[JOINT COMMITTEE PRINT]

EXPLANATION OF THE TAX TECHNICAL CORRECTIONS ACT OF 1995 (H.R. 1121)

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides an explanation of the provisions of the "Tax Technical Corrections Act of 1995" (H.R. 1121), introduced by House Committee on Ways and Means Chairman Archer and Mr. Gibbons on March 3, 1995.

The bill provides technical corrections to recent tax legislation, including the Revenue Reconciliation Act of 1990 ("1990 Act"), the Revenue Reconciliation Act of 1993 ("1993 Act"), and other recent tax legislation.

The amendments made by the bill are intended to correct, clarify, or conform various provisions in recently enacted revenue legislation. Provisions in the bill are generally effective as if included in the original legislation, unless otherwise specified. Provisions in the bill for which no descriptions are provided are clerical in nature.

Except for three provisions, the provisions of H.R. 1121 were included in Title X of H.R. 3419 ("Tax Simplification and Technical Corrections Act of 1993", 103rd Cong.) as reported by the House Committee on Ways and Means on November 10, 1993,[2] and as passed by the House of Representatives on May 17, 1994. In addition, H.R. 1121 differs from H.R. 3419 in that new clerical changes were added, several obsolete provisions were deleted, and several effective dates were changed to reflect the passage of time. The tax technical corrections provisions of H.R. 3419 were derived from H.R. 17 ("Technical Corrections Act of 1993", 103rd Cong.).[3] H.R. 17 and H.R. 3419 also included some nontax technical corrections, which are not included in H.R. 1121.

The three new technical provisions in H.R. 1121 are as follows: (1) clarify that a U.S. shareholder's inclusion of a controlled foreign corporation's earnings invested in excess passive assets is treated like a dividend for purposes of the foreign tax credit limitation (sec. 3(i)(1) of the bill); (2) provide that the exclusion from income for a taxpayer's investment in an annuity contract applies to the taxpayer's entire investment in the contract in the case of an annuity contract with refund feature (sec. 4(m) of the bill); and (3) provide an inflation adjustment of the dollar amount where a parent elects to include a child's unearned income on the parent's return (sec. 4(n) of the bill).

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of the Tax Technical Corrections Act of 1995 (H.R. 1121)* (JCS-6-95), March 8, 1995.
[2] H. Rept. 103-353.
[3] For a description of H.R. 17, see Joint Committee on Taxation, *Explanation of the Technical Corrections Act of 1993 (H.R. 17)* (JCS-2-93), January 8, 1993.

EXPLANATION OF THE BILL

A. Technical Corrections to the Revenue Reconciliation Act of 1990

1. Individual income tax provision: Correction of head of household rate table for proper indexation (sec. 2(a)(3) of the bill and sec. 1(b) of the Code)

Present Law

A separate rate schedule is provided for individuals that are heads of households. The dollar amounts in the schedule are adjusted for inflation.

Explanation of Provision

The bill modifies the rate schedule for individuals that are heads of households to correct a transposition error made in the 1990 Act.

2. Excise tax provisions

a. Application of the 2.5-cents-per-gallon tax on fuel used in rail transportation to States and local governments (sec. 2(b)(2) of the bill, sec. 11211(b)(4) of the 1990 Act, and sec. 4093 of the Code)

Present Law

The 1990 Act increased the highway and motorboat fuels taxes by 5 cents per gallon, effective on December 1, 1990. The 1990 Act continued the exemption from these taxes for fuels used by States and local governments.

The 1990 Act also imposed a 2.5-cents-per-gallon tax on fuel used in rail transportation, also effective on December 1, 1990. Because of a drafting error in the 1990 Act, the 2.5-cents-per-gallon tax on fuel used in rail transportation incorrectly applies to States and local governments.

Explanation of Provision

The bill clarifies that the 2.5-cents-per-gallon tax on fuel used in rail transportation does not apply to such uses by States and local governments.

b. Small winery production credit and bonding requirements (secs. 2(b)(5), (6), and (7) of the bill, sec. 11201 of the 1990 Act, and sec. 5041 of the Code)

Present Law

A 90-cents-per-gallon credit is allowed to wine producers who produce no more than 250,000 gallons of wine in a year. The credit may be claimed against the producers' excise or income taxes.

Wine producers must post a bond in amounts determined by reference to expected excise tax liability as a condition of legally operating.

Explanation of Provision

The bill clarifies that wine produced by eligible small wineries may be transferred without payment of tax to bonded warehouses that become liable for payment of the wine excise tax without losing credit eligibility. In such cases, the bonded warehouse will be eligible for the credit to the same extent as the producer otherwise would have been.

The bill further clarifies that the Treasury Department has broad regulatory authority to prevent the benefit of the credit from accruing (directly or indirectly) to wineries producing in excess of 250,000 gallons in a calendar year.

It is intended that the Treasury regulatory authority extends to all circumstances in which wine production is increased with a purpose of securing indirect credit eligibility for wine produced by such large producers.

The bill also clarifies that the Treasury Department may take the amount of credit expected to be claimed against a producer's wine excise tax liability into account in determining the amount of required bond.

3. Other revenue-increase provisions of the 1990 Act

a. Deposits of Railroad Retirement Tax Act taxes (sec. 2(c)(3) of the bill, sec. 11334 of the 1990 Act, and sec. 6302(g) of the Code)

Present Law

Employers must deposit income taxes withheld from employees' wages and FICA taxes that are equal to or greater than $100,000 by the close of the next banking day. Under the Railroad Retirement Solvency Act of 1983, the deposit rules for withheld income taxes and FICA taxes automatically apply to Railroad Retirement Tax Act taxes (sec. 226 of P.L. 98–76).

Explanation of Provision

The bill conforms the Internal Revenue Code to the Railroad Retirement Solvency Act of 1983 by stating in the Code that these deposit rules for withheld income taxes and FICA taxes apply to Railroad Retirement Tax Act taxes.

rectly or indirectly with certain foreign persons treated as related to the domestic corporation ("reportable transactions") (sec. 6038A(a)). In addition, the Code provides procedures whereby an IRS examination request or summons with respect to reportable transactions can be served on foreign related persons through the domestic corporation (sec. 6038A(e)). Similar provisions apply to any foreign corporation engaged in a trade or business within the United States, with respect to information, records, examination requests, and summonses pertaining to the computation of its liability for tax in the United States (sec. 6038C). Certain noncompliance rules may be applied by the Internal Revenue Service in the case of the failure by a domestic corporation to comply with a summons pertaining to a reportable transaction (a "6038A summons") (sec. 6038A(e)), or the failure by a foreign corporation engaged in a U.S. trade or business to comply with a summons issued for purposes of determining the foreign corporation's liability for tax in the United States (a "6038C summons") (sec. 6038C(d)).

Any corporation that is subject to the provisions of section 6038A or 6038C has the right to petition a Federal district court to quash a 6038A or 6038C summons, or to review a determination by the IRS that the corporation did not substantially comply in a timely manner with the 6038A or 6038C summons (sec. 6038A(e)(4)(A) and (B); sec. 6038C(d)(4)). During the period that either such judicial proceeding is pending (including appeals), and for up to 90 days thereafter, the statute of limitations is suspended with respect to any transaction (or item, in the case of a foreign corporation) to which the summons relates (secs. 6038A(e)(4)(D), 6038C(d)(4)).

The legislative history of the 1989 Act amendments to section 6038A states that the suspension of the statute of limitations applies to "the taxable year(s) at issue."[4] The legislative history of the 1990 Act, which added section 6038C to the Code, uses the same language.[5]

Explanation of Provision

The bill modifies the provisions in sections 6038A and 6038C that suspend the statute of limitations to clarify that the suspension applies to any taxable year the determination of the amount of tax imposed for which is affected by the transaction or item to which the summons relates.

It is intended that, under the provision, a transaction or item would affect the determination of the amount of tax imposed for the taxable year directly at issue, as well as for any taxable year indirectly affected through, for example, net operating loss carrybacks or carryforwards. It is not intended that, under the provision, a transaction or item would affect the determination of the amount of tax imposed for any taxable year other than the taxable year directly at issue solely by reason of any similarity of issues

[4] H. Rept. No. 247, 101st Cong., 1st Sess. 1301 (1989); "Explanation of Provisions Approved by the Committee on October 3, 1989," Senate Finance Committee Print, 101st Cong., 1st Sess. 118 (October 12, 1989).

[5] "Legislative History of Ways and Means Democratic Alternative," House Ways and Means Committee Print (WMCP: 101-37), 101st Cong., 2nd Sess. 58 (October 15, 1990); Report language submitted by the Senate Finance Committee to the Senate Budget Committee on S. 3299, 136 Cong. Rec. S 15629, S 15700 (1990).

b. Treatment of salvage and subrogation of property and casualty insurance companies (sec. 2(c)(4) of the bill and sec. 11305 of the 1990 Act)

Present Law

For taxable years beginning after December 31, 1989, property and casualty insurance companies are required to reduce the deduction allowed for losses incurred (both paid and unpaid) by estimated recoveries of salvage and subrogation attributable to such losses. In the case of any property and casualty insurance company that took into account estimated salvage and subrogation recoverable in determining losses incurred for its last taxable year beginning before January 1, 1990, 87 percent of the discounted amount of the estimated salvage and subrogation recoverable as of the close of the last taxable year beginning before January 1, 1990, is allowed as a deduction ratably over the first 4 taxable years beginning after December 31, 1989. This special deduction was enacted in order to provide such property and casualty insurance companies with substantially the same Federal income tax treatment as that provided to those property and casualty insurance companies that prior to the Revenue Reconciliation Act of 1990 did not take into account estimated salvage and subrogation recoverable in determining losses incurred.

