DESCRIPTION OF S. 1394

(TAX SIMPLIFICATION ACT OF 1991)

AND PROPOSED MODIFICATIONS

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

On March 3, 1992

Prepared by the Staff

of the

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a brief description of the provisions of S. 1394 ("Tax Simplification Act of 1991") and proposed modifications. These provisions are scheduled for markup by the Senate Committee on Finance on March 3, 1992.

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[1] This document may be cited as follows: Joint Committee, Description of S. 1394 (Tax Simplification Act of 1991) and Proposed Modifications (JCX-8-92), March 3, 1992.

S. 1394 -- THE TAX SIMPLIFICATION ACT OF 1991

Title I.--Individual Tax Provisions

1. Rollover of gain on sale of principal residence (sec. 101 of the bill)

Description of Bill

Under present law no gain is recognized on the sale of a principal residence if a new residence at least equal in cost to the sales price of the old residence is purchased and used by the taxpayer as his or her principal residence within a specified period of time. This replacement period generally begins two years before and ends two years after the date of sale of the old residence. The basis of the replacement residence is reduced by the amount of any gain not recognized on the sale of the old residence by reason of section 1034.

The determination whether property is used by a taxpayer as a principal residence depends upon all the facts and circumstances in each case, including the good faith of the taxpayer. No safe harbor is provided for sales of principal residences incident to divorce or marital separation.

In general, nonrecognition treatment is available only once during any two-year period. In addition, if the taxpayer purchases more than one residence during the replacement period and such residences are each used as the taxpayer's principal residence within two years after the date of sale of the old residence, only the last residence so used is treated as the new replacement residence.

Special rules apply, however, if residences are sold in order to relocate for employment reasons. First, the number of times nonrecognition treatment is available during a two-year period is not limited. Second, if a residence is sold within two years after the sale of the old residence, the residence sold is treated as the last residence used by the taxpayer and thus as the only replacement residence.

Under the bill, gain is rolled over from one residence to another residence in the order the residences are purchased and used, regardless of the taxpayer's reasons for the sale of the old residence. In addition, gain may be rolled over more than once within a two-year period. Thus, the rules that formerly applied only if a taxpayer sold his or her residence in order to relocate for employment purposes will apply in all cases.

As under present law, the basis of each succeeding residence is reduced by the amount of gain not recognized on the sale of the prior residence.

Effective date.--The provision applies to sales of old residences (within the meaning of section 1034) after the date of enactment.

Proposed Modification

Delete the provision relating to multiple residences within the rollover period.

Also, provide a safe harbor in the determination of principal residence in certain cases incident to divorce or marital separation. Specifically, provide that a residence is treated as the taxpayer's principal residence at the time of sale if (1) the residence is sold pursuant to a divorce or marital separation, and (2) the taxpayer used such residence as his or her principal residence at any time during the two-year period ending on the date of sale.

Effective date.--The provision applies to sales of old residences (within the meaning of section 1034) after the date of enactment.

2. Due dates for estimated tax payments of individuals (sec. 102 of the bill)

Description of Bill

Under the bill, the due date for the second estimated tax payment of individuals is July 15th of the taxable year for which the payment relates.

Effective date.--The provision is effective for taxable years beginning after December 31, 1991.

Proposed Modification

Delete the provision.

3. Payment of tax by credit card (sec. 103 of the bill)

Description of Bill

The bill permits payment of taxes by credit card, to the extent and under the conditions provided by regulations.

Effective date.--The provision is effective on the date of enactment.

4. Election by parent to claim unearned income of certain children on parent's return (sec. 104 of the bill)

Description of Bill

The bill adjusts for inflation the dollar amounts entered on the Federal income tax return of a parent electing to report a child's unearned income. It likewise indexes the fixed dollar amount used in computing the child's exemption under the alternative minimum tax.

Effective date.--Taxable years beginning after December 31, 1991.

5. Simplified foreign tax credit limitation for individuals (sec. 105 of the bill)

Description of Bill

The bill allows individuals with no more than $200 of creditable foreign taxes, and no foreign source income other than income which is in the passive basket, to elect a simplified foreign tax credit limitation equal to the lesser of 25 percent of the individual's foreign source gross income or the amount of the creditable foreign taxes paid or accrued by the individual during the taxable year. A person who elects the simplified foreign tax credit limitation is not allowed a credit for any foreign tax not shown on a payee statement furnished to him or her, nor is the person entitled to treat any excess credits for a taxable year to which the election applied as a carryover to another taxable year.

For purposes of the simplified limitation, passive income generally is defined to include all types of income that would be foreign personal holding company income under the subpart F rules, plus income inclusions from passive foreign corporations (as defined by the bill), so long as the income is shown on a payee statement furnished to the individual. The statutory exceptions to treating these types of income as passive for foreign tax credit limitation purposes, such as the exceptions for high-taxed income and high withholding tax interest, are not applicable in determining eligibility to use the simplified limitation.

Effective date.--Taxable years beginning after December 31, 1991.

6. Personal transactions by individuals in foreign currency (sec. 106 of the bill)

Description of Bill

In a case where an individual acquires nonfunctional currency and then disposes of it in a personal transaction, and where exchange rates have changed in the intervening period, the bill provides for nonrecognition of an individual's resulting exchange gains not exceeding $200. The bill does not change the treatment of resulting exchange losses. It is understood that under other Code provisions, such losses typically are not deductible by individuals (e.g., sec. 165(c)).

Effective date.--Taxable years beginning after December 31, 1991.

7. Due date for furnishing information to partners of large partnerships (sec. 107 of the bill)

Description of Bill

The bill provides that a large partnership must furnish information returns to partners by the 15th day of the third month following the close of the partnership's taxable year. A large partnership is any partnership with 250 or more partners as well as any partnership subject to the simplified reporting rules for large partnerships (contained in sec. 201 of this bill, described below).

Effective date.--The provision is effective for taxable years ending on or after December 31, 1992.

Proposed Modification

Require information returns to be furnished by the first March 15 following the close of the partnership's taxable year, applicable only to those partnerships subject to the simplified reporting rules for large partnerships.

8. Make income tax withholding rules parallel to rules for exclusion from income for combat pay (sec. 108 of the bill)

Description of Bill

The bill makes the income tax withholding exemption rules parallel to the rules providing for an exclusion from gross income for combat pay.

Effective date.--The provision is effective as of January 1, 1992.

9. Expanded access to simplified income tax returns (sec. 109 of the bill)

Description of Bill

The bill provides that the Secretary of the Treasury (or his delegate) shall take such actions as may be appropriate to expand access to simplified individual income tax forms and to otherwise simplify the individual income tax returns.

The bill also requires that the Secretary submit a report to the Congress on the actions undertaken pursuant to this provision, together with any recommendations he may deem advisable.

Effective date.--The report is due no later than one year after the date of enactment.

10. Simplification of tax treatment of rural letter carriers' vehicle expenses (sec. 110 of the bill)

Description of Bill

The bill repeals the special reimbursement rate available to rural letter carriers who are employees of the U.S. Postal Service of 150 percent of the standard mileage rate. In its place, the bill provides that the rate of reimbursement provided by the Postal Service to rural letter carriers is considered to be equivalent to their expenses. The rate of reimbursement that is considered to be equivalent to their expenses is the current rate of reimbursement contained in the 1991 collective bargaining agreement, which may in the future be increased by no more than the rate of inflation.

Effective date.--The provision is effective for taxable years beginning after December 31, 1991.

11. Exemption from luxury excise tax for certain equipment installed on passenger vehicles for use by disabled individuals (sec. 111 of the bill)

Description of Bill

The bill provides that the luxury excise tax does not apply to a part or accessory installed on a passenger vehicle which compensates for the effect of the disability and enables or assists an individual with a disability to operate the vehicle, or to enter or exit the vehicle.

Effective date.--The provision is effective for purchases after December 31, 1990.

Title II. Treatment of Large Partnerships

A. General Provisions

1. Simplified flow-through for large partnerships (sec. 201 of the bill)

Description of Bill

The bill modifies the tax treatment of a large partnership (generally, a partnership with at least 250 partners, or an electing partnership with at least 100 partners) and its partners. The bill provides that each partner takes into account separately the partner's distributive share of the following items, which are determined at the partnership level: (1) taxable income or loss from passive loss limitation activities; (2) taxable income or loss from other activities (e.g., portfolio income or loss); (3) net capital gain to the extent allocable to passive loss limitation activities and other activities; (4) net alternative minimum tax adjustment separately computed for passive loss limitation activities and other activities; (5) general credits; (6) low-income housing credit; (7) rehabilitation credit; (8) for certain partnerships, tax-exempt interest; and (9) for certain partnerships, foreign taxes paid and foreign source partnership items.

All limitations and other provisions affecting the computation of taxable income or any credit generally are applied at the partnership (and not the partner) level. In addition, all elections affecting the computation of taxable income or any credit are made by the partnership.

In general, the large partnership rules do not apply to an excluded partner's distributive share of partnership items. An excluded partner is any partner (1) owning more than a five percent partnership interest, or (2) materially participating in the partnership's activities and holding any interest that is not a limited partnership interest.

The large partnership rules do not apply to a partnership if at least 50 percent of the value of its assets consists of oil or gas properties. In addition, the rules do not apply to any item attributable to any partnership oil or gas property. An election to apply these rules, however, generally can be made, in which event depletion is computed without regard to percentage depletion, and integrated oil companies and partners holding working interests in oil and gas are treated as excluded partners.

For all partners contributing property to a large partnership, the bill replaces section 704(c) with a "deferred sale" approach. Under the bill, a large partnership takes a fair market value basis in the property, and the contributing partner's precontribution gain or loss is deferred until the occurrence of specified recognition events.

Effective date.--The provisions generally apply to partnership taxable years ending on or after December 31, 1992.

Proposed Modifications

The modifications proposed to be made to the simplified reporting provisions of the large partnership proposal include the following: (1) generally eliminating the excluded partner concept; (2) separately stating creditable foreign taxes and foreign source items for all large partnerships, regardless of whether foreign source income is at least 25 percent of the partnership's gross income; (3) separately stating tax-exempt interest for all large partnerships, regardless of whether at least 50 percent of the value of the partnership's assets consists of tax-exempt obligations; (4) separately stating net capital loss as well as net capital gain, and treating such gain or loss as long-term capital gain or loss; (5) with respect to corporate partners, determining the net AMT adjustment by using the adjustments applicable to corporations; (6) excluding REMIC excess inclusion income from the gross income of the partnership; (7) separately stating a large partnership's discharge of indebtedness income, and clarifying that the provisions of section 108 apply without regard to the large partnership rules; (8) applying certain installment sale rules at the partnership level; (9) modifying the exclusion for service partnerships; (10) allowing the partnership (and not the partners) any credit for RIC capital gains; (11) excluding from the simplified reporting and audit regimes any partnership the principal activity of which is the buying and selling of commodities, or options, futures or forwards with respect to commodities; (12) modifying the deferred sale rules so that certain nonrecognition transactions would not be treated as dispositions that would trigger a contributing partner's deferred gain or loss; and (13) separately stating the credit for producing fuel from a nonconventional source.

