[JOINT COMMITTEE PRINT]

EXPLANATION OF THE TECHNICAL CORRECTIONS ACT OF 1993 (H.R. 17)

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation,[2] provides an explanation of the provisions of the "Technical Corrections Act of 1993" (H.R. 17), introduced by Ways and Means Committee Chairman Rostenkowski on January 5, 1993.

Title I of the bill provides technical corrections to recent tax legislation, including the Revenue Reconciliation Act of 1990 ("1990 Act") and other recent tax legislation. Title II of the bill provides technical corrections to recent social security and human resources legislation, and Title III of the bill provides technical corrections to tariff and customs provisions.

The amendments made by the bill are intended to correct, clarify, or conform various recently enacted tax and certain other legislative provisions. 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.

Most of the provisions of H.R. 17 were included in Title VI of the Conference Agreement on H.R. 11 ("Revenue Act of 1992", 102nd Cong.), as passed by the House and Senate in the 102nd Congress but vetoed by President Bush.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of the Technical Corrections Act of 1993 (H.R. 17)* (JCS-2-93), January 8, 1993.

[2] The explanations of Titles II and III of the bill were prepared by the Majority staff of the House Committee on Ways and Means.

EXPLANATION OF THE BILL *

TITLE I — REVENUE PROVISIONS

I. Technical Corrections to the Revenue Reconciliation Act of 1990

A. Individual Income Tax Provisions

1. Minimum tax rate on certain nonresident aliens (sec. 101(a)(2) of the bill, sec. 11102 of the 1990 Act, and sec. 897 of the Code)

Present Law

The Revenue Reconciliation Act of 1990 (the "1990 Act") increased the alternative minimum tax rate on individuals from 21 percent to 24 percent.

Explanation of Provision

The bill conforms the rate of the minimum tax on the U.S. real property gains of nonresident aliens to the 24 percent minimum tax rate enacted in the 1990 Act.

2. Tax rate of personal holding companies (sec. 101(a)(4) of the bill, sec. 11101 of the 1990 Act, and sec. 541 of the Code)

Present Law

A corporation that is treated as a personal holding company is subject, in addition to the regular corporate tax, to a 28-percent tax on its undistributed personal holding company income for the taxable year. The present-law rate of 28 percent was set by the Tax Reform Act of 1986.[1] This rate reflected the maximum rate of tax on individuals in that Act.

The 1990 Act increased the maximum rate of tax on individuals from 28 percent to 31 percent effective for taxable years beginning after December 31, 1990.

Explanation of Provision

The bill provides that the increase in the individual maximum tax rate to 31 percent also applies to the personal holding company tax rate, effective for taxable years beginning after December 31, 1990.

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* Note: Unless otherwise indicated, the technical correction provision is effective as if included in the original Act to which the provision applies.

[1] See P.L. 99-514, sec. 104 (b)(8).

3. Definition of AGI for the earned income tax credit and the supplemental earned income tax credit for health insurance premiums (sec. 101(a)(5) of the bill, sec. 11111 of the 1990 Act, and sec. 32 of the Code)

Present Law

Under present law, a supplemental earned income tax credit (EITC) is available to certain taxpayers for qualified health insurance expenses. Qualified health insurance expenses for which the credit is available are amounts paid during the taxable year for health insurance coverage that includes one or more qualifying children. These expenses include only those expenses relating to the cost of coverage (i.e., premium cost) paid with after-tax dollars. The maximum credit is $428 in 1991. The credit is phased out as adjusted gross income (AGI) (or earned income, if greater) exceeds $11,250 in 1991. Earned income amounts taken into account in computing the maximum credit and the beginning point of the phase-out range are indexed for inflation.

The calculation of this supplemental child health insurance credit is generally the same as the calculation of the basic EITC. Thus, the same eligibility criteria and income phase-in and phase-out requirements apply. There is no family size adjustment with respect to the health insurance credit.

Present law provides that the amount of expenses taken into account in determining the deduction for health insurance costs of self-employed individuals (sec. 162(l)) is reduced by the amount (if any) of the supplemental child health insurance credit allowable to the taxpayer (sec. 162(l)(3)(B)). This so-called "double-dip" provision creates a calculation problem because the amount of the EITC, the supplemental young child credit, and the child health insurance credit cannot be determined until AGI is determined; however, AGI is determined with reference to the deduction for health insurance costs of self-employed individuals. Thus, the operation of the double-dip provision creates a circularity that increases the complexity of the child health credit.