Explanation of Provision

The bill provides that the earnings and profits of any property and casualty insurance company that took into account estimated salvage and subrogation recoverable in determining losses incurred for its last taxable year beginning before January 1, 1990, is to be determined without regard to the special deduction that is allowed over the first 4 taxable years beginning after December 31, 1989. The special deduction is to be taken into account, however, in determining earnings and profits for purposes of applying sections 56, 902, and subpart F of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1986. This provision is considered necessary in order to provide those property and casualty insurance companies that took into account estimated salvage and subrogation recoverable in determining losses incurred with substantially the same Federal income tax treatment as that provided to those property and casualty insurance companies that prior to the 1990 Act did not take into account estimated salvage and subrogation recoverable in determining losses incurred.

c. Information with respect to certain foreign-owned or foreign corporations: Suspension of the statute of limitations during certain judicial proceedings (sec. 2(c)(5) of the bill, secs. 11314 and 11315 of the 1990 Act, and secs. 6038A and 6038C of the Code)

Present Law

Any domestic corporation that is 25-percent owned by one foreign person is subject to certain information reporting and recordkeeping requirements with respect to transactions carried out diinvolved. Similarly, it is not intended that, under the provision, a transaction or item would affect the determination of the amount of tax imposed on any taxpayer unrelated to the taxpayer to whom the summons is directed.

d. Rate of interest for large corporate underpayments (secs. 2(c)(6) and (7) of the bill, sec. 11341 of the 1990 Act, and sec. 6621(c) of the Code)

Present Law

The rate of interest otherwise applicable to underpayments of tax is increased by two percent in the case of large corporate underpayments (generally defined to exceed $100,000), applicable to periods after the 30th day following the earlier of a notice of proposed deficiency, the furnishing of a statutory notice of deficiency, or an assessment notice issued in connection with a nondeficiency procedure.

Explanation of Provision

The bill provides that an IRS notice that is later withdrawn because it was issued in error does not trigger the higher rate of interest. The bill also corrects an incorrect reference to "this subtitle".

4. Research credit provision: Effective date for repeal of special proration rule (sec. 2(d)(1) of the bill and sec. 11402 of the 1990 Act)

Present Law

The Omnibus Budget Reconciliation Act of 1989 ("1989 Act") effectively extended the research credit for nine months by prorating certain qualified research expenses incurred before January 1, 1991. The special rule to prorate qualified research expenses applied in the case of any taxable year which began before October 1, 1990, and ended after September 30, 1990. Under this special proration rule, the amount of qualified research expenses incurred by a taxpayer prior to January 1, 1991, was multiplied by the ratio that the number of days in that taxable year before October 1, 1990, bears to the total number of days in such taxable year before January 1, 1991. The amendments made by the 1989 Act to the research credit (including the new method for calculating a taxpayer's base amount) generally were effective for taxable years beginning after December 31, 1989. However, this effective date did not apply to the special proration rule (which applied to any taxable year which began prior to October 1, 1990—including some years which began before December 31, 1989—if such taxable year ended after September 30, 1990).

Section 11402 of the Revenue Reconciliation Act of 1990 ("1990 Act") extended the research credit through December 31, 1991, and repealed the special proration rule provided for by the 1989 Act. Section 11402 of the 1990 Act was effective for taxable years beginning after December 31, 1989. Thus, in the case of taxable years beginning before December 31, 1989, and ending after September 30, 1990 (e.g., a taxable year of November 1, 1989 through October

31, 1990), the special proration rule provided by the 1989 Act would continue to apply.

Explanation of Provision

The bill repeals for all taxable years ending after December 31, 1989, the special proration rule provided for by the 1989 Act.

5. Energy tax provision: Alternative minimum tax adjustment based on energy preferences (secs. 2(e)(1) and (4) of the bill, sec. 11531(a) of the 1990 Act, and former sec. 56(h) of the Code)

Present Law

In computing alternative minimum taxable income (and the adjusted current earnings (ACE) adjustment of the alternative minimum tax), certain adjustments are made to the taxpayer's regular tax treatment for intangible drilling costs (IDCs) and depletion. For certain taxable years, a special energy deduction is also allowed. The special energy deduction is initially determined by determining the taxpayer's (1) intangible drilling cost preference and (2) the marginal production depletion preference. The intangible drilling cost preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to the adjustments for IDCs. The marginal production depletion preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to depletion adjustments attributable to marginal production. The intangible drilling cost preference is then apportioned between (1) the portion of the preference related to qualified exploratory costs and (2) the remaining portion of the preference. The portion of the preference related to qualified exploratory costs is multiplied by 75 percent and the remaining portion is multiplied by 15 percent. The marginal production depletion preference is multiplied by 50 percent. The three products described above are added together to arrive at the taxpayer's special energy deduction (subject to certain limitations).

The special energy deduction is not allowed to the extent that it exceeds 40 percent of alternative minimum taxable income determined without regard to either this special energy deduction or the alternative tax net operating loss deduction. Any special energy deduction amount limited by the 40-percent threshold may not be carried to another taxable year. In addition, the combination of the special energy deduction, the alternative minimum tax net operating loss and the alternative minimum tax foreign tax credit cannot generally offset, in the aggregate, more than 90 percent of a taxpayer's alternative minimum tax determined without such attributes.

The special energy deduction was repealed for taxable years beginning after December 31, 1992.

Explanation of Provision

Interaction of special energy deduction with net operating loss and investment tax credit

The bill clarifies that the amount of alternative tax net operating loss that is utilized in any taxable year is to be appropriately adjusted to take into account the amount of special energy deduction claimed for that year. This operates to preserve a portion of the alternative tax net operating loss carryover by reducing the amount of net operating loss utilized to the extent of the special energy deduction claimed, which if unused, could not be carried forward.

In addition, the bill contains a similar provision which clarifies that the limitation on the utilization of the investment tax credit for purposes of the alternative minimum tax is to be determined without regard to the special energy deduction.

Interaction of special energy deduction with adjustment based on adjusted current earnings

The bill provides that the ACE adjustment for taxable years beginning in 1991 and 1992 is to be computed without regard to the special energy deduction. Thus, the bill specifies that the ACE adjustment is equal to 75 percent of the excess of a corporation's adjusted current earnings over its alternative minimum taxable income computed without regard to either the ACE adjustment, the alternative tax net operating loss deduction, or the special energy deduction.

6. Estate tax freezes (sec. 2(f) of the bill, sec. 11602 of the 1990 Act, and secs. 2701–2704 of the Code)

Present Law

Generally

The value of property transferred by gift or includible in the decedent's gross estate is its fair market value. Fair market value is generally the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts (Treas. Reg. sec. 20.2031). Chapter 14 contains rules that supersede the willing buyer, willing seller standard (Code secs. 2701–2704).

Preferred interests in corporations and partnerships

Valuation of retained interests

Scope.—Section 2701 provides special rules for valuing certain rights retained in conjunction with the transfer to a family member of an interest in a corporation or partnership. These rules apply to any applicable retained interest held by the transferor or an applicable family member immediately after the transfer of an interest in such entity. An "applicable family member" is, with respect to any transferor, the transferor's spouse, ancestors of the transferor and the spouse, and spouses of such ancestors.

An applicable retained interest is an interest with respect to which there is one of two types of rights ("affected rights"). The first type of affected right is a liquidation, put, call, or conversion right, generally defined as any liquidation, put, call, or conversion right, or similar right, the exercise or nonexercise of which affects the value of the transferred interest. The second type of affected right is a distribution right[6] in an entity in which the transferor and applicable family members hold control immediately before the transfer. In determining control, an individual is treated as holding any interest held by the individual's brothers, sisters and lineal descendants. A distribution right does not include any right with respect to a junior equity interest.

Valuation.—Section 2701 contains two rules for valuing applicable retained interests. Under the first rule, an affected right other than a right to qualified payments is valued at zero. Under the second rule any retained interest that confers (1) a liquidation, put, call or conversion right and (2) a distribution right that consists of the right to receive a qualified payment is valued on the assumption that each right is exercised in a manner resulting in the lowest value for all such rights (the "lowest value rule"). There is no statutory rule governing the treatment of an applicable retained interest that confers a right to receive a qualified payment, but with respect to which there is no liquidation, put, call or conversion right.

A qualified payment is a dividend payable on a periodic basis and at a fixed rate under cumulative preferred stock (or a comparable payment under a partnership agreement). A transferor or applicable family member may elect not to treat such a dividend (or comparable payment) as a qualified payment. A transferor or applicable family member also may elect to treat any other distribution right as a qualified payment to be paid in the amounts and at the times specified in the election.

Inclusion in transfer tax base.—Failure to make a qualified payment valued under the lowest value rule within four years of its due date generally results in an inclusion in the transfer tax base equal to the difference between the compounded value of the scheduled payments over the compounded value of the payments actually made. The Treasury Department has regulatory authority to make subsequent transfer tax adjustments in the transfer of an applicable retained interest to reflect the increase in a prior taxable gift by reason of section 2701.

Generally, this inclusion occurs if the holder transfers by sale or gift the applicable retained interest during life or at death. In addition, the taxpayer may, by election, treat the payment of the qualified payment as giving rise to an inclusion with respect to prior periods.

The inclusion continues to apply if the applicable retained interest is transferred to an applicable family member. There is no inclusion on a transfer of an applicable retained interest to a spouse for consideration or in a transaction qualifying for the marital deduction but subsequent transfers by the spouse are subject to the inclusion. Other transfers to applicable family members result in

[6] Distribution right generally is a right to a distribution from a corporation with respect to its stock, or from a partnership with respect to a partner's interest in the partnership.

an immediate inclusion as well as subjecting the transferee to subsequent inclusions.

Minimum value of residual interest

Section 2701 also establishes a minimum value for a junior equity interest in a corporation or partnership. For partnerships, a junior equity interest is an interest under which the rights to income and capital are junior to the rights of all other classes of equity interests.

Trusts and term interests in property

The value of a transfer in trust is the value of the entire property less the value of rights in the property retained by the grantor. Section 2702 provides that in determining the extent to which a transfer of an interest in trust to a member of the transferor's family is a gift, the value of an interest retained by the transferor or an applicable family member is zero unless such interest takes certain prescribed forms.

For a transfer with respect to a specified portion of property, section 2702 applies only to such portion. The section does not apply to the extent that the transfer is incomplete.