The special rules applicable to large partnerships holding oil and gas properties would be modified as follows: (a) the simplified reporting regime would be made elective for large partnerships with at least 25 percent (measured by value) of their assets in oil or gas properties; (b) the computation of both cost depletion and percentage depletion (without application of either the "65-percent of taxable income" limitation or the 1,000-barrel-per-day limitation) would be made at the partnership level; and (c) partners who either do not qualify for percentage depletion deductions or for full expensing of intangible drilling and development costs (i.e., integrated oil and gas companies), or who have average daily production of more than 500 barrels of oil and gas, would be disqualified from the large partnership simplified reporting regime with respect to items related to partnership oil or gas property.

In addition to the modifications described above, other clarifying, conforming, clerical and miscellaneous modifications are proposed to the simplified reporting provisions.

2. Simplified audit procedures for large partnerships (sec. 202 of the bill)

Description of Bill

The bill creates a new audit system for large partnerships. The bill defines "large partnership" the same way for audit and reporting purposes (generally, partnerships with at least 250 partners) except that certain oil and gas partnerships are large partnerships for the audit rules but are not subject to the large partnership reporting requirements.

As under present law, large partnerships and their partners are subject to unified audit rules. Unlike present law, however, partnership adjustments generally will flow through to the partners for the year in which the adjustment takes effect. Thus, the current-year partners will adjust their current-year share of partnership items of income, gains, losses, deductions, or credits to reflect partnership adjustments that take effect that year. The adjustments generally will not affect prior year returns of any partners (except in the case of changes to any partner's distributive shares).

Effective date.--The bill applies to partnership taxable years ending on or after December 31, 1992.

Proposed Modification

None (other than modifications to conform to the modifications described in 1., above).

3. Partnership returns on magnetic media (sec. 203 of the bill)

Description of Bill

The bill authorizes the IRS to require large partnerships, and other partnerships with 250 or more partners, to provide the tax return of the partnership and copies of the schedules sent to each partner, to the IRS on magnetic media.

Effective date.--Partnership taxable years ending on or after December 31, 1992.

Proposed Modification

Effective date.--For partnerships that are large partnerships (as defined in the simplified reporting provision), effective for partnership taxable years ending on or after December 31, 1992. For partnerships that are not large partnerships (as defined) but that have 250 or more partners, effective for partnership taxable years ending on or after December 31, 1998.

B. Modification to TEFRA Partnership Proceedings (secs. 211 through 222 of the bill)

Description of Bill

The bill modifies the TEFRA partnership audit proceedings as follows:

1. Treatment of partnership items (sec. 211 of the bill)

The bill clarifies the treatment of partnership items in deficiency proceedings.

Effective date.--The provision is effective for partnership taxable years ending after the date of enactment.

2. Determination of proper audit procedures (sec. 212 of the bill)

The bill permits the IRS to rely on partnership returns to determine the proper audit procedures.

Effective date.--The provision is effective for partnership taxable years ending after the date of enactment.

3. Suspension of statute of limitations for untimely petitions and during bankruptcy proceedings (sec. 213 of the bill)

The bill suspends the statute of limitations for untimely petitions and during bankruptcy proceedings.

Effective date.--The bill shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

4. TEFRA small partnership exception (sec. 214 of the bill)

The bill expands the small partnership exception from TEFRA.

Effective date.--The bill is effective for partnership taxable years ending after the date of enactment.

5. Exclude partial settlements from 1-year assessment rules (sec. 215 of the bill)

The bill excludes partial settlements from 1-year assessment rules.

Effective date.--The bill is effective for partnership taxable years ending after the date of enactment.

6. Request for administrative adjustments (sec. 216 of the bill)

The bill extends the time for filing a request for administrative adjustment.

Effective date.--The bill is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

7. Innocent spouse relief (sec. 217 of the bill)

The bill provides innocent spouse relief for TEFRA proceedings.

Effective date.--The bill is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

8. Partnership level penalties (sec. 218 of the bill)

The bill determines penalties at the partnership level.

Effective date.--The bill is effective for partnership taxable years ending after December 31, 1991.

9. Tax Court jurisdiction (sec. 219 of the bill)

The bill clarifies jurisdiction of the Tax Court.

Effective date.--The bill is effective for partnership taxable years ending after the date of enactment.

10. Premature petitions (sec. 220 of the bill)

The bill modifies the treatment of premature petitions filed by certain partners.

Effective date.--The bill is effective with respect to petitions filed after the date of enactment.

11. TEFRA bond requirements (sec. 221 of the bill)

The bill clarifies the bond requirement for appeals from TEFRA proceedings.

Effective date.--The bill is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

12. Interest suspension (sec. 222 of the bill)

The bill suspends interest where there is a delay in computational adjustment resulting from TEFRA settlements.

Effective date.--The bill is effective with respect to settlements entered into after December 31, 1991.

Proposed Modification

Change the effective date of (3) to make it prospective; add a new provision to allow the IRS to rely on extensions of the statute of limitations that are signed by a tax matters partner who is bankrupt.

Title III.--Foreign Provisions

1. Deferral of tax on income earned through foreign corporations and exceptions to deferral (secs. 301-304 of the bill and secs. 453, 532, 535, 542, 543, 551-558, 563, 954, 1246-1247, and 1291-1297 of the Code)

Description of Bill

In general

The bill replaces the separate anti-deferral regimes of present law with a unified set of rules providing for either partial or full elimination of deferral depending on the circumstances. The bill preserves the present-law approach under which partial current taxation is a function of the type of income earned by the foreign corporation and a level of U.S. ownership in the corporation exceeding some threshold (as currently embodied in subpart F). The bill also preserves the present-law approach under which full current taxation is a function of a type of income or assets of the corporation exceeding some threshold (as currently embodied in subpart F, the PFIC rules, and the foreign personal holding company rules). In both cases, the bill generally applies current taxation through the operating rules of subpart F. The bill eliminates regimes that are redundant or marginally applicable, and ensures that no more than one set of rules generally will apply to a shareholder's interest in any one corporation in any one year.

Replacement of current law regimes for full elimination of deferral

The bill creates a single definition of a passive foreign corporation (PFC) that will unify and replace the foreign personal holding company and PFIC definitions. The rules applicable to PFCs represent a hybrid of characteristics of the foreign personal holding company rules, the PFIC rules, and the controlled foreign corporation rules (subpart F), plus a new mark-to-market regime, as well as a variety of simplifying or technical changes to rules under the existing systems. The differences between the PFIC provisions of present law and the PFC provisions that will be applicable under the bill are explained below.

A PFC is any foreign corporation if (1) 60 percent or more of its gross income is passive income, (2) 50 percent or more of its assets (on average during the year, measured by value) produce passive income or are held for the production of passive income, or (3) it is registered under the Investment Company Act of 1940 (as amended) either as a management company or as a unit investment trust. As under the PFIC rules, the foreign corporation is permitted to elect to measure its assets based on their adjusted bases rather than their value.

As under present law, passive income for this purpose is defined in the bill generally as any income of a kind which would be foreign personal holding company income as defined in section 954(c), subject to the current law exceptions for banking and insurance income and the current look-through rules for certain payments from related persons (current sec. 1296(b)(2)). In addition, the bill provides two clarifications to present law. First, the bill clarifies that, as indicated in the legislative history of the 1988 Act, the same-country exceptions from the definition of foreign personal holding company income in section 954(c) are disregarded. Second, the bill clarifies that any foreign trade income of a foreign sales corporation does not constitute passive income for purposes of the PFIC definition (cf. sec. 951(e)).

The bill modifies the present-law application of the asset test by treating certain leased property as assets held by the foreign corporation for purposes of the PFC asset test. This rule applies to tangible personal property with respect to which the foreign corporation is the lessee under a lease with a term of at least 12 months.

The bill also modifies the present-law rules that provide an exception from the definition of a PFIC in the case of a company changing businesses. Under the bill, if a foreign corporation holds 25 percent or more of the stock of a second corporation that qualifies for the change-of-business exception (current sec. 1297(b)(3)), then in applying the look-though rules (current sec. 1296(c)), the first corporation may treat otherwise passive assets or income of the second corporation as active.

The bill provides a new election that will allow certain passive foreign corporations to be treated as domestic corporations. A foreign corporation is eligible to make this election if (1) it would qualify for treatment as a regulated investment company (RIC) under the relevant provisions of the Code if it actually were a domestic corporation, (2) it meets such requirements as the Secretary may prescribe to ensure the collection of taxes imposed by the Internal Revenue Code on the passive foreign corporation, and (3) the electing passive foreign corporation waives all benefits which are granted by the United States under any treaty (including treaties other than tax treaties) and to which the corporation is otherwise entitled by reason of being a resident of another country. The rules governing such an election will be similar to those applicable to the election by a foreign insurance company to be treated as a domestic corporation under section 953(d).

The bill provides a special rule regarding the application of the PFC rules to tax-exempt organizations that own stock in passive foreign corporations. The passive foreign corporation rules, under the bill, do not apply to any organization exempt from tax under section 501 unless the organization is subject to unrelated business income taxation on its investment income under section 512(a)(3) of the Code. In the case of a tax-exempt organization that is subject to tax on its investment income, the PFC rules apply with respect to amounts taken into account in computing unrelated business taxable income in the same manner as if the organization were fully taxable.

Tax treatment under full elimination of deferral

The benefits of deferral are eliminated with respect to the income of a PFC under three alternative methods: current inclusion, mark-to-market, or interest charge on excess distributions.

Current inclusion method

Mandatory current inclusion.--If a passive foreign corporation is U.S. controlled, the bill will subject every U.S. person owning (directly or indirectly) stock in the PFC to income inclusions under a modified version of the controlled foreign corporation rules. If a PFC is not U.S. controlled, every U.S. person owning (directly or indirectly) 25 percent or more of the vote or value of the stock of the PFC will be subject to the same rules. Under the bill, the entire gross income of the passive foreign corporation (subject to applicable deductions) is treated as foreign personal holding company income, and thus is included (net of appropriate deductions) on a pro rata basis in the income of each U.S. person directly or indirectly owning stock in the PFC, under a modified application of the rules of sections 951 and 961. Actual distributions of earnings by such a PFC are treated similarly to distributions of previously taxed income under section 959 and 961. These rules supersede all application of the present-law rules applicable to foreign personal holding companies, under which earnings are deemed distributed and then contributed to the capital of the foreign personal holding company.

In applying the subpart F inclusion rules to PFC inclusions, the bill departs from subpart F in that foreign personal holding company income is included in the income of U.S. persons without regard to otherwise applicable reductions pursuant to the high-tax exception (under sec. 954(b)(4)) or the export trade corporation rules (secs. 970 and 971). This modification to the application of the controlled foreign corporation rules preserves present law in that no high-tax exception generally is available to PFICs or foreign personal holding companies, and that the PFIC provisions apply in full force to export trade corporations.

