voting rights.*—The proposed regulations would require that employees be permitted to direct the voting of employer stock allocated to their accounts under a leveraged ESOP even though other types of employee plans need not provide employees with these rights. (The Tax Reduction Act of 1975 requires that employees be permitted to direct the voting of employer stock allocated to their accounts under an investment credit ESOP but not under other ESOPs.)

The Congress believes that the regulations should not distinguish between leveraged ESOPs and other employee plans in this regard.

(6) *Dividend restrictions.*—Under the proposed regulations, employer stock held by an ESOP must have unrestricted dividend rights. However dividend restrictions are commonly required in connection with loans. Consequently, the Congress believes that such restrictions should be permitted if they are required in connection with a loan to the ESOP for the purchase of employer securities (but only if the restrictions terminate when the loan is repaid) or if they apply also to a significant portion of the employer stock not held by the ESOP.

(7) *Right of first refusal.*—The proposed regulations prohibit a leveraged ESOP from acquiring, with the proceeds of a loan, employer stock subject to a right of first refusal. Because the shareholders of many corporations (especially smaller businesses) believe that a right of first refusal is necessary to protect their interests, the Congress believes that the prohibition will have a chilling effect upon the establishment of ESOPs and should not be proscribed.

(8) *Treatment of sale as redemption.*—Under the proposed regulations, the sale of stock by a corporate shareholder to the corporation's ESOP could, depending upon the facts and circumstances, be treated as a redemption of the stock by the corporation. If the sale is treated as a redemption, the proceeds of the sale could be considered dividend income rather than capital gain. The Congress believes if such a rule is authorized and proper, its application should not be restricted to ESOPs and should be applied only where the stock sold by the shareholder inures to his benefit (or the benefit of related parties) under the plan.

(9) *Nonvoting common stock, etc.*—The proposed regulations impose special rules on ESOPs which limit the extent to which the plan can acquire employer securities, other than voting common stock with unrestricted dividend rights, with the proceeds of a loan. (The Tax Reduction Act of 1975 does not allow the additional investment credit

for nonvoting employer stock.) The Congress believes that the usual rules applicable to employee plans properly protect the interests of plan participants and that these special rules are not needed.

(10) *Prepayment penalty*.—The proposed regulations specifically prohibit any loan made to an ESOP from containing a provision for a prepayment penalty. The Congress believes that the question of such penalties should be a matter of negotiation between the ESOP and the lender and that prepayment penalties should not be prohibited in all cases. (They should not be allowed of course if, for example, payment of a penalty would be imprudent.)

(11) *No calls or other options*.—The proposed regulations prohibit stock acquired with an ESOP loan from being subject to any calls or options (other than the put option described in (2) above). There is no provision for restrictions which may be required by State or Federal law. The Congress believes that in the limited situation where restrictions are imposed by law, stock in an ESOP should be permitted to have restrictions necessary to comply with the law.

(12) *Comparability*.—The proposed regulations do not permit an ESOP and another plan to be considered a single plan for purposes of determining whether the plans meet the anti-discrimination requirements of the tax law. Although the Congress agrees that an ESOP and another type of plan should not be considered a single plan for this purpose, the Congress believes that this rule should not be applied to disqualify a plan already in existence and that two or more ESOPs can be considered as a single plan in testing the coverage and contributions or benefits under the plans.

As stated in the Report of the Senate Finance Committee on the bill, an ESOP is designed to “build equity ownership of shares in the employer corporation into its employees substantially in proportion to their relative incomes.” (S. Rept. No. 94-938, p. 180.) The Congress understands that, under the proposed regulations, an ESOP could be integrated with the social security system so that employer stock would not be allocated to employees substantially in proportion to their compensation. The Congress believes that social security integration is not consistent with the purposes of an ESOP. The Congress believes, however, that a prohibition on integration should not apply to ESOPs which are now integrated.

(13) *Inferences*.—Although the Congress has commented on the merits of the proposed regulations, these comments should not be taken as inferring approval or disapproval of the provisions not commented upon.

(c). Study of Expanded Stock Ownership

The Act changes the name of the existing Joint Pension Task Force to the Joint Pension, Profit-sharing and Employee Stock Ownership Plan Task Force, and provides that the Task Force is to study employee stock ownership plans. The Task Force, which may consult others who have information concerning employee stock ownership plans, is to report its findings to the Committee on Ways and Means and the Committee on Education and Labor of the House and the Committee on Finance and Committee on Labor and Public Welfare of the Senate by March 31, 1978.

Sec. 804. Investment Credit for Movie and Television Films

Prior to 1971, it was not clear whether (and if so, under what conditions) the investment credit was available for movie or television films. However, a court case had held that movie films were tangible personal property eligible for the investment credit. During the legislative consideration of the Revenue Act of 1971, it was made clear that motion pictures and television films are to be treated as tangible personal property which is eligible for the investment credit (i.e., section 38 property). However, this issue is still being litigated for years prior to 1971, and there are still a number of unsettled issues, such as how to determine the useful life of a film, the basis on which the credit is to be computed, and how to determine whether there has been a predominant foreign use of the film.

The Act provides that for the future, as a general rule, taxpayers sonal property which is eligible for the investment credit (i.e., section will receive two-thirds of a full investment credit for all their films regardless of the actual useful life of any particular film. For the past, taxpayers may elect to take a 40-percent compromise credit for all of their films, regardless of the actual useful life or foreign use of any particular film. Alternatively, taxpayers may determine their investment credit on a film-by-film basis.

The Act permits participations to be included in the credit base of an 80 percent or more U.S. produced film, but not in excess of (a) \$1 million with respect to any one individual for any one film and (b) not in excess of the lesser of (i) 25 percent of participations qualifying under rule (a) or (ii) 12½ percent of the production costs of the taxpayer's films for the year. In addition, any taxpayer who filed a petition in a court by January 1, 1976, may have his investment credit for prior years determined under present law (rather than under the rules of the Act) if he elects present law treatment within 90 days after the date of enactment (October 4, 1976).

The rule for the future applies generally to films placed in service in taxable years beginning after December 31, 1974, but taxpayers may elect this rule for all of their property described in section 50 and placed in service in taxable years beginning before January 1, 1975.

Sec. 805. Investment Tax Credit for Certain Vessels

Under present law, the tax on income deposited into a capital construction fund (established under section 21 of the Merchant Marine Act of 1970) for the construction of certain vessels is deferred. When the funds are withdrawn to purchase a qualified vessel, there is no tax basis in the purchased vessel to the extent of the withdrawal. Under prior law, this reduced the amount of investment credit available on the purchased vessel.

The Act provides for an investment credit of one-half the regular credit on the tax-deferred amounts withdrawn from the capital construction fund which are used to purchase qualified vessels. In addition, Congress intends that taxpayers are to have the right to obtain a court determination as to whether they are, under already existing law, also eligible for the other one-half of the regular investment credit. Also, it is intended that no inferences be drawn either way on this issue from the action taken in this Act.

If a taxpayer claims the full investment credit on its tax return, it is expected that the Internal Revenue Service will provide, by regulations, procedures which will require the taxpayer to indicate on its return that the full investment credit is being claimed. This will alert the Internal Revenue Service to the position taken by the taxpayer on this point. If the IRS asserts a deficiency in this case, the taxpayer has the option of pursuing its claim for the full credit in the Tax Court. In addition, the taxpayer may file a claim for a refund which will allow the taxpayer to pursue its claim with the Court of Claims or in the District Courts.

Where a taxpayer purchases a ship with borrowed funds and uses the capital construction fund to pay off the indebtedness, there initially will be allowed a full investment credit and then subsequently, there is to be a recapture of no more than 50 percent of the amount of the investment credit taken on the purchase price of the ship representing the indebtedness which is being liquidated with tax deferred amounts from the capital construction fund.

The Act applies to taxable years beginning after December 31, 1975. This is not intended to provide any inference about the application of existing law with respect to the availability of the credit for prior (as well as future) years.

Secs. 806 (a)-(d). Additional Net Operating Loss Carryover Years and Carryback Election

Prior law provided that taxpayers were generally allowed to carry a business net operating loss back to the preceding 3 years and forward to the 5 years following the year of the loss. Different carryback and carryover periods are allowed for certain specific types of taxpayers and certain types of losses.

The Act provides two additional carryover years for business taxpayers in general and insurance companies (making a 7-year carryover), as well as for regulated transportation corporations (making a 9-year carryover). In addition, all taxpayers presently entitled to carryback periods for their net operating losses may elect to forego the entire carryback period for a net operating loss in any taxable year. These provisions apply to net operating losses incurred in tax years ending in 1976 or later.

Sec. 806(e). Limitations on Net Operating Loss Carryovers

Present law provides that where new owners buy over 50 percent of the stock of a loss corporation during a 2-year period, its loss carryovers from prior years are allowed in full if the company continues to conduct its prior trade or business. It may add or begin a new business, however, and apply loss carryovers incurred by the former owners against profits from the new business (unless tax avoidance is the principal purpose for the acquisition). If the same business is not continued, however, loss carryovers are completely lost. In the case of a tax-free reorganization, loss carryovers are allowed on a declining scale. If the former owners of the loss company receive 20 percent or more of the value of the stock of the acquiring company, the loss carryovers are allowed in full. For each percentage point less than 20 which the former owners receive, the loss carryover is reduced by 5

percentage points. It is immaterial whether the business of the loss company is continued after the reorganization.

The Act provides parallel rules for taxable acquisitions and tax-free acquisitions of a loss company. The test for carryovers no longer depends on whether the loss company continues its same trade or business. The required continuity of ownership by the former owners of a loss company is increased to 40 percent. For each percentage point less than 40 which the owners of the loss company receive (or retain), the allowable loss carryover is reduced by $3\frac{1}{2}$ percentage points except that for each percentage point less than 20, the allowable loss carryover is reduced by $1\frac{1}{2}$ percentage points. The continuity of ownership requirements are measured by reference to the ownership by the former owners of a loss company of the lesser of "participating stock" of the loss company (or, in the case of a reorganization, of the acquiring company) or of the fair market value of all the stock of that company. These rules apply both where new owners take over a loss company in a taxable purchase of stock and in a tax-free reorganization.

Several technical revisions are also made to the present rules for purchases of stock of a loss company:

(1) The transactions which trigger the loss limitations are expanded to cover several technical gaps in present law, such as cases where a new investor acquires control in a tax-free section 351 exchange, or acquires a partnership interest directly from a partnership (as well as from other partners) which owns stock in the loss corporation.

(2) The group of new owners whose stock ownership causes a reduction in loss carryovers is increased from 10 to 15 persons.

(3) The period during which taxable purchases of a loss company's stock may bring the limitations into play is increased from 2 to 3 years.

(4) The losses affected by the limitations are broadened to include operating losses in the acquisition year itself (under certain conditions).

Exceptions are made from the new purchase rules for start-up losses of a newly formed corporation, exchanges in which creditors of a financially troubled company take over the equity, recapitalizations of a corporation, and acquisitions of employer stock by key employees or by a qualified profit-sharing plan or employee stock ownership plan. Acquisitions of stock by gift or inheritance are also excepted.

In the case of tax-free reorganizations, the former owners of a loss company must receive a participating stock interest in the acquiring company (most types of limited preferred stock will not be sufficient). The loss limitations can no longer be escaped by using a controlled subsidiary of a profit company to acquire a loss company. The loss limitations will also now apply to stock-for-stock ("B") reorganizations. The common ownership exception in prior law is revised so that this rule will operate in a more realistic fashion.

The Act changes the definition of "stock" in prior law in order to limit the exception for certain kinds of preferred stock to fixed-dividend stock which is not convertible into other stock and the redemption and liquidation rights of which are limited generally to paid-in capital or par value.

In order to allow a reasonable time for the Internal Revenue Service to issue regulations under the new rules, the Act delays the effective date of the new rules generally for one year. The new rules apply to reorganizations pursuant to plans adopted by one or more of the parties on or after January 1, 1978. (A reorganization plan will be considered adopted on the date the board of directors adopts the plan or recommends its adoption to the shareholders or on the date the shareholders approve the plan, whichever is earlier.) If the new limitations affect a reorganization occurring in 1978, net operating loss carryovers to 1977 from earlier years will not be affected by the new rules, but carryovers of such losses to 1978 and later years may be limited. A loss occurring in 1977 may also be limited as a carryover to 1978 and later years.

In the case of purchases of stock of a loss company and other acquisitions subject to new sec. 382(a), the new rules take effect for taxable years of a loss corporation beginning after June 30, 1978. However, the "lookback" period under these rules may be to earlier taxable years. The earliest lookback point, however, is January 1, 1978. For example, section 382(a) as amended will take effect for a calendar year corporation during calendar 1979. The first "lookback" period for a calendar year corporation under the new rules will be a transitional 24-month period from December 31, 1979, back to January 1, 1978. When the new rules become fully effective, the lookback period will cover three years, so that for a corporation whose taxable year ends on December 31, 1980, reference will be made back to the first day of that year and then back to January 1, 1979, and then to January 1, 1978.

In this example, the prior rules of section 382(a) will govern the allowance of loss carryovers of the company to its calendar years 1977 and 1978. The new rules will govern loss carryovers from 1978 and earlier years to 1979 and later years. Although the new rules will thus not actually limit carryovers in this example until 1979, the new limitations will affect loss carryovers to 1979 from earlier years. Also, changes in stock ownership occurring during 1978 will be taken into account as part of the lookback period from December 31, 1979, for purposes of testing loss carryovers to 1979 and later years.

Sec. 807. Small Commercial Fishing Vessel Construction Reserves

Under prior law, domestic shipping vessels were required to be 5 net tons or more to be eligible for the capital construction fund. The Act reduces the minimum weight displacement required for capital construction fund eligibility to 2 net tons or more, effective upon the date of enactment (October 4, 1976).

TITLE IX—SMALL BUSINESS PROVISIONS

Sec. 901. Extension of Certain Corporate Income Tax Rate Reductions

Prior to the 1975 Tax Reduction Act, corporate taxable income was subject to a 22-percent normal tax and a 26-percent surtax, with a surtax exemption of \$25,000. The Tax Reduction Act and the Revenue Adjustment Act increased the surtax exemption to \$50,000 and reduced the normal tax to 20 percent on the first \$25,000 of taxable income. This results in a 20-percent rate on the first \$25,000 of income, a 22-percent rate on the next \$25,000 of income and a 48-percent rate on the income in excess of \$50,000. These provisions expired on July 1, 1976.

The Act extends the reduction in corporate tax rates and the increase in the surtax exemption through December 31, 1977, and applies these reduced rates to mutual insurance companies effective for taxable years ending after December 31, 1974.

Sec. 902(a). Change in Number of Subchapter S Shareholders

Under prior law, a corporation was required to have 10 or fewer shareholders in order to be eligible to elect and maintain subchapter S treatment.

Under the Act, 15 shareholders are allowed after the corporation has elected subchapter S treatment for 5 consecutive taxable years. In addition, a corporation may have up to 15 shareholders during this 5-year period if the additional shareholders have acquired their interests through inheritance. This provision is effective for taxable years beginning after December 31, 1976.

Sec. 902(b). Distributions by Subchapter S Corporations

Under present law, the shareholders of a subchapter S corporation are taxed each year on the income of the corporation regardless of whether the income is distributed to the shareholders. The undistributed taxable income may be subsequently distributed tax-free to the shareholders. However, an earnings and profits rule (concerning accelerated depreciation) generally applicable to corporations may cause a distribution to be a taxable dividend rather than a distribution of previously taxed income.

The Act allows a subchapter S corporation's previously taxed income to be distributed to the shareholders tax free even though, as a result of accelerated depreciation, the corporation has undistributed earnings and profits. This provision is effective for taxable years beginning after December 31, 1975.

Sec. 902(c). Additional Changes in Subchapter S Rules

Under prior law, a trust could not be a shareholder in a subchapter S corporation. Also, a husband and wife are treated as one shareholder where the stock is community property or held jointly by them,

but the estate of a deceased spouse was treated as a separate shareholder. All shareholders must consent to an election or revocation of subchapter S status. However, a subchapter S election would be terminated if any new shareholder failed to consent to the election, generally within a period of 30 days.

The Act provides that where either husband or wife, or both, die, the estate of the deceased will be treated as one shareholder with the surviving spouse (or her estate) if husband and wife were treated as one shareholder while both were living and the stock continues to be held in the same proportions as before death. In addition, grantor trusts and voting trusts are to be eligible shareholders; and, any type of trust which receives stock under a will is to be an eligible shareholder, but only for a period of 60 days. Finally, a subchapter S election will not be terminated unless a new shareholder affirmatively refuses to consent to the election within 60 days. These provisions are effective for tax years beginning after December 31, 1976.

TITLE X—CHANGES IN THE TREATMENT OF FOREIGN INCOME

Part I—Foreign Tax Provisions Affecting Individuals Abroad

Sec. 1011. Income Earned Abroad by U.S. Citizens Living or Residing Abroad

Under prior law, U.S. citizens working abroad could exclude from their income up to \$20,000 of earned income (\$25,000 in some cases). U.S. citizens could also claim credit directly against U.S. tax for the foreign taxes paid on the excluded earned income.

The Act retains the earned income exclusion subject to the following modifications: (1) the earned income exclusion is limited to \$20,000 for all employees of U.S. charitable organizations and is reduced to \$15,000 for all other taxpayers; (2) foreign taxes paid on income which is eligible for the exclusion are not allowed as a foreign tax credit against U.S. income tax; (3) income derived beyond the income eligible for exclusion is subject to U.S. tax at the higher rate brackets which would apply if the excluded income were also subject to tax; and (4) income earned abroad which is received outside of the country in which earned in order to avoid tax in that country is not eligible for the exclusion. Under the Act, a taxpayer may make a permanent election not to have the earned income exclusion apply in the year of the election and all subsequent years. The provision applies to taxable years beginning after December 31, 1975.

Sec. 1012. Income Tax Treatment of Nonresident Alien Individuals Who Are Married to Citizens or Residents of the United States

Under prior law, a joint return could not be made by a husband and wife if either one of them at any time during the taxable year was a nonresident alien. If a husband and wife were subject to community property rules, one-half of the earned income of one spouse would be treated as being the income of the other spouse and not subject to U.S. taxation if the other spouse were a nonresident alien and if the income were from foreign sources.

The Act provides that a U.S. citizen or resident married to a nonresident alien is allowed to file a joint return provided that an election is made by both individuals to be taxed on their worldwide income. Where the election to be taxed on worldwide income is not made, certain community property laws are to be made inapplicable for income tax purposes. In addition, a modification is made to the general requirement that nonresident aliens file estimated tax returns by April 15 of the year in question, in those cases where they have until June 15 to file the income tax return for the previous year. The Act provides that in the case of nonresident alien individuals not subject to wage withholding, the due date for filing the estimated tax return

is not to be any earlier than the due date for the tax return for the previous year. The provision applies to taxable years beginning after December 31, 1976, except that individuals are allowed to file joint returns with nonresident aliens for taxable years ending on or after December 31, 1975.

Sec. 1013. Foreign Trusts Having One or More United States Beneficiaries To Be Taxed Currently to Grantor

Under prior law, a trust was taxed in a manner similar to nonresident alien individuals if it were considered to be a foreign trust. Such a trust was not taxed on its foreign source income, but distributions to a U.S. taxpayer from a foreign trust were taxed basically in the same manner as distributions from a domestic trust. A foreign trust created by a U.S. person was required to include capital gains without the section 1202 deduction in distributable net income; however, the beneficiary was entitled to the section 1202 deduction.

Under the Act, a U.S. person who transfers property to a foreign trust is treated as the owner of that property and taxed currently for each taxable year during which that trust has a U.S. beneficiary. In addition, all foreign trusts must include capital gains without the section 1202 deduction in distributable net income. However, the undistributed net income remaining as of December 31, 1975, will be redetermined with the section 1202 deduction. The provision does not apply to employee trusts described in Code section 404(a)(4). The provision applies to taxable years ending after December 31, 1975, but only for trusts created after May 21, 1974, and, in the case of existing trusts, to property transferred after May 21, 1974. However, the provision dealing with capital gains of foreign trusts applies to taxable years ending after December 31, 1975.

Sec. 1014. Interest Charge on Accumulation Distributions From Foreign Trusts

Under prior law, there was no interest charge on accumulation distributions from a foreign trust. The Act imposes an interest charge in the form of an additional tax on beneficiaries receiving taxable accumulation distributions from foreign trusts. The additional tax is 6 percent of the tax otherwise imposed with respect to the distribution for the average number of years during which the amounts were earned. No charge is imposed for the period before January 1, 1977. The provision applies to taxable years beginning after December 31, 1976.

Sec. 1015. Excise Tax on Transfers of Property to Foreign Persons To Avoid Federal Income Tax

Under prior law, an excise tax of 27½ percent was imposed on the amount of the appreciation of stock or securities transferred to foreign entities. The Act increases the excise tax to 35 percent on the amount of the unrecognized appreciation of all property transferred to foreign entities. An election to recognize gain in lieu of paying the excise tax is provided. The provision applies to transfers made after October 2, 1975.

Part II—Amendments Affecting Tax Treatment of Controlled Foreign Corporations and Their Shareholders

Sec. 1021. Amendment of Provision Relating to Investment in U.S. Property by Controlled Foreign Corporations

A U.S. shareholder of a controlled foreign corporation is taxed on the undistributed earnings and profits of the corporation to the extent of the annual increase of its investment in U.S. property. Under prior law, investment in U.S. property included the acquisition by a controlled foreign corporation of any tangible property located in the United States, or stock of a domestic corporation or obligations of a U.S. person (even though unrelated to the investor).

The Act excepts from the definition of U.S. property (1) stock or debt of a domestic corporation (other than a U.S. shareholder) which is not 25 percent owned by the U.S. shareholders, and (2) movable drilling rigs when used on the U.S. continental shelf. The provision applies to taxable years of foreign corporations beginning after December 31, 1975.

Sec. 1022. Repeal of Exclusion for Earnings of Less-Developed Country Corporations for Purposes of Section 1248

The Act repeals the exclusion from dividend treatment provided under prior law for sales or exchanges of stock in less-developed country corporations. However, the exclusion still applies to earnings accumulated before January 1, 1976, whether or not the corporation remains a less-developed country corporation. The provision applies to taxable years beginning after December 31, 1975.

Sec. 1023. Exclusion From Subpart F of Certain Earnings of Insurance Companies

The Act adds an exception to the rules of present law subjecting to current taxation (under subpart F) the tax haven income of foreign subsidiaries of U.S. corporations. The exception applies to dividends and interest income and gains from the sale or exchange of stock or securities by an insurance company in an amount equal to one-third of the company's premium income. The provision applies to taxable years of foreign corporations beginning after December 31, 1975, and to taxable years of U.S. shareholders within which or with which the taxable years of such foreign corporations end.

Sec. 1024. Shipping Profits of Foreign Corporations

Under prior law, tax haven income subject to current taxation included base company shipping income, except to the extent reinvested in shipping assets. Under the Act, shipping operations within one country are excluded from base company income if the company's ships are registered within that country and the company is incorporated there. The provision applies to taxable years of foreign corporations beginning after December 31, 1975, and to taxable years of U.S. shareholders within which or with which such taxable years of the foreign corporations end.