Options and buy-sell agreements

A restriction upon the sale or transfer of property may reduce its fair market value. Treasury regulations provide that a restriction is to be disregarded unless the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than full and adequate consideration (Treas. Reg. sec. 20.2031–2(h)).

Section 2703 provides that for transfer tax purposes the value of property is determined without regard to any option, agreement or other right to acquire or use the property at less than fair market value or any restriction on the right to sell or use such property. Certain options are excepted from this rule. To fall within the exception, the option, agreement, right or restriction must (1) be a bona fide business arrangement, (2) not be a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth, and (3) have terms comparable to similar arrangements entered into by persons in an arm's length transaction.

Explanation of Provision

Preferred interests in corporations and partnerships

Valuation

The bill provides that an applicable retained interest conferring a distribution right to qualified payments with respect to which there is no liquidation, put, call, or conversion right is valued without regard to section 2701. The bill also provides that the retention of such right gives rise to potential inclusion in the transfer tax base. In making these changes, it is understood that Treasury regulations could provide, in appropriate circumstances, that a right to receive amounts on liquidation of the corporation or partnership constitutes a liquidation right within the meaning of section 2701 if the transferor, alone or with others, holds the right to cause liquidation.

The bill modifies the definition of junior equity interest by granting regulatory authority to treat a partnership interest with rights that are junior with respect to either income or capital as a junior equity interest. The bill also modifies the definition of distribution right by replacing the junior equity interest exception with an exception for a right under an interest that is junior to the rights of the transferred interest. As a result, section 2701 does not affect the valuation of a transferred interest that is senior to the retained interest, even if the retained interest is not a junior equity interest.

The bill modifies the rules for electing into or out of qualified payment treatment. A dividend payable on a periodic basis and at a fixed rate under a cumulative preferred stock held by the transferor is treated as a qualified payment unless the transferor elects otherwise. If held by an applicable family member, such stock is not treated as a qualified payment unless the holder so elects.[7] In addition, a transferor or applicable family member holding any other distribution right may treat such right as a qualified payment to be paid in the amounts and at the times specified in the election.

Inclusion in transfer tax base

The bill grants the Treasury Department regulatory authority to make subsequent transfer tax adjustments to reflect the inclusion of unpaid amounts with respect to a qualified payment. This authority, for example, would permit the Treasury Department to eliminate the double taxation that might occur if, with respect to a transfer, both the inclusion and the value of qualified payment arrearages were included in the transfer tax base. It would also permit elimination of the double taxation that might result from a transfer to a spouse, who, under the statute, is both an applicable family member and a member of the transferor's family.

The bill treats a transfer to a spouse falling under the annual exclusion the same as a transfer qualifying for the marital deduction. Thus, no inclusion would occur upon the transfer of an applicable retained interest to a spouse, but subsequent transfers by the spouse would be subject to inclusion. The bill also clarifies that the inclusion continues to apply if an applicable family member transfers a right to qualified payments to the transferor.

The provision clarifies the consequences of electing to treat a distribution as giving rise to an inclusion. Under the bill, the election gives rise to an inclusion only with respect to the payment for which the election is made. The inclusion with respect to other payments is unaffected.

Trust and term interests in property

The bill conforms section 2702 to existing regulatory terminology by substituting the term "incomplete gift" for "incomplete transfer." In addition, the bill limits the exception for incomplete gifts to instances in which the entire gift is incomplete. The Treasury De-

[7] With respect to gifts made in 1990, the provision provides that this election may be made by the due date (including extensions) of the transferor's gift tax return due for the first calendar year after the date of enactment.

partment is granted regulatory authority, however, to create additional exceptions not inconsistent with the purposes of the section. This authority, for example, could be used to except a charitable trust that meets the requirements of section 664 and that does not otherwise create an opportunity for transferring property to a family member free of transfer tax.

7. Miscellaneous provisions

a. Conforming amendments to the repeal of the *General Utilities* doctrine (secs. 2(g)(1) and (2) of the bill, sec. 11702(e)(2) of the 1990 Act, and secs. 897(f) and 1248 of the Code)

Present Law

As a result of changes made by recent tax legislation, gain is generally recognized on the distribution of appreciated property by a corporation to its shareholders. The Technical Corrections subtitle of the 1990 Act and technical correction provisions in prior acts made various conforming amendments arising out of these changes. For example, the 1990 Act made a conforming change to section 355(c) to state the treatment of distributions in section 355 transactions in the affirmative rather than by reference to the provisions of section 311. In addition, the Technical and Miscellaneous Revenue Act of 1988 ("1988 Act") made a conforming change to section 1248(f) to update the references to the nonrecognition provisions contained in that subsection. One of the changes was to change the reference to "section 311(a)" from "section 311".

Explanation of Provision

The bill makes three conforming changes to the Code with respect to the repeal of the *General Utilities* doctrine.

First, section 1248(f) is amended to add a reference to section 355(c)(1), which provides generally for the nonrecognition of gain or loss on the distribution of stock or securities in certain subsidiary corporations. This retains the substance of the law as it existed before the conforming change to section 355(c) made by the 1990 Act. This provision is not intended to affect the authority of the Secretary of the Treasury to issue regulations under section 1248(f) providing exceptions to the rule recognizing gain in certain distributions (cf. Notice 87-64, 1987-2 C.B. 375).

Second, section 1248 is amended to clarify that, notwithstanding the conforming changes made by the 1988 Act, with respect to any transaction in which a U.S. person is treated as realizing gain from the sale or exchange of stock of a controlled foreign corporation, the U.S. person shall be treated as having sold or exchanged the stock for purposes of applying section 1248. Thus, if a U.S. person distributes appreciated stock of a controlled foreign corporation to its shareholders in a transaction in which gain is recognized under section 311(b), section 1248 shall be applied as if the stock had been sold or exchanged at its fair market value. Under section 1248(a), part or all of the gain may be treated as a dividend. Under the bill, the rule treating the distribution for purposes of section 1248 as a sale or exchange also applies where the U.S. person is deemed to distribute the stock under the provisions of section 1248(i). Under section 1248(i), gain will be recognized only to the extent of the amount treated as a dividend under section 1248.

Third, section 897(f), relating to the basis in a United States real property interest distributed to a foreign person, is repealed as deadwood. The basis of the distributed property is its fair market value in accordance with section 301(d).

b. Prohibited transaction rules (sec. 2(g)(3) of the bill, sec. 11701(m) of the 1990 Act, and sec. 4975 of the Code)

Present Law

The Code and title I of the Employee Retirement Income Security Act of 1974 (ERISA) prohibit certain transactions between an employee benefit plan and certain persons related to such plan. An exemption to the prohibited transaction rules of title I of ERISA is provided in the case of sales of employer securities the plan is required to dispose of under the Pension Protection Act of 1987 (ERISA sec. 408(b)(12)). The 1990 Act amended the Code to provide that certain transactions that are exempt from the prohibited transaction rules of ERISA are automatically exempt from the prohibited transaction rules of the Code. The 1990 Act change was intended to be limited to transactions exempt under section 408(b)(12) of ERISA.

Explanation of Provision

The bill conforms the statutory language to legislative intent by providing that transactions that are exempt from the prohibited transaction rules of ERISA by reason of ERISA section 408(b)(12) are also exempt from the prohibited transaction rules of the Code.

c. Effective date of LIFO adjustment for purposes of computing adjusted current earnings (sec. 2(g)(4) of the bill, sec. 11701 of the 1990 Act, sec. 7611(b) of the 1989 Act, and sec. 56(g) of the Code)

Present Law

For purposes of computing the adjusted current earnings (ACE) component of the corporate alternative minimum tax, taxpayers are required to make the LIFO inventory adjustments provided in section 312(n)(4) of the Code. Section 312(n)(4) generally is applicable for purposes of computing earnings and profits in taxable years beginning after September 30, 1984. The ACE adjustment generally is applicable to taxable years beginning after December 31, 1989.

Explanation of Provision

The bill clarifies that the LIFO inventory adjustment required for ACE purposes shall be computed by applying the rules of section 312(n)(4) only with respect to taxable years beginning after December 31, 1989. The effective date applicable to the determination of earnings and profits (September 30, 1984) is inapplicable for purposes of the ACE LIFO inventory adjustment. Thus, the ACE

LIFO adjustment shall be computed with reference to increases (and decreases, to the extent provided in Treasury regulations) in the ACE LIFO reserve in taxable years beginning after December 31, 1989.

d. Low-income housing credit (sec. 2(g)(5) of the bill, sec. 11701(a)(11) of the 1990 Act, and sec. 42 of the Code)

Present Law

The amendments to the low-income housing tax credit contained in the Omnibus Budget Reconciliation Act of 1989 ("1989 Act") generally were effective for a building placed in service after December 31, 1989, to the extent the building was financed by tax-exempt bonds ("a bond-financed building"). This rule applied regardless of when the bonds were issued.

A technical correction enacted in the Revenue Reconciliation Act of 1990 ("1990 Act") limited this effective date to buildings financed with bonds issued after December 31, 1989. Thus, the technical correction applied pre-1989 Act law to a bond-financed building placed in service after December 31, 1989, if the bonds were issued before January 1, 1990.

Explanation of Provision

The bill repeals the 1990 technical correction. The bill provides, however, that pre-1989 Act law will apply to a bond-financed building if the owner of the building establishes to the satisfaction of the Secretary of the Treasury reasonable reliance upon the 1990 technical correction. In the case of buildings placed in service before the date of the bill's enactment, reasonable reliance may be established by a showing of compliance with the law as in effect for those buildings before enactment of the amendments made by the bill.

8. Expired or obsolete provisions ("deadwood provisions") (secs. 2(h)(1)–(19) of the bill and secs. 11801–11816 of the 1990 Act)

Present Law

The 1990 Act repealed and amended numerous sections of the Code by deleting obsolete provisions ("deadwood"). These amendments were not intended to make substantive changes to the tax law.