A passive foreign corporation is treated under the bill as U.S. controlled for this purpose either if it would be treated as a controlled foreign corporation under the rules of subpart F, or if, at any time during the taxable year, more than 50 percent of the vote or value of the corporation's stock were owned directly or indirectly by five or fewer U.S. persons (including but not limited to individuals, and including all U.S. citizens regardless of their residence).

Elective current inclusion.--A U.S. person not subject to the above mandatory current inclusion rules--that is, a U.S. person owning less than 25 percent of the stock in a PFC that is not U.S. controlled--may elect application of those rules. As under current law, the PFC is characterized as a "qualified electing fund" with respect to such a U.S. person. In the application of the elective current-inclusion rules, the passive foreign corporation is treated as a controlled foreign corporation with respect to the taxpayer, and the taxpayer is treated as a U.S. shareholder of the corporation. For foreign tax credit purposes, amounts included in the taxpayer's gross income under this modified application of the controlled foreign corporation rules are treated as dividends received from a foreign corporation which is not a controlled foreign corporation.

Mark-to-market method

Less-than-25-percent shareholders of passive foreign corporations that are not U.S.-controlled, and who do not elect current inclusion ("nonelecting shareholders"), are subject under the bill to one of two methods for taxing the economic equivalent of the PFC's current income: the mark-to-market method or the interest-charge method.

Under the bill, nonelecting shareholders of a PFC with marketable stock are required to mark their PFC shares to market annually. Under the mark-to-market method, the U.S. person is required to include in gross income each taxable year an amount equal to the excess (if any) of the fair market value of the PFC stock as of the close of the taxable year over the adjusted basis of the stock. In the event the adjusted basis of the stock exceeds its fair market value, the U.S. person is allowed a deduction for the taxable year equal to the lesser of the amount of the excess or the "unreversed inclusions" with respect to the stock. The bill defines the term "unreversed inclusions" to mean, with respect to any stock in a passive foreign corporation, the excess (if any) of the total amount of mark-to-market gains with respect to the stock included by the taxpayer for prior taxable years, over the amount of mark-to-market losses with respect to such stock that were allowed as deductions for prior taxable years.

The adjusted basis of stock in a passive foreign corporation is increased by the amount of mark-to-market gain included in gross income, and is decreased by the amount of mark-to-market losses allowed as deductions with respect to such stock.

All amounts of mark-to-market gain on PFC stock, as well as gain on the actual sale or distribution of PFC stock, are treated as ordinary income. Similarly, ordinary loss treatment applies to the deductible portion of any mark-to-market loss on PFC stock, as well as to any loss realized on the actual sale or other disposition of PFC stock to the extent that the amount of such loss does not exceed the unreversed inclusions with respect to that stock. These loss deductions are treated as deductions allowable in computing adjusted gross income.

The source of any amount of mark-to-market gain on PFC stock is determined in the same manner as if the amount of income were actual gain from the sale of stock in the passive foreign corporation. Similarly, the source of any amount allowed as a deduction for mark-to-market loss on PFIC stock is determined in the same manner as if that amount were an actual loss incurred on the sale of stock in the passive foreign corporation.

The mark-to-market method under the bill only applies to passive foreign corporations the stock of which is "marketable." PFC stock is treated as marketable if it is regularly traded on a qualified exchange, whether inside or outside the United States. PFC stock is also treated as marketable, to the extent provided in Treasury regulations, if the PFC continuously offers for sale or has outstanding any stock (of which it is the issuer) that is redeemable at its net asset value in a manner comparable to a U.S. regulated investment company (RIC).

In addition, the bill treats as marketable any stock in a passive foreign corporation that is owned by a RIC that continuously offers for sale or has outstanding any stock (of which it is the issuer) that is redeemable at its net asset value. The bill also treats as marketable any stock in a passive foreign corporation that is held by any other RIC, except to the extent provided in regulations.

The bill coordinates the application of the mark-to-market method with the tax rules generally applicable to RICs. The bill treats mark-to-market gain on PFC stock as a dividend for purposes of both the 90-percent investment income test of section 851(b)(2) and the 30-percent short-short limitation of section 851(b)(3).

The mark-to-market method does not apply to the stock of a U.S. person in any PFC that is U.S. controlled (as discussed above), to the stock of a person choosing qualified electing fund treatment, or to stock of a U.S. person who is a 25-percent shareholder (as defined above).

In the case of a controlled foreign corporation (including a passive foreign corporation that is treated under the bill as a controlled foreign corporation) that owns or is treated as owning stock in a passive foreign corporation, the mark-to-market method generally is applied as if the controlled foreign corporation were a U.S. person. For purposes of the application of subpart F to the controlled foreign corporation, mark-to-market gains are treated as if they were foreign personal holding company income of the character of dividends, interest, royalties, rents or annuities, and allowable deductions for mark-to-market losses are treated as deductions allocable to that category of foreign personal holding company income. The source of such income or loss, however, is determined by reference to the actual (foreign) residence of the controlled foreign corporation.

Interest-charge method

Nonelecting shareholders of a PFC with stock that is not marketable are subject to the interest-charge method, based on the PFIC interest-charge method that is currently provided in Code section 1291, with certain modifications.

First, although allowable foreign tax credits may reduce a U.S. person's net U.S. tax liability on an excess distribution, the interest charge computed on that excess distribution is computed, under the bill, without regard to reductions in net U.S. tax liability on account of direct foreign tax credits.

The PFIC provisions of present law, to the extent provided in regulations, impose recognition of gain in the case of a transfer of PFIC stock in a transaction that would otherwise qualify for the nonrecognition provisions of the Code. The bill imposes that result as a general rule, except as otherwise provided in Treasury regulations. In addition, the bill requires that proper adjustment be made to the basis of property, held by the U.S. person, through which the U.S. person is treated as owning stock in the passive foreign corporation.

The PFIC provisions of present law provide special rules for the application of the interest-charge method in the case of PFIC stock held by an U.S. person through an intermediary entity. These rules describe the dispositions that are treated as dispositions of PFIC stock by the U.S. person, and include rules to eliminate the possibility of double taxation (sec. 1297(b)(5)). The bill clarifies that these rules apply to any transaction that results in the U.S. person being treated as no longer owning the PFC stock, as well as any disposition of the PFC stock by the entity actually owning the PFC stock. These rules apply regardless of whether the transaction involves a disposition of the PFC stock, and regardless of whether the parties to the transaction include the U.S. person, the entity actually owning the PFC stock, or some other entity. The bill also clarifies that an income inclusion under the interest-charge method takes precedence over an income inclusion under subpart F resulting from the same disposition.

Under the bill, the interest-charge method applies to any stock in a passive foreign corporation unless either the stock is marketable (and therefore the mark-to-market method applies) as of the time of the distribution or disposition involved, or the stock in the passive foreign corporation was subject to the current inclusion method (under the bill or under prior law) for each taxable year beginning after December 31, 1986 which includes any portion of the taxpayer's holding period in the PFC stock. In the event that PFC stock, not subject to the current inclusion method, becomes marketable during the taxpayer's holding period, the interest-charge method applies to any distributions and dispositions during the year in which the stock becomes marketable, as well as to the mark-to-market gain (if any) as of the close of that year. In the event that PFC stock was initially marketable, and later becomes unmarketable and subject to the interest-charge method, the taxpayer's holding period in the PFC stock for purposes of the interest-charge method is treated as beginning on the first day of the first taxable year beginning after the last taxable year for which the mark-to-market method applies to the taxpayer's stock in the PFC.

The bill also provides for full basis adjustment for partnerships and S corporations that own stock in a passive foreign corporation subject to the interest-charge method. Although tax is imposed on a distribution or disposition under the interest-charge method without including the distribution or disposition in gross income, thus precluding the natural basis adjustments for amounts included in gross income, the bill grants regulatory authority for appropriate basis adjustments to partnerships and S corporations based on the amount of income subject to tax under the interest-charge method and thereby excluded from gross income.

The bill also includes a special rule to coordinate the application of the interest-charge method to nonelecting shareholders of a passive foreign corporation who are or were residents of Puerto Rico. Under the bill, no interest charge is applicable to amounts of an excess distribution that, were the amounts actually earned in the year to which they are treated as earned under the interest-charge method, would have been eligible for the exclusion under section 933 (for income derived by residents of Puerto Rico from sources within Puerto Rico).

Modification or repeal of other antideferral regimes

The bill treats as foreign personal holding company income for subpart F purposes an amount received under a personal service contract if a person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract. The bill similarly treats as foreign personal holding company income for subpart F purposes any amount received from the sale or distribution or disposition of such a contract. This rule applies only if at some time during the taxable year 25 percent or more of the value of the corporation's stock is owned (directly, indirectly, or constructively) by or for the individual who may be designated to perform the services. Income from such personal service contracts is not, however, treated as passive for foreign tax credit purposes.

The bill repeals the foreign personal holding company provisions, the PFIC provisions (except as modified and preserved as the passive foreign corporation provisions), and the foreign investment company provisions. The bill also excludes all foreign corporations from the application of the accumulated earnings tax and the personal holding company tax.

In addition, the bill denies installment sales treatment for any installment obligation arising out of a sale of stock in a passive foreign corporation. This will prevent shareholders in passive foreign corporations from avoiding the interest charge by means of an installment sale of their PFC stock.

Effective date.--The bill generally is effective for taxable years of U.S. persons beginning after December 31, 1991, and taxable years of foreign corporations ending with or within such taxable years of U.S. persons.

The denial of installment sales treatment is effective for sales or dispositions after December 31, 1991.

The bill does not affect the determination of the basis of stock in a PFIC that was acquired from a decedent in a taxable year beginning before January 1, 1991.