Explanation of Provision

Under the bill, for purposes of the EITC, the supplemental young child credit, and the supplemental child health insurance credit, AGI is calculated assuming that the taxpayer is entitled to the full deduction for health insurance costs under section 162(l). Then, after the maximum child health credit is determined, the double-dip rule (sec. 162(l)(3)(B)) operates as it does under present law.

4. Correction of head of household rate table for proper indexation (sec. 101(a)(7) 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.

B. Excise Tax Provisions

1. Application of the 2.5-cents-per-gallon tax on fuel used in rail transportation to States and local governments (sec. 101(b)(3) 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.

2. Small winery production credit and bonding requirements (secs. 101(b)(6), (7), and (8) 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 pur-

pose 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. Floor stocks refunds for certain cigarette taxes (sec. 101(b)(9) of the bill and sec. 11202 of the 1990 Act)

Present Law

A floor stocks tax, equal to the amount of the rate increase, is imposed when the rates of Federal excise taxes (other than retail taxes) are increased. The cigarette excise tax rates increased on January 1, 1993. Refunds of this tax, as with the underlying excise tax, are permitted in certain cases.

Explanation of Provision

The bill clarifies that the Treasury Department may make refunds of the cigarette floor stocks tax imposed on January 1, 1993, to manufacturers rather than to the persons that actually pay the tax, if the manufacturers demonstrate that the benefit of the refund accrues to the person actually paying the tax.

C. Other Revenue-Increase Provisions of the 1990 Act

1. Deposits of Railroad Retirement Tax Act taxes (sec. 101(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.

2. Treatment of salvage and subrogation of property and casualty insurance companies (sec. 101(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, 952(c)(1) and 960 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.

3. Information with respect to certain foreign-owned or foreign corporations: Suspension of the statute of limitations during certain judicial proceedings (sec. 101(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 directly 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 noncompli-

ance 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." [2] The legislative history of the 1990 Act, which added section 6038C to the Code, uses the same language. [3]

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. There is no intent 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 involved. Similarly, there also is no intent 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.

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[2] H. Rep. 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).

[3] "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).

4. Rate of interest for large corporate underpayments (secs. 101(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".

D. Expiring Tax Provisions

1. Exclusion for employer-provided educational assistance (sec. 101(d)(1) of the bill, sec. 11403 of the 1990 Act, and secs. 127 and 132 of the Code)

Present Law

With respect to amounts paid before July 1, 1992, employer-provided educational assistance is excludable from gross income if the value of the assistance does not exceed $5,250 and certain other requirements are satisfied (sec. 127). Prior to the 1990 Act, the exclusion did not apply to graduate level courses. The 1990 Act eliminated this restriction. The Omnibus Budget Reconciliation Act of 1989 provided that educational assistance that is not excludable under section 127 due to the dollar limitation on the exclusion and the restriction on graduate level courses is excludable from gross income if and only if it qualifies as a working condition fringe benefit (sec. 132(h)).

Explanation of Provision

The bill amends the fringe benefit rules to reflect the fact that the graduate level course restriction has been repealed.

2. Research credit provision: Effective date for repeal of special proration rule (sec. 101(d)(2) of the bill and sec. 11402 of the 1990 Act)

Present Law

The Omnibus Budget Reconciliation Act of 1989 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 (the "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.

E. Energy Tax Provision: Alternative Minimum Tax Adjustment Based on Energy Preferences (secs. 101(e)(1) and (4) of the bill, sec. 11531(a) of the 1990 Act, and 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. 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.

F. Estate Tax Freezes (sec. 101(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. 2701-04).

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 [4] 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 descendents. 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

[4] 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.

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 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.[5] 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.

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[5] With respect to gifts made in 1990, the House bill provides that this election may be made by the due date (including extensions) of the transferor's 1991 gift tax return.

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 Department 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.

G. Miscellaneous Provisions

1. Conforming amendments to the repeal of the *General Utilities* doctrine (secs. 101(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 (the "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.

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).

2. Prohibited transaction rules (sec. 101(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.

3. Effective date of LIFO adjustment for purposes of computing adjusted current earnings (sec. 101(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.

4. Low-income housing credit (sec. 101(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 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 (the "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.

H. Expired or Obsolete Provisions ("Deadwood Provisions") (secs. 101(h)(1)-(18) 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.

II. Other Tax Technical Corrections

A. Hedge Bonds (sec. 102(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.

B. Withholding on Distributions from U.S. Real Property Holding Companies (sec. 102(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 corpo-

rate 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(a)(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(a)(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(a)(2)(i)).

FIRPTA withholding

The Tax Reform 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 ten 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.[6] 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

[6] 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.

of earnings and profits.) Under the bill, the FIRPTA withholding requirements that apply to a section 301 distribution not out of earnings 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.