Explanation of Provision

The bill makes several amendments to restore the substance of prior law which was inadvertently changed by the deadwood provisions of the 1990 Act. These amendments include (1) a provision restoring the prior-law depreciation treatment of certain energy property (sec. 168(e)(3)(B)(vi)); (2) a provision restoring the prior-law definition of property eligible for expensing (sec. 179(d)); and (3) a provision restoring the prior-law rule providing that if any member of an affiliated group of corporations elects the credit under section 901 for foreign taxes paid or accrued, then all members of the group paying or accruing such taxes must elect the credit in order for any dividend paid by a member of the group to qualify for the 100-percent dividends received deduction (sec. 243(b)).

The bill also makes several nonsubstantive clerical amendments to conform the Code to the amendments made by the deadwood provisions. None of these amendments is intended to change the substance of pre-1990 law.

B. Technical Corrections to the Revenue Reconciliation Act of 1993

1. Treatment of full-time students under the low-income housing credit (sec. 3(b) of the bill, sec. 13142 of the 1993 Act and sec. 42 of the Code).

Present Law

The Revenue Reconciliation Act of 1993 ("1993 Act") codified prior law rules relating to the treatment of married students filing joint returns. Further, it provided that a housing unit occupied entirely by full-time students may qualify for the credit if the full-time students are a single parent and his or her minor children and none of the tenants is a dependent of a third party.

Explanation of Provision

The bill provides that the full-time student provision is effective on the date of enactment of the 1993 Act.

2. Indexation of threshold applicable to excise tax on luxury automobiles (sec. 3(c) of the bill, sec. 13161 of the 1993 Act, and sec. 4001(e)(1) of the Code)

Present Law

The 1993 Act indexed the threshold above which the excise tax on luxury automobiles is to apply.

Explanation of Provision

The bill corrects the application of the indexing adjustment so that the adjustment calculated for a given calendar year applies for that calendar year rather than in the subsequent calendar year. This conforms the indexation to that described in the conference report to the 1993 Act.[8] The intent of Congress, as reflected in the conference report, was that current year indexation be effective on the date of enactment of the 1993 Act. Under the bill, the provision would, however, be effective on the date of enactment, to alleviate the difficulties that both taxpayers and the Treasury would experience in administering a retroactive refund effective to August 10, 1993.

[8] See, H. Rept. 103–213, August 4, 1993, p. 558.

3. Indexation of the limitation based on modified adjusted gross income for income from United States savings bonds used to pay higher education tuition and fees (sec. 3(d) of the bill, sec. 13201 of the 1993 Act, and sec. 135(b)(2)(B) of the Code)

Present Law

A taxpayer may exclude from gross income the proceeds from the redemption of qualified United States savings bonds if the proceeds are used to pay qualified higher education expenses and the taxpayer's modified adjusted gross income is equal to or less than $60,000 ($40,000 in the case of a single return). The exclusion is phased out for incomes above these thresholds. The $60,000 ($40,000) threshold is indexed for inflation occurring after 1992.

Explanation of Provision

The bill corrects the indexing of the $60,000 ($40,000) threshold to provide that the thresholds be indexed for inflation after 1989, as was provided prior to the 1993 Act.

4. Treatment of certain nonqualified withdrawals from Merchant Marine capital construction funds (sec. 3(f)(1) of the bill, sec. 13221 of the 1993 Act and sec. 7518(g)(6) of the Code)

Present Law

Nonqualified withdrawals by a taxpayer from a Merchant Marine capital construction generally are subject to the highest marginal tax rate applicable to such type of taxpayer. In the case of a corporation, nonqualified withdrawals from the capital gain account are subject to tax at a 34 percent rate. The Revenue Reconciliation Act of 1993 increased the highest marginal tax rate applicable to the capital gains of a corporation to 35 percent.

Explanation of Provision

The bill provides that in the case of a corporation, nonqualified withdrawals from the capital gain account of a Merchant Marine construction fund are subject to tax at a 35-percent rate.

5. Reporting and notification requirements for lobbying and political expenditures of tax-exempt organizations (sec. 3(g) of the bill, sec. 13222 of the 1993 Act and sec. 6033(e) of the Code)

Present Law

Tax-exempt organizations which incur political expenditures are subject to tax under Code section 527(f). The tax is calculated by applying the highest corporate rate to the lesser of (a) the net investment income of the organization, or (b) the amount of political expenditures incurred by the organization during the taxable year. Expenditures covered by Code section 527(f) are those expended for "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether of not such individual or electors are selected, nominated, elected, or appointed."

Code section 162(e), as amended by the 1993 Act, provides a separate set of rules regarding the tax treatment of lobbying and political expenditures. Political expenditures include amounts paid or incurred in connection with "participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office." Taxpayers may not deduct the portion of dues or similar amounts paid to a tax-exempt organization which the organization notifies the taxpayer are allocable to lobbying or political expenditures.

Code section 6033(e) sets forth reporting and notification requirements applicable to tax-exempt organizations (other than charities) that incur lobbying or political expenditures within the meaning of Code section 162(e). First, the organization must report on its annual tax return both the total amount of its lobbying and political expenditures, and the total amount of dues (or similar payments) allocable to such expenditures. Second, the organization must either provide notice to its members of the portion of dues allocable to lobbying and political expenditures (so that such amounts are not deductible by members), or may elect to pay a proxy tax (at the highest corporate rate) on its lobbying and political expenditures, up to the amount of dues receipts.

Explanation of Provision

The bill amends Code section 6033(e) to clarify that any political expenditures on which tax is paid pursuant to Code section 527(f) are not subject to the reporting and notification requirements of Code section 6033(e). In addition, the bill clarifies that the reporting and notification requirements of Code section 6033(e) apply to organizations exempt from tax under Code section 501(a), other than charities described in section 501(c)(3).

6. Estimated tax rules for certain tax-exempt organizations (sec. 3(h) of the bill, sec. 13225 of the 1993 Act and sec. 6655(g)(3) of the Code)

Present Law

A tax-exempt organization is generally subject to an addition to tax for any underpayment of estimated tax on its unrelated business taxable income or its net investment income (as the case may be). Under the 1993 Act, for years beginning after December 31, 1993, a corporation or tax-exempt organization does not have an underpayment of estimated tax if it makes four timely estimated tax payments that total at least 100 percent of the tax liability shown on its return for the current taxable year. A corporation or tax-exempt organization may estimate its current year tax liability prior to year-end by annualizing its income. The 1993 Act also changed the method by which a corporation annualizes its current year tax liability.

Explanation of Provision

The bill clarifies that the 1993 Act did not change the method by which a tax-exempt organization annualizes its current year tax liability.

7. Current taxation of certain earnings of controlled foreign corporations—application of foreign tax credit limitation (sec. 3(i)(1) of the bill, sec. 13231(b) of the 1993 Act, and sec. 904(d) of the Code)

Present Law

Present law requires U.S. shareholders of a controlled foreign corporation to include in income the corporation's subpart F income, certain earnings invested in U.S. property, and, as modified by the 1993 Act, certain earnings invested in excess passive assets. A U.S. shareholder's tax liability attributable to the inclusion may be offset by foreign tax credits for certain foreign taxes paid or deemed paid by the shareholder.

The foreign tax credit limitation applies separately to several categories of income. The separate limitations apply to a dividend from a controlled foreign corporation to a U.S. shareholder of that controlled foreign corporation by reference to the character of the earnings and profits of the distributing corporation.

An inclusion of a controlled foreign corporation's earnings invested in U.S. property is treated like a dividend for purposes of the foreign tax credit limitation. Although the 1993 Act provided that inclusions of earnings invested in excess passive assets generally are determined in the same manner as inclusions of earnings invested in U.S. property, the 1993 Act did not specify how the separate limitations of the foreign tax credit should apply to inclusions of earnings invested in excess passive assets.

Some have argued that the separate limitations of the foreign tax credit do not apply to an inclusion of a controlled foreign corporation's earnings invested in excess passive assets; rather, that such an inclusion is allocated entirely to the general foreign tax credit limitation, without regard to the character of the underlying earnings and profits of the controlled foreign corporation.

Explanation of Provision

The bill clarifies that a U.S. shareholder's inclusion of a controlled foreign corporation's earnings invested in excess passive assets is treated like a dividend for purposes of the foreign tax credit limitation. Thus, the inclusion is characterized by reference to the underlying earnings and profits of the controlled foreign corporation. This treatment is consistent with present law's application of the separate limitations of the foreign tax credit to other amounts included in income with respect to a controlled foreign corporation.

8. Current taxation of certain earnings of controlled foreign corporations—measurement of accumulated earnings (sec. 3(i)(2) of the bill, sec. 13231(b) of the 1993 Act, and sec. 956A(b) of the Code)

Present Law

Present law, as modified by the 1993 Act, limits the availability of deferral of U.S. tax on certain earnings of controlled foreign corporations by requiring U.S. shareholders of a controlled foreign corporation to include in income the corporation's accumulated[9] or current earnings invested in excess passive assets. Some have argued that the Code's definition of earnings subject to this treatment permits an accumulated deficit in earnings to eliminate positive current earnings, resulting in no income inclusion in a case where an actual distribution would be treated as a dividend out of current earnings. In addition, some have argued that the Code's definition of earnings subject to this treatment takes current-year earnings into account more than once.

Explanation of Provision

The bill clarifies that the accumulated earnings and profits of a controlled foreign corporation taken into account for purposes of determining the foreign corporation's earnings invested in excess passive assets do not include any deficit in accumulated earnings and profits,[10] and do not include current earnings (which are taken into account separately).

9. Current taxation of certain earnings of controlled foreign corporations—aggregation and look-through rules (sec. 3(i)(3) of the bill, sec. 13231(b) of the 1993 Act, and sec. 956A(f) of the Code)

Present Law

Present law, as modified by the 1993 Act, provides certain aggregation and look-through rules in connection with requiring U.S. shareholders of a controlled foreign corporation to include in income certain of the corporation's earnings invested in excess passive assets. Under the aggregation rule, certain groups of controlled foreign corporations that are linked by stock ownership of more than 50 percent (CFC groups) are treated as a single corporation for purposes of determining their earnings invested in excess passive assets. Look-through treatment applies to certain corporations whose stock is owned at least 25 percent by a controlled foreign corporation. Some have argued that these rules permit the assets of one foreign corporation to be taken into account more than once through a combination of CFC group treatment and look-through treatment. In addition, some have argued that these rules permit the assets of one foreign corporation to be taken into account more than once through membership of the foreign corporation in more than one CFC group.