Proposed Modifications

a. Mark-to-market attribution rule.--The attribution rule which, for purposes of the mark-to-market method, treats stock owned (directly or indirectly) by or for a foreign partnership or foreign trust or foreign estate as owned proportionately by its partners or beneficiaries, applies except as provided in regulations.

b. Mark-to-market transition rules.--Mark-to-market gain representing appreciation in the value of PFC stock prior to the effective date of the bill is subject to tax under the interest-charge method, and each shareholder may elect to defer the payment of the tax. Subsequent mark-to-market losses may be deducted to the extent of the pre-effective-date appreciation, and an election to defer the payment of tax is terminated to the extent of such deductions taken and to the extent of excess distributions received. In the case of a regulated investment company, in place of applying the interest-charge method to pre-effective-date gain, a separate nondeductible interest charge is added to the company's tax. The mark-to-market method does not apply to appreciation in the value of the PFC stock prior to the time that a shareholder becomes subject to tax in the United States.

c. Fiscal year for regulated investment companies.--Regulated investment companies are permitted to compute their mark-to-market gain on the basis of a fiscal year ending two months before the close of the calendar year, solely for purposes of determining their ordinary income for purposes of the excise tax on the undistributed income of regulated investment companies.

d. Look-through treatment of capital gains.--As under present law, pass through the characterization of capital gains realized by the PFC to those shareholders who are subject to the current-inclusion method and who are not otherwise treated as "U.S. shareholders" of a CFC under subpart F. Unlike present law, make this treatment also available to qualifying shareholders of corporations that would also be foreign personal holding companies under present law.

e. High-tax exception.--As under present law, make the high-tax exception from current inclusion of PFC income available to shareholders who are otherwise treated as "U.S. shareholders" of a CFC under subpart F. Unlike present law, make this treatment also available to qualifying shareholders of corporations that would also be foreign personal holding companies under present law.

f. Character of income.--Clarify that, as under present law, PFC income included under subpart F is treated as base company income rather than foreign personal holding company income, and is eligible for look-through treatment for foreign tax credit limitation purposes, assuming the look-through rule would otherwise apply under present law.

g. Special basis rules applicable to stock in interest-charge PFCs acquired from decedents.--As under present law, apply the rules that deny basis step-up at death only to interest-charge PFCs. Unlike present law, conform to these basis rules the basis rules for stock acquired from a decedent in a corporation that would also be a foreign personal holding company under present law.

h. Nonrecognition override rules.--As under present law, apply the rules that override nonrecognition transactions only to interest-charge PFCs.

i. Attribution rules for pass-through entities.--Apply the bill's rules attributing stock ownership from partnerships, S corporations, estates, and trusts to their partners, shareholders, or beneficiaries except as provided in regulations.

j. Tiered PFCs.--Under regulations, apply the bill's recognition rules for dispositions by, and distributions to, entities through which U.S. persons own PFC stock.

k. Conform treatment of all income from active assets to the treatment of the assets.--Exclude from the definition of passive income for purposes of the definition of a PFC any income derived from assets that are treated as active assets for purposes of the definition of a PFC.

l. Application to tax exempts.--In the case of a tax-exempt organization, clarify that the PFC rules apply to stock held in a PFC only to the extent that a dividend on that stock would be taken into account in determining the unrelated business taxable income of the organization, and only to that extent.

m. Application to residents of U.S. possessions.--The PFC rules apply equally to all U.S. citizens, without regard to their residence. Special tax treatment available to possessions residents is unaffected by the bill.

n. Regulatory authority to prevent avoidance through renunciation of citizenship.--Give regulatory authority to prevent avoidance of interest charge through changes in citizenship, as well as through changes in residence.

o. Installment sale treatment.--The denial of installment sale treatment to dispositions of PFC stock is limited to stock in interest-charge PFCs.

p. Effect of income with respect to CFCs and PFCs on RICs.--Confirm that a RIC's income from a CFC or PFC, derived from the business of investing in stock or securities, counts toward satisfying the RIC's mandatory 90-percent income threshold (sec. 851(b)(2)).

Effective date.--Generally effective for taxable years of U.S. persons beginning after December 31, 1992, and taxable years of foreign corporations ending with or within such taxable years of U.S. persons.

The denial of installment sales treatment is effective for sales or dispositions after December 31, 1992.

The determination of the basis of stock that was acquired from a decedent in a taxable year beginning before January 1, 1992 is not affected.

2. Modifications to provisions affecting controlled foreign corporations (secs. 311 and 313 of the bill)

Description of Bill

a. Characterization of gain on disposition of stock of lower-tier controlled foreign corporations

The bill provides that if a controlled foreign corporation is treated as having gain from the sale or exchange of stock in a foreign corporation, the gain is treated as a dividend to the same extent that it would have been so treated under section 1248 if the controlled foreign corporation were a U.S. person. However, this rule does not affect the determination of whether the second corporation is a controlled foreign corporation.

Gain on disposition of stock in a related corporation created or organized under the laws of, and having substantial part of assets in a trade or business in, the same foreign country as the gain recipient, even if recharacterized as a dividend under the bill, is not therefore excluded from foreign personal holding company income under the same-country exception that applies to actual dividends.

Effective date.--Effective for gains recognized on transactions occurring after date of enactment of the bill.

b. Subpart F inclusions in year of disposition

Where a U.S. shareholder acquires the stock of a controlled foreign corporation from another U.S. shareholder during the middle of a year in which the controlled foreign corporation earns subpart F income, the bill reduces the acquirer's subpart F inclusion for that year by a portion of the amount of the dividend deemed (under sec. 1248) to be received by the transferor. The portion by which the inclusion is reduced would not exceed the subpart F inclusion for that year times the proportion of the year for which the acquirer did not own the stock.

Effective date.--Effective with respect to dispositions occurring after the date of enactment of the bill.

c. Adjustments to basis of stock held by foreign corporations

The bill provides that when a lower-tier controlled foreign corporation earns subpart F income, and stock in that corporation is later sold by an upper-tier controlled foreign corporation, the resulting income inclusion of the U.S. shareholders are, under regulations, adjusted to account for previous inclusions, in a manner similar to the adjustments now provided to the basis of stock in a first-tier controlled foreign corporation.

Effective date.--Effective for adjustments attributable to inclusions for taxable years of U.S. shareholders beginning after December 31, 1991.

d. Avoiding double inclusions in other cases

The bill contemplates that in the case of a cross-chain section 304 dividend out of the earnings of controlled foreign corporations that were previously included in the income of a U.S. shareholder under subpart F, the Treasury Secretary in his discretion may by regulation treat such dividends as distributions of previously taxed income, with appropriate basis adjustments. In addition to cases involving section 304, the bill provides that the Secretary may by regulation modify the application of subpart F in any other case where there would otherwise be a multiple inclusion of any item of income (or an inclusion or exclusion without an appropriate basis adjustment) by reason of the structure of a U.S. shareholder's holdings in controlled foreign corporations or by reason of other circumstances.

Effective date.--Date of enactment of the bill.

e. Treatment of United States income earned by a controlled foreign corporation

The bill provides that an exemption or reduction by treaty of the branch profits tax that would be imposed under section 884 on a controlled foreign corporation does not affect the general statutory exemption from subpart F income that is granted for U.S. source effectively connected income.

Effective date.--Taxable years ending after the date of enactment.

Proposed Modification

a. Characterization of gain on disposition of stock of lower-tier controlled foreign corporations

The proposed modification would repeal the provision added to section 904(d)(2)(E) by the 1988 Act which, except as provided by regulations, requires a recipient of a distribution from a controlled foreign corporation to have been a United States shareholder in that controlled foreign corporation for the period during which the earnings and profits which gave rise to the distribution were generated in order to avoid treating the distribution as one coming from a noncontrolled section 902 corporation.

Effective date.--Effective for distributions after date of enactment.

b. Subpart F inclusions in year of disposition

None.

c. Adjustments to basis of stock held by foreign corporations

None.

Effective date.--Effective for purposes of determining U.S. shareholder inclusions in taxable years of U.S. shareholders beginning after December 31, 1992.

d. Avoiding double inclusions in other cases

None.

e. Treatment of United States income earned by a controlled foreign corporation

None.

Effective date.--Taxable years beginning after December 31, 1986.

3. Foreign tax credit in year of receipt of previously taxed earnings and profits (sec. 312 of the bill)

Description of Bill

The bill repeals the rules that permit an indirect foreign tax credit to be claimed with respect to a distribution of previously taxed earnings and profits. Under the bill, foreign taxes paid by a foreign corporation with respect to previously taxed earnings and profits remain in that corporation's pool (or pools) of foreign taxes which are available for the indirect foreign tax credit upon subsequent distributions or deemed distributions of earnings and profits that have not been previously taxed at the U.S. shareholder level.

Effective date.--Generally for taxable years beginning after December 31, 1991. However, the provision is not effective with respect to distributions of previously taxed income which occur in taxable years beginning prior to January 1, 1997, if the distributions relate to subpart F income inclusions for taxable years of the U.S. corporate shareholders beginning before January 1, 1992.

Proposed Modification

The proposed modification would retain the present-law provision that permits an indirect foreign tax credit to be claimed with respect to a distribution of previously taxed earnings and profits. However, it would provide authority for Treasury regulations to establish a simplified method for computing the increase in foreign tax credit limitation that results from the application of that provision.

4. Translation of foreign taxes into U.S. dollar amounts (section 321 of the bill)

Description of Bill

The bill grants the Secretary of the Treasury authority to issue regulations that would allow foreign tax payments made by a foreign corporation or by a foreign branch of a U.S. person to be translated into U.S. dollar amounts using an average U.S. dollar exchange rate for a specified period. It is anticipated that the applicable average exchange rate would be the rate as published by a qualified source of exchange rates for the period during which the tax payments were made.

Effective date.--Date of enactment.

Proposed Modification

The proposed modification generally would permit accrual-basis taxpayers to accrue foreign taxes at the average exchange rate for the taxable year to which such taxes relate. If at the close of the second taxable year after the close of the accrual year any tax so accrued has not yet been paid, a redetermination of foreign tax under section 905(c) would be required for the amount of such unpaid tax. That is, the accrual of any tax that is unpaid as of that date would be retroactively denied. In the case of a direct foreign tax credit under section 901, a section 905(c) adjustment for the year of accrual would be required -- generally resulting in the requirement to file an amended tax return for that year. In the case of an indirect foreign tax credit under section 902, an adjustment to the taxpayer's pool of foreign taxes generally would be required.

If tax in excess of the accrued amount (or in excess of the net accrual amount following a section 905(c) adjustment) is actually paid, such excess amount would be translated at the average exchange rate in effect for the year of payment.

Rules similar to those set forth in the bill would apply (1) to tax payments in inflationary currencies, (2) to taxpayers that are not on the accrual basis for determining creditable foreign taxes, or (3) with respect to taxes of an accrual-basis taxpayer that are actually paid in a year prior to the year to which they relate.

Effective date.--Taxes paid or accrued in taxable years beginning after December 31, 1991.

5. Foreign tax credit limitation under the alternative minimum tax (sec. 322 of the bill and sec. 59(a) of the Code)

Description of Bill

For purposes of the alternative minimum tax, the bill permits taxpayers to elect to use as their foreign tax credit limitation fraction the ratio of foreign source regular taxable income to entire alternative minimum taxable income, rather than the ratio of foreign source alternative minimum taxable income to entire alternative minimum taxable income. Foreign source regular taxable income may be used, however, only to the extent it does not exceed entire alternative minimum taxable income.

The election under the bill is available only in the first taxable year beginning after December 31, 1991, for which the taxpayer claims an alternative minimum tax foreign tax credit. The election applies to all subsequent taxable years, and may be revoked only with the permission of the Secretary of the Treasury.

Effective date.--The provision applies to taxable years beginning after December 31, 1991.

Proposed Modification

None.

Effective date.--Taxable years beginning after December 31, 1992.

6. Authority to simplify regulations relating to certain transfers of property involving foreign corporations

Description of Bill

No provision.

Proposed Modification

In inbound cases where nonrecognition treatment must be based on the status of a foreign corporation as a corporation, permit the Secretary to require certain income inclusions without regard to a gain limitation, in cases where anti-abuse rules would otherwise apply. Permit better coordination between inbound and outbound reorganization provisions.

Effective date.--Transfers after December 31, 1993.

7. Simplification of tax on transfers to avoid income tax

Description of Bill

No provision.