C. Treatment of Credits Attributable to Working Interests in Oil and Gas Properties (sec. 102(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.

D. Clarification of Passive Loss Disposition Rule (sec. 102(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 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).[7] 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. The statutory language (as amended by

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

the 1988 Act) providing for the computation 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.

E. Estate Tax Unified Credit Allowed Nonresident Aliens Under Treaty (sec. 102(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.[8] 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.[9]

Specific exemption and unified credit

Prior to the Tax Reform Act of 1976, 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").[10]

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[8] 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).

[9] 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."

[10] See Rev. Rul. 81-303, 1981-2 C.B. 255.

The Tax Reform Act of 1976 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).[11]

The Technical and Miscellaneous Revenue Act of 1988 ("TAMRA") increased the unified credit allowed an estate of a nonresident alien to $13,000. In so doing, TAMRA 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, TAMRA 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. This provision is not intended to affect existing treaties containing pro rata exemptions, because in those treaties taxation follows situs. For future treaties, the bill contemplated 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.

F. Limitation on Deduction for Certain Interest Paid by Corporations to Related Persons (sec. 102(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 ac-

[11] 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).

crued in that year, the disallowed amount is treated under the earnings stripping provision as disqualified interest paid or accrued in the succeeding taxable year.[12]

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 disallow-

[12] 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.)

ance 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 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 amendment is effective as if they were included in the amendments made by section 7210(a) of the Revenue Reconciliation Act of 1989.

G. Branch-Level Interest Tax (sec. 102(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.[13] Where 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 amendments are effective as if they were made by the Tax Reform Act of 1986.

H. Determination of Source in Case of Sales of Inventory Property (sec. 102(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)).

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

Before and after the 1986 Act, statutory rules for sourcing income from inventory sales have included those covering income from (i) 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)); (ii) purchasing inventory property in the United States and selling it outside the United States (sec. 862(a)(6)); (iii) 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 (iv) 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 (section 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. No inference is intended to 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 amendment is effective as if it were included in the Tax Reform Act of 1986.

I. Repeal of Obsolete Provisions (sec. 102(f)(5) of the bill, sec. 10202 of the 1987 Act, 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 (Code sec. 6038). Information reporting is also required with respect to certain foreign-owned domestic corporations (Code 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 amendment is effective upon the date of its enactment.

J. Clarification of Certain Stadium Bond Transition Rule in Tax Reform Act of 1986 (sec. 102(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 to 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.

K. Health Care Continuation Rules (sec. 102(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 (the "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.

L. Taxation of Excess Inclusions of a Residual Interest in a REMIC for Taxpayers Subject to Alternative Minimum Tax With Net Operating Losses (sec. 102(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.

Finally, 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.

Effective Date

The bill 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.

M. Conforming Amendments Relating to Pension Reemployment Rights of Members of the Uniformed Services (sec. 102(j) of the bill and sec. 414 of the Code)

Legislative Background and Present Law

Veterans' bill

H.R. 1578 ("Uniformed Services Employment and Reemployment Rights Act of 1991") was passed by the House of Representatives on May 14, 1991. The Senate passed an amended version of the bill on October 1, 1992, which version, as further amended, was agreed to by the House on October 5, 1992, returning the bill to the Senate. There was no further action on the bill during the 102nd Congress.

H.R. 1578, as passed by the House and Senate, amends chapter 43 of title 38, United States Code, to provide for reemployment rights and benefits for individuals who serve in the uniformed services (i.e., the United States Armed Forces or the commissioned

corps of the Public Health Service). The bill provides, among other things, that service in the uniformed services is considered service with the employer for retirement plan benefit accrual purposes; the employer that reemploys the individual is liable for funding any resulting obligation; and the reemployed individual is entitled to any accrued benefits derived from employee contributions to the extent that the individual makes payments to the plan with respect to the contributions.

Internal Revenue Code

Under the Internal Revenue Code, overall limits are provided on contributions and benefits under certain retirement plans. Annual additions with respect to each participant under a qualified defined contribution plan generally are limited to the lesser of $30,000 or 25 percent of compensation. Annual deferrals with respect to each participant under an eligible deferred compensation plan (sec. 457) generally are limited to the lesser of $7,500 or 33⅓ percent of includible compensation. There is no provision under present law that permits contributions or deferrals to exceed these annual limits in the case of required contributions with respect to a reemployed member of the uniformed services.

Other requirements for which there is no special provision for required contributions with respect to a reemployed member of the uniformed services include the qualified plan nondiscrimination and coverage rules.