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[9] Accumulated earnings and profits are taken into account only to the extent that they were accumulated in taxable years beginning after September 30, 1993.

[10] Incurred in taxable years beginning after September 30, 1993.

Explanation of Provision

The bill clarifies that, within the regulatory authority provided to the Secretary of the Treasury under the 1993 Act, regulations are specifically authorized to coordinate the CFC group treatment and look-through treatment applicable for purposes of determining a foreign corporation's earnings invested in excess passive assets. Pending the promulgation of guidance by the Secretary, it is intended that taxpayers be permitted to coordinate such treatment using any reasonable method for taking assets into account only once, so long as the method is consistently applied to all controlled foreign corporations (whether or not members of any CFC group) in all taxable years.

10. Treatment of certain leased assets for PFIC purposes (sec. 3(i)(5) of the bill, sec. 13231(d)(4) of the 1993 Act, and sec. 1297(d) of the Code)

Present Law

Under present law, as modified by the 1993 Act, certain property leased by a foreign corporation may be treated as an asset actually owned by the foreign corporation in measuring the assets of the foreign corporation for purposes of the passive foreign investment company ("PFIC") asset test of section 1296(a)(2). The 1993 Act provided a special measurement rule, under which the adjusted basis of the leased asset for this purpose is determined by reference to the unamortized portion of the present value of the payments under the lease for the use of the property. Some have argued, however, that the special measurement rule does not apply to PFICs that are permitted to measure their assets by fair market value, rather than by adjusted basis. Under this argument, the entire fair market value of the leased asset might be treated as owned by the foreign corporation.

Explanation of Provision

The bill clarifies that, in the case of any item of property leased by a foreign corporation and treated as an asset actually owned by the foreign corporation in measuring the assets of the foreign corporation for purposes of the PFIC asset test, the amount taken into account with respect to the leased property is the amount determined under the 1993 Act's special measurement rule, which is based on the unamortized portion of the present value of the payments under the lease for the use of the property. That is, the provision clarifies that the special measurement rule of the 1993 Act applies to all PFICs, regardless of whether they are generally permitted to measure their assets by fair market value rather than adjusted basis.

11. Amortization of goodwill and certain other intangibles (sec. 3(k) of the bill, sec. 13261(g) of the 1993 Act and sec. 197 of the Code)

Present Law

The 1993 Act allows amortization deductions to certain intangible assets acquired after the 1993 Act's effective date that were not amortizable under prior law. The 1993 Act contains "antichurning" rules that deny amortization to intangible assets that were not amortizable under prior law if such assets are acquired by the taxpayer after the effective date from certain related parties.

The 1993 Act also contains an election under which a taxpayer and certain related parties may elect to treat all acquisitions after July 25, 1991 as subject to the provisions of the 1993 Act.

Explanation of Provision

The bill clarifies that when a taxpayer and its related parties have made an election to apply the 1993 Act to all acquisitions after July 25, 1991, the antichurning rules will not apply when property acquired from an unrelated party after July 25, 1991 (and not subject to the antichurning rules in the hands of the acquirer) is transferred to a taxpayer related to the acquirer after the date of enactment of the 1993 Act.

12. Empowerment zones and eligibility of small farms for tax incentives (sec. 3(l) of the bill, sec. 13301 of the 1993 Act and sec. 1397B(d)(5)(B) of the Code)

Present Law

Under the 1993 Act, during 1994 and 1995, six empowerment zones and 65 enterprise communities will be designated in eligible urban areas, and three empowerment zones and 30 enterprise communities will be designated in rural areas. Special tax incentives (i.e., a wage credit, additional section 179 expensing, and expanded tax-exempt financing) are available for certain business activities conducted in urban and rural empowerment zones. Expanded tax-exempt financing benefits are available for certain facilities located in urban and rural enterprise communities.

The empowerment zone wage credit is not available with respect to any individual employed by a trade or business the principal activity of which is farming (within the meaning of subparagraphs (A) and (B) of section 2032A(e)(5)) if, as of the close of the current taxable year, the sum of the aggregate unadjusted bases (or, if greater, the fair market value) of assets of the farm exceed $500,000 (sec. 1396(d)(2)(E)). In contrast, the additional section 179 expensing (available in empowerment zones) and expanded tax-exempt financing benefits (available in both empowerment zones and enterprise communities) are not allowed for any trade or business the principal activity of which is farming if, as of the close of the preceding taxable year, the sum of the aggregate bases (or, if greater, the fair market value) of the assets of the farm exceed $500,000 (sec. 1397B(d)(5)).

Explanation of Provision

The bill provides that the $500,000 asset test for determining whether a farm is eligible for additional section 179 expensing (in an empowerment zone) and expanded tax-exempt financing benefits (in an empowerment zone or enterprise community) is applied based on the assets of the farm at the end of the current taxable year. Thus, the $500,000 asset test for determining farm eligibility is based on the same taxable period (i.e., the current taxable year) for purposes of all tax incentives available in empowerment zones and enterprise communities.

C. Other Tax Technical Corrections

1. Hedge bonds (sec. 4(b) of the bill, sec. 11701 of the 1990 Act, and sec. 149(g) of the Code)

Present Law

The 1989 Act provided generally that interest on hedge bonds is not tax-exempt unless prescribed minimum percentages of the proceeds are reasonably expected to be spent at set intervals during the five-year period after issuance of the bonds (sec. 149(g)). A hedge bond is defined generally as a bond (1) at least 85 percent of the proceeds of which is not reasonably expected to be spent within three years following issuance and (2) more than 50 percent of the proceeds of which is invested at substantially guaranteed yields for four years or more.

This restriction does not apply to hedge bonds, however, if at least 95 percent of the proceeds is invested in other tax-exempt bonds (not subject to the alternative minimum tax). The 95-percent investment requirement is not violated if investment earnings exceeding five percent of the proceeds are temporarily invested for up to 30 days pending reinvestment in taxable (including alternative minimum taxable) investments.

Explanation of Provision

The bill clarifies that the 30-day exception for temporary investments of investment earnings applies to amounts (i.e., principal and earnings thereon) temporarily invested during the 30-day period immediately preceding redemption of the bonds as well as such periods preceding reinvestment of the proceeds.

2. Withholding on distributions from U.S. real property holding companies (sec. 4(c) of the bill, sec. 129 of the Deficit Reduction Act of 1984, and sec. 1445 of the Code)

Present Law

In general

Under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), a foreign investor that disposes of a U.S. real property interest generally is required to pay tax on any gain on the disposition. For this purpose a U.S. real property interest generally includes stock in a domestic corporation that is a U.S. real property holding corporation ("USRPHC"), or was a USRPHC at any time during the previous five years.

A sale or exchange of stock in a USRPHC is an example of a disposition of a U.S. real property interest. In addition, provisions of subchapter C of the Code treat amounts received in certain corporate distributions as amounts received in sales or exchanges, giving rise to tax liability under the FIRPTA rules when a foreign person receives such a distribution from a present or former USRPHC. Thus, amounts received by a foreign shareholder in a USRPHC in a distribution in complete liquidation of the USRPHC are treated as in full payment in exchange for the USRPHC stock, and are therefore subject to tax under FIRPTA (sec. 331; Treas. Reg. sec. 1.897–5T(b)(2)(iii)). Similarly, amounts received by a foreign shareholder in a USRPHC upon redemption of the USRPHC stock are treated as a distribution in part or full payment in exchange for the stock, and are therefore subject to tax under FIRPTA (sec. 302(a); Treas. Reg. sec. 1.897–5T(b)(2)(ii)). Third, amounts received by a foreign shareholder in a USRPHC, in a section 301 distribution from the USRPHC that exceeds the available earnings and profits of the USRPHC, are treated as gain from the sale or exchange of the shareholder's USRPHC stock to the extent that they exceed the shareholder's adjusted basis in the stock; such amounts are therefore also subject to tax under FIRPTA (sec. 301(c)(3); Treas. Reg. sec. 1.897–5T(b)(2)(i)).

FIRPTA withholding

The Deficit Reduction Act of 1984 established a withholding system to enforce the FIRPTA tax. Unless an exception applies, a transferee of a U.S. real property interest from a foreign person generally is required to withhold the lesser of 10 percent of the amount realized (purchase price), or the maximum tax liability on disposition (as determined by the IRS) (sec. 1445).

Although the FIRPTA withholding requirement by its terms generally applies to all dispositions of U.S. real property interests, and subchapter C treats amounts received in certain distributions as amounts received in sales or exchanges, the FIRPTA withholding provisions also provide express rules for withholding on certain distributions treated as sales or exchanges. Generally, distributions in a transaction to which section 302 (redemptions) or part II of subchapter C (liquidations) applies are subject to 10-percent withholding.[11] Although a section 301 distribution in excess of earnings and profits is also treated as a disposition for purposes of computing the FIRPTA liability of a foreign recipient of the distribution, there is no corresponding withholding provision expressly addressed to the payor of such a distribution.

Explanation of Provision

The bill clarifies that FIRPTA withholding requirements apply to any section 301 distribution to a foreign person by a domestic corporation that is or was a USRPHC, which distribution is not made out of the corporation's earnings and profits and is therefore treated as an amount received in a sale or exchange of a U.S. real property interest. (The bill does not alter the withholding treatment of section 301 distributions by such a corporation that are out of earnings and profits.) Under the bill, the FIRPTA withholding requirements that apply to a section 301 distribution not out of earnings

[11] Under other rules, dividend distributions (i.e., distributions to which sec. 301(c)(1) applies) to foreign persons by U.S. corporations, including USRPHCs, are subject to 30-percent withholding under the Code. Under treaties, the withholding on a dividend may be reduced to as little as 5 or 15 percent.

and profits are similar to the requirements applicable to redemption or liquidation distributions to a foreign person by such a corporation. The provision is effective for distributions made after the date of enactment of the bill. No inference is intended to be drawn from the provision as to the FIRPTA withholding requirements applicable to such a distribution under present law.