Proposed Modification

Outbound transfers now subject to section 1491 would continue to be subject to tax, but the tax would be an income tax, rather than an excise tax, and recognized gain would result in a step-up of basis of the property transferred.

Effective date.--Transfers after date of enactment.

Title IV.--Other Income Tax Provisions

A. Provisions Relating to S Corporations

1. Determination of whether an S corporation has one class of stock (sec. 401 of the bill)

Description of Bill

The bill provides that for purposes of determining whether a corporation meets the subchapter S one-class-of-stock requirement, a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Effective date.--Taxable years beginning after December 31, 1982.

2. Authority to validate certain invalid elections (sec. 402 of the bill)

Description of Bill

Under the bill, the authority of the Internal Revenue Service to waive the effect of an inadvertent termination is extended to allow the Service to waive the effect of an invalid election caused by an inadvertent failure to qualify as a small business corporation or to obtain the required shareholder consents.

The bill also allows the Internal Revenue Service to treat a late Subchapter S election as timely where the Service determines that there was reasonable cause for the failure to make the election timely.

Effective date.--Taxable years beginning after December 31, 1982.

3. Treatment of distributions by S corporations during loss year (sec. 403 of the bill)

Description of Proposal

The bill provides that the adjustments for distributions made by an S corporation during a taxable year are taken into account before applying the loss limitation for the year. Thus, distributions during a year reduce the adjusted basis for purposes of determining the allowable loss for the year, but the loss for a year does not reduce the adjusted basis for purposes of determining the tax status of the distributions made during that year.

The bill also provides that in determining the amount in the accumulated adjustment account for purposes of determining the tax treatment of distributions made during a taxable year by an S corporation having accumulated earnings and profits, net negative adjustments (i.e., the excess of losses and deductions over income) for that taxable year are disregarded.

Effective date.--Distributions made in taxable years beginning after December 31, 1991.

4. Treatment of S corporations as shareholders in C corporations (sec. 404(a) of the bill)

Description of Bill

The bill repeals the rule that treats an S corporation in its capacity as a shareholder of another corporation as an individual. Thus, the liquidation of a C corporation into an S corporation will be governed by the generally applicable subchapter C rules, including the provisions of sections 332 and 337 allowing the tax-free liquidation of a corporation into its parent corporation. An S corporation will also be eligible to make a section 338 election (assuming all the requirements are otherwise met), resulting in immediate recognition of all the acquired C corporation's gains and losses (and the resulting imposition of a tax).

Effective date.--Taxable years beginning after December 31, 1991.

5. S corporations permitted to hold subsidiaries (sec. 404(b) of the bill)

Description of Bill

The bill repeals the rule that an S corporation may not be a member of an affiliated group of corporations. Thus, an S corporation will be allowed to own up to 100 percent of the stock of a C corporation. However, an S corporation cannot be included in a group filing a consolidated return.

Effective date.--Taxable years beginning after December 31, 1991.

6. Elimination of pre-1983 earnings and profits of S corporations (sec. 404(c) of the bill)

Description of Bill

The bill provides that if a corporation is an S corporation for its first taxable year beginning after December 31, 1991, the accumulated earnings and profits of the corporation as of the beginning of that year are reduced by the accumulated earnings and profits (if any) accumulated in any taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S.

Effective date.--Taxable years beginning after December 31, 1991.

7. Determination of shareholder's pro rata share where disposition of entire interest (sec. 404 (d) of the bill)

Description of Bill

Under the bill, the present-law rule, allowing an S corporation to elect to close its books for purposes of determining shares of income on the termination of a shareholder's interest, will be the mandatory rule in the case of the disposition of a shareholder's entire interest in the corporation.

Effective date.--Taxable years beginning after December 31, 1991.

Proposed Modification

Delete the provision from the bill.

8. Treatment of items of income in respect of a decedent held by an S corporation (sec. 404(e) of the bill)

Description of Bill

The bill provides that a person acquiring stock in an S corporation from a decedent will treat as income in respect of a decedent ("IRD") his pro rata share of any item of income of the corporation which would have been IRD if that item had been acquired directly from the decedent. Where a item is treated as IRD, a deduction for the estate tax attributable to the item generally will be allowed under the provisions of section 691(c). The stepped-up basis in the stock will be reduced by the extent to which the value of the stock is attributable to items consisting of IRD. This basis rule is comparable to the present-law partnership rule.

Effective date.--Decedents dying after date of enactment of the bill.

B. Accounting Provisions

1. Modifications to the look-back method for long-term contracts (sec. 411 of the bill)

Description of Bill

Election not to apply the look-back method for de minimis amounts

The bill provides that a taxpayer may elect not to apply the look-back method with respect to a long-term contract if for each prior contract year, the cumulative taxable income (or loss) under the contract as determined using estimated contract price and costs is within 10 percent of the cumulative taxable income (or loss) as determined using actual contract price and costs.

Thus, under the election, upon completion of a long-term contract, a taxpayer would be required to apply the first step of the look-back method (the reallocation of gross income using actual, rather than estimated, contract price and costs), but would not be required to apply the additional steps of the look-back method if the application of the first step resulted in de minimis changes to the amount of income previously taken into account for each prior contract year.

The election applies to all long-term contracts completed during the taxable year for which the election is made and to all long-term contracts completed during subsequent taxable years, unless the election is revoked with the consent of the Secretary of the Treasury.

Election not to reapply the look-back method

The bill provides that a taxpayer may elect not to reapply the look-back method with respect to a contract if, as of the close of any taxable year after the year the contract is completed, the cumulative taxable income (or loss) under the contract is within 10 percent of the cumulative look-back income (or loss) as of the close of the most recent year in which the look-back method was applied (or would have applied but for the other de minimis exception described above). In applying this rule, amounts that are taken into account after completion of the contract are not discounted.

Thus, an electing taxpayer need not apply or reapply the look-back method if amounts that are taken into account after the completion of the contract are de minimis.

The election applies to all long-term contracts completed during the taxable year for which the election is made and to all long-term contracts completed during subsequent taxable years, unless the election is revoked with the consent of the Secretary of the Treasury.

Interest rates used for purposes of the look-back method

The bill provides that for purposes of the look-back method, only one rate of interest is to apply for each accrual period. An accrual period with respect to a taxable year begins on the day after the return due date (determined without regard to extensions) for the taxable year and ends on such return due date for the following taxable year. The applicable rate of interest is the overpayment rate in effect for the calendar quarter in which the accrual period begins.

Effective date.--Contracts completed in taxable years ending after the date of enactment.

2. Simplified method for applying uniform cost capitalization rules (sec. 412 of the bill)

Description of Bill

The bill authorizes (but does not require) the Treasury Department to issue regulations that allow taxpayers in appropriate circumstances to determine the costs of any administrative, service, or support function or department that are allocable to production or resale activities by multiplying the total amount of costs of any such function or department by a fraction, the numerator of which is the amount of costs of the function or department that was allocable to production or resale activities for a base period and the denominator of which is the total amount of costs of the function or department for the base period.

Effective date.--Generally taxable years beginning after the date of enactment of the bill.

C. Minimum Tax Provisions

1. Depreciation under the corporate alternative minimum tax (sec. 421 of the bill)

Description of Bill

The bill applies a 120-percent declining balance method (switching to straight-line at a point maximizing depreciation deductions) for personal property (other than transition property to which the ACRS system in effect before the Tax Reform Act of 1986 applies) for determining the alternative minimum taxable income (AMTI) of a corporation. No further depreciation adjustment for this property would be required for the adjusted current earnings (ACE) component of the corporate alternative minimum tax (AMT).

Corporate taxpayers may elect to use the 120-percent declining balance method of depreciation for regular tax purposes.

Effective Date.--The provision is effective for property placed in service in taxable years beginning after December 31, 1990.

Proposed Modification

Delete provision. (Another item in the Chairman's proposal would provide that no additional adjustment be made for adjusted current earnings for property placed in service on or after February 1, 1992.)

2. Treatment of built-in losses for purposes of the corporate alternative minimum tax (sec. 422 of the bill)

Description of Bill

The bill repeals the ACE rule relating to the treatment of built-in losses after a change of ownership. Thus, for ACE purposes, the treatment of built-in losses would be similar to the treatment of net operating loss carryovers (in the same way that the treatment of built-in losses is similar to the treatment of net operating losses for regular tax purposes).

Effective date.--The provision is effective for changes of ownership occurring after December 31, 1991.

D. Tax-Exempt Bond Provisions

1. Simplification of arbitrage rebate requirement for governmental bonds (sec. 431 of the bill)

<u>Description of Bill</u>

The bill expands an exception to the arbitrage rebate requirement to exempt from rebate certain governmental and qualified 501(c)(3) bonds if at least 95 percent of the bond proceeds are spent within six months after the bonds are issued, and the remainder is spent within one year. Present law requires that no more than the lesser of five percent of $100,000 remain unspent after six months.

<u>Effective date</u>.--The provision applies to bonds issued after the date of the bill's enactment.

2. Simplification of compliance with 24-month arbitrage rebate exception for construction bonds (sec. 432 of the bill)

<u>Description of Bill</u>

The bill exempts earnings on construction bond proceeds invested in bona fide debt service funds from rebate if the spending and penalty requirements of the 24-month exception to the arbitrage rebate requirement for such bonds otherwise are satisfied.

<u>Effective date</u>.--The provision applies to bonds issued after the date of the bill's enactment.

3. Automatic extension of initial temporary period for certain construction bonds (sec. 433 of the bill)

<u>Description of Bill</u>

The bill provides that the initial temporary period for construction bonds is automatically extended for a period of 12 months if at least 85 percent of the available construction proceeds are spent within the original initial temporary period and the issuer reasonably expects to spend the remaining proceeds within the 12-month extension period. Construction bonds eligible for this automatic extension include only those bonds currently eligible for the 24-month rebate exception for construction bonds.

<u>Effective date</u>.--The provision applies to bonds issued after the date of the bill's enactment.

4. **Simultaneous issuance of certain discrete issues not aggregated (sec. 434 of the bill)**

<u>Description of Bill</u>

The bill allows discrete issues of governmental bonds to be issued simultaneously without being treated as a single issue if one of the issues is a tax and revenue anticipation note that is reasonably expected to be exempt from the arbitrage rebate requirement.

<u>Effective date</u>.--The provision applies to bonds issued after the date of the bill's enactment.

<u>Proposed Modification</u>

Include no inference language with respect to the proper treatment of bonds issued before the date of the bill's enactment.

5. **Authority for Treasury Department to exempt certain taxpayers from tax-exempt interest reporting requirement (sec. 435 of the bill)**

<u>Description of Bill</u>

The bill authorizes the Internal Revenue Service to provide exceptions from the requirement that taxpayers report interest on State and local government bonds on their Federal income tax returns.

<u>Effective date</u>.--The provision is effective for taxable years beginning after the date of the bill's enactment.

6. **Repeal deadwood provisions (sec. 436 of the bill)**

<u>Description of Bill</u>

The bill deletes as deadwood two expired exceptions to the arbitrage rebate requirement which applied to certain student loan bonds issued before January 1, 1989.