Explanation of Provision

The provision amends the Internal Revenue Code to provide special rules in the case of certain required contributions ("make-up contributions") with respect to a reemployed member of the uniformed services. The provision applies only with respect to contributions to a qualified defined contribution plan or eligible deferred compensation plan (sec. 457) that are required under chapter 43 of title 38, United States Code, as in effect on the day after such chapter is amended to expressly provide pension rights for reemployed veterans.

Under the provision, if any contribution is made by an employer under a qualified defined contribution plan or eligible deferred compensation plan ("individual account plan") with respect to an individual, and such contribution is required by reason of the individual's rights under chapter 43 of title 38, then such contribution is not subject to the generally applicable plan contribution limits in the year in which made.[14] In addition, a plan under which such make-up contribution is made will not be treated as failing to meet any requirement applicable to individual account plans (e.g., nondiscrimination rules, including the special ADP and ACP tests applicable to qualified cash or deferred arrangements) by reason of the making of such contribution, nor will the make-up contribution be taken into account in applying the plan contribution limits to any other contribution made during the year. Required contribu-

[14] However, the amount of any make-up contribution cannot exceed the aggregate amount of employer contributions that would have been permitted under the plan contribution limits had the individual continued to be employed by the employer during the period of uniformed service.

tions are deductible by the employer in the year made, notwithstanding the generally applicable deduction limit on plan contributions (sec. 404(a)), and such contributions are not taken into account in determining the deductibility of other plan contributions made during the year.

A special rule applies in the case of make-up contributions of salary reduction and employer matching amounts. Under the provision, a plan that provides for elective deferrals will be treated as meeting the requirements of chapter 43 of title 38 if the employer permits reemployed servicepersons to make additional elective deferrals under the plan during the period which begins on the date of reemployment and has the same length as the period of the individual's absence due to uniformed service (but in no case more than 5 years). The amount of the additional deferrals may not exceed the amount of deferrals that the individual would have been permitted to make under the plan had the individual continued to be employed by the employer during the period of uniformed service and received compensation at the same rate as received from the employer immediately before such service.

The employer is required to match any additional elective deferrals at the same rate that would have been required had the deferrals actually been made during the period of uniformed service. Additional deferrals and employer matching contributions are treated as required employer contributions for purposes of the rule exempting such contributions from the plan qualification rules described above.

The provision clarifies that nothing in chapter 43 of title 38 is to be construed as requiring any earnings to be credited to an employee with respect to any contribution before such contribution is actually made. In addition, nothing in chapter 43 of title 38 requires any make-up allocation of any forfeiture, or of any employer contribution which was either (1) voluntary (such as a discretionary profit-sharing contribution) or (2) the total amount of which was determined without reference to the number of, or compensation of, plan participants before being allocated to the accounts of participants. For example, make-up contributions would not be required under a plan that provides for a contribution of a set dollar amount, or set percentage of profits, each year. However, make-up contributions would be required under a plan that provides for contributions based on a percentage of participants' compensation. Any election by an employer to provide credit for such amounts (to the extent permitted under chapter 43 of title 38) is subject to applicable nondiscrimination and other plan qualification standards.

The provision also provides that a plan may suspend repayment of a plan loan for the period of uniformed service without adverse consequences to the individual.

Because make-up contributions under the bill are not made retroactively, but only after a serviceperson's reemployment, amended tax and information returns generally will not be required.

Effective Date

The provision is effective only if there is enacted a law passed by the 103rd Congress which amends chapter 43 of title 38 of the

United States Code to expressly provide pension rights for unemployed veterans. If such a law is enacted, this provision applies in cases in which the employee is reemployed on or after August 1, 1990.

N. Application of Harbor Maintenance Tax to Alaska and Hawaii Ship Passengers (sec. 102(k) 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).

Effective Date

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

O. Treatment of Certain RIC and REIT Reorganizations (sec. 102(l) of the bill and sec. 852(a) of the Code)

Present Law

A corporation cannot qualify as a regulated investment company ("RIC") for any taxable year unless (1) the RIC provisions applied to the company for all taxable years ending on or after November 8, 1983, or (2) at the close of the taxable year, the company has no earnings and profits attributable to any taxable year during which it was not a RIC (sec. 852(a)(2)). Thus, a corporation that was not a RIC during the taxable year that ended on or after November 8, 1983, cannot elect RIC status without distributing any earnings and profits attributable to non-RIC years.

Similar rules provide that a corporation cannot qualify as a real estate investment trust ("REIT") for any taxable year unless (1) the REIT provisions applied to the corporation for all taxable years beginning after February 28, 1986, or (2) at the close of the taxable year, the investment trust has no earnings and profits attributable to any taxable year during which it was not a REIT (sec. 857(a)(3)).