3. Treatment of credits attributable to working interests in oil and gas properties (sec. 4(d) of the bill, sec. 501 of the Tax Reform Act of 1986, and sec. 469 of the Code)

Present Law

Under present law, a working interest in an oil and gas property which does not limit the liability of the taxpayer is not a "passive activity" for purposes of the passive loss rules (sec. 469). However, if any loss from an activity is treated as not being a passive loss by reason of being from a working interest, any net income from the activity in subsequent years is not treated as income from a passive activity, notwithstanding that the activity may otherwise have become passive with respect to the taxpayer.

Explanation of Provision

The bill provides that any credit attributable to a working interest in an oil and gas property, in a taxable year in which the activity is no longer treated as not being a passive activity, will not be treated as attributable to a passive activity to the extent of any tax allocable to the net income from the activity for the taxable year. Any credits from the activity in excess of this amount of tax will continue to be treated as arising from a passive activity and will be treated under the rules generally applicable to the passive activity credit. The provision applies to taxable years beginning after December 31, 1986.

4. Clarification of passive loss disposition rule (sec. 4(e) of the bill, sec. 501 of the Tax Reform Act of 1986, sec. 1005(a)(2)(A) of the Technical and Miscellaneous Revenue Act of 1988, and sec. 469(g)(1)(A) of the Code)

Present Law

The Tax Reform Act of 1986 ("1986 Act") provided that if a passive activity is disposed of in a transaction in which all gain or loss is recognized, any overall loss from the activity in the year of disposition is recognized and allowed against income (whether active or passive income).[12] The language of the 1986 Act provided that any loss was allowable, first, against income or gain from the passive activity, second, against income or gain from all passive activities, and finally, against any other income or gain. This rule was rewritten by the technical corrections portion of the Technical and Miscellaneous Revenue Act of 1988 ("1988 Act"). The statutory language (as amended by the 1988 Act) providing for the computation

[12] See S. Rept. 99-313, p. 725.

of the overall loss for the taxable year of disposition is not entirely clear where the activity is disposed of at a gain.

Explanation of Provision

The bill clarifies the rule relating to the computation of the overall loss allowed upon the disposition of a passive activity. The bill provides that, in a transaction in which all gain or loss is recognized on the disposition of a passive activity, any loss from the activity for the taxable year (taking into account all income, gain, and loss, including gain or loss recognized on the disposition) in excess of any net income or gain from other passive activities for the taxable year is treated as a loss which is not from a passive activity. The provision applies to taxable years beginning after December 31, 1986.

5. Estate tax unified credit allowed nonresident aliens under treaty (sec. 4(f)(1) of the bill, sec. 5032(b)(2) of the Technical and Miscellaneous Revenue Act of 1988, and sec. 2102(c)(3)(A) of the Code)

Present Law

Amount subject to tax

For U.S. citizens and residents, the amount subject to Federal estate and gift tax is determined by reference to all property, wherever situated. For nonresident aliens, the Code provides that the amount subject to Federal estate and gift tax is determined only by reference to property situated in the United States.

The United States has entered into bilateral treaties designed to avoid double transfer taxation. Early treaties typically did this by providing rules for determining situs and requiring that the State of domicile allow a credit for taxes paid to the situs country.[13] In contrast, treaties signed in the 1980s, and the U.S. and OECD model treaties, exempt most property, wherever situated, from taxation outside the State of domicile.[14]

Specific exemption and unified credit

Prior to the Tax Reform Act of 1976 ("1976 Act"), the Code allowed a "specific exemption" against the estate tax. The estate of a U.S. citizen or resident was allowed an exemption of $60,000, while the estate of a nonresident alien was allowed a lesser amount. A number of U.S. estate tax treaties ratified in the 1950s allowed a nonresident alien a "specific exemption" equal to the exemption allowed a U.S. citizen or resident multiplied by the percentage of the gross estate subject to U.S. estate tax (the "pro rata exemption").[15]

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[13] See Staff of the Joint Committee on Taxation, 98th Cong., 2d Sess., *Explanation of Proposed Estate and Gift Tax Treaty Between the United States and Sweden* 8 (1984).

[14] See, e.g., U.S. Treasury Model Estate and Gift Tax Treaty (1980), Article 7, paragraph 1: "Transfers and deemed transfers by an individual domiciled in a Contracting State of property other an property referred to in Article 5 (Real Property) and 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) shall be taxable only in that State."

[15] See Rev. Rul. 81–303, 1981–2 C.B. 255.

The 1976 Act replaced the specific exemption with a unified credit of $47,000 for the estate of U.S. citizen or resident and $3,600 for the estate of a nonresident alien. After 1976, two courts interpreted the pro rata exemption allowed in the 1950s treaties as applying to the unified credit, i.e., as allowing a unified credit no less than the unified credit allowed a U.S. citizen or resident multiplied by the percentage of the gross estate situated in the United States (and therefore subject to U.S. estate tax under those treaties).[16]

The Technical and Miscellaneous Revenue Act of 1988 ("1988 Act") increased the unified credit allowed an estate of a nonresident alien to $13,000. In so doing, the 1988 Act provided that, "to the extent required by any treaty," the estate of a nonresident alien is allowed a unified credit equal to the unified credit allowed a U.S. citizen or resident multiplied by the percentage of the gross estate situated in the United States (Code sec. 2102(c)(3)(A)). Thus, the 1988 Act did not override the "specific exemption" language of the 1950s treaties, as interpreted by the two courts, and could be interpreted as encouraging the negotiation of pro rata unified credits in future treaties.

Explanation of Provision

The bill clarifies that in determining the pro rata unified credit required by treaty, property exempted by the treaty from U.S. estate tax is not treated as situated in the United States. Under this rule, a treaty granting a pro rata unified credit would allow a nonresident alien the unified credit allowed a U.S. citizen or resident multiplied by the percentage of the gross estate subject to U.S. estate tax, as modified by treaty.

The bill is not intended to affect existing treaties containing pro rata exemptions, because in those treaties taxation follows situs. For future treaties, it is intended that any pro rata unified credit negotiated not exceed the proportion of the gross worldwide estate subject to U.S. estate and gift tax, as modified by treaty. The provision is effective upon the date of its enactment.

6. Limitation on deduction for certain interest paid by corporation to related persons (sec. 4(f)(2) of the bill, sec. 7210(a) of the 1989 Act, and sec. 163(j) of the Code)

Present Law

Subject to certain limitations, a taxpayer may deduct interest paid or accrued on indebtedness within a taxable year (sec. 163(a)). The 1989 Act added a so-called "earnings stripping" limitation on interest deductibility with respect to certain interest paid by corporations to related persons (sec. 163(j)). If the provision applies to a corporation for a taxable year, it disallows deductions for certain amounts of "disqualified interest" paid or accrued by the corporation during that year. If in a taxable year a deduction is disallowed, under the provision, for an amount of interest paid or accrued in that year, the disallowed amount is treated under the

[16] See *Mudry* v. *United States*, 11 Cl. Ct. 207 (1986) (Swiss treaty); *Burghardt* v. *Commissioner*, 80 T.C. 705 (1983), aff'd, 734 F.2d 3 (3d Cir. 1984) (Italian treaty).

earnings stripping provision as disqualified interest paid or accrued in the succeeding taxable year.[17]

In order for the earnings stripping provision to apply to a corporation for a taxable year, two thresholds must be exceeded. To exceed the first threshold, the corporation must have "excess interest expense" as that term is defined in the Code for this purpose. To exceed the second threshold, the corporation must have a ratio of debt to equity as of the close of the taxable year in question (or on any other day prescribed by the Secretary in regulations) that exceeds 1.5 to 1. Excess interest expense is the excess (if any) of the corporation's net interest expense over the sum of 50 percent of the adjusted taxable income of the corporation plus any excess limitation carryforward from a prior year. Excess limitation is the excess (if any) of 50 percent of adjusted taxable income over net interest expense.

Explanation of Provision

The bill provides that the debt-equity threshold does not apply for purposes of applying the earnings stripping provision to a carryover of excess interest expense from a prior taxable year. Thus, the bill clarifies that excess interest carried forward from a year in which the debt-equity ratio threshold is exceeded may be deducted in a subsequent year in which that threshold is not exceeded, but only to the extent that such interest would not otherwise be treated as excess interest expense in the carryforward year.

For example, assume that in year 1 $20 of a corporation's interest expense is nondeductible due to the operation of the earnings stripping provision. The corporation carries forward the $20 of interest deduction that it could not use in year 1. Assume that in year 2 the corporation has a debt-equity ratio of 1 to 1 and $50 of current net and gross interest expense, all of which is disqualified interest, and that it earns $400 of adjusted taxable income. The bill is intended to clarify that the $20 of interest carried forward from year 1 is deductible in year 2. This is because $70, the sum of the current net interest expense for year 2 ($50) plus the interest expense carried over from year 1 ($20), does not exceed one-half of adjusted taxable income in year 2.

As another example, assume that in year 2 the corporation has a debt-equity ratio of 1 to 1 and $50 of current net and gross interest expense, all of which is disqualified interest, and that it earns $80 of adjusted taxable income. The bill is intended to clarify that the $20 of interest carried forward from year 1 is not deductible in year 2. This is because the current net interest expense for year 2 ($50) exceeds by $10 one-half of adjusted taxable income in year 2 ($80 divided by 2, or $40). Therefore, treating the year 1 carryover as an interest expense in year 2 causes the corporation to have excess interest expense equal to $30. But for the debt-equity safe harbor, the corporation would have a $30 interest expense disallowance in year 2 if the carried over amount were treated as having been paid in year 2. Under the bill, no actual year 2 interest

[17] Disqualified interest is interest paid by a corporation to related persons that are not subject to U.S. tax on the interest received. (If, in accordance with a U.S. income tax treaty, interest income of a related person is subject to a reduced rate of U.S. tax, a portion of the interest paid to the related person is deemed to be interest on which no tax is imposed.

can be disallowed. However, under these facts, none of the interest carried over from year 1 can be deducted in year 2. Instead, the interest carried over from year 1 is carried forward for potential deduction (subject to the same rules that applied to the carryforward in year 2) in a year subsequent to year 2.