<u>Effective date</u>.--The provision is effective on and after the date of the bill's enactment.

7. **Expansion of exception to pro rata disallowance of bank interest expense related to investment in tax-exempt bonds**

<u>Description of Bill</u>

No provision.

Proposed Modification

Financial institutions that invest in tax-exempt bonds are precluded from deducting a pro rata portion of their interest expense determined by reference to the percentage of their assets that consist of such bonds. This pro rata disallowance rule does not apply to governmental bonds issued by entities that issue no more than $10 million of such bonds during a calendar year (the "small issuer exception"). Bond issues in excess of $10 million do not qualify for the small-issuer exception even if the proceeds are re-loaned to issuers borrowing less than $10 million in a calendar year.

The proposed modification would increase the $10 million annual issuance limit to $25 million, and would provide that pooled financing bonds would qualify for the exception if all borrowers from the pool would qualify if borrowing directly from a financial institution, and if certain other requirements were satisfied.

Effective date.--The proposed modification would apply to bonds issued after December 31, 1992.

8. Recharacterize qualified 501(c)(3) bonds and repeal $150 million per-organization limit on certain of these bonds

Description of Bill

No provision.

Proposed Modification

Tax-exempt bonds for use by private, nonprofit organizations ("section 501(c)(3) organizations") are characterized as private activity bonds, and except for qualified hospital bonds, are subject to a per-organization limit of $150 million of bonds that may be outstanding at any time.

The proposed modification would reinstate the pre-1986 characterization of these bonds which treated them as more similar to governmental (rather than private activity) bonds, and would repeal the $150 million limit and made other technical and conforming amendments.

Effective date.--The proposed modification would apply to bonds issued after December 31, 1992.

E. Other Provisions

1. Treatment of Certain Revocable Trusts as Estates (sec. 441 of the bill)

<u>Description of Bill</u>

The bill treats as estates certain grantor trusts receiving the residue of the probate estate under the grantor's will. If no will is admitted to probate, the revocable trust that is primarily responsible for paying taxes, debts and expenses of administration is treated as an estate. The bill applies only to years beginning within three years, nine months of the decedent's death.

<u>Effective date</u>.--Decedents dying after date of enactment.

<u>Proposed Modification</u>

Delete the provision of the bill.

2. Matching rules for payments to partners (sec. 442 of the bill)

Description of Bill

The bill defers the deduction of guaranteed payments by a partnership until the year in which they are includible in the partner's income.

Effective date.--Amounts taken into account after date of enactment.

Proposed Modification

Delete the provision of the bill.

3. Close partnership taxable year with respect to deceased partner (sec. 443 of the bill)

Description of Bill

The bill provides that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation or otherwise.

Effective date.--Partnership taxable years beginning after December 31, 1991.

4. Clarification of Amount of Gain Recognized by a Securityholder in a Reorganization, Etc. (sec. 444 of the bill)

Description of Bill

The bill provides that for purposes of determining the amount of gain recognized to a securityholder in a reorganization (or a sec. 355 distribution), the excess of the issue price (as defined in secs. 1273 and 1274) of the securities received over the adjusted issue price of the securities surrendered will be treated as other property. If securities are received and none surrendered, the entire issue price is treated as other property. If the issue price of the securities received does not exceed the adjusted issue price of the securities surrendered, then no amount of the securities is treated as other property.

The adjusted issue price of a security surrendered means the issue price of the security, increased by the OID previously included in the gross income of any holder of the security (determined without to the special rule for subsequent holders), or decreased by the amount of bond premium which would have been allowed as a deduction (or offset) if the bond had always been held by the original holder. Where section 1273(b)(4) applies to a security, the stated redemption price is reduced by the amount of the redemption price which is treated as interest (for example, under sec. 483).

<u>Effective date</u>.--Exchanges and distributions after the date of enactment.

Proposed Modification

Delete the provision from the bill.

Title V.--Estate and Gift Tax Provisions

1. Waiver of right of recovery for certain marital deduction property (sec. 501 of the bill)

Description of Bill

Under the bill, a surviving spouse's estate has a right of recovery with respect to qualified terminable interest property (QTIP) unless the spouse otherwise directs in a provision of the will (or revocable trust) specifically referring to Code section 2207A, which grants such right.

Effective date.--Decedents dying after the date of enactment.

Proposed Modification

Revise the bill to provide that the right of recovery with respect to QTIP is waived by language specifically indicating intent to waive the right, rather than by language specifically referring to section 2207A. Adopt the same rule for waiving the right of contribution with respect to property over which the decedent retained the right to enjoyment or income.

2. Inclusion in gross estate of certain gifts made within three years of death (sec. 502 of the bill)

Description of Bill

The bill provides that a transfer from a revocable trust within three years of death does not result in including the transfer in the gross estate. The bill also revises section 2035 to improve its clarity.

Effective date.--Decedents dying after the date of enactment.

Proposed Modification

Revise the bill to provide that a transfer from a trust over which the grantor held the power to revoke would be treated as if made directly by the grantor (and not includible in the grantor's gross estate).

3. Definition of qualified terminable interest property (sec. 503 of the bill)

Description of Bill

Under the bill, an income interest does not fail to be a qualified income interest, a prerequisite for the marital deduction, solely because income accumulated prior to death is not required to be distributed to the surviving spouse's estate. Such income is included in the surviving spouse's gross estate.

Effective date.--Decedents dying, and gifts made, after date of enactment.

4. Requirements for qualified domestic trust (sec. 504 of the bill)

Description of Bill

A transfer to an noncitizen spouse qualifies for the marital deduction only if made to a qualified domestic trust. The bill provides that, if the governing instrument requires all trustees be U.S. citizens or domestic corporations, the requirement that U.S. trustees have the right to withhold estate tax on distributions shall be waived.

Effective date.--As if included in the Technical and Miscellaneous Revenue Act of 1988 (i.e., decedents dying after November 10, 1988).

5. Election of special use valuation of farm property for estate tax purposes (sec. 505 of the bill)

Description of Bill

The bill allows an estate to use special use valuation if the executor makes an election and submits the required recapture agreement, so long as the executor supplies missing requisite information within a reasonable period of time (not exceeding 90 days) after IRS notification. The bill also allows signatures to be added to the agreement during that time period.

Effective date.--Decedents dying after the date of enactment.

Title VI.--Excise Tax Provisions

A. Motor Fuel Excise Tax Provisions

1. Consolidate provisions imposing diesel and aviation fuel excise taxes (sec. 601 of the bill)

Description of Bill

The bill combines the diesel and aviation fuel tax provisions currently divided between Code sections 4041 and 4091 into a revised section 4091.

Effective date.--The provision is effective for sales or uses on or after January 1, 1992.

Proposed Modification

Delay effective date to sales or uses on or after January 1, 1993.

2. Revision of fuel tax credit and refund procedures (sec. 602 of the bill)

Description of Bill

The bill allows a refund or credit to taxpayers for diesel and aviation fuel sold tax-paid to certain persons who resell for tax-exempt uses. The bill also consolidates the user credit and refund provisions for the fuels excise taxes into one section of the Code. Finally, the bill eliminates the waiver requirement for fuels tax refunds for cropdusters and other fertilizer applicators.

Effective date.--The provision is effective for sales or uses on or after January 1, 1992.

Proposed Modification

Delay effective date to sales or uses on or after January 1, 1993.

3. Authority to provide exceptions from information reporting with respect to diesel fuel and aviation fuel (sec. 603 of the bill)

Description of Bill

The bill permits the IRS by regulation to provide exceptions to the mandatory information return requirement for certain sales or uses of diesel and aviation fuel.

Effective date.--The provision applies to sales or uses on or after January 1, 1992.

Proposed Modification

Delay effective date to sales or uses on or after January 1, 1993.

B. Provisions Relating to Distilled Spirits, Wine, and Beer

1. Refund of tax on certain imported bottled distilled spirits (sec. 611 of the bill)

Description of Bill

Present law provides that when tax-paid distilled spirits which have been withdrawn from bonded premises of a distilled spirits plant are returned for destruction or redistilling, the excise taxes are refunded (sec. 5008(c)), but this provision does not apply to imported bottled distilled spirits, which are withdrawn from customs custody and not from bonded premises. The bill conforms the procedures for refunds of tax collected on imported bottled distilled spirits returned to bonded premises to the rules for domestically produced and imported bulk distilled spirits. Thus, refunds would be available for all distilled spirits on their return to a bonded distilled spirits plant.

Effective date.--The provision is effective beginning 180 days after enactment.

2. Bond for exported distilled spirits (sec. 612 of the bill)

Description of Bill

Bond generally must be furnished to the Department of the Treasury when distilled spirits are removed from bonded premises for exportation without payment of tax. Under present law, these bonds are cancelled or credited when evidence is submitted to the Department of the Treasury that the distilled spirits have been exported (sec. 5175(c)). The bill authorizes the Department of the Treasury to permit records of exportation to be maintained by the exporter, rather than requiring submission to it of proof of exportation in all cases.

Effective date.--The provision is effective beginning 180 days after enactment.

3. Distilled spirits plant records (sec. 613 of the bill)

Description of Bill

Under present law, distilled spirits plant proprietors are required to maintain records of their production, storage, denaturation, and other processing activities on the premises where the operations covered by the records are carried on (sec. 5207(c)). The bill permits distilled plant proprietors to maintain records of their activities at locations other than the premises where the operations covered by the records are carried on (e.g., corporate headquarters), provided that the records are available for inspection by the Treasury Department during business hours.

Effective date.--The provision is effective beginning 180 days after enactment.

4. Transfers from breweries to distilled spirits plants (sec. 614 of the bill)

Description of Bill

Under present law, beer may be transferred without payment of tax from a brewery to a distilled spirits plant to be used in the production of distilled spirits, but only if the brewery is contiguous to the distilled spirits plant (sec. 5222(b)). The bill allows beer to be transferred without payment of tax from a brewery to a distilled spirits plant to be used in the production of distilled spirits, regardless of whether the brewery is contiguous to the distilled spirits plant.

Effective date.--The provision is effective beginning 180 days after enactment.

Proposed Modification

Allow brewers to receive credits/refunds on beer transferred directly from wholesale and retail outlets to distilled spirits plants as well as that transferred from or through brewery premises.

5. Posting of sign by wholesale liquor dealers (sec. 615 of the bill)

Description of Bill

Under present law, wholesale liquor dealers (i.e., dealers, other than wholesale dealers in beer alone, who sell distilled spirits, wine, or beer to other persons who re-sell such products) are required to post a sign conspicuously on the outside of their place of business indicating that they are wholesale liquor dealers (sec. 5115). The bill repeals this requirement.

Effective date.--The provision is effective upon enactment.

6. Refund of tax for wine returned to bond (sec. 616 of the bill)

Description of Bill

Under present law, when unmerchantable wine is returned to bonded production premises, tax that has been paid is refunded or credited to the proprietor of the bonded wine cellar to which the wine is delivered (sec. 5044). In contrast, when beer is returned to a brewery, tax that has been paid is refunded or credited, regardless of whether the beer is unmerchantable (sec. 5056(a)). The bill deletes the requirement that wine returned to bonded premises be "unmerchantable" in order for tax to be refunded or credited to the proprietor of the bonded wine cellar to which the wine is delivered.