In addition, proposed regulations generally require a RIC that succeeds to non-RIC earnings and profits to distribute those earn-

ings and profits if the RIC is to continue to be taxable as a RIC.[15] These proposed regulations also generally require a REIT that succeeds to non-REIT earnings and profits to distribute those earnings and profits if the REIT is to continue to be taxable as a REIT.[16]

Explanation of Provision

The bill provides that a corporation cannot qualify as a RIC for any taxable year if the corporation is required to take into account earnings and profits that were accumulated by any other corporation unless those earnings and profits were accumulated by a corporation (1) that was subject to the RIC provisions for all taxable years ending on or after November 8, 1983, or (2) in a taxable year to which the RIC provisions applied. The bill provides similar rules for REITs.

No inference is intended with respect to present law on whether a RIC or REIT that succeeds to earnings and profits of a non-RIC or non-REIT, respectively, is permitted to retain these earnings and profits and continue to be taxable as a RIC or REIT.

Effective Date

The bill is effective for RICs and REITs that succeed to the earnings and profits of a non-RIC or a non-REIT, respectively, by reason of any transaction occurring after January 5, 1993.

P. Exclusion From Income For Combat Zone Compensation (sec. 102(n)(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 such service) (limited to $500 per month for 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.

[15] Prop. Treas. Reg. sec. 1.852-12.
[16] Prop. Treas. Reg. sec. 1.857-11.

TITLE II—SOCIAL SECURITY AND HUMAN RESOURCES

A. Social Security Provisions

1. Security benefits for disabled widows (sec. 201(a) of the bill, sec. 5103 of the 1990 Act, and 42 U.S.C. 423(f)(2))

Present Law

The Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) changed the definition of disability for disabled widows to the same definition that applies to disabled workers.

Explanation of Provision

The provision corrects two references to the previous standard for disabled widows which are now obsolete and which were inadvertently left unchanged by OBRA 1990.

2. Representative payee reform (sec. 201(b) of the bill and sec. 5105 of the 1990 Act)

Present Law

The Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) improved the representative payee system by requiring stricter standards to be used by the Social Security Administration in determining the fitness of the representative payee applicant to manage benefit payments on behalf of the beneficiary.

Explanation of Provision

The provision amends section 5105(d)(1) of the Omnibus Budget Reconciliation Act to redesignate paragraphs in section 205(j) of the Social Security Act.

3. Coordination of rules relating to fees for representatives of claimants for Social Security and SSI benefits (sec. 201(c) of the bill, sec. 5106 of the 1990 Act, 42 U.S.C. 406(b)(1) and 42 U.S.C. 1383(d)(2)(A)(i))

Present Law

The Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) established a new streamlined procedure for the approval of fees for representatives of claimants for title II (Social Security) and title XVI (Supplemental Security Income or SSI) benefits. In general, it permitted claimants' representatives to collect a fee of 25 percent of the total past-due benefits, not to exceed $4,000. If a claimant is concurrently entitled to past-due benefits under both titles, a windfall offset reduction is applied to whichever benefit is paid second.

That is, benefits paid under one title are reduced to account for overlapping benefits previously paid under the other title.

Explanation of Provision

The provision clarifies that, in concurrent title II/title XVI cases in which the windfall offset applies, a fee could not be approved under the streamlined procedures which is in excess of 25 percent of the combined benefits payable after application of the windfall offset, and such a fee could not exceed $4,000.

The provision would take effect as if it had been included in the Omnibus Budget Reconciliation Act of 1990.

4. Elimination of advanced tax transfers (201(d) of the bill, sec. 5115 of the 1990 Act, and 42 U.S.C. 401(a))

Present Law

The Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) eliminated the practice of crediting to the social security trust funds, at the start of each month, the full amount of social security tax receipts which were expected to be collected throughout the month. The trust funds are now credited with the receipts as they are collected throughout each month.

Explanation of Provision

The provision amends section 5115 of the Omnibus Budget Reconciliation Act of 1990 to amend the last sentence of section 201(a) of the Social Security Act by eliminating the second "and" where it appears as a duplication.

5. Elimination of rounding distortion in the calculation of the contribution/benefit bases and earnings test exempt amounts (sec. 202 of the bill and 42 U.S.C. 430(b))

Present Law

The OASDI contribution and benefit base, the HI contribution base, and the social security earnings test exempt amounts are adjusted automatically each year based on a formula that reflects increases in average wages in the economy. The amounts that result from applying the formula are rounded to the nearest multiple of $300 in the case of the OASDI contribution and benefit base and the HI contribution base and to the nearest multiple of $10 in the case of the monthly earnings test exempt amounts. Because each annual increase is based on the rounded amount for the preceding year, this procedure can result in distortions over time that are unpredictable and attributable solely to the cumulative effects of rounding.