Part III—Amendments Affecting Treatment of Foreign Taxes

Sec. 1031. Requirement That Foreign Tax Credit Be Determined on Overall Basis

Under prior law, the foreign tax credit limitation could be determined on either a per-country or an overall basis (the taxpayer had to elect the latter). The Act repeals the per-country limitation and requires that all taxpayers determine their foreign tax credit limitation on the overall basis. Special transitional rules are provided for taxpayers previously on the per-country limitation to permit the carry-over of some excess credits from per-country years to overall years. The provision applies to taxable years beginning after December 31, 1975. In the case of certain mining companies, the effective date is delayed for 3 years. Losses sustained by these mining companies during the period that they are permitted to use the per-country limitation are subject to recapture on a per-country limitation basis if foreign source income is earned in future years. Further, with respect to income from sources within a possession, the repeal of the per-country limitation is also delayed for a three-year period, subject to recapture on a per-country basis.

Sec. 1032. Recapture of Foreign Losses

Under prior law, foreign losses generally reduced U.S. tax on U.S. source income by decreasing the worldwide taxable income on which the U.S. tax was based. In addition, when the business operations in the loss country (or countries) became profitable, a credit against U.S. tax was allowed for taxes paid to that country (or countries) without any recapture of the prior benefits (except in the case of foreign oil-related losses which were subject to recapture).

To reduce these advantages, the Act extends the recapture provisions to all foreign losses. The Act requires that in cases where a loss from foreign operations reduces U.S. tax on U.S. source income, the tax benefit derived from the deduction of these losses is to be recaptured by the United States if the company subsequently derives income from abroad. In general, the recapture is accomplished by treating a portion of foreign income which is subsequently derived as income from domestic sources. The amount of the foreign income which is to be treated as income from domestic sources in a subsequent year is limited to the lesser of the amount of the loss (to the extent that the loss has not been recaptured in prior taxable years) or 50 percent of the foreign taxable income for that year, or such larger percent as the taxpayer may choose. The proportionate foreign tax credit disallowance rule applicable to foreign oil-related losses is repealed.

The provision applies to losses sustained in taxable years beginning after December 31, 1975. It is not applicable to a loss from the disposition of a debt obligation of a foreign government issued before May 14, 1976, for property located in that country, or to a loss suffered subsequent to the effective date but attributable to an economic loss (worthlessness of stock or debt) which actually occurred prior to the effective date.

Sec. 1033. Gross up of Dividends From Less-Developed Country Corporations

The Act repeals the rule provided in prior law under which dividends from less-developed country corporations were not grossed-up reduced proportionately. In general, this provision applies for taxable deemed-paid foreign tax credits attributable to those dividends were reduced proportionately. In general, this provision applies for taxable years beginning after December 31, 1975.

Sec. 1034. Treatment of Capital Gains for Purposes of Foreign Tax Credit

The rules under prior law as to the netting of long-term and short-term gains and losses in cases where some gains or losses are U.S. source while others are foreign source were unclear. Also, the foreign tax credit limitations were not adjusted to reflect the lower tax rate on capital gains income received by corporations. The foreign tax credit could be inflated because the source of capital gain income is determined by the place of the sale of the asset, regardless of where used. Under the Act, the following modifications in the foreign tax credit limitation are made: (1) net U.S. capital losses offset net foreign capital gains; (2) in the case of corporations, only 30/48 of the foreign source net capital gain (or loss) is included in the foreign tax credit limitation; and (3) the gain from the sale or exchange of personal property outside the United States which is not subject to a substantial foreign tax is considered U.S. source income unless one of three exceptions applies. The modifications apply to taxable years beginning after December 31, 1975, except that the source rule modification only applies to sales or exchanges made after November 12, 1975.

Sec. 1035. Foreign Oil and Gas Extraction Income

Under prior law, foreign taxes which were allowable as a credit with respect to foreign oil and gas extraction income (including income from the extraction by the taxpayer of oil or gas for another person) were limited to a percentage of that income (52.8 percent for years ending in 1975, 50.4 percent for years ending in 1976, and 50 percent for years ending in 1977 and thereafter, computed on an overall basis) and could only be used to offset U.S. tax on oil-related income. For purposes of this limitation, "foreign oil and gas extraction income" is the income derived by the taxpayer from extraction (by the taxpayer or any other person) of minerals from oil and gas wells. Income from extraction includes the purchase and sale of crude oil by the taxpayer in cases where the taxpayer is not performing the extraction operations. Also, it includes income in cases where the taxpayer is performing extraction services within a country for the government of that country (whether or not the taxpayer purchased the oil from that government). Any excess foreign tax could only be used to offset U.S. tax on other oil-related income.

Under the Act, the limitation on foreign taxes on extraction income allowable as a credit is reduced, for taxable years ending after 1976, to 48 percent of that income computed on an overall basis. The Act provides permanent carryover rules for excess extraction taxes. Under

the Act, extraction taxes paid in taxable years ending after the date of enactment which exceed the limitation for the year can be carried back for two years to taxable years ending after December 31, 1974, and can be carried forward for five years. The amount carried to years after 1977 may not exceed 2 percentage points above the corporate tax rate.

Under prior law, individuals were subject to the same percentage limitation on foreign taxes paid with respect to foreign oil and gas extraction income as those imposed on corporations. The Act provides that the allowable foreign tax credit on foreign oil and gas extraction income for individuals is equal to the average U.S. effective rate of tax on that income (individuals will be limited to a separate overall foreign tax credit limitation for foreign oil and gas extraction income). The provision applies to taxable years ending after December 31, 1974.

Rev. Rul. 76-215, 1976 I.R.B. No. 23, holds that the contractor under a production-sharing contract in Indonesia is not entitled to a foreign tax credit for payments made by the government-owned company to the foreign government. The IRS announced that this ruling would apply only prospectively to claims for credits for taxes paid in taxable years beginning after June 30, 1976. The Act provides that Rev. Rul. 76-215 is not to apply for taxable years ending in 1977 to amounts paid to foreign governments and designated as taxes under production-sharing contracts entered into before April 8, 1976, for taxable years beginning on or after June 30, 1976. The credit is limited to 48 percent of the extraction income from the contracts. This provision applies to taxable years beginning on or after June 30, 1976.

Sec. 1036. Underwriting Income

The source of insurance underwriting income was not specified in the Code. The Act provides that the source of underwriting income is to be the place where the risk is located. The provision applies to taxable years beginning after December 31, 1976.

Sec. 1037. Third-Tier Foreign Tax Credit When Code Section 951 Applies

Under prior law, if a domestic corporation were required to include in its income amounts under subpart F, a deemed-paid foreign tax credit would be available with respect to foreign taxes paid by a first-tier foreign subsidiary (10 percent owned by the domestic corporation) and by a second-tier foreign subsidiary (50 percent owned by the first-tier foreign subsidiary). However, unlike the credit on actual distributions, there was no credit with respect to foreign taxes paid by a third-tier foreign subsidiary. Under the Act, the foreign tax credit under subpart F is made consistent with the credit for actual dividends from second and third-tier foreign subsidiaries. Thus, a credit is allowed for foreign taxes paid by a third-tier foreign subsidiary, and a second-tier or a third-tier corporation need only be 10 percent owned by a prior tier, provided the domestic corporation has, directly or indirectly, at least a net 5 percent ownership in each lower tier. The provision applies with respect to earnings and profits included in income in taxable years beginning after December 31, 1976.

Part IV—Money or Other Property Moving Out of or Into the United States

Sec. 1041. Interest on Bank Deposits Earned by Nonresident Aliens and Foreign Corporations

Under prior law, interest paid to a nonresident alien or foreign corporation from deposits with persons carrying on the banking business was exempt from U.S. tax, but the exemption was due to expire with respect to interest paid after December 31, 1976. The Act makes the exemption permanent.

Sec. 1042. Changes in Ruling Requirements Under Code Section 367; Certain Changes in Section 1248

In certain exchanges relating to the organization, reorganization, and liquidation of a foreign corporation, nonrecognition of gain was not available under prior law unless a ruling that tax avoidance is not present had been obtained from the IRS before the exchange. The Act permits nonrecognition of gain if a request for a ruling that tax avoidance is not present is filed within 183 days after the beginning of the transfer in the case of outbound transfers. In the case of all other transfers, regulations are to provide the extent to which earnings are to be taken into account in order to prevent avoidance of tax.

Under prior law no court review of the ruling was available. The Act provides for Tax Court review of these rulings.

In addition, under prior law, certain nonrecognition provisions allowed repatriation of accumulated earnings and profits of a foreign corporation without dividend treatment. The nonrecognition provisions are modified under the Act so that repatriated earnings and profits do not escape dividend treatment.

The Act applies generally to sales, exchanges, and distributions taking place after October 9, 1975. However, until January 1, 1978, rulings may be required on all transfers. In certain transfers not involving U.S. persons which took place between 1962 and 1976, taxpayers are given 183 days after the enactment of the Act to obtain a ruling.

The Act provides a special rule dealing with the situation where there are a number of outbound transfers which are treated by the Secretary as part of the same exchange. Pursuant to this rule, if there is an organization, reorganization, or liquidation involving a transfer or transfers of property by a U.S. person to a foreign corporation, nonrecognition of gain will be permitted if a request for a ruling that a tax avoidance purpose is not present is filed within 183 days after the beginning of the transfer. Under this rule, the taxpayer may request a ruling not later than the 183rd day after the beginning of any transfer which is part of the exchange, whether or not a ruling has been requested with respect to prior transfers which are part of the exchange. If the Secretary determines that the entire exchange does not involve a tax avoidance purpose, nonrecognition of gain will be permitted for that transfer and any subsequent transfers. Nonrecognition will be provided with respect to those transfers which are part of the exchange but which begin more than 183 days before

the ruling request is made if the Secretary determines that tax avoidance will not result if the earlier transfers are provided nonrecognition treatment and if a ruling was obtained for the earlier transfer. If no ruling was obtained for the earlier transfer, nonrecognition treatment will not be accorded the earlier transfer if a ruling is required for that transfer for there to be nonrecognition. However, failure of the taxpayer to apply for a ruling with respect to an earlier transfer will not automatically result in taxable treatment of the earlier transfer because the Secretary may require nonrecognition treatment of the earlier transfer in those situations he deems appropriate even in the absence of a ruling.

Sec. 1043. Contiguous Country Branches of Domestic Life Insurance Companies

Prior law subjected all U.S. companies to tax on their worldwide taxable income. Under the Act, a U.S. mutual life insurance company may elect to account for contiguous country business separately from other business to avoid U.S. taxation on contiguous country income to the extent such income is not repatriated. A company making this election must recognize as gain the net unrealized appreciation on the branch's assets. A domestic stock life insurance company selling policies similar to those sold by a mutual company may transfer assets to a contiguous country subsidiary and recognize the net gain on the assets transferred.

The provision applies to taxable years beginning after December 31, 1975.

Sec. 1044. Transitional Rule for Bond, etc. Losses of Foreign Banks

Under prior law, gains and losses on the sale or exchange of government and corporate bonds and certain other types of indebtedness were treated as ordinary income and loss in the case of financial institutions and foreign corporations which would be considered banks if they were domestic corporations. However, for taxable years beginning before July 12, 1969, these amounts were treated as capital gain or loss. The Act provides that, for foreign corporations which otherwise would be considered financial institutions, net gains from these transactions will be considered capital gain to the extent of any capital loss carryovers attributable to the same types of sales or exchanges in taxable years beginning before July 12, 1969.

Part V—Special Categories of Foreign Tax Treatment

Sec. 1051. Tax Treatment of Corporations Conducting Trade or Business in Puerto Rico and Possessions of the United States

Under prior law, corporations operating a trade or business in a possession were entitled to exclude from gross income all income from sources without the United States including foreign source income earned outside the possession if they satisfied an 80-percent source and a 50-percent active trade or business test. However, dividends from a possessions corporation were not eligible for the intercorporate dividends received deduction.

Under the Act, a corporation meeting the 80-percent and 50-percent tests is entitled to a special tax credit equal to the U.S. tax on that income plus income from certain investments in that possession. In addition, dividends from a possessions corporation are eligible for the intercorporate dividends received deduction. The Act disallows any foreign tax credits for taxes paid by the possessions corporation or for the Puerto Rican withholding tax on liquidation or on distributions of earnings. These provisions apply to taxable years beginning after December 31, 1975.

However, the Act continues to exempt foreign source income derived from sources outside the possession which is earned before October 1, 1976, whether or not the invested funds are derived from the possessions business. In addition, the foreign tax credit is allowed for taxes paid with respect to liquidations occurring before January 1, 1979, to the extent the taxes are attributable to amounts earned before January 1, 1976.

Sec. 1052. Western Hemisphere Trade Corporations

The Act phases out the 14-percent tax rate reduction provided under prior law for Western Hemisphere trade corporations over a 4-year period beginning in 1976.

Sec. 1053. Repeal of Provisions Relating to China Trade Act Corporations

The special tax benefits granted to China Trade Act corporations and their shareholders, which generally permitted the corporation and its shareholders to pay no U.S. tax are phased out over three years beginning in 1976.

Part VI.—Denial of Certain Tax Benefits for Cooperation With or Participation in International Boycotts and in Connection with the Payment of Certain Bribes

Secs. 1061–1064; 1066 and 1067. Denial of Certain Tax Benefits for Cooperation With or Participation in an International Boycott

Prior law contained no tax provisions dealing with international boycotts. The Act denies to any person who agrees to participate in or cooperate with any international boycott based on race, nationality or religion the benefits of the foreign tax credit, deferral of earnings of foreign subsidiaries, and DISC to the extent these tax benefits are attributable to operations of that person (or its affiliates) in connection with which there was boycott participation or cooperation.

The benefits of deferral and DISC are denied to the taxpayer by requiring a deemed distribution of earnings to the shareholders of the DISC or controlled foreign corporation. The benefits of the foreign tax credit are denied to the taxpayer by reducing the otherwise allowable foreign tax credit to which the taxpayer would be entitled under sections 901, 902, and 960 of the Code after applying the limitation, if applicable, of section 907. Taxes which are denied the foreign tax credit under this provision are not entitled to be carried back or forward as foreign tax credits but may be eligible to be deducted in

computing taxable income. Of course, if so deducted, the rules of sections 861 and 862 will apply with respect to the deduction.

A taxpayer participates in or cooperates with an international boycott if the taxpayer agrees, as a condition of doing business directly or indirectly within a country or with the government, a company, or a national of a country (1) to refrain from doing business within a country which is the object of an international boycott or with the government, companies, or nationals of that country; (2) to refrain from doing business with any U.S. person engaged in trade within another country which is the object of an international boycott or with the government, companies, or nationals of that country; (3) to refrain from doing business with any company whose ownership or management is made up, all or in part, of individuals of a particular nationality, race, or religion, or to remove (or refrain from selecting) corporate directors who are individuals of a particular nationality, race, or religion; (4) to refrain from employing individuals of a particular nationality, race, or religion; or (5) to refrain from shipping or insuring products on a carrier owned, leased, or operated by a person who does not participate in or cooperate with an international boycott.

The Act permits a taxpayer to agree to comply with certain laws without being treated as agreeing to participate in or cooperate with an international boycott. A taxpayer may agree to meet requirements imposed by a foreign country with respect to an international boycott if a U.S. law, executive order, or regulation sanctions that participation or cooperation. Secondly, the taxpayer may agree to comply with a prohibition on the importation of goods produced in whole or in part in any boycotted country or to comply with a prohibition imposed by a country on the exportation of products obtained in that country to any boycotted country. The taxpayer however, may not agree to refrain from importing or exporting to or from a particular country products which are, or which contain components which are, made by a company on a boycott list.

A person is not considered as having participated in or cooperated with an international boycott unless he has agreed to such participation or cooperation. The agreement need not be in writing; there may be an implied agreement. However, an agreement will not be inferred from the mere fact that any country is exercising its sovereign rights. Thus, a taxpayer is not considered to have agreed to participate in or cooperate with an international boycott merely by reason of the inability of the taxpayer to obtain an export or import license from a sovereign country for specific goods. Similarly, a taxpayer's inability, under the laws or administrative practices of a country, to bring certain personnel into that country, to bring certain ships into the waters of that country, to provide certain services in that country, or to import or export certain products to or from a country, is not to be considered to constitute an agreement to participate in or cooperate with an international boycott. Further, the signing (at the time of import), of a certification as to content, which is required to obtain an import license, does not by itself constitute an agreement by the taxpayer. However, this will not permit the making of an agreement

not to import certain goods into the country. In addition, a course of conduct of complying with sovereign law may, along with other factors, be evidence of an agreement.

If the taxpayer has participated in or cooperated with an international boycott in a country, he is presumed to have participated in or cooperated with that boycott with respect to all operations in all countries which require of the taxpayer (or of other persons, whether or not related to the taxpayer) participation in or cooperation with that international boycott. However, the taxpayer may establish that he has conducted clearly separate and identifiable operations in that country or another country through the same corporation or related corporations with respect to which there is no cooperation with or participation in that boycott.

The international boycott provisions apply to any participation in or cooperation with an international boycott made more than 30 days after the date of enactment (October 4, 1976). However, in the case of operations which are carried out in accordance with the terms of a binding contract entered into before September 2, 1976, the international boycott provisions shall apply to participation or cooperation after December 31, 1977.

Sec. 1065. Denial of Certain Tax Benefits Attributable to Bribe-Produced Income

Under prior law, illegal payments to government officials were not deductible, but the denial of the deduction for bribes had little impact on bribes paid by foreign subsidiaries or DISCs.

The Act subjects to current taxation as a deemed dividend an amount equal to the amount of any bribe paid by a foreign subsidiary or a DISC of a U.S. company. In addition, the earnings and profits of any foreign subsidiary which has paid a bribe are not to be reduced by the amount paid. The provision applies to illegal payments made 30 or more days after enactment.

TITLE XI—AMENDMENTS AFFECTING DISC

Sec. 1101. Amendments Affecting DISC

The DISC provisions under prior law permitted shareholders to defer taxation of up to 50 percent of the export profits allocated to the DISC. Under the Act, incremental rules are adopted for taxable years beginning after December 31, 1975, which permit DISC benefits to the extent that current export gross receipts exceed 67 percent of the average for a 4-year moving base period (initially 1972–1975) which moves forward after 1979. A small DISC exemption to the incremental rule is provided for DISCs having taxable income of \$150,000. DISC benefits are terminated for 50 percent of military sales made in taxable years beginning after December 31, 1975. Fixed contract sales of natural resource products denied DISC benefits under the Tax Reduction Act of 1975 are made eligible for DISC benefits for an additional 5-year period from March 17, 1975 until March 18, 1980.

Under prior law, DISC benefits were denied for sales of depletable natural resources including timber. Under the Act, timber is excluded from the definition of depletable natural resources and thus will continue to receive DISC benefits. Upon the disqualification of a DISC, the accumulated DISC income is recaptured under present law over a period equal to the period that the DISC was in existence not to exceed 10 years. The Act provides that upon the disqualification of a DISC, the accumulated DISC income is recaptured over a period equal to twice the period that the DISC was in existence not to exceed 10 years. Where DISC benefits with respect to a product terminate, loans to the related supplier would not qualify as a producer's loan under prior law. The Act provides that where DISC benefits with respect to a product terminate, loans to a related supplier may still qualify as a producer's loan.

Also under prior law, taxpayers could prevent recapture of DISC benefits by selling or distributing DISC stock in certain nontaxable transactions. Under the Act, the sale or distribution of DISC stock in certain nontaxable transactions will result in recapture of accumulated DISC income.

Under prior law, the combination of the general deemed distribution rule and the rule prescribing the source of any distribution to meet the 95 percent export receipts requirement could result in a partial double counting of the DISC's taxable income with respect to terminating deferral of taxation to its shareholders. The Act eliminates the problem of double counting by altering the source rules for distributions to meet qualification requirements.

TITLE XII—ADMINISTRATIVE PROVISIONS

Sec. 1201. Public Inspection of Written Determinations by Internal Revenue Service

Under prior law, private letter rulings and other written determinations of the IRS were made public by the courts under the Freedom of Information Act. Certain confidential and other information was exempted from disclosure by the FOIA, but the taxpayer's identity was disclosed.

Under the Act, IRS written determinations such as letter rulings and technical advice memoranda are to be made public, after deletion of certain information. Deleted material includes the taxpayer's name and other identifying details; commercial or financial information which is privileged or confidential; trade secrets; classified matter; information exempted by statute; bank regulation information; matters of personal privacy; and geological and geophysical information including maps concerning wells. The Act establishes procedures for resolution of disputes regarding deletion of information before public inspection of the written determination is available, including court actions to restrain disclosure and to obtain additional disclosure.

Background file documents related to a written determination are to be made available upon request. Determinations requested before November 1, 1976, are made public, except for certain required rulings, contingent upon funds being appropriated to the IRS for that purpose. Rules are established for the order in which prior determinations will be released, with the more recent determinations given priority.

If the IRS receives a communication concerning a pending request for a written determination from anyone outside the IRS (other than the taxpayer), the contact is to be noted, or "flagged", on the determination when it is made public. Any person may file suit and learn the identity of the taxpayer, if the Tax Court finds evidence that an impropriety occurred or undue influence was exercised with respect to the determination. The Tax Court could also order disclosure of other material previously deleted.

The Act provides that the Secretary may determine any precedential effect of these written determinations by regulation and creates a civil remedy for intentional or willful failure of the IRS to make required deletions or to follow the procedures of this section, including minimum damages of \$1,000 plus costs. It permits the IRS to collect fees for search and duplication costs in making information available on request, and establishes rules for IRS records disposal.

Sec. 1202. Disclosure of Returns and Return Information

(a) *General.*—Under prior law, tax returns were "public records", but they were generally open to inspection only under regulations or executive orders. Additionally, the statute provided a number of specific situations in which tax returns could be disclosed. The Act provides that returns and return information are to be confidential and not subject to disclosure except as specifically provided by statute.

In general, "returns" were defined in the regulations previously in effect as including information returns, schedules, lists, and other written statements filed with the IRS which are supplemental to, or become a part of, the return and other records, reports, information received orally or in writing, factual data, documents, papers, abstracts, memoranda, or evidence taken, or any portion thereof relating to returns and schedules, etc. The Act defines the term "return" to mean any tax or information return, declaration of estimated tax or claim for refund which is required or permitted to be filed with respect to any person. It also includes any amendment, supplemental schedule or attachments filed with the tax return, information return, etc. "Return information" is defined as any data received by or prepared by the Secretary with respect to a return or with respect to the determination of the existence of the liability of any person for any tax, penalty, interest, fine, forfeiture, or other imposition. Information as to whether a taxpayer's return was, is being, or will be examined is also to be considered return information. Under the Act, data in a form that cannot be associated with or otherwise identify a particular taxpayer will not constitute return information.

(b) *Disclosure to Congress.*—Congressional committees were classified in three categories for disclosure purposes under prior law. The tax committees could inspect tax information in executive session. Select committees of the House and Senate could inspect tax information in executive session if specifically authorized to do so by a resolution of the appropriate body. Standing and select committees could inspect tax information under an executive order issued by the President for the committee in question and on the adoption of a resolution (by the full committee) authorizing inspection.

The Act provides that the tax-writing committees, upon written request of their respective chairmen, may have access to returns and return information in executive session. The Chief of Staff of the Joint Committee on Taxation may have access to returns and return information. Nontax committees are to be furnished returns and return information in executive session upon (1) a committee action approving the decision to request such returns, (2) an authorizing resolution of the House or Senate, as the case may be, and (3) a written request by the Chairman of the committee. The resolution of the appropriate body authorizing these committees to obtain returns or return information must specify the purpose for the inspection and that the inspection is to be made only if there is no alternative source of information reasonably available to the committee. The committees, through the committee Chairman and ranking minority member, can designate no more than 4 agents (2 majority and 2 minority) to inspect the returns or return information requested.