As a third example, assume that in year 2 the corporation has a debt-equity ratio of 1 to 1 and $50 of current net and gross interest expense, all of which is disqualified interest, and that it earns $110 of adjusted taxable income. The bill is intended to clarify that $5 of interest carried forward from year 1 is deductible in year 2, and the other $15 of interest carried forward from year 1 is not deductible in year 2. This is because the current net interest expense for year 2 ($50) is $5 less than one-half of adjusted taxable income in year 2 (one-half of $110, or $55). Therefore, even if the debt-equity safe harbor had not been met in year 2, the corporation would have had $5 of excess limitation in year 2 had there been no carryover amount from year 1. On the other hand, treating the year 1 carryover as an interest expense in year 2 causes the corporation to have excess interest expense equal to $15. This $15 may be carried forward to a subsequent year.

The provision is effective as if included in the amendments made by section 7210(a) of the Revenue Reconciliation Act of 1989.

7. Branch-level interest tax (sec. 4(f)(3) of the bill, sec. 1241 of the 1986 Act, and sec. 884 of the Code)

Present Law

Interest paid (or treated as if paid) by a U.S. trade or business (i.e., a U.S. branch) of a foreign corporation is treated as if paid by a U.S. corporation and, hence, is U.S. source and subject to U.S. withholding tax of 30 percent, unless the tax is reduced or eliminated by a specific Code or treaty provision. The Treasury has regulatory authority to limit U.S. sourcing, and hence U.S. withholding, to the amount of interest reasonably expected to be deducted in arriving at the U.S. branch's effectively connected taxable income.

To the extent a U.S. branch of a foreign corporation has allocated to it under Treasury Regulation section 1.882–5 an interest deduction in excess of the interest actually paid by the branch (this generally occurs where the indebtedness of the U.S. branch is disproportionately small compared to the total indebtedness of the foreign corporation), the excess is treated as if it were interest paid on a notional loan to a U.S. subsidiary (the U.S. branch, in actuality) from its foreign corporate parent (the home office). This excess is subject to the 30-percent tax, absent a specific Code exemption or treaty reduction (sec. 884(f)(1)(B)).

These branch-level interest taxes, along with the branch profits tax, were intended to reflect the view that a foreign corporation doing business in the United States generally should be subject to the same substantive tax rules that apply to a foreign corporation operating in the United States through a U.S. subsidiary.[18] Where

[18] Staff of the Joint Committee on Taxation, 100th Cong., 1st Sess., *General Explanation of the Tax Reform Act of 1986*, at 1036 (1987).

a U.S. corporation pays interest to its foreign corporate parent, that interest, like the interest deducted by a U.S. branch of a foreign corporation, is also generally subject to a 30-percent U.S. withholding tax unless the tax is reduced by treaty. In the case of a U.S. subsidiary of a foreign parent corporation, the withholding tax applies without regard to whether the interest payment is currently deductible by the U.S. subsidiary. For example, deductions for interest may be delayed or denied under section 163, 263, 263A, 266, 267, or 469, but it is still subject (or not subject) to withholding when paid without regard to the operation of those provisions.

Explanation of Provision

The bill provides that the branch level interest tax on interest not actually paid by the branch applies to any interest which is allocable to income which is effectively connected with the conduct of a trade or business in the United States. Similarly, in the case of interest paid by the U.S. branch, the bill provides regulatory authority to limit U.S. sourcing, and hence U.S. withholding, to the amount of interest reasonably expected to be allocable to income which is effectively connected with the conduct of a trade or business in the United States. Thus, where an interest expense of a foreign corporation is allocable to U.S. effectively connected income, but that interest expense would not have been fully deductible for tax purposes under another Code provision had it been paid by a U.S. corporation, the bill clarifies that such interest is nonetheless treated for branch level interest tax purposes like a payment by a U.S. corporation to a foreign corporate parent. Similarly, with regard to the Treasury's regulatory authority to treat an interest payment by a foreign corporation's U.S. branch as though not paid by a U.S. person for source and withholding purposes, the bill clarifies that the authority extends to interest payments in excess of those reasonably expected to be allocable to U.S. effectively connected income of the foreign corporation.

These provisions are effective as if they were made by the Tax Reform Act of 1986.

8. Determination of source in case of sales of inventory property (sec. 4(f)(4) of the bill, sec. 211 of the 1986 Act, and sec. 865(b) of the Code)

Present Law

Prior to the 1986 Act, the source of income derived from the sale of personal property generally was determined by the place of sale (commonly referred to as the "title passage" rule) (see, e.g., Treas. Reg. sec. 1.861–7, T.D. 6258, 1957–2 C.B. 368). While the 1986 Act generally replaced the place-of-sale rule for sales of personal property with a residence-of-the-seller rule (sec. 865(a)), the Act did not change the place-of-sale rule for most sales of inventory property (sec. 865(b)).

Before and after the 1986 Act, statutory rules for sourcing income from inventory sales have included those covering income from (1) purchasing inventory property outside the United States (other than within a U.S. possession) and selling it in the United States (sec. 861(a)(6)); (2) purchasing inventory property in the

United States and selling it outside the United States (sec. 862(a)(6)); (3) selling outside the United States inventory property which has been produced by the taxpayer in the United States (or selling in the United States inventory property which has been produced by the taxpayer outside the United States) (sec. 863(b)(2)); and (4) purchasing inventory property in a U.S. possession and selling it in the United States (sec. 863(b)(3)). Prior to the 1986 Act, these provisions were not limited in application to income from sales of inventory property, but rather covered sales of personal property generally.

In addition to statutory rules for sourcing items of income from transactions involving inventory property specified in the Code, such as those listed above, the Code both before and after the 1986 Act has contained other sourcing rules that do not make specific reference to property sales, and includes general regulatory authority to allocate and apportion between U.S. and foreign sources items of gross income, expenses, losses, and deductions other than those specified in sections 861(a) and 862(a) (sec. 863(a)). In carving income from the sale inventory property out of the general residence-of-the-seller rule of section 865, section 865(b) makes reference to the above statutory rules making specific reference to inventory property, but not to the general grant of regulatory authority in section 863(a).

Explanation of Provision

The bill modifies the general provision relating to the sourcing of income from the sale of personal property (sec. 865) so that the cross-reference to sourcing rules applicable to inventory property includes a reference to all of section 863, rather than simply to section 863(b). The bill thus clarifies that, to the extent that the Secretary of the Treasury had general regulatory authority to provide rules for the sourcing of income from the sales of personal property prior to the 1986 Act, the Secretary of the Treasury retains that authority under present law with respect to inventory property.

The bill is not intended to increase the Treasury Secretary's regulatory authority under section 863(a) beyond the authority that he had under the law in effect prior to the enactment of the 1986 Act. It is intended that no inference be drawn from this provision either as to the correctness of, or as to the post-1986 Act implications of, any judicial decision interpreting the scope of that pre-1986 Act authority.

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

9. Repeal of obsolete provisions (sec. 4(f)(5) of the bill, sec. 10202 of the Revenue Act of 1987, and secs. 6038(a)(1)(F) and 6038A(b)(4) of the Code)

Present Law

A U.S person who controls a foreign corporation must report certain information related to that foreign corporation as may be required by the Treasury Secretary (sec. 6038). Information reporting is also required with respect to certain foreign-owned domestic corporations (sec. 6038A). Included under each of these information reporting provisions is a requirement to report such information as the Treasury Secretary may require for purposes of carrying out the provisions of section 453C. Section 453C, relating to certain indebtedness treated as payment on installment obligations (the so-called "proportional disallowance rule"), was repealed in the Revenue Act of 1987.

Explanation of Provision

The bill repeals as obsolete the information reporting requirements of sections 6038 and 6038A relating to section 453C. The provision is effective upon the date of its enactment.

10. Clarification of certain stadium bond transition rule in Tax Reform Act of 1986 (sec. 4(g) of the bill and sec. 1317(3)(A) of the Tax Reform Act of 1986)

Present Law

The Tax Reform Act of 1986 included a transition rule authorizing tax-exempt bonds not exceeding $200 million to be issued by or on behalf of the City of Cleveland, Ohio, to finance a stadium. The bonds were required to be issued before January 1, 1991 (and were so issued). As enacted, the rule required Cleveland to retain a residual interest in the stadium following planned private business use.

Explanation of Provision

The bill permits the residual interest in the stadium currently held by the City of Cleveland to be assigned to Cuyahoga County, Ohio (the county in which both Cleveland and the stadium are located) because of a change in Ohio State law prior to issuance of the bonds. The bill does not extend the time for issuing the bonds or otherwise affect the amount of bonds or the location or design of the stadium.

11. Health care continuation rules (sec. 4(h) of the bill, sec. 7862(c)(5) of the 1989 Act, sec. 4980B(f)(2)(B)(i) of the Code, sec. 602(2)(A) of ERISA, and sec. 2202(2)(A) of the Public Health Service Act)

Present Law

The Revenue Reconciliation Act of 1989 ("1989 Act") amended the health care continuation rules to provide that if a covered employee is entitled to Medicare and within 18 months of such entitlement separates from service or has a reduction in hours, the duration of continuation coverage for the spouse and dependents is 36 months from the date the covered employee became entitled to Medicare. One possible interpretation of the statutory language, however, would permit continuation coverage for up to 54 months. This extension of the coverage period was not intended.

Explanation of Provision

The bill amends the Code (sec. 4980B), title I of the Employee Retirement Income Security Act (sec. 602), and the Public Health

Service Act (sec. 2202(2)(A)) to limit the continuation coverage in such cases to no more than 36 months. The provision is effective for plan years beginning after December 31, 1989.