Explanation of Provision

The provision would designate 1993 as the base year to be used in calculations of the OASDI contribution and benefit base, HI contribution base, and the social security earnings test exempt amounts for all years following 1993. The adjustment of these

amounts would then be linked more closely to changes in average wage levels and be consistent with the method used to adjust other wage-indexed program amounts, such as the amount required for a quarter of coverage.

Effective Date

The provision would apply to determinations of the OASDI contribution and benefit base and HI contribution base for years after 1993 and to determinations of the social security earnings test exempt amounts for taxable years ending after 1993.

B. Income Security and Human Resources Provisions

1. Corrections related to income security and human resources provisions of the Omnibus Budget Reconciliation Act of 1990 (sec. 211 of the bill and secs. 5035, 5057, 5105, 5107, 5109, 11115, and 13101 of the 1990 Act)

Present Law

The Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) included a number of provisions amending the Supplemental Security Income (SSI) and Aid to Families with Dependent Children (AFDC) programs. Included in these provisions were two separate amendments to section 1139(d) that were intended to clarify the interim and final reporting dates for the National Commission on Children. As enacted, however, the two amendments differ with respect to the reporting date for the interim report.

Explanation of Provisions

The provisions clarify that the interim reporting date for the Commission is March 31, 1990. The provisions make several other technical and conforming amendments related to the SSI and AFDC provisions enacted under OBRA 1990, including amendments that redesignate sections of law so that they are appropriately designated and amendments that correct cross references. The amendments also delete a clause in Title XVI of the Social Security Act dealing with representative payee record keeping and auditing requirements for parents and spouses that was deleted in Title II of the Social Security Act by section 5105(b)(A)(i) of OBRA 1990, but left inadvertently in Title XVI.

2. Corrections related to the human resources and income security provisions of the Omnibus Budget Reconciliation Act of 1989 (sec. 212 of the bill and secs. 8004, 8006, and 8007 of the 1989 Act)

Present Law

The Omnibus Budget Reconciliation Act of 1989 (OBRA 1989) included provisions amending the Aid to Families with Dependent Children (AFDC) quality control and foster care and adoption assistance programs.

Explanation of Provisions

The provisions make several technical and conforming amendments related to the AFDC and foster care and adoption assistance programs.

3. Elimination of obsolete provisions relating to treatment ofthe earned income tax credit (sec. 213 of the bill, secs. 1612 and 1631 of the Social Security Act, and secs. 1382 and 1383 of the Code)

Present Law

Title XVI of the Social Security Act includes obsolete provisions relating to the treatment of the earned income tax credit.

Explanation of Provision

The provision eliminates the obsolete provisions.

4. Redesignation of certain provisions (sec. 214 of the bill, sec. 1631 of the Social Security Act, and sec. 1383 of the Code)

Present Law

Subparagraphs (1) and (2) of Section 1631(e)(6) of the Social Security Act were incorrectly designated.

Explanation of Provision

The provision correctly designates the subparagraphs.

TITLE III—TARIFF AND CUSTOMS PROVISIONS

A. Technical Amendments to the Harmonized Tariff Schedule of the United States (HTSMS)

1. Tapestry and upholstery fabrics (sec. 301(a)(1) of the bill, sec. 472(b) of the Customs and Trade Act of 1990, sec. 10011(a) of the Omnibus Budget Reconciliation Act of 1990, and subheading 5112.19.20 to the HTS)

Present Law

The Customs and Trade Act of 1990 (P.L. 101-382, hereafter referred to as "the Trade Act") added several new HTS subheadings to headings 5111 and 5112 for tapestry fabrics and upholstery fabrics of a weight exceeding 300 grams per square meter. This reduced the tariff rate from 36.1 percent ad valorem to 7 percent ad valorem for these fabrics.

New HTS subheading 5112.19.10 was renumbered as 5112.19.20 in the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508, hereafter referred to as "OBRA 1990").

Explanation of Provision

Adding the words "of a weight exceeding 300 g/m2" to HTS subheading 5112.19.20 inadvertently raised the column 1 duty rate on certain tapestry and upholstery fabrics. Deleting these words restores prior HTS treatment.

The change applies retroactively to allow importers to apply for reassessment of duties levied since October 1, 1990 using the higher rate.