Under prior law, the tax committees and select committees authorized to inspect tax information could submit "any relevant or useful" information obtained to the House or Senate. The Act provides that the tax-writing committees may submit tax information to the Senate or House, as the case may be. The nontax-writing committees may submit such information to the Senate or House sitting in executive session. The Joint Committee on Taxation, or its Chief of Staff, may submit tax information to the House Committee on Ways and Means or to the Senate Committee on Finance sitting in executive session.

(c) *Disclosure to the President (and other Federal agencies).*—A previous executive order permitted so-called “tax checks” and inspection of tax returns by the President and certain designated White House employees. Requests for tax checks and inspection were to be in writing and signed by the President personally.

The Act provides that disclosure of returns and return information can be made to the President and/or to certain named employees of the White House Office upon the written request of the President, signed by him personally. A request is to specify, among other things, the reason disclosure is requested. The President (or a duly authorized representative of the Executive Office) and the head of a Federal agency also may make a written request for a “tax check” with respect to prospective appointees. The “tax check” is limited to the inquiry as to whether the individual has filed income tax returns for the last 3 years, has failed to pay any tax within 10 days after notice and demand or has been assessed a negligence penalty within the current or immediately preceeding 3 years, has been or is under any criminal tax investigation (and the results of such investigation), or has been assessed a civil penalty for fraud. A prospective employee will be notified by the IRS within 3 days of its receipt of a request for a tax check on the prospective employee. The President and the head of any agency requesting returns and return information under this section will be required to file quarterly a confidential report with the Joint Committee on Taxation identifying the taxpayers, the returns or return information involved, and the reason for requesting such returns or return information. However, the President will not be required to report on requests pertaining to current employees of the executive branch. The reports will be maintained by the Joint Committee on Taxation for a period not exceeding 2 years unless, within that period of time, the Joint Committee on Taxation determines that a disclosure to the Congress is necessary.

(d) *Criminal and civil tax cases.*—Under prior law, tax returns and other tax information of any taxpayer could be furnished upon request, without written application, to U.S. Attorneys and Justice Department attorneys in civil or criminal tax cases referred by the IRS to the Justice Department for prosecution or defense. Where the Justice Department was investigating a possible violation of the civil or criminal tax laws and the matter had not been referred to the Justice Department by the IRS, a Justice Department attorney or U.S. attorney could obtain tax information upon written application where it was “necessary in the performance of his official duties”. The Justice Department could also obtain the returns of potential witnesses and third parties. Also, the IRS would answer an inquiry from the Justice Department as to whether a prospective juror had been investigated by the IRS.

Under the Act, the Justice Department will continue to receive returns and return information with respect to the taxpayer whose civil or criminal tax liability is at issue. Written request is required in cases other than refund cases and cases referred by the IRS. The return or return information of a third party will be disclosed to the Justice Department in the event that the treatment of an item reflected on his return is or may be relevant to the resolution of an issue of the taxpayer’s liability. The return or return information of a third

party will also be disclosed to the Justice Department if the third party's return or return information relates or may relate to a transaction between the third party and the taxpayer whose tax liability is or may be at issue and if the return information pertaining to that transaction may effect the resolution of an issue of the taxpayer's tax liability. A third party return may also be disclosed in a court proceeding, subject to the same item and transactional tests described above, except that the items and transactions must have a direct relationship to the resolution of an issue of the taxpayer's liability. In tax cases, the Justice Department and the taxpayer whose liability is at issue will be allowed to inquire of the IRS as to whether a prospective juror has been under an audit or investigation by the IRS. However, responses to such inquiries are to be limited to the existence or nonexistence of an IRS audit or investigation.

(e) *Nontax criminal cases.*—Under prior law, a U.S. Attorney or an attorney of the Department of Justice could obtain tax information in any case “where necessary in the performance of his official duties”. This could be obtained on written application, giving the name of the taxpayer, the kind of tax involved, the taxable period involved, and the reason inspection was desired. The application was to be signed by the U.S. Attorney involved or by the Attorney General, Deputy Attorney General, or an Assistant Attorney General. Tax information obtained by the Justice Department could be used in proceedings conducted by or before any department or establishment of the Federal Government or in which the United State was a party. The IRS also would answer an inquiry from the Justice Department as to whether a prospective juror had been investigated by the IRS.

Under the Act, tax information may be disclosed to the Justice Department and other Federal agencies for nontax criminal purposes only by order of a U.S. District Court. The order will be issued upon a showing that: (i) there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed; (ii) there is reason to believe that the return or return information is probative evidence of a matter in issue related to the commission of the criminal act; and (iii) the information sought to be disclosed cannot reasonably be obtained from any other source unless it is determined that, notwithstanding the reasonable availability of the information from another source, the return or return information sought constitutes the most probative evidence of a matter in issue relating to the commission of the criminal act.

The first requirement set forth above (“reasonable cause . . .”) is intended to be less strict than the “probable cause” standard for issuing a search warrant, and this “reasonable cause” requirement is to be construed according to the plain meaning of the words involved. The term “criminal act” includes any act with respect to which the criminal penalty provisions of a Federal nontax statute (which may also include civil penalty provisions) would apply. This court procedure contemplates an *in camera* inspection of the return or return information by the judge to determine whether any part or parts thereof meet the requirements outlined above. Only the part or parts of the return or return information determined by the court to meet these requirements would be subject to disclosure under this provision. In this regard, the Congress intends that the more personal the infor-

mation involved (e.g., medical and psychiatric information), the more restrictive the court would be in allowing disclosure.

The return or return information may be introduced in an administrative or judicial hearing if the court finds that it is probative of a matter at issue relevant in establishing the commission of a crime or the guilt of a party. The credibility of a witness does not constitute a matter in issue for purposes of these rules. Thus, under the Act, a return or return information will not be admissible for purposes of "collateral impeachment" (i.e., discrediting a witness on matters not bearing upon the question of the commission of a crime or the guilt of a party). Only those parts of the return determined by the court to be necessary to the investigation or prosecution will be subject to disclosure.

The Act also authorizes the IRS, either upon its own initiative or pursuant to written request, to disclose in writing to the Justice Department or any other Federal agency information relating to the possible violation of a Federal criminal law which is received from sources other than the taxpayer or his representatives.

(f) *Nontax civil matters.*—Under prior law, U.S. Attorneys and officials of other Federal agencies could obtain tax information in nontax civil cases in the same manner and to the same extent as in nontax criminal cases. The Act provides that disclosure of returns and return information cannot be made to the Justice Department or other Federal enforcement agencies in nontax civil cases except in those instances where the Department is defending the United States in a suit involving a renegotiation of contracts previously determined by the Renegotiation Board. Disclosure is also allowed under the Act to Treasury personnel of returns or return information for purposes of tax administration.

(g) *GAO.*—Under prior law, the GAO did not have independent authority to inspect tax returns. It did have access to tax returns when it audited IRS operations as the agent of the Joint Committee on Taxation. The Act authorizes the GAO to inspect returns and return information to the extent necessary in conducting an audit of the IRS or the Bureau of Alcohol, Tobacco and Firearms required by section 117 of the Budget and Accounting Procedures Act of 1950. It is intended that the GAO examine returns and individual tax transactions only for the purpose of, and to the extent necessary to serve as a reasonable basis for, evaluating the effectiveness, efficiency and economy of IRS operations and activities. It is not intended that the GAO would superimpose its judgment upon that of the IRS in specific tax cases. GAO is to notify the Joint Committee on Taxation in writing of the subject matter of the planned audit and any plans for inspection of tax returns. GAO can proceed with its planned audit unless the Joint Committee, by a two-thirds vote of its members, vetoes the GAO audit plan within 30 days of receiving written notice of the proposed audit from GAO.

The Act also authorizes the GAO to review and evaluate the compliance by the Federal and State agencies which have received returns and return information from the IRS with the requirements regarding the use and safeguarding of the returns and return information.

(h) *Statistical use.*—The Census Bureau, the Bureau of Economic Analysis, the Federal Trade Commission, and the Securities & Ex-

change Commission have previously been authorized to use tax returns and return information for statistical purposes. Under the Act, Census, the BEA, the FTC, and non-IRS Treasury personnel can obtain tax returns and limited return information for statistical and research purposes. The BEA and the FTC will only receive corporate tax information. Publication of statistical studies identifying any particular taxpayer is prohibited.

(i) *Inspection by Federal agencies.*—Under prior law, several agencies could generally inspect tax information for qualified purposes without making a specific written request for the information. Inspection of tax information on a general basis was made most often by HEW, the Renegotiation Board and the FTC. Under the Act, limited disclosures on a general basis are permitted to the Social Security Administration, the Railroad Retirement Board, the Department of Labor, the Pension Benefit Guaranty Corporation, and the Renegotiation Board in certain limited situations where the return information is directly related to programs administered by the agency in question.

(j) *State and local governments.*—On the written request of the State Governor, tax returns could previously be inspected by State tax officials for purposes of administering the State's tax laws. Tax information could also be obtained by the States for local governments for their use in administering the local tax laws.

The Act provides that Federal tax returns and return information may be disclosed to State tax officials solely for use in administering the State's tax laws. The tax information will not be available to the State Governor or any other nontax personnel, or to local governments. No disclosure may be made to any State that requires taxpayers to attach to, or include in, State tax returns a copy of any portion of the Federal return (or any information reflected on the Federal return) unless the State adopts provisions of law by December 31, 1978, protecting the confidentiality of the attached copies of the Federal returns and the included return information. Although the copies of the Federal returns or the return information required by a State or local government to be attached to, or included in, the State or local return do not constitute Federal "returns or return information" subject to the Federal confidentiality rules, the policy underlying this requirement is that the attached copy of the return and the included information should be treated by State and local governments as confidential rather than effectively as public information. However, it is not intended that States be required to enact confidentiality statutes which are copies of the Federal statutes. Thus, State tax authorities can disclose State returns and return information, including any portion of the Federal return (or information reflected on the Federal return) which the State requires the taxpayer to attach to, or to include in, his State tax return, to any State or local officers or employees whose official duties or responsibilities require access to such State return or return information pursuant to the laws of that State.

In order to protect the confidentiality of returns which the States receive from the IRS under the present exchange programs, the returns are, in most States, processed on computers used solely by the State tax authorities. In certain States, however, the requirements of the tax authorities are not sufficient to justify a separate computer, and, accordingly, the tax authorities have the Federal tax returns

processed on central computers shared by several State agencies which are operated by State employees who are not in the tax department. In such situations, the IRS requires that tax department personnel be present at all times when the Federal tax returns are being processed. The Act permits those States currently time-sharing with other State agencies to continue to do so to the extent authorized and under the conditions specified in Treasury regulations.

(k) *Taxpayers with a material interest.*—Income tax returns have previously been open to inspection by certain persons with a material interest in those returns. For example, returns were open to the filing taxpayers, trust beneficiaries, partners, heirs of the decedent, etc. Under the Act, persons with a material interest will continue to have the right to inspect returns and, where appropriate, return information to the same extent as provided under current regulations. Return information (in contrast to “returns”) can be disclosed to persons with a material interest only to the extent the IRS determines this would not adversely affect the administration of the tax laws.

(l) *Miscellaneous disclosures.*—Several provisions of prior regulations allowed the disclosure of tax information for miscellaneous administrative and other purposes. In other cases, the statute specifically required public disclosure and certain types of returns (e.g., applications for exempt status by organizations). Under the Act, returns will continue to be open to public inspection in those situations where public disclosure is required in present law. Limited disclosure of returns and return information is permitted in some, but not all, of the miscellaneous situations where disclosure was permitted under prior law.

Under prior law, address information was provided to the Federal Parent Locator Service regarding “absent parents” under Public Law 93-647 (section 453 of the Social Security Act). The Act modifies the rules for the disclosure of return information to the Federal, State and local child support enforcement offices by providing for disclosure of certain information from IRS master files. Disclosure of other return information is permitted only to the extent that it cannot be reasonably obtained from another source.

The Act also authorizes the IRS to disclose to other Federal agencies the mailing addresses of taxpayers from whom the agencies are attempting to collect a claim under the Federal Claims Collection Act.

(m) *Procedures and records concerning disclosure.*—Several different offices of the IRS have had the responsibility for approving the disclosure of tax information to particular agencies. The IRS has maintained records concerning disclosure, but the type of records maintained have not been standardized as between, e.g., Service Centers, and a complete inventory of records has not been maintained. The Act provides that in those cases in which disclosure or inspection of returns or return information is permitted, it is to be permitted only at the times, in the manner, and at the places prescribed by regulations. The IRS and each Federal and State agency receiving tax information will be required to maintain a standardized system of permanent records on the use and disclosure of returns and return information.

(n) *Safeguards.*—Except for the general criminal penalty for unauthorized disclosure, the tax law did not previously provide rules for safeguarding tax information disclosed by the IRS to other agencies.

The IRS had no authority to audit the safeguards established by other agencies or to stop disclosure to other agencies that did not properly maintain safeguards. Under the Act, no tax information is to be furnished by the IRS to another agency (including commissions, States, etc.) unless the other agency complies with a comprehensive system of administrative, technical, and physical safeguards designed to protect the confidentiality of the returns and return information. In the event of an unauthorized disclosure by the other agency or its failure to maintain adequate safeguards, the IRS may (subject to an administrative appeal procedure) terminate disclosure to that agency.

(o) *Reports to Congress.*—Since 1971, the Joint Committee on Taxation has received from the IRS a semi-annual report on disclosure of tax information. The Act requires the IRS to make a confidential report to the Joint Committee each year on all requests (and the reasons therefor) received for disclosure of tax returns or return information. The report is to include, as a separate section to be publicly disclosed, a listing of all agencies receiving tax return information, the number of cases in which disclosure was made to them during the year, and the general purposes for which the requests were made. In addition, the IRS is required to file a quarterly report with the tax committees regarding procedures and safeguards followed by recipients of returns and return information.

(p) *Enforcement.*—Under prior law, unauthorized disclosure of a Federal income tax return or financial information appearing thereon by a Federal or State employee was a misdemeanor punishable by a fine of up to \$1,000 or imprisonment of up to one year, or both. It was also a misdemeanor punishable in the same manner for any person to print or publish an income tax return or financial information appearing therein. Under the Act, the criminal violation of the disclosure rules is a felony punishable by a fine of up to \$5,000 and imprisonment of up to 5 years, or both. It is also a felony, subject to the same penalties, for any person willfully to receive returns or return information as a result of an offer by that person of an item of material value in exchange for the unauthorized disclosure. A civil remedy is provided for any taxpayer damaged by any unlawful disclosure of returns or return information.

(q) *Effective date.*—The provisions in the Act concerning the confidentiality of tax returns are effective as of January 1, 1977.

Sec. 1203. Income Tax Return Preparers

Prior law provided only that tax return preparers must sign returns they prepared. No penalties were provided for failure to sign. Preparers were subject to criminal fraud penalties of fines up to \$5,000 and 3 years' imprisonment for willfully aiding or assisting in the preparation of a fraudulent return. (Also, preparers were subject to penalties for improper disclosure of tax return information.)

Under the Act, the provisions affecting tax return preparers are enlarged and strengthened. Any person who prepares or employs another to prepare a return or claim for refund for compensation must meet specific disclosure requirements and is subject to penalties for negligent or fraudulent preparation of returns. An exception is provided for preparers of refund claims filed as a result of an IRS audit.

Authorization is given the IRS to modify annual reporting requirements, provided detailed records and information are available and accessible to the Service. Injunctions may be sought against preparers engaging in certain specified practices. The Act applies to documents prepared after December 31, 1976.

Congress also clarified certain language which appears in the Finance Committee's Report relating to income tax return preparers. The Act imposes a penalty for any understatement of tax liability caused by an income tax return preparer due to negligent or intentional disregard of rules and regulations. Congress agrees with the Finance Committee's intention, as stated in the Committee Report, that this provision should be interpreted in a manner similar to existing section 6653(a) of the Code which imposes penalties for disregard of rules and regulations by taxpayers on their own returns. Consistent with section 6653(a), the Committee Report states that an income tax return preparer's good faith dispute about an interpretation of a statute is not considered negligent or intentional disregard of rules and regulations.

However, the Report of the Finance Committee goes on to state that an income tax return preparer may complete a return relying on case law that conflicts with rulings or regulations, "provided he clearly sets forth in the return the relevant rulings or regulations which he disputes and the judicial decision upon which he relies." Such disclosure is not required to avoid penalties under section 6653(a) of the Code, and the Committee did not intend that more stringent requirements be applied under the new section 6694(a). Congress agrees that while there may be instances in which some form of disclosure on a return would be necessary to avoid penalties under section 6694(a), that would depend on all the relevant facts and circumstances in the particular case, as is true under section 6653(a).

Sec. 1204. Jeopardy and Termination Assessments

Under prior law, no court or administrative review was made of the appropriateness of a jeopardy or termination assessment. No restrictions were placed on sale of property seized pursuant to one type of jeopardy assessment. A termination assessment created a "deficiency" and presumably short taxable years.

The Act requires the Internal Revenue Service to furnish the taxpayer with a written statement setting forth the basis for a jeopardy or termination assessment within 5 days after the assessment is made, and provides for administrative review within an additional 15 days. The taxpayer may then obtain an expedited de novo determination of the reasonableness of the assessment by a United States District Court. The Commissioner has the burden of proof on whether it is reasonable for a jeopardy or termination assessment to stand, but the taxpayer has the burden of proof on the reasonableness of the amount assessed. This division of the burden of proof is similar to the division in a civil tax fraud case where the government has the burden of proof on the fraud issue, and the taxpayer the burden on the issue of a deficiency in tax. However the government is not required to carry its burden of proof in the court review of a jeopardy or termination assessment under the special evidentiary standard of proof applicable to proving civil fraud, i.e., "clear and convincing evidence." Rather,

the usual standard is to apply, as it does where the government is given the burden of proof in a deficiency case on a tax issue it failed to raise in its notice of deficiency. The Act also provides restrictions on the sale of property seized pursuant to one type of jeopardy assessment (where there are no restrictions under the present law). In the case of termination assessments, the Act provides for notice of deficiency to the taxpayer only after the close of the normal taxable year and for no closing or reopening of a taxpayer's taxable year. The Act applied to assessments where the notice and demand take place after December 31, 1976. However, H.R. 1142, which passed the Congress on October 1, 1976, moved the date forward to February 28, 1977.

Sec. 1205. Administrative Summons

The Act provides generally, in the case of a third party summons served on banks and certain other third parties, that the taxpayer (or other person to whom the summoned records pertain) is to receive notice of the summons from the Service within 3 days of the time of its service and have the right to stay compliance by notifying the person summoned within 14 days not to comply with the summons. The Service is then required to seek enforcement of the summons in a Federal court and the taxpayer has standing to challenge such enforcement. Notice is not required in the case of an administrative summons to a bank issued in connection with IRS collection activities. In the case of a John Doe summons (where the identity of the taxpayer is not known) the Service must go into court, establish reasonable basis for requesting the summons, and receive court approval before issuing the summons.

The Act also provides for suspension of the civil and criminal statute of limitations where the summons is protested by the taxpayer or his nominee, or agent, or other person under the taxpayer's direction or control. The Act suspends the notice requirement where a summons is issued solely to determine if records exist or to learn the identity of a person having a numbered bank account, or where notice may result in a material interference in an investigation. The Act also provides for the reimbursement of witness costs in accordance with regulations.

The Act applied to summons issued after December 31, 1976. However, H.R. 1142, which passed the Congress on October 1, 1976, moved the date forward to February 28, 1977.

Sec. 1206. Assessments in Case of Mathematical or Clerical Errors

Under prior law, where a tax deficiency resulted from a mathematical error, the taxpayer did not have a right to appeal to the Tax Court, as provided in other cases. In practice, the Internal Revenue Service allowed the taxpayer time to explain and substantiate a claim that there was no error. The Service has applied the mathematical errors procedure in 5 general categories of mistakes, only one of which literally involves arithmetic miscalculations.

The Act defines five sets of mathematical or clerical errors, and the procedure which is to be followed before the Service may assess a deficiency. Under the procedure, the taxpayer must be given an explanation of the error and time to file a request for abatement of the assessment. The Service may not assess a deficiency before the taxpayer

has agreed to it or the specified period has expired. The taxpayer is allowed 60 days from date of notice to file a request for abatement. If such a request is filed, the Service must abate the assessment; the Service then may assert a deficiency. The provision covers: (1) arithmetic errors; (2) errors in transferring amounts on the tax forms; (3) missing schedules or forms; (4) inconsistent entries and computations; and (5) entries that exceed statutory limitations. The provision applies to returns filed after December 31, 1976.

Sec. 1207. Withholding Provisions

Sec. 1207(a). Withholding State Income Taxes From Military Personnel

Under prior law, Federal withholding of State income taxes from military personnel was prohibited. The Act requires the Federal Government to enter into an agreement with a requesting State for the mandatory Federal withholding of State income tax from members of the military who are legal residents of that State and obligated to pay that State's income tax. Such withholding is to be implemented within 120 days of any request made by a State official after the date of enactment.

Sec. 1207(b). Withholding of State or Local Income Tax from Members of the National Guard or Ready Reserve

Under prior law, withholding of State or local income tax from members of the National Guard or ready reserve by the Federal Government was prohibited. The Act requires the Federal Government to enter into agreements with requesting States to withhold in those cases when members are paid for regular training. Withholding is to be implemented within 120 days of any request made by a State official after the date of enactment.

Sec. 1207(c). Voluntary Withholding of State Income Taxes From Federal Employees

Under prior law, Federal withholding of State income taxes from Federal employees in States where withholding is voluntary was prohibited. The Act permits Federal withholding of State income taxes from Federal employees in States where it is voluntary when employees request it. Withholding is to be implemented within 120 days of any request made by a State official after the date of enactment.

Sec. 1207(d). Withholding of Federal Income Tax on Certain Gambling Winnings

Under prior law, withholding of Federal income tax from gambling winnings was not required although information reports were generally to be submitted on winnings of \$600 or more. The Act imposes withholding at a 20-percent rate on winnings of more than \$1,000 from sweepstakes, wagering pools, and lotteries and from other types of gambling if the odds are 300 to 1 or more, with certain exceptions.

First, the withholding does not apply to winnings from slot machines, keno, and bingo.

Second, in the case of state-conducted lotteries, withholding applies only to winnings of more than \$5,000. State-conducted sweepstakes and wagering pools are not included in the \$5,000 exemption, but

rather are treated the same as privately-conducted sweepstakes and wagering pools (and thus are subject to withholding on any net winnings exceeding \$1,000). Under the Act, Congress intends that the term "wagering pools" is to include all pari-mutuel betting pools, including on- and off-track racing pools, and similar types of betting pools.

Withholding applies to winnings net of the ticket price, taking into account all tickets for identical wagers. For example, if one \$100 bet and two \$50 bets are placed on a single horse to win a single racetrack event, any winnings from the three tickets must be added together and the ticket prices of all three tickets may be deducted to determine net winnings. However, if the bets are placed on different horses or on different events, the net winnings are to be determined separately for each ticket.

In addition, the Internal Revenue Service is to report, prior to 1979, to the House Committee on Ways and Means and the Senate Committee on Finance on the operation of the present reporting system (IRS Form 1099) as applied to winnings from keno, bingo, and slot machines, and is to make a recommendation whether or not such winnings should be subject to withholding. In the interim, the Internal Revenue Service is to modify the reporting requirements (on IRS Form 1099) with respect to winnings from these sources. This modification should include a lower threshold for the requirement that the payor report payments to the Internal Revenue Service to the extent that current reporting practices differ from that set out in the Internal Revenue Code (sec. 6041).