Effective date.--The provision is effective beginning 180 days after enactment.

7. Use of ameliorating material in certain wines (sec. 617 of the bill)

Description of Bill

The Code contains rules governing the extent to which ameliorating material (e.g., sugar) may be added to wines made from high acid fruits and the product still be labelled as a standard, natural wine. In general, ameliorating material may not exceed 35 percent of the volume of juice and ameliorating material combined (sec. 5383(b)(1)). However, wines made exclusively from loganberries, currants, or gooseberries are permitted a volume of ameliorating material of up to 60 percent (sec. 5384(b)(2)(D)). The bill modifies the wine labeling restrictions to allow any wine made exclusively from a fruit or berry with a natural fixed acid of 20 parts per thousand or more (before any correction of such fruit or berry) to contain a volume of ameliorating material not in excess of 60 percent.

Effective date.--The provision is effective beginning 180 days after enactment.

8. Domestically produced beer for use by foreign embassies, etc. (sec. 618 of the bill)

Description of Bill

Under present law, domestically produced distilled spirits and wine may be removed from bond, without payment of tax, for transfer to any customs bonded warehouse for storage pending removal for the official or family use of representatives of foreign governments or public international organizations (secs. 5066 and 5362(e)). (A similar rule also applies under present law to imported distilled spirits, wine, and beer.) The bill extends this rule to domestically produced beer.

Effective date.--The provision is effective beginning 180 days after enactment.

9. Withdrawal of beer for destruction (sec. 619 of the bill)

Description of Bill

Present law does not specifically permit beer to be removed from a brewery for destruction without payment of tax. The bill allows beer to be removed from a brewery without payment of tax for purposes of destruction, subject to Treasury Department regulations.

Effective date.--The provision is effective beginning 180 days after enactment.

10. Records of exportation of beer (sec. 620 of the bill)

Description of Bill

Present law provides that a brewer is allowed a refund of tax paid on exported beer upon submission to Department of the Treasury of certain records indicating that the beer has been exported (sec. 5055). The bill repeals the requirement that proof of exportation be submitted to the Treasury Department in all cases as a condition of receiving a refund of tax. This proof will continue to be required to be maintained at the exporter's place of business.

Effective date.--The provision is effective beginning 180 days after enactment.

11. Transfer to brewery of beer imported in bulk (sec. 621 of the bill)

Description of Bill

Under present law, distilled spirits imported into the United States in bulk containers may (under certain circumstances) be transferred from customs custody to bonded premises of a distilled spirits plant without payment of tax (sec. 5232). The bill extends this rule to beer imported into the United States in bulk containers and transferred to a brewery, subject to Treasury Department regulations.

Effective date.--The provision is effective beginning 180 days after enactment.

C. Other Excise Tax Provisions

1. Authority to grant exemptions from registration requirements (sec. 631 of the bill)

Description of Bill

The bill gives the IRS authority to exempt parties to the transfer of articles subject to Federal excise taxes from certain registration requirements.

Effective date.--The provision applies to sales after the 180th day after the date of enactment.

2. Repeal expired reduction in tax on piggyback trailers (sec. 632(a) of the bill)

Description of Bill

Piggyback trailers and semitrailers sold within the 1-year period beginning on July 18, 1984 were permitted a temporary reduction in the retail excise tax on trailers. The bill repeals as "deadwood" the temporary reduction in tax on piggyback trailers.

Effective date.--The provision is effective on the date of enactment.

3. Repeal expired deep seabed minerals excise tax (sec. 632(b) of the bill)

Description of Bill

The bill deletes as deadwood certain expired Code provisions imposing an excise tax on certain minerals mined on the deep seabed. The tax had been imposed in anticipation of a Law of the Sea Treaty which the United States did not sign.

Effective date.--The provision is effective on the date of the bill's enactment.

Title VII -- Administrative Provisions

A. General Administrative Provisions

1. Simplification of employment taxes on domestic services (sec. 701 of the bill)

Description of Bill

The bill changes the threshold for withholding and paying social security taxes from $50 a quarter to $300 a year. The bill requires an individual who employs only household employees to report any social security or Federal unemployment tax obligation for wages paid to such employees on his or her income tax return for the year.

Effective date.--The provision is effective for remuneration paid in calendar years beginning after December 31, 1991.

Proposed Modification

Effective date.--Remuneration paid in calendar years beginning after December 31, 1992.

2. Penalties for failure to provide reports relating to pension payments (sec. 702 of the bill)[1]

Description of Bill

The bill incorporates into the general penalty structure for failure to file information reports the penalties for failure to provide information reports relating to pension payments to the IRS and to recipients.

Effective date.--The bill applies to returns and statements the due date for which is after December 31, 1991.

Proposed Modification

Effective date.--Returns and statements the due date for which is after December 31, 1992.

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[1] This provision is also in section 310 of S. 1364, the Employee Benefits Simplification and Expansion Act of 1991.

3. Use of reproductions of returns stored in digital image format (sec. 703 of the bill)

Description of Bill

The bill provides that the term reproduction includes a reproduction from a digital image.

Effective date.--The provision is effective on the date of enactment.

4. Repeal of requirement to register tax shelters (sec. 704 of the bill)

Description of Bill

The bill repeals the tax shelter registration requirements.

Effective date.--The provision is effective on the date of enactment.

Proposal Modification

Drop provision.

5. Repeal of authority to disclose whether prospective juror has been audited (sec. 705 of the bill)

Description of Bill

The bill repeals the requirement that the Secretary disclose, upon the written request of either party to the lawsuit, whether an individual who is a prospective juror has or has not been the subject of an audit or other tax investigation by the Internal Revenue Service.

Effective date.--The provision is effective for judicial proceedings pending on, or commenced after, the date of enactment.

6. Repeal of special audit provisions for subchapter S items (sec. 706 of the bill)

Description of Bill

The bill repeals the unified audit procedures for S corporations.

Effective date.--The provision is effective for taxable years beginning after the date of enactment.

7. Clarification of statute of limitations (sec. 707 of the bill)

<u>Description of Bill</u>

The bill clarifies that the return that starts the running of the statute of limitations for a taxpayer is the return of the taxpayer and not the return of another person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit.

<u>Effective date</u>.--The provision is effective for taxable years beginning after the date of enactment.

8. Clarification of employment tax status of fishermen

<u>Description of Bill</u>

No provision.

<u>Proposed Modification</u>

The present-law exemption from employment taxes for certain fishermen on boats with a normal operating crew of fewer than 10 individuals would be modified. The operating crew of a boat would be treated as normally made up of fewer than 10 individuals if average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of 10 or fewer individuals. In addition, the exemption would continue to apply if the crew member receives, in addition to the cash remuneration permitted under present law, cash remuneration which does not exceed $100 per trip, is contingent on a minimum catch, and is paid solely for additional duties (e.g., mate, engineer, or cook) for which additional cash remuneration is traditional.

<u>Effective date.</u>--The proposal would generally apply to remuneration paid after December 31, 1991. In addition, the amendments would apply to remuneration paid after December 31, 1984, and before January 1, 1992, unless the payer treated such remuneration when paid as being subject to employment taxes.

B. Tax Court Provisions

1. Overpayment determinations of Tax Court (sec. 711 of the bill)

Description of Bill

The bill clarifies that an order to refund an overpayment is appealable in the same manner as a decision of the Tax Court.

Effective date.--The provision is effective on the date of enactment.

2. Awarding of administrative costs (sec. 712 of the bill)

Description of Bill

The bill provides that a taxpayer who seeks an award of administrative costs must apply for such costs within 90 days of the date on which the taxpayer was determined to be a prevailing party. The bill also provides that a taxpayer who seeks to appeal an IRS denial of an administrative cost award must petition the Tax Court within 90 days after the date that the IRS mails the denial notice.

Effective date.--The provision is effective on the date of enactment.

3. Redetermination of interest pursuant to motion (sec. 713 of the bill)

Description of Bill

The bill provides that a taxpayer must file a "motion" (rather than a "petition") to seek a redetermination of interest in the Tax Court.

Effective date.--The provision is effective on the date of enactment.

4. Application of net worth requirement for awards of litigation costs (sec. 714 of the bill)

Description of Bill

The bill provides that the net worth limitations currently applicable to individuals also apply to estates and trusts for purposes of awards of litigation costs. The bill also provides that individuals who file a joint tax return shall be treated as one individual for purposes of computing the net worth limitations.

Effective date.--The provision applies to proceedings commenced after the date of enactment.

C. Cooperative Agreements with State Tax Authorities (sec. 721 of the bill)

Description of Bill

The bill authorizes the Secretary to enter into cooperative agreements with State tax authorities to enhance joint tax administration. These agreements may include (1) joint filing of Federal and State income tax returns, (2) single processing of these returns, and (3) joint collection of taxes (other than Federal income taxes).

Effective date.--This provision is effective on the date of enactment.

Title VIII--Additional Provisions

1. Income taxation of accumulation trusts

Description of Bill

No provision.

Proposed Modification

Exempt amounts accumulated in domestic trusts after December 31, 1992, from the so-called "throwback rule," under which distributions of accumulated income to the beneficiaries are thrown back to the year in which the income would have been taxed to the beneficiary if it had been distributed currently. Also provide that precontribution gain on property sold by a domestic trust is no longer taxed at the contributor's marginal tax rates. These modifications would not apply to any trust created before March 1, 1984, unless the taxpayer establishes that the trust would not have been aggregated under the standard contained in section 643(f).

Effective date.--Taxable years beginning after December 31, 1992.

2. Include fractional share of property qualifying for the marital deduction in the gross estate

Description of Bill

No provision.

Proposed Modification

To qualify for the marital deduction under present law, a trust generally must grant the surviving spouse an income interest in, or a power of appointment over, a specified portion of property. The modification would require that the specified portion be expressed as a fraction or percentage of trust property.

Effective date.--Gifts made, and decedents dying, after date of enactment. The bill exempts a transfer under a will or revocable trust executed before the date of enactment if either (1) on that date the decedent was under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of death, or (2) the decedent dies within three years after the date of enactment. The exemption does not apply if the will or trust is amended after the date of enactment in any respect that increases the amount of the transfer or alters the terms by which the interest passes.

3. Simplify payroll tax deposit requirements

Description of Bill

No provision.

Proposed Modification

In general

The proposal would replace the entire payroll tax deposit system. In general, the new system would consist of three basic deposit timetables. The first, which would be most generally applicable (and would replace the eighth-monthly system), would require deposits twice a week, on Tuesdays and Fridays. The second, which would apply to large depositors, would retain the requirement of present law that cumulations of an amount to be deposited of $100,000 or more must be deposited on the next day. The third, which would apply to many small depositors, would provide generally that if the amount required to be deposited was $12,000 or less per quarter for a previous one-year base period, deposits must be made only once a month, on or before the fifteenth day of the following month.