12. Taxation of excess inclusions of a residual interest in a REMIC for taxpayers subject to alternative minimum tax with net operating losses (sec. 4(i) of the bill and sec. 860E(a)(6) of the Code)

Present Law

Residual Interests in a REMIC

A real estate mortgage investment conduit ("REMIC") is an entity that holds real estate mortgages. All interests in a REMIC must be "regular interests" or "residual interests." A regular interest is an interest the terms of which are fixed on the start-up day, which unconditionally entitles the holder to receive a specified principal amount, and which provides that interest amounts are payable based on a fixed rate (or a variable rate to the extent provided in the Treasury regulations). A residual interest is any interest that is so designated and that is not a regular interest in a REMIC.

Generally, the holder of a residual interest in a REMIC takes into account his daily portion of the taxable income or net loss of such REMIC for each day during which he held such interest. The taxable income of any holder of a residual interest in a REMIC for any taxable year cannot be less than the excess inclusion for the year (sec. 860E). Thus, in general, income from excess inclusions cannot be offset by a net operating loss (or net operating loss carryover) in computing the taxpayer's regular tax.

Alternative minimum tax

Taxpayers are subject to an alternative minimum tax which is payable, in addition to all other tax liabilities, to the extent it exceeds the taxpayer's regular tax. The tax is imposed at a rate of 24 percent (20 percent in the case of a corporation) on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income generally is the taxpayer's taxable income, as increased or decreased by certain adjustments and preferences. Under the alternative tax net operating loss deduction, a taxpayer may deduct ninety percent of its net operating loss carryovers against alternative minimum taxable income.

Because the determination of a taxpayer's alternative minimum taxable income begins with taxable income, a holder of a residual interest in a REMIC may have positive alternative minimum taxable income even where the taxpayer has a net operating loss for the year.

Explanation of Provision

The bill provides that three rules for determining the alternative minimum taxable income of a taxpayer that is not a thrift institution that holds residual interests in a REMIC.

First, the alternative minimum taxable income of such a taxpayer is computed without regard to the REMIC rule that taxable income cannot be less than the amount of excess inclusions. This provision prevents a taxpayer from having to include in alternative minimum taxable income preference items for which it received no tax benefit.

Second, the alternative minimum taxable income of such a taxpayer for a taxable year cannot be less than the excess inclusions of the residual interests for that year. In effect, this provision prevents nonrefundable credits from reducing the taxpayer's income tax below an amount equal to what the tentative minimum tax would be if computed only on excess inclusions.

Third, the amount of any alternative minimum tax net operating loss deduction of such a taxpayer is computed without regard to any excess inclusions. This provision insures that the net operating losses will not reduce any income attributable to any excess inclusions. Thus, all such taxpayers subject to the alternative minimum tax will pay a tax on excess inclusions at the alternative minimum tax rate, regardless of whether the taxpayer has a net operating loss.

The provision is effective for all taxable years beginning after December 31, 1986, unless the taxpayer elects to apply the rules of the bill only to taxable years beginning after the date of enactment.

13. Application of harbor maintenance tax to Alaska and Hawaii ship passengers (sec. 4(j) of the bill and sec. 4462(b) of the Code)

Present Law

A harbor maintenance excise tax ("harbor tax") of 0.125 percent of value applies generally to commercial cargo (including passenger fares) loaded or unloaded at U.S. ports (sec. 4461). The harbor tax does not apply to commercial cargo (other than crude oil with respect to Alaska) loaded or unloaded in Alaska, Hawaii, and U.S. possessions where such cargo is transported to or from the U.S. mainland (for domestic use) or where such cargo is loaded and unloaded in the same State (Alaska or Hawaii) or possession (sec. 4462(b)).

Explanation of Provision

The bill clarifies that the harbor tax does not apply to passenger fares where the passengers are transported on U.S. flag vessels operating solely within the State waters of Alaska or Hawaii and adjacent international waters (i.e., leaving and returning to a port in the same State without stopping elsewhere).

The provision applies as if included in the Harbor Maintenance Revenue Act of 1986 (April 1, 1987).

14. Modify effective date provision relating to the Energy Policy Act of 1992 (sec. 4(k) of the bill and secs. 53 and 30 of the Code)

Present Law

The nonconventional fuels production credit (sec. 29) cannot reduce the taxpayer's tax liability to less than the amount of the tentative minimum tax. The credit for prior year minimum tax liability (sec. 53) is increased by the amount of the nonconventional fuels credit not allowed for the taxable year solely by reason of the limitation based on the taxpayer's tentative minimum tax.

Explanation of Provision

The bill corrects a cross reference to section 29(b)(6)(B) contained in section 53(d)(1)(B)(iv), and clarifies that the correction applies to taxable years beginning after December 31, 1990. In addition, section 2(e)(5) of the bill clarifies that a correction made in the Energy Policy Act of 1992 to a similar cross reference in section 53(d)(1)(B)(iii) applies to taxable years beginning after December 31, 1990.

The bill also clarifies the relationship between the basis adjustment rules for the electric vehicle credit (sec. 30(d)(1)) and the alternative minimum tax.

15. Treat qualified football coaches plan as multiemployer pension plan for purposes of the Internal Revenue Code (sec. 4(l) of the bill and sec. 1022 of ERISA)

Present Law

Section 3(37) of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by Public Law 100–202 (Continuing Appropriations for Fiscal Year 1988), provides that, for purposes of Title I of ERISA, a qualified football coaches plan generally is treated as a multiemployer plan and may include a qualified cash or deferred arrangement. Under section 3(37) of ERISA, a qualified football coaches plan is defined as any defined contribution plan established and maintained by an organization described in section 501(c) of the Internal Revenue Code (the "Code"), the membership of which consists entirely of individuals who primarily coach football as full-time employees of 4-year colleges or universities, if the organization was in existence on September 18, 1986. This definition is generally intended to apply to the American Football Coaches Association.

However, section 9343(a) of the Omnibus Budget Reconciliation Act of 1987 (P.L. 100–203) provides that Titles I and IV of ERISA are not applicable in interpreting Title II of ERISA (the Code provisions relating to qualified plans), except to the extent specifically provided in the Code or as determined by the Secretary of the Treasury.

Explanation of Provision

The bill amends Title II of ERISA to provide that, for purposes of determining the qualified plan status of a qualified football coaches plan, section 3(37) of ERISA is treated as part of Title II of ERISA and a qualified football coaches plan is treated as a multiemployer collectively bargained plan.

The provision is effective for years beginning after December 22, 1987 (the date of enactment of P.L. 100–202).

16. Determination of unrecovered investment in annuity contract (sec. 4(m) of the bill and sec. 72(b) and (c) of the Code)

Present Law

An exclusion is provided for amounts received as an annuity under an annuity, endowment, or life insurance contract, as determined under a statutory exclusion ratio (sec. 72(b)). The exclusion ratio is determined as the ratio of (1) the taxpayer's investment in the contract (as of the annuity starting date) to (2) the expected return under the contract (as of such date). In the case of a contract with a refund feature, the amount of a taxpayer's investment in the contract is reduced by the value of the refund feature (sec.72(c)).

This exclusion was modified by the Tax Reform Act of 1986 to limit the excludable amount to the taxpayer's unrecovered investment in the contract, and to provide a deduction for the unrecovered investment in the contract if payments as an annuity under the contract cease by reason of the death of an annuitant. In the case of a contract with a refund feature, the 1986 Act modifications reduce the exclusion ratio so that it is possible that less than the entire investment in the contract can be recovered tax-free.

Explanation of Provision

The bill modifies the definition of the unrecovered investment in the contract, in the case of a contract with a refund feature, so that the entire investment in the contract can be recovered tax-free.

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

17. Election by parent to claim unearned income of certain children on parent's return (sec. 4(n) of the bill and secs. 1 and 59(j) of the Code)

Present Law

The net unearned income of a child under 14 years of age is taxed to the child at the parent's statutory rate. Net unearned income means unearned income less the sum of $650 (for 1995) and the greater of: (1) $650 (for 1995) or, (2) if the child itemizes deductions, the amount of allowable deductions directly connected with the production of the unearned income. The dollar amounts are adjusted for inflation.

In certain circumstances, a parent may elect to include a child's unearned income on the parent's income tax return if the child's income is less than $5,000. A parent making this election must include the gross income of the child in excess of $1,000 in income for the taxable year. In addition, the parent must report an additional tax liability equal to the lesser of (1) $75 or (2) 15 percent of the excess of the child's income over $500. The dollar amounts for the election are not adjusted for inflation.

A person claimed as a dependent cannot claim a standard deduction exceeding the greater of $650 (for 1995) or such person's earned income. For alternative minimum tax purposes, the exemption of a child under 14 years of age generally cannot exceed the sum of such child's earned income plus $1,000. The $650 amount is adjusted for inflation but the $1,000 amount is not.

Explanation of Provision

The bill adjusts for inflation the dollar amounts involved in the election to claim unearned income on the parent's return. It likewise indexes the $1,000 amount used in computing the child's alternative minimum tax.

The provision is effective for taxable years beginning after December 31, 1994.

18. Exclusion from income for combat zone compensation (sec. 4(o)(4) of the bill and sec. 112 of the Code)

Present Law

The Code provides that gross income does not include compensation received by a taxpayer for active service in the Armed Forces of the United States for any month during any part of which the taxpayer served in a combat zone (or was hospitalized as a result of injuries, wounds or disease incurred while serving in a combat zone) (limited to $500 per month for commissioned officers). The heading refers to "combat pay," although that term is no longer used to refer to special pay provisions for members of the Armed Forces, nor is the exclusion limited to those special pay provisions (hazardous duty pay (37 U.S.C. sec. 301) and hostile fire or imminent danger pay (37 U.S.C. sec. 310)).

Explanation of Provision

The bill modifies the heading of Code section 112 to refer to "combat zone compensation" instead of "combat pay." The bill also makes conforming changes to cross-references elsewhere in the Code.

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