The withholding provisions apply to payments of winnings made after the 90th day after the date of enactment (October 4, 1976).

Sec. 1207(e). Withholding of Federal Taxes on Certain Individuals Engaged in Fishing

Under prior law, crewmen on boats taking fish or other forms of aquatic animal life were usually treated, for tax purposes, as regular employees, not as self-employed. Under the Act, crewmen on boats engaged in taking fish or other aquatic animal life with an operating crew of fewer than ten are to be treated as self-employed for Federal tax purposes if their sole remuneration is a share of the boat's catch (or the proceeds of the catch), or, in the case of an operation involving more than one boat, a share of the entire fleet's catch.

Also, the Act requires boat operators to report the weight of the catch distributed to each crewman, or, in cases of distributions of proceeds of the catch, the dollar amount distributed to each crewman. In addition, the retroactive date of the provision is not to result in requiring crewmen who have been treated as ordinary employees to pay the higher rate of social security tax required of self-employed individuals, nor are refunds of the employer's share of social security taxes to be made to boat operators in such cases. Otherwise, the provision is applicable to services performed after December 31, 1971.

Because the status of individuals as independent contractors or employees for Federal tax purposes presents an increasingly important problem of tax administration, the Congress joins in the request of the

Senate Finance Committee (S. Rept. 94-938, p. 604) that the staff of the Joint Committee on Taxation make a general study of this area. The designation of fishermen as "self-employed" is for the specific tax purpose only and is not intended to affect their rights to bargain collectively or their status under the antitrust or other laws.

Sec. 1208. State-Conducted Lotteries

Under prior law, an excise tax of 2 percent was placed on amounts wagered, and an annual occupational tax of \$500 was imposed on each person who is liable for the wagering tax. In addition, a tax of \$250 per year was imposed on coin gaming devices including those which dispense lottery tickets. An exemption was provided for sweepstakes or lotteries conducted by a State where the winners are determined by a horse race.

The Act eliminates the rule that a winner of State lotteries be determined by a horse race and an exemption from the tax on gambling devices is provided for State lotteries. The change is effective for wagers made, or periods ending, after March 10, 1964.

Sec. 1209. Minimum Exemption From Levy for Wages, Salary, and Other Income

Prior law enumerated a relatively limited list of items of a taxpayer which are exempt from levy for taxes. These exempt items included unemployment benefits but not wages, salary, or other income (except that needed to pay pre-levy court-ordered child support). Prior law also required repeated levies in cases involving wages and salaries.

The Act provides an exemption from levy for a minimum amount of an individual's wages, salary, or income derived from other sources. In the case of an individual who is paid on a weekly basis, the amount of the exemption is \$50 per week, plus \$15 per week for each dependent. Individuals who are paid on other than a weekly basis will have, as nearly as possible, an equivalent exemption from levy. The taxpayer must verify the number of his dependents. In addition, a levy on salary or wages of a taxpayer is to be continuous from the date the levy is first made until the tax liability with respect to which it is made is satisfied or becomes unenforceable because of the lapse of time. The Act applied with respect to levies made after December 31, 1976. However, H.R.-1142, which passed the Congress on October 1, 1976, moved the date forward to February 28, 1977.

Sec. 1210. Joint Committee Refund Cases

Under prior law, reports concerning refunds of income, estate, gift and other types of taxes were required to be submitted to the Joint Committee on Taxation if the refunds were in excess of \$100,000.

The Act increases the jurisdictional amount for Joint Committee refund cases to \$200,000. Also, the Act adds refunds of taxes on private foundations and pension plans as subject to the report requirements and authorizes the Chief of Staff of the Joint Committee to conduct a post-audit review of other cases. These provisions are effective generally upon the date of enactment (October 4, 1976), except that the post-audit review provision is effective on January 1, 1977.

Sec. 1211. Use of Social Security Numbers

Under prior law, a person required to file a Federal income tax return had to include a taxpayer identification number on the return. In general, individuals used their social security numbers for this purpose. However, the Internal Revenue Code did not specifically require or authorize use of the social security number as the identifying number on Federal tax returns. The Act requires that, except as otherwise specified under regulations, an individual shall use his social security number for Federal income tax purposes. This provision applies upon the date of enactment.

Under the Privacy Act of 1974, it was unlawful for any Federal, State or local government agency to deny to any individual any right, benefit, or privilege provided by law because of the individual's refusal to disclose his social security number, except where (a) disclosure is required by Federal statute, or (b) disclosure is required by a Federal, State or local agency under a statute or regulation prior to January 1, 1975. The Act changes the effect of the Privacy Act to permit a State or local government to use social security numbers for the purpose of establishing the identification of individuals affected by any tax, general public assistance, driver's license, or motor vehicle registration law within its jurisdiction and to require an individual to furnish his social security number for the purpose of administering tax, general public assistance, driver's license, and motor vehicle registration laws.

Under prior law, it was a misdemeanor to willfully and fraudulently use a social security number to obtain or to increase the amount of a benefit under any program financed with Federal funds. The Act makes it a misdemeanor to willfully and fraudulently use a social security number for any purpose. The Act also makes it a misdemeanor for any individual to disclose or compel the disclosure of the social security number of any person in violation of the laws of the United States. These provisions apply upon the date of enactment.

Sec. 1212. Interest on Mathematical Errors on Returns Prepared by IRS

Under prior law, interest on any underpayment of tax ran from the original due date (regardless of extensions) to the date on which payment was received. The Act authorizes the IRS to abate any portion of interest owed by a taxpayer as a result of a mathematical error on returns prepared by the Internal Revenue Service where the amounts in question are below tolerance levels established by the IRS. The two principal factors to be taken into account by the IRS in establishing the tolerance levels are (1) the cost of determining, assessing, and collecting the interest and (2) sound and equitable tax administration. This provision of the Act applies to returns filed for taxable years beginning after the date of enactment.

TITLE XIII—TAX-EXEMPT ORGANIZATIONS

Sec. 1301. Modification of Foundation Self-Dealing Rules in 1969 Act Relating to Leased Property

Under present law, self-dealing rules generally prevent sales, exchanges, or leases of property between private foundations and disqualified persons. There are transitional rules for certain sales of excess business holdings by foundations and continuation of certain leases. Prior to the Act, there was no transition rule which permitted a sale of leased property by a foundation to a disqualified person.

The Act permits a foundation to sell, exchange, or otherwise dispose of certain property to a disqualified person where the property is now being leased to the disqualified person (pursuant to a binding contract which was in effect on October 9, 1969) if the foundation receives no less than fair market value for the property. This provision applies to dispositions made after the date of enactment (October 4, 1976) and before January 1, 1978.

Sec. 1302. Private Foundation Set-Asides

Under prior law, an amount "set aside" by a foundation for a special project could be treated as a qualifying distribution for the payout requirements only if approved in advance by the IRS. The foundation had to establish that set-asides would be paid out for a specific project within 5 years and that the project could better be accomplished by a set-aside than by immediate payment.

The Act retains the general set-aside rules (as indicated above) but provides an alternative which permits set-asides without advance IRS approval under temporary, relaxed rules which require principally that—

(1) the set-aside be for a project which will not be completed before the end of the year;

(2) the foundation distributes in each year after 1975 (or if later, after the end of the fourth taxable year following its creation) not less than the required payout; and

(3) during the 4 years prior to the first taxable year beginning after 1975 (or if later, after the end of the fourth taxable year following its creation) the foundation has distributed an aggregate amount not less than the sum of a percentage of the regular, required payout increasing by 20% annually.

The statute of limitations on assessments and collections is held open during the extended payout period. This provision applies to taxable years beginning on or after January 1, 1975.

Sec. 1303. Mandatory Payout Rate for Private Foundations

Under prior law, a private foundation had to distribute for charitable purposes the greater of (1) all its adjusted net income or (2) an annually determined variable percentage of its noncharitable assets.

The percentage was set at 6.75 percent for taxable years beginning in 1976.

The Act reduces the mandatory payout requirement to 5 percent and provides that this percentage is to be permanent. It also establishes certain explicit rules for valuing a private foundation's noncharitable assets in determining the required charitable expenditures (minimum investment return). In determining the value of securities for minimum charitable expenditures purposes, their fair market value (determined without regard to any reduction in value) shall not be reduced unless, and only to the extent that, the private foundation establishes that as a result of (1) the size of the block of such securities, (2) the fact that the securities are securities in a closely held corporation, or (3) the fact that the sale of such securities would result in a forced or distress sale, the securities could not be liquidated within a reasonable period of time except at a price less than fair market value. Any reduction in value for any of the three reasons shall not in the aggregate exceed 10 percent of the fair market value of the securities. The Act applies to taxable years beginning after December 31, 1975.

Sec. 1304. Extension of Time To Amend Charitable Remainder Trust Governing Instruments

Under the Tax Reform Act of 1969, in order for an estate tax charitable deduction to be allowable for the bequest of a remainder interest to charity, the remainder interest must be in the form of a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund. Prior law contained special transitional rules which permitted post-death modification of a will or trust created before September 21, 1974, which contained a bequest of a remainder interest to charity, to conform to the new requirements of the Tax Reform Act of 1969, if the modification was made before December 31, 1975.

The Act extends the time for modification of a will or trust which contains a bequest of a remainder interest to charity to qualify for an estate tax charitable deduction until December 31, 1977, and also allows a will or trust created after September 21, 1974, and before December 31, 1977 to qualify for the extension.

In making this extension, Congress stated that this is to be the last extension of these transitional rules.

Sec. 1305. Unrelated Trade or Business Income of Trade Shows, State Fairs, etc.

Under present law, tax-exempt organizations are taxed on their "unrelated business taxable income". "Unrelated business taxable income" had been interpreted prior to the Act to include certain income from fairs and expositions sponsored by tax-exempt organizations and rental income from display space leased at a convention or trade show if the exhibitor is permitted to sell his wares at the convention or trade show.

The Act exempts from the unrelated business income tax the income from fairs and expositions of an exempt charitable, social welfare, or agricultural organization, which operates a public entertainment activity that meets certain conditions. In order to qualify for the exemp-

tion, the organization must also regularly conduct, as one of its substantial exempt purposes, a fair or exposition which is both agricultural and educational. Where the exemption applies, the conducting of qualified public entertainment activities will not affect the tax-exempt status of the sponsoring organization.

In addition, the Act exempts from the unrelated business income tax the income from conventions and trade shows of certain exempt organizations (generally, unions and trade associations) which regularly conducted as one of their exempt purposes a convention or trade show activity which stimulates interest in, and demand for, an industry's products in general. There are also a series of conditions which must be met by a qualifying convention and trade show activity.

The provision applies to income from fairs and expositions in taxable years after 1962, and to income from conventions and trade shows in taxable years beginning after the date of enactment (October 4, 1976).

Sec. 1306. Declaratory Judgments Regarding Tax-Exempt Status of Charitable, etc., Organizations

Prior to the Act, the Tax Court could hear declaratory judgment suits only on the tax status of employee retirement plans. In no other case could an individual or an organization seek a declaratory judgment as to an organization's tax-exempt status.

Under the Act, the Federal District Court for the District of Columbia, the U.S. Court of Claims, and the United States Tax Court are granted jurisdiction in a suit brought by an organization in an actual controversy in a case involving an IRS determination (or failure to make a determination) with respect to the organization's tax-exempt status as a qualified charitable contribution donee, as a private foundation, or as a private operating foundation. The Act applies to pleadings filed more than 6 months after the date of enactment but only with respect to IRS determinations (or requests for determinations) made after January 1, 1976.

Sec. 1307. Lobbying by Public Charities

Under prior law, an organization could not be exempt from income tax and could not receive deductible contributions as a charity unless "no substantial part of the activities of [the organization] is carrying on propaganda, or otherwise attempting, to influence legislation."

The Act provides a new elective set of tests and requirements for determining whether an organization, exempt from tax under section 501(c)(3), has engaged in excessive lobbying activities sufficient to cause it to lose its tax exemption and qualification for receiving deductible contributions. In general, the new tests and requirements cannot be elected by churches, organizations affiliated with churches, certain "support" organizations (described in sec. 509(a)(3)), or by private foundations. The "substantiality" test of prior law continues to apply to nonelecting and ineligible organizations.

Under the new rules, a public charitable tax-exempt organization may elect to replace the present "substantial part of activities" test with a sliding-scale limitation on lobbying activities defined in terms

of expenditures for influencing legislation, which allows proportionately less expenditures for larger organizations. The basic permitted level of expenditures is 20 percent of the first \$500,000 of the organization's exempt purpose expenditures for the year, plus 15 percent of the second \$500,000, plus 10 percent of the third \$500,000, plus 5 percent of any additional expenditures. Within these limits, no more than one-quarter is permitted for so-called "grassroots lobbying" (that is, attempts to influence the general public on legislative matters). In no event can an organization's lobbying expenditures exceed \$1 million for any one year. To forestall the creation of numerous organizations to avoid the effects of the expenditure tests or the \$1 million limitation, affiliation rules are provided which aggregate the expenditures of related organizations. In addition, a person may not deduct out-of-pocket expenditures incurred on behalf of a charitable organization if the expenditures are made to influence legislation and if the organization is eligible to elect the new expenditure tests.

An electing organization which exceeds any of the expenditure limitations in a taxable year will incur an excise tax of 25 percent of its excessive lobbying expenditures. If an electing organization's lobbying expenditures exceed the expenditure limitations by more than 50 percent over a 4-year period, the organization will lose its tax-exempt status under section 501(c)(3). An organization which has lost its exempt status under section 501(c)(3) due to excessive lobbying cannot become an exempt organization under section 501(c)(4).

The Act also requires an electing organization to disclose on its information return the amount of its lobbying expenditures (total and grassroots), together with the amount that it could have spent for these purposes without the imposition of the new excise tax. If an electing organization is a member of an affiliated group, then this information must be provided with respect to the electing organization and the entire group.

In general, these new rules apply to taxable years beginning after December 31, 1976. However, the rule which provides that a section 501(c)(3) organization that loses its tax-exempt status due to excessive lobbying cannot become a section 501(c)(4) organization applies to activities occurring after the date of enactment.

Sec. 1308. Tax Liens, etc., Not To Constitute "Acquisition Indebtedness"

Generally, an exempt organization is taxed on investment income only to the extent there is "acquisition indebtedness" on the investment property generating the income. The Internal Revenue Service has taken the position that, under prior law, special assessments (payable in installments) imposed by a State or local governmental unit constitute acquisition indebtedness.

The Act provides that amounts of indebtedness for taxes or special assessments by State or local governmental units and secured by a lien on property are not acquisition indebtedness until, and to the extent that, the amounts become due and payable and the organization has had an opportunity to pay them. This provision applies to all taxable years ending after December 31, 1969.

Sec. 1309. Extension of Private Foundation Transitional Rule For Sale of Business Holdings

Under prior law, the self-dealing rules for private foundations contained a transition rule which expired on January 1, 1975. This rule permitted private foundations to sell, exchange, or otherwise dispose of, certain "nonexcess" business holdings to disqualified persons.

The Act extends the period for application of this transitional rule. This provision applies to dispositions occurring after the date of enactment (October 4, 1976) and before January 1, 1977.

Sec. 1310. Imputed Interest on Private Foundations

Prior law required each private non-operating foundation to distribute annually an amount equal to the greater of the foundation's adjusted net income or its minimum investment return. Adjusted net income includes imputed interest.

The Act excludes from a private foundation's adjusted net income amounts of imputed interest on sales made prior to January 1, 1970. This provision applies to taxable years ending after the date of enactment (October 4, 1976).

Sec. 1311. Certain Hospital Services

Under prior law, income received by tax-exempt hospitals from providing services to other tax-exempt hospitals was taxed as "unrelated business taxable income."

The Act exempts from the tax on unrelated business income the income that a tax-exempt hospital receives for providing certain services to other small tax-exempt hospitals, each serving 100 or fewer inpatients, to the extent that the services are provided at a fee or other charge that does not exceed the actual cost of providing those services plus a reasonable amount for a return on the capital goods used in providing those services. For this purpose, the actual cost of providing the services includes straight-line depreciation. This provision applies to all open years under the 1954 Code.

Sec. 1312. Clinical Services of Cooperative Hospitals

Under present law, cooperative organizations providing certain specified services for tax-exempt hospitals are also tax-exempt organizations. However, prior to the Act, the specified permissible services did not include clinical services.

The Act adds clinical services to the specified services permitted to be performed by a tax-exempt cooperative service organization, effective for taxable years ending after December 31, 1976.

Sec. 1313. Exemption of Certain Amateur Athletic Organizations From Tax

Under existing law, athletic organizations which teach youth or which are affiliated with charitable organizations may be exempt under section 501(c)(3) and may receive tax-deductible contributions. Under prior law, certain other organizations which foster national or international amateur sports competition were exempt from taxation under other provisions (such as sec. 501(c)(4) or (6)) but often did not qualify to receive tax-deductible contributions.

The Act permits an organization the primary purpose of which is to foster national or international amateur sports competition to qualify as an organization described in section 501(c)(3) and to receive tax-deductible contributions. However, to qualify for tax exemption as a charitable organization and for the receipt of deductible contributions, the organization must not make available athletic equipment or facilities. This restriction is intended to prevent the allowance of these benefits for organizations which, like social clubs, provide facilities and equipment for their members. This provision is not intended to adversely affect the qualification for charitable tax-exempt status or tax deductible contributions of any organization which would qualify under the standards of prior law. This provision applies on the day after the date of enactment (October 4, 1976).

TITLE XVI—CAPITAL GAINS AND LOSSES

Sec. 1401. Capital Loss Offset Against Ordinary Income

Capital losses are deductible in full against capital gains. Under prior law, individuals could deduct the excess of capital losses over capital gains against up to \$1,000 of ordinary income each year, with an unlimited carryover to future years.

The Act raises the amount of ordinary income against which capital losses may be offset to \$2,000 in 1977, and to \$3,000 in 1978 and subsequent years.

Sec. 1402. Holding Period for Long-Term Capital Gains

The Act lengthens the holding period defining long-term capital gains and losses from 6 months to 9 months in 1977, and to one year in 1978 and subsequent years. Agricultural commodity futures contracts will retain the 6-month holding period. In addition, the requirement of prior law that certain timber be treated as sold on the first day of the calendar year in which that timber is cut is deleted.

Sec. 1403. Capital Loss Carryover for Mutual Funds

The Act extends the capital loss carryover period for mutual funds from 5 years to 8 years. This provision applies to loss years ending after December 31, 1969.

Sec. 1404. Gain on Sale of Residence by Elderly

Under prior law, if a taxpayer who had attained age 65 sold his principal residence, he could exclude from income the entire gain on the sale if the adjusted sales price were \$20,000 or less. However, if the adjusted sales price exceeded \$20,000, he could exclude only that portion of the gain which \$20,000 bore to the adjusted sales price.

The Act increases the \$20,000 amount to \$35,000. The provision applies to taxable years beginning after December 31, 1976.

TITLE XV—PENSION AND INSURANCE TAXATION

Sec. 1501. Individual Retirement Account (IRA) for Spouse

Under prior law, the IRA deduction could not exceed \$1,500 or 15 percent of compensation (whichever is less), so that a person without earned income was not allowed an IRA deduction. The IRA deduction was not allowed to a person for a contribution to the IRA of another person.

Under the Act, an individual with compensation (and who is eligible to deduct IRA contributions) can contribute up to \$875 to his own IRA and \$875 to an IRA separately owned by his spouse or can contribute up to \$1,750 to an IRA which credits \$875 to a subaccount for the husband and \$875 to a subaccount for his wife. (The single account with two subaccounts could be considered a common investment fund.) Under the Act, although the spouses own separate subaccounts, each could have a right of survivorship with respect to the subaccount of the other. As under prior law, the deduction is limited to 15 percent of compensation. Under the Act, an IRA deduction is allowed under the new rules or the prior rules (but not both). The provision applies to taxable years beginning after December 31, 1976.

Sec. 1502. Limitation on Contributions to Certain H.R. 10 Plans

Under prior law, a self-employed individual could set aside up to \$750 of self-employment income in an H.R. 10 plan without regard to the usual rule limiting H.R. 10 plan contributions to 15 percent of self-employment income. However, due to a technical problem, a plan could have been disqualified if the contribution exceeded 25 percent of the individual's self-employment income.

The Act allows a self-employed individual to set aside up to \$750 of self-employment income in an H.R. 10 plan without regard to the usual 15-percent limitation or the 25-percent limitation. The exception only applies if the individual's adjusted gross income does not exceed \$15,000. The provision applies to years beginning after December 31, 1975.

Sec. 1503. Retirement Deductions for Members of Armed Forces Reserves, National Guard and Volunteer Firefighters

Prior law provided that a participant in a governmental plan was not allowed a deduction for an IRA contribution so that the deduction was not allowed to members of the Armed Forces Reserves or National Guard covered by a military retirement plan or to members of a volunteer fire department covered by a governmental plan for firefighters.

The Act allows a member of the Armed Forces Reserves or National Guard to qualify for an IRA deduction for a year (if otherwise qualified) despite participation in the military retirement plan if the member has 90 or fewer days of active duty (other than for training)

during the year. It also extends the deduction for contributions to an IRA to an individual who would be eligible for an IRA but for membership in a volunteer fire department or in a governmental plan for volunteer firefighters. The deduction is limited to firefighters who have not accrued an annual benefit in excess of \$1,800 (when expressed as a single life annuity payable at age 65) under a firefighters' plan. The provision applies to taxable years beginning after December 31, 1975.

Sec. 1504. Tax-Exempt Annuity Contracts in Closed-End Mutual Funds

Under prior law, amounts contributed by certain tax-exempt organizations and educational institutions to provide annuities for employees were not included in the income of the employees if the contributions were invested in open-end mutual funds (and used to provide a retirement benefit), or used to purchase annuity contracts. (An open-end mutual fund is a regulated investment company which issues redeemable shares.) The Act extends prior law by allowing contributions for tax-sheltered annuities to be made to closed-end investment companies as well as to open-end mutual funds and annuity contracts. (A closed-end investment company is a regulated investment company which issues nonredeemable shares.) The provision applies to taxable years beginning after December 31, 1975.

Sec. 1505. Pension Fund Investments in Segregated Asset Accounts of Life Insurance Companies

Under existing law, a segregated asset account could serve as an investment account and reserve for an insurance contract providing for annuities under which the premiums or benefits depend on the performance of the assets in the account.

The Act clarifies present law by allowing a qualified pension plan to invest in an insurance contract with a segregated asset account even though the contract does not provide annuities. A pension fund can invest assets in such an account in lieu of a trust if the investment is otherwise permitted under law. The Act also clarifies the treatment of pension fund investments in nonsegregated accounts. The provision applies for taxable years beginning after December 31, 1975.

Sec. 1506. Study of Salary Reduction Pension Plans

On December 6, 1972, the IRS issued proposed regulations which would have changed the tax treatment of salary reduction, cafeteria, and cash or deferred profit-sharing plans. In order to allow time for Congressional study of these areas, section 2006 of ERISA provided for a temporary freeze of the status quo until December 31, 1976.

Under the Act, the temporary freeze of the status quo (under which plans established before June 27, 1974, are governed by the law in effect prior to the 1972 proposed regulations) is extended until January 1, 1978.

Sec. 1507. Consolidated Returns for Life and Mutual Insurance Companies

Under prior law, life insurance companies could not file consolidated returns with non-life companies. In addition, mutual casualty insurers were effectively precluded from filing consolidated returns with other types of companies.