Tuesday, Friday deposit rule

The Tuesday/Friday rule would operate in the following manner. Amounts attributable to wage payments made on Wednesday, Thursday, or Friday would be required to be deposited on or before the following Tuesday. Amounts attributable to wage payments made on Saturday, Sunday, Monday, or Tuesday would be required to be deposited on or before the following Friday.

Small depositor rules

The small depositor rules would operate as follows. If an employer is a small depositor, deposits of employment taxes attributable to wage payments during a month must be made on or before the fifteenth day of the following month.

A person would be a small depositor for a calendar quarter if, for each calendar quarter in the base period, the amount of employment taxes attributable to payments in each of those calendar quarters was $12,000 or less. The base period would be defined to be the four calendar quarters ending with the second preceding calendar quarter before the quarter with respect to which the deposit requirements were being determined. The only exception to this would be that the $100,000 rule would apply to all depositors, including small depositors.

New companies would initially be treated as small depositors. For purposes of performing the base period determination, a company would be considered to have employment taxes of zero for any calendar quarter in which a company did not exist. Consequently, new companies would, for at least the first two calendar quarters of their existence, be required to deposit only once a month (unless they fall within the $100,000 rule).

Safe harbor

The proposal would provide a statutory safe harbor with respect to certain shortfalls in deposits. An employer would be treated as having deposited the required amount of employment taxes in any deposit if the shortfall did not exceed the greater of $100 or two percent of the amount of employment taxes otherwise required to be deposited. A shortfall would be the excess of the amount required to be deposited (without regard to this rule) over the amount actually deposited on or before the last day on which that deposit is required. Any shortfall would be required to be deposited as required by Treasury regulations.

Definitions and other rules

The proposal would provide that deposits are required only on banking days. If a deposit would be required to be made on or before a day that is not a banking day, the deposit would be considered to have been made on a timely basis if made on or before the close of the next banking day.

Effective date.--The proposal would be effective for amounts attributable to payments made after December 31, 1992.

4. Firearms Excise Tax Exemption for Custom Gunsmiths

Description of Bill

No provision.

Proposed Modification

The proposal would exempt small manufacturers and importers from the present-law 11-percent excise tax on firearms (rifles and shotguns) and ammunition and the present-law 10-percent tax on pistols and revolvers, if such manufacturer or importer manufactures or imports less than 50 such articles per year.

Effective date.--The proposal would be effective for articles sold after September 30, 1983. In the case of any taxable year ending before the date of enactment, the period for claiming a credit or refund of any overpayment of tax resulting from the proposed exemption from tax shall not expire before one year after the date of enactment.

5. Discharge of Indebtedness Income from Prepayment of REA Loans at a Discount

Description of Bill

No provision.

Proposed Modification

Under Code section 501(c)12), a rural electric cooperative is exempt from tax if at least 85 percent of its income is derived from its members. In two prior technical corrections, Congress has provided that the 85-percent test would be determined without regard to discharge of indebtedness income arising from the prepayment at a discount of loans made by the Rural Electrification Administration pursuant to the provisions of the 1988 and 1989 Budget Reconciliation Acts. The proposed amendment would extend that treatment to certain prepayment of REA loans provided by the 1990 Farm Act.

6. Private Foundation Common Investment Fund

Description of Bill

No provision.

Proposed Modification

Section 501(c)(3) requires that an organization be organized and operated exclusively for an exempt purpose in order to qualify for tax-exempt status under that section. Section 501(f) provides that an organization is treated as organized and operated exclusively for charitable purposes if it is comprised solely of members that are educational institutions and is organized and operated solely to collectively invest in stocks and securities on behalf of the members.

The proposed modification would provide that a cooperative service organization comprised solely of members that are tax-exempt private foundations and community foundations shall be treated as organized and operated exclusively for charitable purposes if: (1) it has at least 20 members; (2) no one member holds (after the organization's second taxable year) more than 10 percent (by value) of the interests in the organization; (3) no one member controls the organization or any other member; (4) the members are permitted to dismiss any of the organization's investment advisors upon a vote of members holding a majority of interest in the account managed by such advisor; (5) the organization is organized and operated solely to collectively invest in stocks and securities.

A cooperative service organization meeting the criteria of the proposed modification would be subject to the present-law excise tax provisions applicable to private foundations, other than sections 4940 and 4942. For purposes of section 4940, the proportionate share (whether or not distributed) for each member of the net income of the organization would be flowed through to the member.

Effective date.--The proposed modification would apply to taxable years beginning after December 31, 1991.

7. Treatment of Nuclear Decommissioning Funds

Description of Bill

No provision.

Proposed Modification

The present-law investment restrictions applicable to nuclear decommissioning funds would be repealed.

Effective date.--The proposal would apply to taxable years beginning after December 31, 1991.

8. Taxable Year Election for Partnerships, S Corporations, and Personal Service Corporations

Description of Bill

No provision.

Proposed Modification

A partnership, S corporation, or personal service corporation would be allowed to elect any taxable year without regard to the length of the deferral period of the taxable year elected if the annual financial statements (if any) of the entity used for credit purposes or provided to the partners, shareholders, or other proprietors of the entity cover the same period as the taxable year elected.

The proposal would increase the amount of the required payment that must be made by a partnership or S corporation that elects a taxable year other than the required taxable year (including any partnership or S corporation that has an election in effect on the date of enactment of the bill).[1] In addition, the proposal would require an additional payment for any taxable year that a partnership or S corporation first makes a taxable year election or changes a taxable year election to increase the deferral period.

The proposal would also modify the minimum distribution requirement that must be satisfied by a personal service corporation that elects a taxable year other than the required taxable year (including a personal service corporation that has an election in effect on the date of enactment of the bill).

Effective date.--The proposal would apply to taxable years beginning after December 31, 1991.

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[1] The required payment would be determined by using the highest rate of tax in effect under section 1 of the Code plus 2 percentage points.

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9. **Treatment of amounts received by telephone cooperatives**

Description of Bill

No provision.

Proposed Modification

Mutual or cooperative telephone companies ("telephone cooperatives") are exempt from Federal income tax if 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses (sec. 501(c)(12)(A)). In applying this 85-percent test, certain income received by a telephone cooperative is disregarded, including income received from a nonmember telephone company for the performance of communication services which involve members of the telephone cooperative, certain pole rental income, and income from the sale of display listings in a telephone directory sold to members of the telephone cooperative (sec. 501(c)(12)(B)).

The proposal would amend section 501(c)(12) to provide that a 50 percent of the income received by a telephone cooperative from a nonmember telephone company (e.g., fees received for originating a long-distance call placed by a member) would be treated as collected from members of the telephone cooperative. The remaining 50 percent of income received by a telephone cooperative from a nonmember telephone company would, as under present law, be excluded from the 85-percent test under section 501(c)(12)(B)(i).

The proposal also would exclude from the 85-percent test under section 501(c)(12) amounts received by a telephone cooperative from billing and collection services performed for another telephone company (e.g., a long-distance carrier).

In addition, the proposal would provide that tax-exempt telephone cooperatives would be permitted to earn certain investment income in excess of 15 percent of their total income (but not in excess of 35 percent of total income) without losing their tax-exempt status. Tax-exempt telephone cooperatives would be subject to the unrelated business income tax (UBIT) on such investment income between the 15-percent and 35-percent range.

<u>Effective date</u>.--The proposal would be effective for taxable years beginning before, on, or after the date of enactment.

10. Modifications to the Reforestation Trust Fund

Description of Bill

No provision.

Proposed Modification

The maximum amount that may be transferred to the Reforestation Trust Fund for any fiscal year would be increased from $30 million to $45 million. The additional $15 million that is transferred to the Reforestation Trust Fund for any fiscal year would be available to the Department of the Interior for the reforestation and forest conservation activities of the Bureau of Land Management in any State and related administrative costs. To the extent that the wood product tariffs are insufficient to provide an additional $15 million for any fiscal year, the Treasury Department would be required to transfer to the Reforestation Trust Fund an amount equal to the Federal portion of the receipts from the sale of certain timber located on Federal land.

Effective date.--The proposal would be effective on October 1, 1992.

11. Determinations of gas produced from qualifying sources under the nonconventional fuels production credit

Description of Bill

No provision.

Proposed Modification

With respect to determinations required under the Internal Revenue Code of whether gas is produced from geopressured brine, Devonian shale, coal seams, or from a tight formation, in the event that such a determination is not made by the Federal Energy Regulatory Commission in accordance with section 503 of the Natural Gas Policy Act of 1978 due to the expiration of that statute through enactment of the Natural Gas Wellhead Decontrol Act of 1989,[1] the proposed modification would require the Secretary of Treasury to make such a determination. For this purpose, the proposal would mandate that any such determination by the Treasury Department be made using the guidelines set forth in section 503 of the Natural Gas Policy Act of 1978 prior to its repeal.

In addition, the proposed modification would clarify that for purposes of the nonconventional fuels production credit, the definitions of gas produced from geopressured brine, Devonian shale, coal seams, or from a tight formation would be as established by the Federal Energy Regulatory Commission under the Natural Gas Policy Act of 1978 prior to repeal of provisions of that statute relating to such definitions.

Effective date.--With respect to well and formation determinations required to be made by the Treasury Department, the proposed modification would be effective for determinations with respect to which no such determination is made by the Federal Energy Regulatory Commission as a result of the repeal of section 503 of the Natural Gas Policy Act of 1978. The proposed modification clarifying the definitions of certain qualifying fuels would be effective after December 31, 1992.

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1 P.L. 101-60; 103 Stat. 157 (1989).

12. Treatment of housing cooperatives

Present Law

Unlike other corporations, a cooperative association is not taxable on income from patronage sources.

A membership organization operated primarily to furnish services or goods to its members may deduct costs attributable to furnishing services or goods to its members only to the extent of income derived from the members (sec. 277).

Explanation of Proposal

The proposal provides that section 277 would not apply to a cooperative housing corporation and that patronage losses of such a corporation could not offset earnings that are not patronage earnings.

Patronage earnings and losses would generally include earnings and losses derived from business done with or for patrons of the corporation. In addition, the proposal would treat as patronage sourced: (1) interest on reasonable reserves established in connection with the corporation, (2) income from laundry and parking attributable to tenants-stockholders and their guests, and (3) (in the case of a limited equity cooperative housing corporation) rental income attributable to a housing project operated by the corporation.

Effective Date

The proposal applies to taxable years beginning after date of enactment.

13. **Treatment of safe harbor leases of membership organizations**

Description of Bill

None.

Proposed Modification

A membership organization cannot offset losses from transactions with members with income from transactions with nonmembers. The Internal Revenue Service has taken the position that interest income derived from a safe-harbor sale-leaseback transaction is not derived from transactions with members while the rental expense from the transaction must be allocated between income derived from members and nonmembers.

Under the modification, the interest income and rental expense from the sale and leaseback of the property under a safe-harbor lease are to be first netted and the difference allocated between members and nonmembers in proportion to the business done with each group.

Effective date:--All open taxable years.