2. Gloves (sec. 301(a)(2) of the bill, secs. 10011 (a), (b)(2), and (b)(6) of OBRA 1990, and Chapter 61 and 62 to the HTS)

Present Law

In OBRA 1990, the HTS subheading 6216.00.47 was deleted; 6216.00.49 was redesigned as 6216.00.52, and it was indented so that it aligned with 6216.00.46 (which had been redesignated from 6216.00.44). Inadvertently, the superior text "Other," placed just above deleted 6216.00.47, was not stricken.

OBRA 1990 redesignated 6116.10.25 as 6116.10.45.

Explanation of Provision

The word "Other", inadvertently kept above the deleted 6216.00.47, is stricken.

New HTS subheading 6116.10.45 is redesignated as 6116.10.48 to avoid reusing a previously used subheading number.

3. Agglomerate stone floor and wall tiles (sec. 301(a)(3) of the bill, sec. 484B and 485(b) of the Trade Act, and subheading 6810.19.12 to the HTS)

Present Law

The Trade Act added a new HTS subheading (6810.19.12) for agglomerate marble floor tiles. This reduced the tariff rate from 21 percent ad valorem to 4.9 percent ad valorem for these types of tiles.

The provision as written only applies to geological marble and not to other types of material which may be commonly referred to as "marble," but are not recognized as such by the Explanatory Notes to the HTS.

Explanation of Provision

The description for HTS subheading 6810.19.12 is changed from "agglomerate marble tiles" to "floor and wall tiles of stone agglomerated with binders other than cement." The rewording covers tiles produced from chips or dust of various natural stones mixed with a plastic resin binding material.

The change applies retroactively to allow importers to apply for reassessment of duties levied since January 1, 1989 using the higher rate.

4. 2,4-Diaminobenzesulfonic acid (sec. 301(a)(4) of the bill, sec. 349 of the Trade Act, and subheading 9902.30.43 to the HTS)

Present Law

Under HTS 9902.30.43, which grants a duty suspension to 2,4-Diaminobenzesulfonic acid, "2911.51.50" is cited as the HTS subheading that imports of this chemical enter under.

Explanation of Provision

The correct HTS subheading that imports of 2,4-Diamino-benzenesulfonic acid enter under, "2921.59.50", is now cited.

5. Machines used in the manufacture of bicycle Parts (sec. 301(a)(5) of the bill, sec. 439 of the Trade Act, and subheading 9902.84.79 to the HTS)

Present Law

The Trade Act suspended the duty on machines used to manufacture bicycle wheels by adding a new HTS subheading, 9902.84.79. The machines covered include "wheeltruing" and "rim punching" machines. Subheading 9902.84.79 refers only to HTS subheading 8479.89.90 which covers "machines and mechanical appliances."

Explanation of Provision

Wheeltruing machines are covered by HTS subheading 9031.80.00 and rim punching machines are covered by HTS subheading 8462.49.00. These two additional subheadings are now referenced in subheading 9902.84.79.

The change applies retroactively to allow importers to apply for reassessment of duties levied since October 1, 1990.

6. Copying machines and parts (sec. 301(a)(6) of the bill, sec. 462(d)(2) of the Trade Act, and subheading 9902.90.90 to the HTS)

Present Law

HTS subheading 99021.90.90 provides duty-free treatment for parts and accessories of electrostatic copying machines. The Trade Act amended 9902.90.90 to cover parts and accessories intended for attachment to electrostatic copiers. Subheading 9902.90.90 refers to subheading 8472.90.80 as the provision that covers parts and accessories for attachment to electrostatic copiers.

Explanation of Provision

Parts intended for attachment to electronic copiers are covered by HTS subheading 8473.40.40 This additional subheading is now referenced in subheading 9902.90.90.

The change applies retroactively to allow importers to apply for reassessment of duties levied since January 1, 1989 using the higher rate.

B. Clarification Regarding the Application of Customs User Fees (sec. 302 of the bill, sec. 111(b)(2)(D)(v) of the Trade Act, sec. 13031(b)(8)(D) of the Consolidated Omnibus Budget Reconciliation Act of 1985, and 19 U.S.C. 58c(b)(8)(D)

Present Law

Section 111(b) of the Trade Act of 1990 provides that, in the case of agricultural products of the United States processed and packed in foreign trade zones, the ad valorem merchandise processing fee (MPF) shall be applied solely to the value of the foreign material used to make the container; it exempts the value of the domestic agricultural products from the MPF. The U.S. Customs Service has ruled that, for all products not covered by this provision and in the absence of an express provision to the contrary, the MPF would be assessed on both the domestic and foreign value of the merchandise entering from foreign trade zones.

Explanation of Provision

The bill clarifies that the MPF is to be applied only to the foreign value of the merchandise entered from a foreign trade zone. In addition, the bill also provides that the provision made by section 111(b))2)(D)(iv) of the Trade Act of 1990 regarding the application of the MPF to processed agricultural products will also apply to all unliquidated entries from foreign trade zones beginning December 1, 1986.