The Act allows life insurance companies and other mutual insurance companies to file consolidated returns with other companies beginning in 1981, subject to certain rules. First, consolidated returns may be filed by a life company and another company only where they have been affiliated for the preceding 5 years. Second, the amount of any non-life company loss which may be so applied against life company income in 1981 and the proportion of the life insurance company income which may be so offset in 1981 is limited to 25 percent. Third, in 1982 the percentage referred to above is to be 30 percent, and thereafter the percentage is to be 35 percent. Fourth, nonlife losses accumulated before consolidation cannot be applied against life company income after consolidation.

Sec. 1508. Guaranteed Renewable Life Insurance Contracts

Under present law, a life insurance company can deduct 10 percent of the increase in its reserves for nonparticipating contracts for a taxable year or, if greater, 3 percent of the premiums for the year (excluding the portion of the premiums which was allocable to annuity features) attributable to nonparticipating contracts (other than group contracts) if the policies are issued or renewed for at least 5 years.

The Act provides that the time for which a policy is issued or renewed includes the period for which the insurer guarantees that the policy is renewable by the policyholder. The provision applies to taxable years beginning after 1957.

Sec. 1509. Study of Expanded Participation in Individual Retirement Accounts

Under present law, an individual who is an active participant in a qualified pension, etc., plan, a tax-sheltered annuity, or a governmental plan cannot make deductible contributions to an IRA.

The Act provides that the staff of the Joint Committee on Taxation is to study the concept of allowing an IRA deduction to a participant in a qualified plan or tax-sheltered annuity. The staff is to report its findings to the Ways and Means Committee of the House and the Finance Committee of the Senate.

Sec. 1510. Taxable Status of Pension Benefit Guaranty Corporation

Under present law, a corporation organized under an Act of Congress is not generally exempt from Federal taxation unless that Act so provides. The Pension Benefit Guaranty Corporation was not specifically exempted from Federal taxation by ERISA (The Employee Retirement Income Security Act of 1974). The Act amends ERISA to clarify the intent of Congress that the Pension Benefit Guaranty Corporation is to be exempt from all Federal taxation except taxes imposed under the Federal Insurance Contributions Act (social security taxes) and the Federal Unemployment Tax Act (unemployment taxes). The exemption applies from September 2, 1974 (the date of enactment of ERISA).

Sec. 1511. Level Premium Plans Covering Owner-Employees

Under present law providing specifically for H.R. 10 plans, an owner-employee covered by such a plan can contribute each year an amount in excess of the general H.R. 10 percentage limit (15 percent

of earned income) to a plan funded with level premium annuity contracts, if the fixed premium does not exceed \$7,500 and does not exceed the owner-employee's three-year average of deductible amounts. The amount in excess of 15 percent of the owner-employee's earned income is not deductible. Under prior law, a separate provision for all qualified plans, including level premiums H.R. 10 plans, limited contributions to 25 percent of earned income.

The Act allows the owner-employee to make such level payments without regard to the overall 25-percent limitation and adds rules regarding the treatment of contributions under the anti-discrimination rules applicable to pension plans. The rule applies for years beginning after December 31, 1975 (the effective date of the overall limitation).

Sec. 1512. Lump-Sum Distributions From Pension Plans

Under present law, the part of a lump-sum distribution earned before 1974 is treated as capital gain and the post-1973 part is taxed, if the taxpayer elects, as ordinary income in a "separate basket", with 10-year income averaging. If the election is not made, the post-1973 part of the distribution is taxed as ordinary income under the usual rules.

Under the Act, a taxpayer may irrevocably elect to treat all of a lump sum distribution as if it were earned after 1973 so that it will be taxed as ordinary income in a separate basket, with 10-year income averaging. The election applies to distributions made after 1975 in taxable years beginning after December 31, 1975.

TITLE XVI—REAL ESTATE INVESTMENT TRUSTS

Sec. 1601. Deficiency Dividend Procedure

Under present law, a REIT is provided the same general conduit treatment that applies to a mutual fund. If a trust qualifies as a REIT, income of the REIT which is distributed to investors is taxed to them and not to the REIT. A REIT was required to distribute at least 90 percent of its REIT taxable income in the year earned or the next succeeding year. Failure to meet the distribution requirement resulted in loss of REIT status.

The Act provides for a deficiency dividend procedure which permits qualifying distributions to be made in subsequent years when an adjustment by the IRS occurs that either increases the amount which the REIT is required to distribute to meet the distribution requirement or decreases the amount of dividends previously distributed for that year. This deficiency dividend procedure is available only where the entire amount of the adjustment was not due to fraud with intent to evade tax or willful failure to file an income tax return. In addition, the Act imposes a penalty on the amount of the adjustment to the extent that the deficiency dividend deduction is allowed. This provision is effective for determinations occurring after the date of enactment (October 4, 1976).

Sec. 1602. Failure To Meet Income Source Tests

Under present law, a REIT is required to derive annually at least 90 percent of its gross income from certain passive sources and at least 75 percent of its gross income from certain real estate sources. Prior to the Act, failure to meet these requirements resulted in disqualification.

The Act provides that failure to meet the 75-percent or 90-percent requirements will not result in disqualification if (1) the REIT sets forth the source and nature of its gross income in its return, (2) the inclusion of any incorrect information in this schedule is not due to fraud with intent to evade tax, and (3) the failure to meet the income source requirements is due to reasonable cause and not due to willful neglect. In addition, the Act imposes a 100-percent tax on the *net* income attributable to the *greater* of the amount by which the REIT fails the 75-percent or 90-percent requirements. This provision is effective for determinations made, and taxable years beginning, after the date of enactment (October 4, 1976).

Sec. 1603. Treatment of Property Held for Sale to Customers

Under prior law, a REIT was not permitted to hold any property (other than foreclosure property) primarily for sale to customers in the ordinary course of its trade or business. Failure to meet the requirement resulted in disqualification.

The Act eliminates the prohibition against holding property for sale to customers. Instead, it imposes a 100-percent tax on the net

income from such property (other than foreclosure property). This provision is generally effective for taxable years beginning after the date of enactment. In addition, a REIT can elect to apply this provision with respect to determinations occurring after the date of enactment (October 4, 1976).

Sec. 1604. Certain Other Changes in Limitations and Requirements

(a). Increase in 90-Percent Gross Income Requirement to 95 Percent

Under prior law, in order to qualify for REIT status, the trust had to derive at least 90 percent of its income from certain passive sources.

The Act increases the percentage of gross income that must be derived from certain passive sources from 90 percent to 95 percent effective for taxable years beginning after 1979.

(b). Change in Definition of "Rents From Real Property"

Under present law, "rents from real property" qualify for both the 75-percent and 90-percent requirements. Prior to the Act, "rents from real property" did not include (1) amounts received for customary services if separate charges were made for such services, (2) amounts attributable to the rental of personal property even if incidental to the rental of real property, and (3) amounts which were contingent upon the net income or profits of anybody deriving income from property.

The Act modifies the definition of "rents from real property" to include (1) amounts received for customary services even if separate charges are made for such services and (2) amounts attributable to personal property incidental to the rental of real property if the amount allocable to personal property is less than 15 percent of total rent. In addition, the Act provides that where a REIT leases to a prime tenant with a rent based on a percentage of the prime tenant's gross receipts and the prime tenant subleases to a subtenant with a rent based on a percentage of the subtenant's net income or profits, only a portion of the rent received from the prime tenant does not qualify as "rents from real property." This provision is effective for taxable years beginning after the date of enactment (October 4, 1976).

(c). Change in Distribution Requirements

Under prior law, in order to qualify for REIT status, a trust had to distribute 90-percent of its REIT taxable income. If a trust qualifies for REIT status, the nonqualifying income was not subject to tax at the REIT level if such income was distributed to its shareholders.

The Act increases the distribution requirement from 90 percent to 95 percent for taxable years beginning after 1979.

(d). Termination or Revocation of Election

Under prior law, a REIT which lost its status as a REIT in one year could requalify in the next subsequent year even if the REIT purposefully did not qualify in the preceding year.

The Act provides that a REIT which voluntarily disqualifies itself from REIT status cannot requalify for 5 years. This provision is generally effective for taxable years beginning after the date of enactment (October 4, 1976).

Sec. 1605. Excise Tax on Distributions Made After Taxable Year

Under present law, a REIT can elect to treat dividends paid during one year as qualifying distributions for the next preceding year even though the REIT's shareholders are not taxed until the distribution is received.

The Act imposes an excise tax on a REIT to the extent that it fails to distribute 75 percent of the income it is required to distribute during the year the income is earned. The excise tax is effective for taxable years beginning after 1979.

Sec. 1606. Allowance of Net Operating Loss Carryover

Under prior law, a REIT was not allowed to use a net operating loss carryover to reduce its taxable income and distribution requirements.

The Act allows the net operating loss deduction to a REIT for carryovers but not carrybacks. This provision is generally effective for taxable years ending after the date of enactment (October 4, 1976).

Sec. 1607. Alternative Tax in Case of Capital Gains

Under present law, a REIT is taxed at a flat 30-percent rate on its net capital gains less amounts of net capital gain distributed to shareholders. However, under prior law, it could not reduce its net capital gains by ordinary losses as is permitted ordinary corporations.

The Act permits a REIT to reduce its net capital gains by its ordinary losses if it does not use the alternative tax (30 percent) on net capital gains. This provision is effective for taxable years ending after the date of enactment (October 4, 1976).

TITLE XVII—RAILROAD AND AIRLINE PROVISIONS

Sec. 1701(a). Railroad Ties

Railroads generally use retirement-replacement depreciation for track costs under which original track costs are capitalized and later replacements are entirely or partly deducted currently.

The Act allows a taxpayer using the retirement-replacement method for track costs to claim a current deduction for costs of replacing one type of railroad tie with another type of tie.

Sec. 1701(b). Investment Credit Limitation for Railroads

The amount of any investment credits which may be used for any taxable year is generally limited to 50 percent of tax liability for that year. Public utilities, however, are allowed to use their credits up to 100 percent of tax liability for taxable years ending in 1975 and 1976 and in percentages which are reduced annually by 10 percentage points for later years until 1981, when the limitation returns to 50 percent.

The Act allows railroads to take investment credits up to 100 percent of tax liability for taxable years ending in 1977 and 1978 with annual reductions of 10 percentage points thereafter until the limitation returns to 50 percent for taxable years ending after 1982. Only a railroad, and not a lessor of railroad property, is entitled to this temporary increase in the investment credit limitation.

Sec. 1702. Amortization of Railroad Grading and Tunnel Bores

Domestic railroad common carriers may generally amortize railroad grading and tunnel bores placed in service after 1968 on a straight-line basis over a 50-year period.

The Act extends this same treatment on an elective basis to railroad grading and tunnel bores placed in service before January 1, 1969. This provision applies to taxable years beginning after December 31, 1974.

Sec. 1703. Investment Credit Limitation for Airlines

The amount of any investment credits which may be used for any taxable year is generally limited to 50 percent of tax liability for that year. Public utilities, however, are allowed to use their credits up to 100 percent of tax liability for taxable years ending in 1975 and 1976 and in percentages which are reduced annually by 10 percentage points for later years until 1981, when the limitation returns to 50 percent.

The Act allows all common carrier airlines to take investment credits up to 100 percent of tax liability for taxable years ending in 1977 and 1978 with annual reductions of 10 percentage points thereafter until the limitation returns to 50 percent for taxable years ending in after 1982. Only an airline, and not a lessor of airline property, is entitled to this temporary increase in the investment credit limitation.

TITLE XVIII—INTERNATIONAL TRADE AMENDMENTS

Sec. 1801. United States International Trade Commission

Under prior law (section 330(d) of the Tariff Act of 1930), if a majority of the Commissioners on the International Trade Commission voting on an escape clause or market disruption case under section 201 or 406 of the Trade Act of 1974, respectively, could not agree on a remedy finding or recommendation, then the President could consider the “findings” agreed upon by one-half the number of Commissioners voting to be the “findings” of the Commission. If the Commission was equally divided into two groups, the President could consider the finding of either group to be the finding of the Commission. Also, under prior law, a Commissioner had to leave office on the day his term expired whether or not his successor was ready to take office.

Under the amendment made by section 1801 of the Act, if a majority of the Commissioners voting on an escape clause or market disruption case cannot agree on a remedy finding, then the remedy finding agreed upon by a plurality of not less than 3 Commissioners shall be treated as the remedy finding of the Commission for the purposes of the Congressional override in sections 202 and 203 of the Trade Act of 1974. If the Commission is tied on the remedy vote, and each voting group includes not less than 3 Commissioners, then (1) if the President takes the action recommended by one of those groups, the remedy finding agreed upon by the other group shall, for purposes of the Congressional override, be treated as the remedy finding of the Commission, or (2) if the President takes action which differs from the action agreed upon by both such groups, the remedy finding agreed upon by either such group may be considered by the Congress as the remedy finding of the Commission for purposes of the Congressional override. It is the intention of the Congress that this amendment apply only for purposes of implementing the Congressional override in sections 202 and 203 of the Trade Act of 1974. It is not intended that this provision affect in any way the rules of procedure of the International Trade Commission. Further, the Congress strongly urges the Commissioners to reach majority agreement on all determinations, findings, and recommendations in all cases.

Under section 1801, a Commissioner may continue to serve as a Commissioner after the expiration of his term of office until his successor is appointed and qualified.

Sec. 1802. Exclusion of Countries Which Aid and Abet International Terrorists From Preferential Tariff Treatment

Under Title V of the Trade Act of 1974, eligible articles imported into the United States from beneficiary developing countries are duty free. Under section 502 of the Trade Act, certain countries are prohibited from being designated as beneficiary developing countries. The

prohibitions apply to (1) Communist countries generally; (2) members of OPEC; (3) countries which have expropriated U.S. property without prompt, adequate, and effective compensation; (4) countries which do not cooperate with the United States to prevent narcotics from unlawfully entering the United States; (5) countries which do not eliminate reverse preferences; and (6) countries which do not recognize arbitral awards to U.S. citizens. Prohibitions (4), (5) and (6) may be waived by the President if he determines that such a waiver will be in the national economic interest of the United States.

Under the Act, a new prohibition is added to the definition of beneficiary developing country which provides that a country may not be designated if it aids or abets, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism. This prohibition may be waived by the President if he determines that the waiver will be in the national economic interest of the United States. This provision applies on the date of enactment (October 4, 1976).

TITLE XIX—REPEAL AND REVISION OF OBSOLETE, RARELY USED, ETC., PROVISIONS OF INTERNAL REV- ENUE CODE OF 1954

Secs. 1901-08; 1951-52. "Deadwood" Provisions

The Internal Revenue Code, prior to this Act, contained many provisions which were no longer used in computing taxes or were little used and of minor importance. In addition, the Code contained phrases and legal expressions which could be replaced with clearer, more direct, and shorter wording.

By eliminating and replacing these provisions and expressions, the Act repeals almost 150 sections of the Internal Revenue Code and makes deletions in approximately 850 other sections of the Code. In simplifying Code language, the Act makes changes such as substituting the term "ordinary income" for "gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231."

The deleted provisions include those which deal only with past years, situations which were narrowly defined and are unlikely to recur, as well as provisions which have largely, if not entirely, outlived their usefulness.

TITLE XX—ESTATE AND GIFT TAX PROVISIONS

Sec. 2001 (a)(2) and (b)(2). Unified Credit

Under prior law, the estate of each decedent who was a resident or citizen of the U.S. was entitled to an exemption of \$60,000 for estate tax purposes and a donor who was not a nonresident alien was entitled to an exemption of \$30,000 for gift tax purposes.

The Act provides a unified credit of \$47,000 (equivalent to an exemption of \$175,625) in lieu of the exemptions for estate and gift taxes. The credit is to be phased-in over a 5-year period. Subject to a transitional rule for certain gifts, the amount of the credit is \$30,000 for gifts made in, and decedents dying in 1977; \$34,000 in 1978; \$38,000 in 1979; \$42,500 in 1980; and \$47,000 in 1981.

The unified credit is to be reduced by an amount equal to 20 percent of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977. However, the unified credit is not to be reduced for any amount allowed as a specific exemption for gifts made prior to September 9, 1976. As a transitional rule for gift tax purposes, only \$6,000 of the unified credit can be applied with respect to gifts made after December 31, 1976, and prior to July 1, 1977.

Sec. 2001 (a)(1) and (b)(1). Unification of Estate and Gift Tax Rates

Under present law, an estate tax is imposed upon transfers at death and a gift tax is imposed on gifts during lifetime. Under prior law, each tax had a separate schedule with the gift tax rate schedule being three-fourths of the estate tax rate schedule for corresponding brackets.

The Act provides a unified rate schedule for estate and gift taxes. The lowest effective rate (after taking into account the unified credit) is 32 percent. The highest rate is 70 percent for cumulative taxable transfers in excess of \$5 million. This provision applies to estates of decedents dying after December 31, 1976, and gifts made after that date.

Sec. 2001(a)(5). Transfers Made Within 3 Years of Death

Under prior law, transfers made within 3 years of death were presumed to be made in "contemplation of death" and included in the decedent's gross estate unless the executor could prove to the contrary.

The Act eliminates the contemplation of death presumption and provides for the inclusion in the decedent's gross estate of all gifts (in excess of the \$3,000 annual exclusion) made within the 3-year period prior to the decedent's death. This provision applies to gifts made after December 31, 1976.

Sec. 2001(a)(5). Gross-up for Gift Taxes

Under prior law, the tax paid with respect to a gift was not included in the estate or gift tax base. Thus, an amount equal to the gift tax was removed from a decedent's gross estate and also allowed as a credit against estate tax if the gift was included in the gross estate even though the transfer was a "death-bed transfer." However, if the transfer had not been made during lifetime, the entire amount was included in the decedent's gross estate.

The Act requires the gift tax on gifts made within 3 years of the decedent's death to be included (or "grossed-up") in the decedent's gross estate. This provision applies to gifts made after December 31, 1976.

Sec. 2002(a). Increase in Estate Tax Marital Deduction

Under present law, the estate of each decedent is permitted a deduction for property passing to a surviving spouse. However, under prior law, the deduction could not exceed one-half of the value of the adjusted gross estate.

The Act increases the maximum estate tax marital deduction to the greater of \$250,000 or one-half of the decedent's adjusted gross estate. This provision applies to estates of decedents dying after December 31, 1976.

Sec. 2002(b). Increase in Gift Tax Marital Deduction

Under prior law, in the case of gifts, a deduction was allowed for one-half of the value of the property transferred to the spouse.

The Act provides an unlimited marital deduction for the first \$100,000 of lifetime transfers to a spouse. Thereafter, the deduction allowed is 50 percent of gifts in excess of \$200,000. This provision applies to gifts made after December 31, 1976.

Sec. 2002(c). Joint Interests

Under prior law, the entire value of property owned in joint tenancy was included in the decedent's gross estate except for the portion of property which was attributable to the consideration furnished by the survivor.

The Act replaces the "consideration furnished test" with a fractional interest rule in certain cases where property is held by husband and wife with rights of survivorship. Under the fractional interest rule, where a joint tenancy is created by a transfer subject to gift tax at the time of creation, the property is then treated as belonging 50 percent to each spouse for estate tax purposes. This provision applies to joint interests created after December 31, 1976.

Sec. 2003. Special Valuation for Certain Property

Under existing law, the value of the property included in the gross estate of the decedent is its fair market value at the date of the decedent's death (or at the alternate valuation date). One of the most important factors in determining fair market value is the "highest and best use" to which the property can be put.

The Act provides that, if certain conditions are met, the executor may elect to value qualified real property included in the decedent's gross estate on the basis of such property's value in its current use

rather than on the basis of its highest and best use. Qualified real property includes property used for farming or other closely held business use. This special valuation may not be used to decrease the value of the decedent's gross estate by more than \$500,000. Also, the Act provides specific valuation methods for qualifying real property.

In general, the tax benefits derived from the special valuation are recaptured if the property is disposed of to nonfamily members or ceases to be used for farming or closely held business purposes within 15 years after the death of the decedent (with a phase-out of the amount recaptured over the last 5 years).

This provision applies to estates of decedents dying after December 31, 1976.

Sec. 2004(a)-(d). Extension of Time for Payment of Estate Tax

Under existing law, the estate tax generally must be paid nine months after the decedent's death. However, there are two provisions which permit portions of the estate tax to be paid over a period of up to 10 years. In order to qualify under the first provision (sec. 6166), the value of the closely held business must exceed 35 percent of the value of the gross estate or 50 percent of the taxable estate of the decedent. Under prior law, the executor must show that payment on the original due date would cause "undue hardship" in order to qualify under the second provision (sec. 6161).

The Act adds a new provision for extended payments during a 15-year period for the estate tax attributable to a farm or other closely held business (including a trade or business of being an artist, craftsman, etc.). In order to qualify, the value of the farm or other closely held business must constitute at least 65 percent of the value of the adjusted gross estate. No tax (i.e., only interest) is required to be paid during the first 5 years, and thereafter, the tax is payable in equal installments over a period of up to 10 years. A special 4 percent interest rate is provided for the estate tax attributable to the first \$1 million of farm or other closely held business property.

In addition, the Act retains the present ten-year extension for payment of estate tax (sec. 6166) attributable to closely held businesses where the value of a closely held business exceeds 35 percent of the value of the gross estate or 50 percent of the taxable estate of the decedent.

The Act substitutes a "reasonable cause" standard in the ten-year discretionary extension of estate tax for the "undue hardship" standard of prior law.

A special lien is provided for the payment of the deferred taxes under either of the two extensions for closely held businesses. Where this lien procedure is followed, the executor is discharged from personal liability.

This provision applies to estates of decedents dying after December 31, 1976.

Sec. 2004(e). Redemption of Stock To Pay Estate Tax

Under prior law, stock in a closely held corporation that was redeemed within 4 years of the decedent's death was taxed as capital gain rather than as dividend income. To qualify, the value of the decedent's stock in the closely held business must have been either 35 percent of

the gross estate or 50 percent of the taxable estate. The value of the redeemed stock qualifying for this treatment could not exceed the sum of all death taxes plus funeral and administration expenses.

The Act requires that, in order to qualify for capital gains treatment, the value of the decedent's stock of the closely held corporation must exceed 50 percent of the value of the adjusted gross estate. The stock that can qualify for capital gains treatment is limited to stock which is redeemed from a shareholder whose interest in the estate is reduced (either directly or through a binding obligation to contribute) by the payment of the death taxes and funeral and administration expenses. In addition, the Act extends the time for redemption to 15 years in cases where an election has been made for the deferred payment of taxes.

This provision applies to estates of decedents dying after December 31, 1976.

Sec. 2005. Carryover of Basis of Property

Under prior law, the cost or other basis of property acquired from or passing from a decedent generally was "stepped-up" to its fair market value at the date of death (or the alternative valuation date). However, where property is transferred by gift, the basis of the property in the hands of the donee is generally the same as the donor's basis (i.e., the donor's basis is "carried over" to the donee).

The Act provides that the basis of most property acquired from or passing from a decedent who dies after December 31, 1976, is to be the same as the decedent's basis immediately before his death (with certain adjustments). The basis of appreciated property is increased by Federal and State death taxes attributable to the appreciation in that property. In addition, the aggregate basis of all carryover basis property may be increased to a minimum of \$60,000. A \$10,000 exemption is provided for household and personal effects of the decedent. However, the basis of property cannot be increased above the estate tax value by these adjustments.

In addition, as a transitional rule, the adjusted basis of property which the decedent is treated as having held on December 31, 1976, is increased, for purposes of determining gain (but not loss), to its fair market value on December 31, 1976. In essence, this rule continues existing law with respect to appreciation in property occurring before January 1, 1977, and provides everyone with a "fresh start" with respect to the carryover basis rule for property acquired from a decedent.

In order to avoid the necessity of obtaining an appraisal on all property held on December 31, 1976, the Act contains a provision which requires that all property, other than a marketable bond or security, be valued under a special valuation method for purposes of this transitional rule. In general, the special rule determines the adjustment by assuming that any appreciation since the acquisition of the property until the date of the decedent's death occurred at the same rate over the entire time that the decedent is treated as holding the property.

The special valuation method must be used for all property other than marketable bonds or securities. Thus, the special valuation method must be used even though the executor or beneficiary of the decedent can establish that the fair market value of the property on December 31, 1976, is other than the value determined under the special valuation method. Under the Act, the value of marketable bonds or securities for purposes of the transitional rule is to be based on actual market value on December 31, 1976.

The carryover basis provision is effective for property acquired from, or passing from, a decedent after December 31, 1976.

Sec. 2006. Generation-Skipping Transfers

The Act imposes a tax in the case of generation-skipping transfers under a trust or similar arrangement (such as a life estate) upon the distribution of the trust assets to a generation-skipping heir (for example, a distribution to a great-grandchild of the grantor) or upon the termination of an intervening interest in the trust (for example,

the termination of an interest held by the transferor's grandchild). An exception is provided which permits one generation to be skipped in the case where the generation-skipping transfer is to a grandchild of the grantor. Thus, the tax will not be imposed on the termination of the life estate of the child of the grantor where the trust provided a life estate for the child and the remainder to the grandchildren of the grantor. However, the maximum amount that can be transferred under this exception without the imposition of a generation-skipping tax is \$250,000 for each child who is treated as a transferor of the remainder interest.

The tax will be substantially equivalent to the estate tax which would have been imposed if the property had been actually transferred outright to each successive generation. For example, where a trust is created for the benefit of the grantor's grandchild, with remainder to the great-grandchild, then, upon the death of the grandchild, the tax will be computed by adding the grandchild's portion of the trust assets to the grandchild's estate, and computing the tax at the grandchild's marginal tax rate. In other words, the grandchild is treated under the Act as a "deemed transferor" of the trust property.

The deemed transferor's marginal transfer tax rate will be used as a measuring rod for purposes of determining the tax imposed on the generation-skipping transfer but the deemed transferor or his estate will not be liable for the payment of the tax. Instead, the tax will generally be paid from the trust property. However, the trust will be entitled to any unused portion of the deemed transferor's unified transfer tax credit, the credit for tax on prior transfers, the charitable deduction (if part of the trust property were left to charity), the credit for State inheritance taxes and a deduction for certain administrative expenses. Trust property is also entitled to basis adjustments similar to those allowed for property which is subject to tax upon outright transfer. The alternate valuation date is also available where a taxable termination occurs upon the death of a deemed transferor.

The generation-skipping tax will not be imposed in the case of outright transfers. In addition, the tax will not be imposed by reason of the death of a member of an older generation if the decedent was not treated as a beneficiary because he had (i) nothing more than a right of management over the trust assets or (ii) a limited power to appoint the trust assets among the lineal descendants of the grantor. As a rule of administrative convenience, the tax will not be imposed in the case of distributions of current income from a generation-skipping trust.

In general, these provisions apply to generation-skipping transfers which occur after April 30, 1976. However, the provisions would not apply to any transfers under a trust which was irrevocable on April 30, 1976. In the case of a revocable trust or will in existence on April 30, 1976, the provisions will not apply if the grantor dies before January 1, 1982, and the trust instrument or will is not amended after April 30, 1976, in any way which increases generation-skipping. Where the grantor is incompetent, the grace period will be extended for a period of two years after the disability is removed.

Sec. 2007. Orphans' Exclusion

There is no provision under present law which allows an estate tax deduction for the value of any interest in property which passes from a decedent to an orphaned child.

The Act provides an estate tax deduction for amounts which pass to a child of the decedent if the child is under 21 years of age, has no known parent, and there is no surviving spouse of the decedent. The maximum deduction under this provision is \$5,000 for each year the child is under age 21. This provision applies to estates of decedents dying after December 31, 1976.

Sec. 2008(a). Requirement That IRS Furnish a Statement Explaining Estate or Gift Valuation

Under present law, the IRS can require that the executor submit a copy of any appraisals he has obtained in determining value of property included in the decedent's gross estate. However, prior to the Act there was no administrative provision which provided an affirmative requirement on the part of the IRS to disclose the method or basis used by the IRS in arriving at its determination of value.

The Act provides that if the IRS makes a determination of the value of any item of property for purposes of the estate or gift tax laws or the generation-skipping tax, the executor or donor may request that the IRS furnish a written statement explaining the basis on which the valuation was determined. This provision applies to estates of decedents dying after December 31, 1976, and gifts and generation-skipping transfers occurring after December 31, 1976.

Sec. 2008(b). Gift Tax Returns

Prior to the Act, gift tax returns generally were required to be filed for each calendar quarter in which a donor transferred by gift an amount in excess of the annual \$3,000 exclusion per donee.

The Act provides that a gift tax return must be filed on a quarterly basis only when the sum of (1) taxable gifts made during the calendar quarter plus (2) all other taxable gifts made during the calendar year for which a return has not been filed, exceeds \$25,000. If total taxable gifts made during the calendar year did not exceed \$25,000, only one return will need to be filed for the calendar year. This provision applies to gifts made after December 31, 1976.

Sec. 2008(c). Public Index of Filed Tax Liens

Under present law, a Federal tax lien generally takes priority over other interests in property subject to the lien which are held by purchasers, holders of security interests and certain other persons if notice of the tax lien has been appropriately filed before such interests were acquired.

The Act provides that a notice of a Federal tax lien is not to be treated as meeting the filing requirements unless a public index of the lien is maintained at the district office of the Internal Revenue Service in which the property subject to the lien is situated. For this purpose, an index of liens affecting real property will be maintained in the district office for the area in which the real property is physically located. In the case of liens affecting personal property, the index will be maintained in the district office for the area in which the residence of the taxpayer is located at the time the notice of lien is filed.

The provision is effective on the 120th day after the date of enactment in the case of notices filed on or after the date of enactment. In the case of liens filed before the date of enactment, the Act is effective on the 270th day after enactment.

Sec. 2009(a). Inclusion of Stock in Decedent's Estate Where Decedent Retained Voting Rights

Under present law, an inter vivos transfer made by the decedent is included in his gross estate if he retained for his lifetime either the right to possess or enjoy the property or the right to designate the person who will possess or enjoy the property. In *U.S. v. Byrum*, the U.S. Supreme Court held that the retention of the power to vote stock in a closely held corporation did not require the stock to be included in the decedent's gross estate.

The Act requires the inclusion of stock in the gross estate of the decedent if the decedent retained the voting rights in the stock. This provision applies to transfers made after June 22, 1976.

Sec. 2009(b). Disclaimers

Under prior law, there were several estate and gift tax provisions which provided rules governing the tax consequences of an effective disclaimer. However, these provisions did not contain uniform rules on what constitutes an effective disclaimer for estate and gift tax purposes.

The Act provides a single set of definitive rules for disclaimers for purposes of estate, gift, and generation-skipping transfer taxes. This provision generally applies to transfers creating an interest in the disclaiming person made after December 31, 1976.

Sec. 2009(c) (1), (2), (3), and (4). Estate and Gift Tax Exclusions for Qualified Retirement Benefits

Generally, the value of a survivor's interest in an annuity purchased by the decedent is included in the decedent's gross estate. However, under present law, an exclusion for estate and gift tax purposes is provided for the value of the portion of a survivor's annuity attributable to employer contributions to a qualified retirement plan.

The Act extends the exclusion to a survivor's interest in an H.R. 10 plan and an individual retirement account. A distribution from an individual retirement account to a beneficiary does not have to be in the form of a typical commercial annuity contract to qualify for the exclusion. Generally, the exclusion is to be available in situations where a liquidity problem might exist because the schedule of payments to be made from the account will not provide current funds to pay the estate tax. The Act removes the exclusion for all lump-sum distributions of the survivor's interest. This provision applies to the estates of decedents dying and gifts made after December 31, 1976.

Sec. 2009(c)(5). Gift Tax Treatment of Certain Community Property

Under present law, in community property States, no portion of a survivor annuity in a qualified plan attributable to employer contributions is includible in the gross estate of the employee's spouse if the spouse predeceased the employee. However, prior to the Act, for gift

tax purposes, if an employee predeceases his spouse in a community property State, the surviving spouse was treated as having made a gift of one-half of any benefits payable to other beneficiaries.

The Act provides a gift tax exclusion (similar to the existing estate tax exclusion) for the value, to the extent attributable to employer contributions, of any interest of an employee's spouse in a specified annuity contracts, or retirement plan payments. This provision is effective for calendar quarters beginning after December 31, 1976.

Sec. 2009(d). Income Tax Treatment of Certain Selling Expenses of Estates and Trusts

Under present law, an estate or trust is not permitted to deduct any item for income tax purposes if that same item is deducted for estate tax purposes. However, a number of courts have held that items which reduce the sales price, such as selling expenses, can be deducted for estate tax purposes as well as reduce the sales price for income tax purposes.

The Act provides that an item may not be used to offset the sales price for income tax purposes if the same item is deducted for estate tax purposes. This provision applies to taxable years ending after the date of enactment (October 4, 1976).

Sec. 2010. Estate Tax Credit For Payment in Kind

Under present law, in addition to legal tender, it is lawful for the Secretary of the Treasury to accept checks or money orders in payment of tax liability. Prior to the Act, there was no provision authorizing the Secretary of the Treasury to accept other forms of payment, such as the conveyance of real property.

The Act allows the Secretary of the Treasury to accept conveyance of real property located within the boundaries of the Toiyabe National Forest as payment of estate tax imposed on the estate of LaVere Redfield. However, interest will accrue if the property is not conveyed expeditiously.

TITLE XXI—MISCELLANEOUS PROVISIONS

Sec. 2101. Tax Treatment of Certain Housing Associations

Under prior law, most condominium management associations and residential real estate management associations could not qualify for tax-exempt status.

The Act provides that a condominium management association or a residential real estate management association may elect to be treated as a tax-exempt organization. If an election is made, the association is not taxed on membership dues, fees and assessments received from members of the association who own residential units in the particular condominium or subdivision. However, the association is to be taxed as a corporation (without the surtax exemption) on other income, including investment income and income derived from a trade or business. Deductions are allowed for expenses directly related to the production of nonexempt income, and a \$100 deduction against non-exempt income is provided so that associations with only a minimal amount of otherwise taxable income will not be subject to tax.

In order to qualify for this treatment, the association must be organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property. At least 60 percent of the association's gross income must consist solely of membership dues, fees or assessments from owners of residential units or residential lots, and at least 90 percent of the association's annual expenditures must be to acquire, construct, manage, maintain, care for, or improve association property. In addition to the general requirements, substantially all of the units or lots must be used as residences.

A cooperative housing corporation is not permitted to elect to be treated as a tax-exempt organization under these new rules. However, a cooperative housing corporation will be able to take depreciation on property leased to tenant-stockholders, even though the tenant-stockholders may also be able to depreciate their stock if they use the proprietary lease or right of tenancy to which the stock is allocable in a trade or business or for the production of income. The Act also modifies the prior law rule that a tenant-stockholder in a cooperative housing corporation must be an individual. Under the Act, a lending institution which obtains stock in a cooperative housing corporation through foreclosure may be treated as a tenant-stockholder for up to 3 years.

These provisions generally apply to taxable years beginning after December 31, 1973. However, the provision relating to foreclosures by lending institutions applies to stock acquired after the date of enactment.

Sec. 2102. Treatment of Certain Crop Disaster Payments

Insurance proceeds received by a taxpayer as a result of destruction or damage to crops may generally be included in income in the taxable year following the year of their receipt, if it can be established that

the income from the crops which were destroyed or damaged would otherwise have been properly included in income in a following taxable year.

The Act extends this provision to taxpayers using the cash receipts and disbursements method of accounting who receive certain payments pursuant to the Agricultural Act of 1949 if such payments are received as a result of (1) destruction or damage to crops caused by drought, flood or any other natural disaster, or (2) the inability to plant crops because of such a natural disaster. The provision is effective for payments received after December 31, 1973, in taxable years ending after that date.

Sec. 2103. Tax Treatment of Certain 1972 Disaster Losses

Under the Act, in the case of a 1972 disaster loss in a Presidentially designated disaster relief area, the tax on the first \$5,000 of compensation received with respect to the loss is not to exceed the tax which would have been payable if the \$5,000 (or lesser) deduction had not been claimed. This treatment applies only if elected by the taxpayer and only if certain conditions are satisfied. Any tax with respect to this \$5,000 amount which was still unpaid on October 1, 1975, may be paid in three equal annual installments beginning on April 15, 1977.

The provision is effective for all years (whether or not open).

Sec. 2104. Worthless Debts of Political Parties

The Act allows a deduction for worthless debts owned by political parties (or campaign committees) if the debts arise from bona fide sales of goods or services in the ordinary course of a trade or business, if more than 30 percent of the total business is with political parties, and if substantial efforts are made to collect the debt. The Act applies for taxable years beginning after December 31, 1975. The provision of prior law was not intended to apply to taxpayers whose primary business was to provide goods or services to political parties. The Act thus reflects Congress' original intent regarding prior law.

Sec. 2105. Tax-Exempt Bonds for Student Loans

Under prior law, only interest on obligations issued by or on behalf of governmental entities, such as States and their political subdivisions, was exempt from Federal income taxation. In addition, even these obligations were generally not exempt if the proceeds might have been used to purchase nonexempt securities or obligations whose yield was likely to exceed the yield on the governmental obligations.

Under the Act, obligations are also to be exempt from tax if issued by nonprofit corporations organized or requested to act by a State or a political subdivision solely to acquire student loan notes. In addition, student loan incentive payments made by the Commissioner of Education are not to be taken into account in determining whether the yield on student loan notes is higher than the yield on obligations issued to finance the student loan program. These provisions are effective for obligations issued on or after the date of enactment (after October 4, 1976).

Sec. 2106. Personal Holding Company Amendments

Under present law, royalties (other than mineral, oil or gas royalties and copyright royalties) received by a corporation are personal holding company income, regardless of how much income of other types

the corporation may have (sec. 543(a)(1)). "Royalties" include amounts received for a license to use trade brands, secret processes, franchises and similar intangible property. Under a separate rule of prior law (sec. 543(a)(6)), rents received by a corporation from leasing corporate "property" to a 25-percent or greater shareholder were personal holding income only if over 10 percent of the company's income came from other types of personal holding company income. In Rev. Rul. 71-596, 1971-2 Cum. Bull. 242, the IRS ruled that a company's income from licensing a major shareholder to make and sell a secret process was governed by the "royalty" rule rather than by the "shareholder rent" rule.

The Act amends the shareholder rent rule (in section 543(a)(6)) to apply that rule only to tangible property leased by a corporation to one or more of its major shareholders. (Even if income received by the corporation from renting tangible property to a major shareholder qualifies under the tests in section 543(a)(6) as nonpersonal holding company income, such income also constitutes rental income for purposes of the general rent rules in section 543(a)(2) of present law and, as such, must be separately tested under those rules.)

This provision clarifies the shareholder rent rule in prior law, which had been interpreted by the courts (in accord with Rev. Rul. 71-596) to mean that amounts received by a corporation from leasing intangible property to a major shareholder are to be treated as royalty income under the royalty rule, regardless of whether such income also qualifies under the shareholder rent rule. The provision makes clear, in effect, that income from the use of secret processes, trade brands and other intangible property (but not including certain specially-treated royalties), are always to be treated as personal holding company income under the general royalty rule (sec. 543(a)(1)), regardless of whether they are received from a shareholder of the corporation or from an unrelated third party.

The Act provides, however, that solely for purposes of determining (under section 543(a)(6), as amended) whether over 10 percent of the corporation's income is derived from personal holding company income, income from a lease of intangible property to a 25 percent or greater shareholder is not to be treated as personal holding company income, but only if the shareholder also leases tangible property from the corporation a substantial amount of which he uses, along with the intangible property, in the active conduct of a trade or business.

The new rule applies to taxable years beginning after December 31, 1976.

Sec. 2107. Work Incentive (WIN) and Federal Welfare Recipient Employment Tax Credits

Under prior law, the work incentive (WIN) credit, equal to 20 percent of the wages paid during the first 12 months of employment to qualified AFDC recipients, was available to employers engaged in a trade or business who hired such employees. Qualified participants were certified by the local WIN agency. The credit was recaptured in the case of an employee who ceased to work for the original employer before the end of an additional 12 months after completing one year of employment unless the employee voluntarily

quit, became disabled, or was fired for misconduct. The amount of the credit available in any year was limited to the first \$25,000 of tax plus one-half of tax liability in excess of \$25,000.

Under the Federal welfare recipient employment incentive tax credit (welfare recipient tax credit), which expired July 1, 1976, all private employers including those who provide employment for private household workers were eligible for the credit. Qualified employees were AFDC recipients who had received benefits for the 90 days preceding employment. The credit was essentially the same as the WIN credit: 20 percent of eligible wages, except that there was a limit of \$5,000 a year on the annual eligible wages for non-business employees; the same overall credit limit of \$25,000 of tax plus one-half of the excess also applied. There was no limit on the number of months the credit was available. The State or local welfare agency certified recipients as qualified.

The Act makes the WIN credit available from the date of hiring if employment is not terminated without cause before the end of 90 days after the first 90 days of employment, and adds an additional exemption to the recapture rules so that there would be no recapture of the credit if the employee were laid off due to a substantial reduction in business. It doubles the limit on the credit from \$25,000 to \$50,000 plus one-half of the excess over \$50,000. The Act also doubles the limit on the welfare recipient tax credit from \$25,000 to \$50,000 plus one-half of the excess over \$50,000. It provides a limit of 12 months for which the wages of any one employee will be eligible for the welfare recipient tax credit. The Act authorizes the WIN agencies also to certify eligibility for the welfare recipient tax credit. The Act extends the expiration date of the welfare recipient tax credit from July 1, 1976, to December 30, 1979.

Sec. 2108. Repeal of Excise Tax on Certain Light-Duty Truck Parts

Under present law, an 8-percent manufacturers excise tax applies to the sale of truck parts and accessories. However, no tax is imposed on such parts when included on a light-duty truck (10,000 lbs. or less gross vehicle weight) by a truck manufacturer, since the excise tax on light-duty trucks was repealed in 1971. Under prior law, the 8-percent tax applied if the part were added by a dealer (and not considered to be "further manufacture").

Under the Act, the 8-percent excise tax on truck parts and accessories is to be refunded or credited to the manufacturer where the part or accessory is sold on or in connection with the first retail sale of a light-duty truck. The provision applies to sales after the date of enactment (after October 4, 1976).

Sec. 2109. Exemption From Manufacturers Excise Tax for Certain Articles Resold After Modification

Under present law, a 10-percent manufacturers excise tax is imposed on sales of bodies and chassis for heavy trucks, buses not used for mass transport, heavy trailers and semi-trailers, and highway tractors. An 8-percent tax is imposed on sales of parts or accessories for trucks and buses. Under prior law, persons who obtained bodies or chassis and certain parts or accessories from different manufacturers and combined them were considered further manufacturers and paid a 10-percent

tax on their further sale, after credit for tax previously paid; however, persons who bought the entire combination from a single manufacturer did not pay a manufacturers excise tax on a further sale.

Under the Act, a resale of an article subject to the 10-percent tax is not to be taxed merely because the article is combined with any coupling device, wrecker crane, loading and unloading equipment, aerial ladder or tower, snow and ice control equipment, earthmoving, excavation and construction equipment, spreader, sleeper cab, cab shield, or wood or metal floor. The provision applies to resales on or after the date of enactment (October 4, 1976).

Sec. 2110. Franchise Transfers

Under present law, the transfer of a franchise, trademark or trade name is not to be considered as a sale or exchange of a capital asset if the transferor retained any significant power, right, or continuing interest with respect to the subject matter of the franchise, trademark, or trade name. Under prior law, no statutory rule prevented avoidance of this limitation through the use of partnerships.

The Act provides that, with respect to certain partnership distributions, sales of partnership interests, and distributions in liquidation of partnership interests, the potential ordinary income from the transfer of a franchise, trademark or trade name is to be treated as an "unrealized receivable" of a partnership. The effect is to apply to partnerships the same rule that currently applies to sole proprietorships. This provision is effective for transactions occurring after December 31, 1976, in taxable years ending after that date.

Sec. 2111. Employer's Duties To Keep Records and To Report Tips

Under present law, employees are required to report to employers all tips received, including charge account tips. Employers are to include such tips in reporting to the IRS the employees' wages subject to withholding. The IRS recently ruled that sec. 6041(a) of the Code required employers to report separately to the IRS charge account tips not reported to employers by employees and therefore not reported to IRS by employers as wages subject to withholding.

Under the Act, the IRS is not to take action to enforce its recent rulings on these matters before 1979. Thus, the charge tip reporting rules are to be administered during this period as they were prior to the recent rulings. This provision is not intended to affect the Service's ability to effect audits in the area of tip income.

Sec. 2112. Treatment of Certain Pollution Control Facilities

From 1969 through December 31, 1975, an election for 5-year amortization was available to a taxpayer who installed a new identifiable, certified pollution control facility in connection with property that was in operation before January 1, 1969. However, the amortizable basis of the facility was not eligible for the investment tax credit. The Act generally provides an election for 5-year amortization of facilities installed in property in existence before January 1, 1976, makes amortization available for facilities that will prevent the creation or emission of pollutants, and provides one-half of the investment credit for such facilities placed in service after December 31, 1976. The extension of the 5-year amortization election and its availability

for preventive facilities apply for taxable years beginning after December 31, 1975. The investment credit provision applies for taxable years beginning after December 31, 1976.

More specifically, the Act extends the election to facilities that will prevent the creation or emission of pollutants when installed at the site of a plant or other property in existence before January 1, 1976, which do not lead to a significant increase in output or capacity, a significant extension of useful life, or a significant reduction in total operating costs for such plant or other property (or any unit thereof), or a significant alteration in the nature of a manufacturing production process or facility. For purposes of this provision, "significant" means a change of more than 5 percent. In determining how significant the effect of a pollution control facility is upon output, capacity, costs or useful life of property, the relevant area for examination is to be the operating unit most directly associated with the pollution control facility.

The Act extends the definition of a qualified pollution control facility to include, for example, a facility located at a plant site which prevents the creation of a pollutant by removing sulphur from fuel before it is burned at the plant. The definition includes such facilities as a recovery boiler that removes pollutants from material at some point in the otherwise unchanged production process at the plant. The Act does not include as a qualified pollution control facility a facility that makes a significant change in, or functions as, a new manufacturing or production process or facility. Where a plant that has employed heat to process a material converts to an electrolytic process, the latter is not a qualified pollution control facility because it is also a new manufacturing or production process even though it may prevent the creation or emission of pollutants.

Although the Act provides a broader definition of a pollution control facility that will be eligible for the amortization election, that definition does not apply in determining whether a facility is a pollution control facility eligible for tax-exempt industrial development bond financing.

Sec. 2113. Qualification of Fishing Organizations as Tax-Exempt Agricultural Organizations

Under prior law, fishing organizations could qualify as tax-exempt business leagues, but not as tax-exempt agricultural organizations. Tax-exempt agricultural organizations receive lower postal rates than do tax-exempt business leagues.

Under the Act, the term "agricultural", for tax purposes, is to include the harvesting of aquatic resources. The provision is to be effective for all taxable years ending after December 31, 1975.