C. Technical Amendments to the Omnibus Trade and Competitiveness Act of 1988 (sec. 303 of the bill, sec. 1102(a) of the Omnibus Trade and Competitiveness Act of 1988, and 19 U.S.C. 2902(a))

Present Law

Section 1102(a) of the Omnibus Trade and Competitiveness Act of 1988 (19 U.S.C. 2902) (hereafter referred to as "the 1988 Trade Act") provides the President the authority to proclaim certain tariff reductions pursuant to trade agreements with foreign countries. Paragraph (a)(2) provides the President the authority to reduce tariff rates in existence as of August 23, 1988, at which time the Tariff Schedules of the United States (TSUS) were in effect. Pursuant to Title I, Subtitle B of the 1988 Trade Act, the TSUS were replaced by the HTS effective January 1, 1989. Tariff negotiations in the Uruguay Round of Multilateral Trade Negotiations have been conducted on the basis of U.S. tariff rates under the HTS rather than under the TSUS.

Explanation of Provision

The correction amends the 1988 Trade Act to reflect the fact that any tariff reductions that might be proclaimed by the President pursuant to Section 1102(a) of the 1988 Trade Act will be based upon the tariff rates under the HTS rather than under the TSUS.

D. Technical Amendment to the Customs and Trade Act of 1990 (sec. 304 of the bill, sec. 484H(b) of the Trade Act, and 19 U.S.C. 1553 note)

Present Law

The Customs and Trade Act of 1990 ("the 1990 Trade Act") provides for transportation in bond of Canadian lottery material.

Explanation of Provision

The bill replaces the phrase "entered or withdrawn from warehouse for consumption" in the "Effective Date" section of the 1990 Trade Act with "entered for transportation in bond". This had been done to clarify that Canadian lottery material is not entered into the U.S. for consumption.

E. Technical Amendment Regarding Certain Beneficiary Countries (sec. 305 of the bill, sec. 213(h) of the Caribbean Basin Economic Recovery Act (19 U.S.C. 2703(h)(1)), and sec. 204(c)(1) of the Andean Preference Act (19 U.S.C. 3203(c)(1)))

Present Law

Section 313(h) of the Caribbean Basin Economic Recovery Act provides duty reductions on certain handbags, luggage, flat goods, work gloves, and leather wearing apparel. An identical provision was included in the Andean Trade Preference Act.

Explanation of Provision

The bill clarifies that such duty reductions do not apply to such articles made of textiles and subject to textile agreements, effective 15 days after date of enactment.

F. Clarification of Fees for Certain Customs Services (sec. 306 of the bill, sec. 13031(b)(9)(A) of the Consolidated Omnibus Budget Reconciliation Act of 1985, and 19 U.S.C. 58c(b)(9)(A))

Present Law

19 U.S.C. 58(c) authorizes the Customs Service to provide reimbursable services to air couriers operating in express consignment carrier facilities and in centralized hub facilities. The Customs Service has interpreted the present statute to prevent Customs from providing reimbursable services during daytime hours to centralized hub facilities.

Explanation of Provision

The bill clarifies that Customs may provide daytime reimbursable services to centralized hub facilities during daytime hours. The provision also calcifies that Customs may be reimbursed for all services related to the determination to release cargo, and not just "inspectional" services. These services are reimbursable regardless of whether they are performed on site or not.

G. Conforming Amendment to Section 337 of The Tariff Act of 1930 (sec. 307 of the bill, sec. 337(b)(3) of the Tariff Act of 1930, and 19 U.S.C. 1337(b)(3))

Present Law

Section 337(b)(3) of the Tariff Act of 1930 (19 U.S.C. 1337(b)(3)) requires the International Trade Commission to terminate, or not institute, an investigation under section 337 in certain circumstances. These circumstances include those in which the Commission has reason to believe that the mater before it is based solely on alleged acts and effects which are within the purview of the countervailing and antidumping duty provisions of the Tariff Act of 1930, or relates to an alleged copyright infringement with respect to which action is prohibited under section 1002 of title 17.

Explanation of Provision

Section 337(b)(3) was amended by the Audio Home Recording Act of 1992 (P.L. 102-563) to include reference to an alleged copyright infringement with respect to which action is prohibited under section 1002 of title 17. The language of the amendment, however, incorrectly cited the countervailing and antidumping duty provisions of the Tariff Act of 1990. This technical amendment merely corrects the erroneous citation of these countervailing and antidumping duty provisions in section 337(b)(3).

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