Sec. 2114. Application of Section 6013(e) of the Code (Innocent Spouse Rule)

Section 6013(e) of the Code, enacted January 12, 1971, generally relieved a spouse from tax liability for income omitted from a tax return, if he or she was not responsible for the omission and did not benefit from the unreported income. The Act extends relief under the innocent spouse provision to taxpayers who, but for the *res judicata* effect of an adverse judicial decision, would have been relieved of

liability under the 1971 statute. The Act applies to all taxable years beginning after December 31, 1961, and ending on or before January 12, 1971, and is effective until the end of the first calendar year following the date of enactment.

Sec. 2115. Modifications in Limitations on Percentage Depletion for Oil and Gas Wells

The Tax Reduction Act of 1975 generally repealed percentage depletion for oil and gas but provided a limited exemption from repeal for taxpayers who were neither refiners nor retailers. In any event, percentage depletion was disallowed on any proven property transferred after 1974. Also, percentage depletion on oil and gas was limited to 65 percent of the taxpayer's taxable income.

The Act modifies these provisions to correct certain technical problems and to prevent instances of unintended hardship. Under the Act, a taxpayer is not to be treated as a retailer in cases where gross sales of oil and gas products attributable to the taxpayer are less than \$5 million in any one year. Also, bulk sales of oil or natural gas to industrial or utility customers are not to be treated as retail sales. Likewise, a taxpayer is not to be treated as a retailer if all sales of oil or natural gas products occur outside the United States, and none of the taxpayer's domestic production is exported.

In addition, the Act provides that oil or natural gas property is not to be treated as "transferred" property merely because there is a change in beneficiaries under a trust if the change occurs by reason of births, adoptions, or deaths involving a single family. Also, trusts are permitted to compute the 65 percent of taxable income limitation without regard to any deduction for distributions to beneficiaries.

The Act also permits percentage depletion to be retained on property which is transferred by individuals, corporations and other entities, all of which are part of the same controlled group after the transfer (and thus must continue to combine oil production to determine the maximum number of barrels of oil eligible for percentage depletion). However, if any transferee ceases to be part of the same controlled group as the transferor at some later time, percentage depletion is to be disallowed with respect to the transferred property as of that date (in order to prevent a proliferation of the limited exemption from the repeal of percentage depletion). These provisions are effective January 1, 1975, and are applicable to taxable years ending after December 31, 1974.

Sec. 2116. Implementation of Federal-State Tax Collection Act of 1972

Under present law, a State whose individual income tax laws substantially conform to the Federal individual income tax could enter into an agreement with the Internal Revenue Service for the IRS to collect and administer the State tax. Prior law provided that at least two States with 5 percent of the Federal individual tax returns must have elected to have their taxes "piggybacked" for the piggyback system to be generally available.

The Act makes explicit that no costs will be charged to any State for "piggybacking"; reduces to one the number of States necessary to start the system; and eliminates the requirement that 5 percent or more of Federal returns be initially involved in triggering the system.

Also, it permits certain adjustments for State sales tax credits. The provision takes effect upon the date of enactment (October 4, 1976).

Sec. 2117. Cancellation of Certain Student Loans

Under prior law, gross income included income from the discharge of indebtedness. Gross income did not include amounts received as a scholarship or fellowship grant at an educational institution, unless such amounts represented compensation for services or are primarily for the benefit of the grantor. The Service ruled that discharges of indebtedness on student loans issued after June 11, 1973, were includable in gross income.

The Act provides that no amount shall be included in gross income by reason of the discharge of all or part of a student loan if, pursuant to the loan agreement, such discharge is made because the individual works for a certain period of time in certain geographical areas or for certain classes of employers. This provision applies only to loans made by a governmental agency. The provision is effective for discharges of indebtedness made before January 1, 1979.

Sec. 2118. Simultaneous Liquidation of Parent and Subsidiary Corporations

Under present law, a corporation which sells its assets and liquidates completely within 12 months generally is not taxable on gain from its sale of assets. Its shareholders, however, are taxable on the liquidation proceeds they receive. The selling company in this situation was taxable under prior law, however, if it was a controlled subsidiary of a parent corporation. (In this latter situation, the parent corporation is not taxable when it liquidates the subsidiary). If both the parent and the subsidiary planned to liquidate after the subsidiary sold its assets, however, two taxes could be imposed under prior law. The subsidiary could be taxed on its gain from the sale and the parent's shareholders could also be taxable when the parent liquidated.

The Act adds a rule providing that if a controlled subsidiary sells its assets and then both it and its parent corporation liquidate completely within 12 months, only one tax will be imposed and that will fall only on the parent's shareholders. This rule is effective for sales of assets under a plan of complete liquidation adopted on or after January 1, 1976.

Sec. 2119. Prepublication Expenditures

Under prior law, IRS regulations and Revenue Ruling 73-395, 1973-2 Cum. Bull. 87, denied a current deduction for research expenses incurred in connection with literary, historical, or similar projects. The ruling required that publishers' prepublication expenditures had to be capitalized and could be depreciated.

The Act, which applies to all open years, allows publishers to continue their customary, consistent tax accounting methods regarding prepublication expenditures without regard to Revenue Ruling 73-395 until the IRS issues new, prospective regulations.

Sec. 2120. Contributions in Aid of Construction for Certain Utilities

Under a recent revenue ruling by the IRS (Rev. Rul. 75-557), certain contributions in aid of construction were treated as income rather than nontaxable contributions to the capital of a utility.

The Act treats certain contributions in aid of construction to water and sewage disposal utilities as nontaxable contributions to capital. Any cash contributions must be spent for qualifying water or sewage disposal facilities before the end of the second taxable year following the year the contribution was received. However, nontaxable treatment will not be accorded to customer connection fees. Customer connection fees include any payments made by a customer to the utility for the cost of installing the connection between the customer's property and the utility's main water or sewer lines (including the cost of meters and piping) and any amounts paid as service charges for stopping or starting service. In addition, a requirement is added to insure that nontaxable treatment is accorded to only those utilities that are required to serve the public. This provision is effective for contributions made after January 31, 1976.

In providing these special rules for water and sewage disposal companies, the Congress intends that no inference be drawn as to the proper treatment of such items by companies which are not water or sewage disposal utilities.

Sec. 2121. Prohibition of Discriminatory State or Local Taxes on Generation or Transmission of Electricity

Under prior law, any restrictions on the power of States or their political subdivisions to tax goods or services produced in the taxing State for nondomiciliary use outside the taxing State are derived from court interpretations of the interstate commerce clause of the Constitution.

The Act prohibits any State or political subdivision of a State from directly or indirectly imposing any tax on the generation or transmission of electricity which discriminates against out-of-State users. This provision is effective for taxable years beginning after June 30, 1974.

Sec. 2122. Deduction for Cost of Removing Architectural and Transportation Barriers for the Handicapped and Elderly

Generally, costs incurred to improve property used in a trade or business must be capitalized and may be depreciated over the useful life of the property.

The Act provides an elective current deduction for the removal of architectural and transportation barriers to the handicapped and elderly (age 65 or over) in any facility or public transportation vehicle owned or leased for use in a trade or business. The Act defines handicapped individuals to include the deaf and blind. The barrier removal must meet government standards. The maximum deduction is \$25,000 per taxpayer for any taxable year. The deduction is effective for taxable years beginning after December 31, 1976, and ending before January 1, 1980.

Sec. 2123. Report on High-Income Taxpayers

The Act instructs the Secretary of the Treasury to publish statistics on the tax liability of people with high total income, including the number and average income of high-income people with no income tax liability (after credits); the specific deductions, exclusions and credits used to avoid tax; the overall number of high-income individuals; and the total income and tax liability of the high-income group. Income,

for this purpose, shall approximate real economic income and shall include at least two adjustments: (1) adjusted gross income (AGI) shall be reduced by investment income and expense to the extent it does not exceed investment income; and (2) tax preference items excluded or deducted in arriving at AGI shall be added back into income for this purpose. These adjustments are to be made separately, as well as together.

Sec. 2124. Tax Treatment of Certified Historic Structures

Under prior law, the original users of depreciable real property constructed after July 24, 1969, were allowed to depreciate the property using accelerated methods of depreciation, including the 150 percent declining balance method (200 percent in the case of residential rental property).

The Act provides that accelerated depreciation methods are not allowed with respect to real property constructed on a site which had been occupied by a certified historic structure which was demolished or substantially altered (other than by virtue of a certified rehabilitation). A "certified historic structure" is defined as a depreciable building or structure which is (a) listed in the National Register, (b) located in a Registered Historic District and is certified by the Secretary of the Interior as being of historic significance to the district, or (c) located in a historic district designated under a State or local statute containing criteria satisfactory to the Secretary of the Interior. A "certified rehabilitation" is defined to be any rehabilitation of a certified historic structure which the Secretary of the Interior has certified as being consistent with the historic character of such property or district. The required use of straight line depreciation applies to additions to the capital account after December 31, 1975, and before June 15, 1981.

Under prior law, the expenses of demolishing an old building, and the remaining undepreciated basis of the demolished building, were deductible unless the building was acquired with a view toward its demolition. The Act provides that in case of the demolition of a certified historic structure, or of any other structure in a Registered Historic District unless certified by the Secretary of the Interior prior to its demolition not to be of historic significance to the district, no deduction is to be allowed for (1) the amount expended for its demolition or (2) any loss sustained on account of the demolition. Deductions disallowed under this provision are to be treated as chargeable to the capital account with respect to the land on which the demolished structure was located, and thus are not to be includible in the depreciable basis of any replacement structure. The disallowance of deductions applies to demolitions commencing after June 30, 1976, and before January 1, 1981.

Under existing law, accelerated depreciation methods are generally not allowable with respect to used property acquired after July 24, 1969. A 125 percent declining-balance method may be employed to depreciate used residential property with a useful life of 20 years or more at the time of acquisition. The costs of rehabilitating an existing structure must be capitalized and depreciated according to the method (straightline or 125 percent declining balance) used to depreciate the structure. Under the Act, taxpayers are to be allowed an election to treat for depreciation purposes "substantially rehabilitated historic property" as if they were the original users of the property (i.e., they

allowed to use the 150 percent (or 200 percent in the case of residential rental property) declining-balance method of depreciation with respect to the entire basis of the rehabilitated property). A "substantially rehabilitated historic property" is defined to be any certified historic property if the capital expenditures incurred in the certified rehabilitation of the property during the 24-month period ending on the last day of the taxable year exceed the greater of (1) the taxpayer's adjusted basis in the structure on the first day of the 24-month period or (2) \$5,000. Accelerated depreciation on substantially rehabilitated historic property applies to additions to the capital account after June 30, 1976, and before July 1, 1981.

The Act also allows taxpayers an election, in lieu of claiming the depreciation deductions otherwise allowable, to amortize over a 60-month period the capital expenditures incurred in a certified rehabilitation of an historic structure. Amortization in excess of depreciation otherwise allowable is to be recaptured as ordinary income on a sale of the property. Five-year amortization applies to additions to capital account after June 14, 1976, and before June 15, 1981.

A charitable deduction was not allowed under prior law for contributions to charity (not in trust) of less than the taxpayer's entire interest in the property unless it was a contribution of an undivided interest in the property, a contribution which would have been entitled to a charitable deduction if it had been made in trust, or a contribution of a remainder interest in real property consisting of personal residences or farms. Under the Act, a deduction is allowed for the contribution to a charitable organization exclusively for "conservation purposes" of (1) a lease on, option to purchase, or easement with respect to real property of not less than 30 years' duration or (2) a remainder interest in real property. For this purpose, a charitable contribution includes a contribution to a governmental unit. The term "conservation purposes" is defined to mean the preservation of land areas for public recreation, education, or scenic enjoyment, the preservation of historically important land areas or structures, or the preservation of natural environmental systems. Such contributions also qualify as charitable contributions for estate and gift tax purposes. The deductions are allowable for charitable contributions and transfers made after June 13, 1976, and before June 14, 1977.

Sec. 2125. Supplemental Security Income for Victims of Certain Natural Disasters

In general, an SSI recipient living in someone else's household has his benefits reduced by one-third to reflect a lower level of need. P.L. 94-331 eliminated for up to six months the one-third reduction in the case of individuals displaced as a result of a major disaster occurring between June 1, 1976 and December 31, 1976.

The Act extends the period during which the one-third reduction may be suspended from six months to 18 months.

Sec. 2126. Net Operating Loss Carryovers for Cuban Expropriation Losses

Under prior law, a taxpayer could carry over a net operating loss attributable to Cuban expropriation to each of 15 taxable years following the taxable year of the loss.

The Act extends the carryover period for five years to 20 taxable years following the loss.

Sec. 2127. Outdoor Advertising Displays

Prior law provided generally that if real property were involuntarily converted as the result of a condemnation, and the taxpayer used the proceeds to obtain "like kind" replacement property, gain on the conversion was not recognized. There has been conflicting authority as to whether billboards and other outdoor advertising displays qualify as real property for purposes of this non-recognition rule.

Under the Act, an irrevocable election is provided for taxpayers to treat qualifying outdoor advertising displays as real property. The availability of this election to treat outdoor advertising displays as real property should not be interpreted to prevent owners of such displays who do not make an election from treating them as personal property. Also, the Act provides that replacement real property is to be considered as "like kind" even though the replacement property is a different type of real property interest than the taxpayer held in an outdoor advertising display which was involuntarily converted. This provision is effective for taxable years beginning after 1970.

Sec. 2128. Excise Tax Treatment of Large Cigars

Prior law provided a bracket system of excise taxes on large cigars (those weighing more than three pounds per thousand) under which the rate varied depending on the amount of the intended retail price of the cigar. The maximum tax was \$20 per thousand on cigars retailing for 20 cents or more each.

The Act changes the bracket system to an ad valorem tax of 8½ percent of the wholesale price (retaining the \$20 per thousand maximum). The change is to be effective on the first month which begins more than 90 days after the date of enactment (i.e., February 1, 1977).

Sec. 2129. Gain From Sales or Exchanges Between Related Parties

Under prior law, gain from a sale or exchange of depreciable property was denied capital gain treatment if the sale were between a husband and wife, or between an individual and a corporation if over 80 percent of the value of the corporation's stock were owned by the individual, his spouse, and his minor children or grandchildren. Several courts have held that this provision did not apply to gain from the sale of depreciable property between two corporations controlled by the same individual (or his family).

The Act broadens the scope of this provision to cover a sale or exchange of depreciable property between commonly controlled corporations; The Act also broadens the constructive ownership rules which trigger the restrictions under this provision to include stock owned by the taxpayer's parents, his adult children, and by any trust, estate or partnership of which the taxpayer is a beneficiary or partner. In addition, the Act makes this provision apply where an individual owns 80 percent or more (rather than only over 80 percent) of the stock of a corporation.

These new rules apply to sales or exchanges after the date of enactment except sales or exchanges made pursuant to a binding contract entered into before the date of enactment.

Sec. 2130. Armed Forces Health Professions Scholarships

Under IRS rulings, amounts received under the Armed Forces Health Professions Scholarship Program (and similar programs) were to be taxable as compensation for 1976 and future years (because a special 3-year legislative exemption ended December 31, 1975).

The Act excludes from income in 1976, 1977, 1978 and 1979 amounts received under the Armed Forces Health Professions Scholarship Program (and similar programs) by a member of the uniformed services participating in the programs in 1976.

Sec. 2131. Exchange Funds

Under present law, a group of investors cannot pool appreciated stocks or other property in a new corporation without paying capital gains tax on the appreciation. This rule was added in 1966. The law remained silent, however, on the possibility of using a partnership or a trust as the vehicle to pool and diversify investments tax-free. On April 28, 1975, the Internal Revenue Service issued a private ruling holding that an exchange fund could be formed tax-free (under prior law) as a publicly syndicated limited partnership.

The Act:

- (1) Amends the partnership rules to make taxable the contribution of property to an exchange fund formed as a partnership (general or limited);
- (2) Makes taxable a merger or other reorganization involving an undiversified investment company (such as a merger of a personal holding company owning a limited group of stocks with a widely-diversified mutual fund); and
- (3) Makes taxable any future transactions where similar diversification of investments is sought through a trust or a common trust fund.

These new rules apply generally to reorganizations after February 17, 1976, and to transfers to trusts or common trust funds on or after April 8, 1976. In the case of partnerships, the new rules apply to transfers after February 17, 1976. However, certain transfers to a partnership after February 17, 1976, are excepted if before March 27, 1976, the partnership either filed a request for a private letter ruling from the Service or filed a registration statement with the SEC.

Sec. 2132. Contributions of Certain Government Publications

In most situations, Government publications received by taxpayers without charge (e.g., copies of the Congressional Record received by Members of Congress) or at a reduced price were treated as capital assets under prior law. One consequence of that treatment was that taxpayers could claim a deduction for the full fair market value of any Government publication which they contributed to a charity (such as a library or a university) for a use related to the charity's exempt purpose.

Under the Act, U.S. Government publications which are received from the Government without charge or below the price at which they are sold to the general public are no longer to be treated as capital assets in the hands of the taxpayer receiving the publications. This treatment is also to apply to any Government publication held by a taxpayer in whose hands the basis of that publication is determined by reference to its basis in the hands of a person receiving it free or at a reduced price. This provision applies to sales, exchanges, and contributions made after the date of enactment. (October 4, 1976).

Sec. 2133. Study of Tax Incentives by Joint Committee

The Act requires the Joint Committee on Taxation to study, in consultation with Treasury, tax incentives, especially as used to provide stimulus to the economy during a recession. A report is to be made to the Senate Finance Committee and the House Ways and Means Committee no later than September 30, 1977.

Sec. 2134. Group Prepaid Legal Services

Under prior law, depending on the structure of the specific group legal services plan, an employee had to pay tax on either (1) his share of employer contributions to the plan on his behalf, or (2) the value of legal services or reimbursements received by him under the plan. The Act excludes from an employee's income both (1) employer contributions and (2) benefits received under qualified group legal services plans. It applies to plans established to provide personal legal services for employees, their spouses and dependents through prepayment of, or advance provision for, legal fees. Plans must be organized through tax-exempt organizations or trusts (or established through insurance companies). To qualify, plans must be nondiscriminatory with respect to enrollment and benefits. Limitations are placed on amounts contributed to provide benefits for employee-shareholders or owners. A transition period is provided for existing plans to meet the statutory requirements. The provision applies to taxable years beginning after December 31, 1976, and ending before January 1, 1982.

A study of the provision by the Departments of the Treasury and of Labor is required and final reports must be submitted to the House Committee on Ways and Means and to the Senate Committee on Finance not later than December 31, 1980.

Sec. 2135. Certain Charitable Contributions of Inventory

Under prior law, a taxpayer's deduction for contributions of appreciated ordinary income property, such as inventory, was limited to the taxpayer's basis in the property.

The Act generally allows a corporation a charitable deduction for the sum of the taxpayer's basis in the property plus one-half of the appreciation of ordinary income property, such as inventory, but the deduction in no event is to exceed twice the basis of the contributed property. The new provisions apply only to property donated to a public charity or private operating foundation for use in its exempt purpose for the care of the ill, the needy, or infants and do not apply to amounts treated as ordinary income because of recapture rules. Also, property which does not satisfy the relevant requirements of the Federal Food, Drug, and Cosmetic Act is not eligible for an increased deduction under these provisions. These provisions apply to contributions made after the date of enactment (October 4, 1976).

Sec. 2136. Tax Treatment of the Grantor of Certain Options

Under IRS rulings, gain from the lapse of an option and gain or loss from a closing transaction in options have been generally treated as ordinary income or loss.

The Act provides that gain from the lapse of an option and gain or loss from a closing transaction in options are to be treated as short-term capital gain or loss.

The provisions apply to options granted after September 1, 1976.

Sec. 2137. Exempt-Interest Dividends of Regulated Investment Companies

Distributions by a regulated investment company (commonly called a mutual fund) from capital gains recognized by it may be treated as capital gain to its shareholders (i.e., the character of the capital gain is "flowed-through" to the shareholders). Under certain conditions, similar flow-through treatment is provided for dividend

income. However, there was no flow-through treatment for tax-exempt interest under prior law. Consequently, distributions of tax-exempt interest by a regulated investment company were taxable income to its shareholders.

The Act permits, in certain cases, the character of tax-exempt interest distributed by a regulated investment company to flow-through as tax-exempt interest to its shareholders. The new rules apply to taxable years beginning after December 31, 1975.

Sec. 2138. Common Trust Fund Treatment of Certain Custodial Accounts

Under prior law, banks could hold in a common trust fund assets held by the bank in its capacity as trustee, executor, administrator or guardian.

The Act extends common trust treatment to cover custodial accounts, such as uniform gifts to minors act accounts.

Sec. 2139. Support Test for Dependent Children of Separated or Divorced Parents

Under prior law, the noncustodial parent received an exemption for a child (of separated or divorced parents) if (1) he or she contributed at least \$1,200 for support of all the children of the separated or divorced couple, and (2) the custodial parent did not clearly establish more support for the child than the noncustodial parent. Otherwise, the custodial parent received the exemption.

The Act allows the noncustodial parent to receive an exemption for a child only if he or she contributes at least \$1,200 for *each* of the children (in addition to the other requirements in prior law). The provision is effective for taxable years beginning after the date of enactment.

Sec. 2140. Deferral of Gain on Involuntary Conversion of Real Property

A taxpayer can elect to defer any gain realized on the involuntary conversion of real property held for productive use in a trade or business (and not stock in trade or other property held primarily for sale) if the converted property is replaced by property of a like kind. However, under prior law in order to qualify, the converted property must have been replaced no later than two years after the close of the first taxable year in which any of the gain was realized.

The Act extends the period for replacement to three years after the close of the first taxable year in which any of the gain from the conversion is realized. The provision applies to dispositions of property after 1974 unless condemnation proceedings began prior to the date of enactment.

Sec. 2141. Livestock Sold on Account of Drought

Under the Act, a cash method taxpayer may elect to include in the taxable year following the taxable year of sale or exchange income from the sale or exchange of livestock sold on account of drought. This treatment is limited to income from the sale or exchange of livestock (1) the number of which is in excess of usual business practice, and (2) which would not have been sold but for the drought. Also, the drought must occur in an area which is designated as eligible for Federal assistance. The election is available only to a taxpayer whose principal trade or business is farming. The election is effective for taxable years beginning after December 31, 1975.

APPENDIX A: Revenue Estimates

TABLE 1.—REVENUE EFFECT OF TAX REFORM, ESTATE AND GIFT TAX, AND TAX CUT PROVISIONS OF THE ACT,
SUMMARY AND BY TITLE ¹

[In millions of dollars; fiscal years]

	1977	1978	1979	1980	1981
SUMMARY					
Tax reform.....	1,593	1,719	2,038	2,118	2,470
Estate and gift tax.....	—728	—728	—921	—1,134	—1,449
Extension of tax cuts.....	—17,326	—13,776	—7,966	—8,348	—7,212
Total.....	—15,733	—12,785	—6,849	—7,364	—6,191
BY TITLE					
II—Tax shelters.....	417	395	501	488	527
III—Minimum and maximum tax.....	1,095	1,283	1,464	1,603	1,758
IV—Extension of individual income tax reductions.....	—14,350	—9,293	—4,506	—4,731	—4,968
V—Tax simplification in the individual income tax.....	—409	—442	—457	—478	—499
VI—Business-related individual income tax provisions.....	215	231	273	306	315
VII—Accumulation trusts.....	(2)	(2)	(2)	(2)	(2)
VIII—Capital formation.....	—1,457	—3,593	—3,796	—4,000	—2,499
IX—Small business provisions.....	—1,676	—1,177			
X—Changes in the treatment of foreign income.....	150	108	182	197	198
XI—Amendments affecting DISC.....	468	553	559	598	728
XII—Administrative provisions.....	88	55	55	55	55
XIII—Tax exempt organizations.....	—5	—5	(2)	(2)	(2)
XIV—Treatment of certain capital losses; holding period for capital gains and losses.....	—6	10	79	73	58
XV—Pension and insurance taxation.....	—18	—29	—29	—31	—30
XVI—Real estate investment trusts.....	(2)	(2)	(2)	(2)	(2)
XVII—Railroad provisions.....	—87	—139	—118	—98	—80
XVIII—International Trade Amendments.....					
XX—Estate and gift taxes.....		—728	—921	—1,134	—1,449
XXI—Miscellaneous provisions.....	—158	—14	—135	—212	—305
Total.....	—15,733	—12,785	—6,849	—7,364	—6,191

¹ Does not include Title I—Short Title and Title XIX—Repeal and Revision of Obsolete, Rarely Used, Etc., Provisions.

² Less than \$5,000,000.

TABLE 2.—REVENUE EFFECT OF TAX REFORM, ESTATE AND GIFT TAX, AND TAX CUT PROVISIONS¹ OF ACT
BY TITLE AND SECTION

[In millions of dollars; fiscal years]

	1977	1978	1979	1980	1981
PART I. TAX REFORM					
TITLE II					
Tax Shelters					
Real estate provisions:					
Sec. 201—Amortization of real property construction period interest and taxes	102	126	190	152	149
Sec. 202—Recapture of depreciation on real property	9	18	28	38	56
Sec. 203—5 year amortization of low income housing	-1	-4	-8	-8	-7
Farming provisions:					
Sec. 204—Limitation on deductions to amount at risk	(?)	(?)	(?)	(?)	(?)
Sec. 206—Termination of additions to excess deductions account	(?)	(?)	(?)	(?)	(?)
Sec. 207—Limitation on deductions for farming syndicates	86	32	32	33	34
Sec. 207—Accrual accounting for farm corporations	8	18	18	18	18
Oil and gas provisions:					
Sec. 204—Limitation on deductions to amount at risk	50	18	6	3	6
Sec. 205—Recapture of intangible drilling costs	7	14	42	51	65
Movie provisions:					
Sec. 204—Limitations on deductions to amount at risk	3	10	14	17	18
Sec. 210—Capitalization rules	29	19	9	4	4
Equipment leasing provisions: Sec. 204—Limitation on deductions to amount at risk					
	4	14	17	17	14
Sports franchise provisions:					
Sec. 212—Allocation of basis to player contracts	1	4	6	6	8
Sec. 212—Recapture of depreciation on player contracts	7	6	7	7	7
Partnership provisions:					
Sec. 213—Partnership syndication and organization fees	(?)	(?)	(?)	(?)	(?)
Sec. 213—Retroactive allocations of partnership income or loss	(?)	(?)	(?)	(?)	(?)
Sec. 213—Partnership special allocations	(?)	(?)	(?)	(?)	(?)
Sec. 213—Limitation on deductible losses of limited partners	(?)	(?)	(?)	(?)	(?)
Sec. 213—Limitation on additional first year depreciation for partnerships	12	10	10	10	10
Interest provisions:					
Sec. 208—Prepaid interest	(?)	(?)	(?)	(?)	(?)
Sec. 209—Limitation on deduction of nonbusiness interest	100	110	130	140	145
Other provisions: Sec. 214—Scope of waiver of statute of limitations in case of hobby loss elections					
	(?)	(?)	(?)	(?)	(?)
Total	417	395	501	488	527
TITLE III					
Minimum Tax and Maximum tax					
Sec. 301—Minimum tax for individuals	1,032	1,135	1,249	1,373	1,511
Sec. 301—Minimum tax for corporations	59	124	185	194	204
Sec. 302—Maximum tax	4	24	30	36	43
Total	1,095	1,283	1,464	1,603	1,758
TITLE V					
Tax Simplification in the Individual Income Tax					
Sec. 501—Revision of tax tables for individuals					
Sec. 502—Deduction for alimony allowed in determining adjusted gross income					
	-7	-44	-49	-54	-59
Sec. 503—Revision of retirement income credit					
	-391	-340	-340	-340	-340
Sec. 504—Credit for child care expenses					
	-384	-368	-404	-444	-488
Sec. 505—Changes in exclusion for sick pay and certain military, etc., disability pensions					
	380	357	387	417	450
Disability payments for civilian Government employees for injuries resulting from acts of terrorism					
	(?)	(?)	(?)	(?)	(?)
Sec. 506—Moving expenses					
	-7	-47	-51	-57	-62
Sec. 507—Tax revision study by Joint Committee					
Total	-409	-442	-457	-478	-499

See footnotes at end of table.

TABLE 2.—REVENUE EFFECT OF TAX REFORM, ESTATE AND GIFT TAX, AND TAX CUT PROVISIONS¹ OF ACT BY TITLE AND SECTION—Continued

[In millions of dollars; fiscal years]

	1977	1978	1979	1980	1981
TITLE VI					
Business-Related Individual Income Tax Provisions					
Sec. 601—Deductions for expenses attributable to business use of homes, rental of vacation homes, etc.....	207	206	235	268	305
Sec. 602—Deductions for attending foreign conventions.....	(2)	(2)	(2)	(2)	(2)
Sec. 603—Change in tax treatment of qualified stock options.....	7	20	33	33	5
Sec. 604—State legislators' travel expenses away from home.....	(3)	(3)	(3)	(3)	(2)
Sec. 605—Deduction for guarantees of business bad debts to guarantors not involved in business.....	1	5	5	5	5
Total.....	215	231	273	306	315
TITLE VII					
Accumulation Trusts					
Sec. 701—Accumulation trusts.....	(2)	(2)	(2)	(2)	(2)
TITLE VIII					
Capital Formation					
Sec. 802—First-in first-out treatment of investment credit amounts (For extension of 10-percent credit see Part III of this table).....	(2)	(2)	-5	-20	-40
Sec. 803—Modifications in employee stock ownership plans.....	-107	-257	-303	-332	-189
Employee stock ownership plan regulations.....					
Study of expanded stock ownership.....					
Sec. 804—Investment credit in the case of movie and television films.....	⁴ -37	⁴ -18	⁴ -13	⁴ -13	-3
Sec. 805—Investment credit in the case of certain ships.....	-13	-12	-15	-18	-23
Sec. 806—Additional net operating loss carryover years; limitations on net operating loss carryovers.....	(2)	(2)	(2)	(2)	(2)
Sec. 807—Small fishing vessel construction reserves.....	(2)	(2)	(2)	(2)	(2)
Total.....	-157	-287	-336	-383	-255
TITLE IX					
Small Business Provisions					
Sec. 902—Liberalization of subchapter S rules governing number of shareholders.....	(2)	(2)	(2)	(2)	(2)
Liberalization of other subchapter S shareholder rules.....	(2)	(2)	(2)	(2)	(2)
Distributions by subchapter S corporations.....	(2)	(2)	(2)	(2)	(2)
TITLE X					
Changes in the Treatment of Foreign Income					
Part I—Foreign tax provisions affecting individuals abroad:					
Sec. 1011—Income earned abroad by U.S. citizens living or residing abroad.....	44	38	38	38	38
Sec. 1012—Income tax treatment of nonresident alien individuals who are married to citizens or residents of the United States.....	-1	-5	-5	-5	-5
Sec. 1013—Foreign trusts having one or more U.S. beneficiaries to be taxed currently to grantor.....	12	10	10	10	10
Sec. 1014—Interest charge on accumulation distributions from foreign trusts.....	(2)	(2)	(2)	(2)	(2)
Sec. 1015—Excise tax on transfers of property to foreign persons to avoid Federal income tax.....	(2)	(2)	(2)	(2)	(2)
Part II—Amendments affecting tax treatment of controlled foreign corporations and their shareholders:					
Sec. 1021—Amendment of provision relating to investment in U.S. property by controlled foreign corporations.....	(2)	(2)	(2)	(2)	(2)
Sec. 1022—Repeal of exclusion for earnings of less developed country corporations for purposes of section 1248.....	14	10	10	10	10
Sec. 1023—Exclusion from subpart F of certain earnings of insurance companies.....	-14	-10	-10	-10	-10
Sec. 1024—Shipping profits of foreign corporations.....	(2)	(2)	(2)	(2)	(2)
Limitation on definition of foreign base company sales income in the case of certain agricultural products.....					

See footnotes at end of table.

TABLE 2.—REVENUE EFFECT OF TAX REFORM, ESTATE AND GIFT TAX, AND TAX CUT PROVISIONS¹ OF ACT BY TITLE AND SECTION—Continued

[In millions of dollars; fiscal years]

	1977	1978	1979	1980	1981
TITLE X—Continued					
Changes in the Treatment of Foreign Income					
Part III—Amendments affecting treatment of foreign taxes:					
Sec. 1031—Requirement that foreign tax credit be determined on overall basis.....	51	35	39	45	45
Sec. 1032—Recapture of foreign losses.....	2	8	14	22	28
Sec. 1033—Dividends from less developed country corporations to be grossed up for purposes of determining United States income and foreign tax credit against that income.....	80	55	55	55	55
Sec. 1034—Treatment of capital gains for purposes of foreign tax credit.....	14	10	10	10	10
Sec. 1035—Foreign oil and gas extraction income.....	-6	23	50	50	50
Sec. 1036—Underwriting income.....	(2)	(2)	(2)	(2)	(2)
Sec. 1037—Third-tier foreign tax credit when section 951 applies.....	-4	-10	-10	-10	-10
Part IV—Money or other property moving out of or into the United States:					
Sec. 1041—Portfolio debt investments in United States of nonresident aliens and foreign corporations.....	-55	-115	-125	-135	-145
Sec. 1042—Changes in ruling requirements under section 367; certain changes in section 1248.....	(2)	(2)	(2)	(2)	(2)
Sec. 1043—Contiguous country branches of domestic life insurance companies.....	-12	-8	-8	-8	-8
Sec. 1044—Transitional rule for bond, etc., losses of foreign banks.....	(2)				
Part V—Special categories of foreign tax treatment:					
Sec. 1051—Tax treatment of corporations conducting trade or business in Puerto Rico and possessions of the United States.....	6	10	10	10	10
Sec. 1052—Western Hemisphere trade corporations.....	19	25	34	45	50
Sec. 1053—Repeal of provisions relating to China Trade Act corporations.....	(2)	(2)	(2)	(2)	(2)
Part VI—Denial of certain tax benefits on international boycotts and bribe-produced income.....					
	(2)	32	70	70	70
Total, title X.....	150	108	182	197	198
TITLE XI					
Amendments affecting DISC					
Sec. 1101—Amendments affecting DISC.....	468	553	559	598	728
TITLE XII					
Administrative provisions					
Sec. 1207—Withholding:					
Withholding of Federal tax on gambling winnings.....	101	68	68	68	68
Withholding of Federal tax on certain individuals engaged in fishing ⁵	-13	-13	-13	-13	-13
Sec. 1212—Abatement of interest when return is prepared for taxpayer by the Internal Revenue Service.....	(2)	(2)	(2)	(2)	(2)
Total.....	88	55	55	55	55
TITLE XIII					
Tax Exempt Organizations					
Sec. 1301—Disposition of private foundation property under transition rules of Tax Reform Act of 1969.....	(2)	(2)			(2)
Sec. 1302—New private foundations set-asides.....	(2)	(2)	(2)	(2)	(2)
Sec. 1303—Minimum distribution amount for private foundations.....	(2)	(2)	(2)	(2)	(2)
Sec. 1304—Extension of time to amend charitable remainder trust governing instrument.....	-5	-5			
Sec. 1305—Unrelated trade or business income of trade shows, State fairs, etc.:					
Charitable organizations not subject to an unrelated business income tax on rental income from trade shows.....	(2)	(2)	(2)	(2)	(2)
County fairs not subject to an unrelated business income tax.....	(2)	(2)	(2)	(2)	(2)
Sec. 1306—Declaratory judgments with respect to section 501(c)(3) status and classification.....					
Sec. 1307—Lobbying by public charities.....	(2)	(2)	(2)	(2)	(2)

See footnotes at end of table.

TABLE 2.—REVENUE EFFECT OF TAX REFORM, ESTATE AND GIFT TAX, AND TAX CUT PROVISIONS¹ OF ACT BY TITLE AND SECTION—Continued

[In millions of dollars; fiscal years]

	1977	1978	1979	1980	1981
TITLE XIII—Continued					
Tax Exempt Organizations					
Sec. 1308—Tax liens, etc., not to constitute acquisition indebtedness.....	(2)	(2)	(2)	(2)	(2)
Sec. 1309—Extension of self-dealing transition rules for private foundations.....	(2)	(2)	(2)	(2)	(2)
Sec. 1310—Imputed interest.....	(2)	(2)	(2)	(2)	(2)
Sec. 1311—Certain hospital services.....	(2)	(2)	(2)	(2)	(2)
Sec. 1312—Clinical services of cooperative hospitals.....	(2)	(2)	(2)	(2)	(2)
Sec. 1313—Exemption of certain amateur athletic organizations from tax.....	(2)	(2)	(2)	(2)	(2)
Total.....	-5	-5	(2)	(2)	(2)
TITLE XIV					
Treatment of Certain Capital Losses; Holding Period for Capital Gains and Losses					
Sec. 1401—Increase in amount of ordinary income against which capital loss may be offset.....	-22	-162	-248	-260	-273
Sec. 1402—Increase in holding period required for capital gain or loss to be long term.....	33	218	377	392	407
Sec. 1403—Allowance of 8-year capital loss carryover in case of regulated investment companies.....	-13	-21	-25	-34	-51
Sec. 1404—Sale of residence by elderly.....	-4	-25	-25	-25	-25
Total.....	-6	10	79	73	58
TITLE XV					
Pension and Insurance Taxation					
Sec. 1501—Retirement savings for certain married individuals.....	-2	-14	-15	-17	-17
Sec. 1502—Limitation on contributions to certain pension, etc., plans.....	(2)	(2)	(2)	(2)	(2)
Sec. 1503—Participation by members of reserves or national guard in individual retirement accounts, etc.....	-6	-5	-5	-5	-5
Participation by certain volunteer firemen in individual retirement accounts, etc.....	(2)	(2)	(2)	(2)	(2)
Sec. 1504—Certain investments by annuity plans.....					
Sec. 1505—Segregated asset accounts.....					
Sec. 1506—Study of salary reduction pension plans.....					
Sec. 1507—Consolidated returns for life and other insurance companies.....					
Sec. 1508—Treatment of certain life insurance contracts guaranteed renewable.....					
Sec. 1509—Study of expanded participation in IRA's.....					
Sec. 1510—Taxable status of Pension Benefit Guaranty Corporation.....					
Sec. 1511—Level premium plans covering owner-employees.....	(2)	(2)	(2)	(2)	(2)
Sec. 1512—Lump-sum distributions from qualified pension, etc., plans.....	-10	-10	-9	-9	-8
Total.....	-18	-29	-29	-31	-30
TITLE XVI					
Real Estate Investment Trusts					
Secs. 1601—1608—Real estate investment trusts.....	(2)	(2)	(2)	(2)	(2)
TITLE XVII					
Railroad and Airline Provisions					
Sec. 1701—Certain provisions relating to railroads.....	-29	-66	-65	-53	-41
Sec. 1702—Amortization over 50-year period of railroad grading and tunnel bores placed in service before 1969.....	-26	-18	-18	-18	-18
Sec. 1703—Certain provisions relating to airlines.....	-32	-55	-35	-27	-21
Total.....	-87	-139	-118	-98	-80

See footnotes at end of table.

TABLE 2.—REVENUE EFFECT OF TAX REFORM, ESTATE AND GIFT TAX, AND TAX CUT PROVISIONS¹ OF ACT BY TITLE AND SECTION—Continued

[In millions of dollars; fiscal years]

	1977	1978	1979	1980	1981
TITLE XVIII					
International Trade Amendments					
Sec. 1801—United States International Trade Commission.....					
Sec. 1802—Trade Act of 1974 Amendments.....					
TITLE XXI					
MISCELLANEOUS PROVISIONS					
Sec. 2101—Tax treatment of certain housing associations.....	(2)	(2)	(2)	(2)	(2)
Sec. 2102—Treatment of certain disaster payments.....	-48	-42	-42	-42	-42
Sec. 2103—Tax treatment of certain 1972 disaster losses.....	-60	-15	-15		
Sec. 2104—Tax treatment of certain debts owned by political parties, etc., to accrual basis taxpayers.....	(2)	(2)	(2)	(2)	(2)
Sec. 2105—Tax-exempt bonds for student loans.....	(2)	(2)	(2)	(2)	(2)
Sec. 2106—Personal holding company income amendments.....	(2)	(2)	(2)	(2)	(2)
Sec. 2107—Work incentive program expenses.....	-3	-7	-11	-14	-9
Sec. 2108—Repeal of excise tax on light-duty truck parts.....	-3	-3	-3	-3	-3
Sec. 2109—Exclusion from excise tax on certain articles resold after modification.....	(2)	(2)	(2)	(2)	(2)
Sec. 2110—Franchise transfers.....	(2)	(2)	(2)	(2)	(2)
Sec. 2111—Employers' duties in connection with the recording and reporting of tips.....	(2)	(2)			
Sec. 2112—Treatment of certain pollution control facilities.....	59	102	18	-70	-160
Sec. 2113—Clarification of status of certain fishermen's organizations.....	(2)	(2)	(2)	(2)	(2)
Sec. 2114—Application of section 6013 (e) of the Internal Revenue Code of 1954.....	(2)	(2)			
Sec. 2115—Amendments to rules relating to limitation on percentage depletion in case of oil and gas wells.....	-24	-10	-10	-10	-10
Transfers of oil and gas property within the same controlled group or family.....	(2)	(2)	(2)	(2)	(2)
Sec. 2116—Implementation of Federal-State Tax Collection Act of 1972.....					
Sec. 2117—Cancellation of certain student loans.....	(2)	(2)	(2)	(2)	(2)
Sec. 2118—Treatment of gain or loss on sales or exchanges in connection with simultaneous liquidation of a parent and subsidiary corporation.....	(2)	(2)	(2)	(2)	(2)
Sec. 2119—Regulations relating to tax treatment of certain pre-publication expenditures of publishers.....					
Sec. 2120—Contributions in aid of construction for certain utilities.....	-16	-11	-11	-11	-11
Sec. 2121—Prohibition of discriminatory State taxes on production and consumption of electricity.....					
Sec. 2122—Allowance of deduction for eliminating architectural and transportation barriers for the handicapped.....	-4	-10	-10	-6	
Sec. 2123—High-income taxpayer report.....					
Sec. 2124—Tax incentives to encourage the preservation of historic structures.....	-1	-3	-8	-12	-16
Sec. 2125—Amendment to Supplemental Security Income program.....					
Sec. 2126—Extension of carryover period for Cuban expropriation losses.....	(2)	(2)	(2)	(2)	(2)
Sec. 2127—Outdoor advertising displays.....	-7	-7	-7	-7	-7
Sec. 2128—Tax treatment of large cigars.....					
Sec. 2129—Treatment of gain from sales or exchanges between related parties.....	(2)	(2)	(2)	(2)	(2)
Sec. 2130—Application of section 117 to certain education programs for members of the uniformed services ²	-10	-8	-8	-2	
Sec. 2131—Exchange funds.....	(2)	(2)	(2)	(2)	(2)
Sec. 2132—Contributions of certain Government publications.....	(2)	(2)	(2)	(2)	(2)
Sec. 2133—Tax incentives study.....					
Sec. 2134—Prepaid legal expenses.....	-5	-8	-16	-21	-33
Sec. 2135—Special rule for certain charitable contributions of inventory and other property.....	-19	-22	-22	-24	-24
Sec. 2136—Tax treatment of the grantor of options of stock, securities, and commodities.....	3	10	10	10	10
Sec. 2137—Exempt-interest dividends of regulated investment companies.....	(2)	(2)	(2)	(2)	(2)
Sec. 2138—Common trust fund treatment of certain custodial accounts.....					
Sec. 2139—Support test for dependent children of divorced, etc., parents.....					
Sec. 2140—Involuntary conversions of real property.....	(2)	(2)	(2)	(2)	(2)
Sec. 2141—Livestock sold on account of drought.....	-20	20			
Total.....	-158	-14	-135	-212	-305
Total for Part I, Tax Reform.....	1,593	1,719	2,038	2,118	2,470

See footnotes at end of table.

TABLE 2.—REVENUE EFFECT OF TAX REFORM, ESTATE AND GIFT TAX, AND TAX CUT PROVISIONS ¹ OF ACT BY TITLE AND SECTION—Continued

[In millions of dollars; fiscal years]

	1977	1978	1979	1980	1981
PART II. ESTATE AND GIFT TAX					
TITLE XX					
Estate and Gift Taxes ⁷					
Unified rates and credit.....		-541	-756	-1,012	-1,380
Marital deduction.....		-153	-162	-171	-181
Valuation.....		-14	-15	-16	-17
Extension of time.....		-20	-24	-28	-33
Unification.....	(*)	(*)	(*)	(*)	(*)
Generation skipping.....				(*)	(*)
Carryover of basis.....	(*)	(*)	36	93	162
Total.....		-728	-921	-1,134	-1,449
PART III. EXTENSION OF TAX REDUCTIONS					
TITLE IV					
Extension of Individual Income Tax Reductions					
Sec. 401—Extensions of individual income tax reductions:					
(a) General tax credit.....	-9,509	-3,462			
(b) Standard deduction.....	-4,146	-4,481	-4,506	-4,731	-4,968
(c) Earned income credit.....	-695	-1,350			
Sec. 402—Refunds of earned income credit disregarded in the administration of Federal programs and federally assisted programs.....					
Total.....	-14,350	-9,293	-4,506	-4,731	-4,968
TITLE VIII					
Capital Formation					
Sec. 801—Extension of \$100,000 limitation on used property for the investment credit.....	-38	-142	-149	-156	-118
Sec. 802—Extension of 10-percent investment credit.....	-1,262	-3,164	-3,311	-3,461	-2,126
Total.....	-1,300	-3,306	-3,460	-3,617	-2,244
TITLE IX					
Small Business Provisions					
Sec. 901—Extension of certain corporate income tax rate reductions.....	-1,676	-1,177			
Total for Part III, Extension of Tax Reductions.....	-17,326	-13,776	-7,966	-8,348	-7,212
Grand total, Parts I, II, and III.....	-15,733	-12,785	-6,849	-7,364	-6,191

¹ This table has omitted Title I—Short Title and Title XIX—Repeal and Revision of Obsolete, Rarely Used, Etc., Provisions.

² Less than \$5,000,000.

³ The revenue impact of this provision will not be very great; its magnitude, however, is not determinable because of lack of information regarding the practices of the State legislators during the period covered by the provision.

⁴ Reflects liability of prior years.

⁵ It is estimated that this provision will decrease budget receipts by \$65,000,000 in the aggregate over the next 5 fiscal years.

⁶ There is also an estimated \$2,000,000 decrease in budget receipts for fiscal year 1976 under this provision.

⁷ The long-run estimates are as follows: unified rates and credit, \$-1.23 billion; marital deduction, -\$153 million; valuation, -\$14 million; extension of time, less than \$500,000; unification, \$300 million; generation skipping, \$280 million; carryover of basis, \$1.08 billion; and total, \$263 million.

