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REPORT
105–356

TAX TECHNICAL CORRECTIONS ACT OF 1997

OCTOBER 29, 1997.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ARCHER, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 2645]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 2645) to make technical corrections related to the Taxpayer Relief Act of 1997 and certain other tax legislation, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

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The amendments (stated in terms of the page and line numbers of the introduced bill) are as follows:

Page 3, strike line 4 and insert the following:

32 (determined without regard to subsection (n)) for the taxable year.

The amount of the credit allowed under this subsection shall not be treated as a credit allowed under this subpart and shall reduce the amount of credit otherwise allowable under subsection (a) without regard to section 26(a).

Page 5, strike lines 16, 17, and 18.

Page 5, line 19, strike "(2)" and insert "(1)".

Page 5, line 23, strike "(3)" and insert "(2)".

Page 6, line 22, strike "(4)" and insert "(3)".

Page 41, strike line 11 and all that follows through line 2 on page 42 and insert the following:

(a) AMENDMENT RELATED TO SECTION 901 OF 1997 ACT.—Section 9603(c)(7) of the 1986 Code is amended—

(1) by striking "resulting from the amendments made by" and inserting "(and transfers to the Mass Transit Account) resulting from the amendments made by subsections (a) and (b) of section 901 of", and

(2) by inserting before the period "and deposits in the Highway Trust Fund (and transfers to the Mass Transit Account) shall be treated as made when they would have been required to be made without regard to section 901(e) of the Taxpayer Relief Act of 1997".

Page 47, strike lines 1 through 8 and insert the following:

(3) Subsection (c) of section 6421 of the 1986 Code is amended—

(A) by striking "(2)(A)" and inserting "(2)", and

(B) by adding at the end of the following sentence: "Subsection (a) shall not apply to gasoline to which this subsection applies."

Page 60, after line 12, insert the following new paragraph:

(3) Subsections (a) and (b) of section 6421 of the 1986 Code are each amended by striking "subsection (j)" and inserting "subsection (i)".

I. SUMMARY AND BACKGROUND

A. Purpose and Summary

H.R. 2645 provides technical and clerical corrections to recent tax legislation, primarily the Taxpayer Relief Act of 1997 ("1997 Act"). The clerical provisions are not discussed in the explanation (Part II). The technical corrections generally are effective as if included in the original provisions to which they relate.

B. Background and Need for Legislation

The bill provides technical and clerical corrections to recent tax legislation that are necessary to reflect the intent of the 1997 Act and other tax legislation. The Committee worked closely with the Treasury Department to accomplish needed and timely technical corrections, which are reflected in the Committee bill as reported. Technical and clerical amendments were made pursuant to staff drafting authority.

C. Legislative History

H.R. 2645 was introduced by Chairman Archer and Mr. Rangel on October 9, 1997, and was considered by the Committee in a markup on October 9, 1997. The bill was ordered favorably reported, without amendment, by a voice vote on October 9, 1997, with a quorum present.

II. EXPLANATION OF THE BILL

TECHNICAL CORRECTIONS TO THE TAXPAYER RELIEF ACT OF 1997

A. Amendments to Title I of the 1997 Act Relating to the Child Credit

1. Stacking rules for the child credit under the limitations based on tax liability (sec. 3(a) of the bill, sec. 101(a) of the 1997 Act, and sec. 24 of the Code)

Present Law

Present law provides a $500 ($400 for taxable year 1998) tax credit for each qualifying child under the age of 17. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or a descendent of either), a stepson or stepdaughter of the taxpayer or an eligible foster child of the taxpayer. For taxpayers with modified adjusted gross income in excess of certain thresholds, the allowable child credit is phased out. The length of the phase-out range is affected by the number of the taxpayer's qualifying children.

Generally, the maximum amount of a taxpayer's child credit for each taxable year is limited to the excess of the taxpayer's regular

tax liability over the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit). In the case of a taxpayer with three or more qualifying children, the maximum amount of the taxpayer's child credit for each taxable year is limited to the greater of: (1) the amount computed under the rule described above, or (2) an amount equal to the excess of the sum of the taxpayer's regular income tax liability and the employee share of FICA taxes (and one-half of the taxpayer's SECA tax liability, if applicable) reduced by the earned income credit. In the case of a taxpayer with three or more qualifying children, the excess of the amount allowed in (2) over the amount computed in (1) is a refundable credit.

Nonrefundable credits may not be used to reduce tax liability below a taxpayer's tentative minimum tax. Certain credits not used as result of this rule may be carried over to other taxable years, while others may not. Special stacking rules apply in determining which nonrefundable credits are used in the current year. Generally, the stacking rules require that nonrefundable personal credits be considered first,[1] followed by other credits, business credits, and the investment tax credit. Refundable credits, which are not limited by the minimum tax, are not stacked until after the nonrefundable credits.

Explanation of Provision

The bill clarifies the application of the income tax liability limitation to the refundable portion of the child credit by treating the refundable portion of the child credit in the same way as the other refundable credits. Specifically, after all the other credits are applied according to the stacking rules of the income tax limitation then the refundable credits are applied first to reduce the taxpayer's tax liability for the year and then to provide a credit in excess of income tax liability for the year.

Effective Date

The provision is effective for taxable years beginning after December 31, 1997.

2. Treatment of a portion of the child credit as a supplemental child credit (sec. 3(b) of the bill, sec. 101(b) of the 1997 Act, and sec. 32(m) of the Code)

Present Law

A portion of the child credit may be treated as a supplemental child credit. The amount of the supplemental child credit, if any,

[1] It is understood that there is also a stacking rule under which the income tax liability limitation applies between the nonrefundable personal credits, including the nonrefundable portion of the child credit. Generally, the nonrefundable portion of the child credit and the other nonrefundable personal credits which do not provide a carryforward are grouped together and stacked first followed by the nonrefundable personal credits which provide a carryforward for purposes of applying the income tax liability limitation. Therefore, if the sum of the taxpayer's nonrefundable credits exceeds the difference between the taxpayer's regular income tax liability and the taxpayer's tentative minimum tax (determined without regard to the alternative minimum foreign tax credit) then the nonrefundable personal credits which do not provide a carryforward would be applied to reduce the income tax liability for that year first and any excess credits which allow a carryforward would be available to reduce the taxpayer's income tax liability in future years.

equals the excess of (1) $500 times the number of qualifying children up to the excess of the taxpayer's income tax liability (net of applicable credits other than the earned income credit) over the taxpayer's alternative minimum tax liability (determined without regard to the alternative minimum foreign tax credit) over (2) the sum of the taxpayer's regular income tax liability (net of applicable credits other than the earned income credit) and the employee share of FICA taxes (and one-half of the taxpayer's SECA tax liability, if applicable) reduced by any earned income credit amount. The supplemental child credit is treated as provided under the earned income credit and the child credit amount is reduced by the amount of the supplemental child credit.

Explanation of Provision

The bill clarifies that the treatment of a portion of the child credit as a supplemental child credit under the earned income credit (sec. 32) and the offsetting reduction of the child credit (sec. 24) does not affect any other credit available to the taxpayer. It also clarifies that the earned income credit rules (e.g., the phaseout of the earned income credit) generally do not apply to the supplemental child credit.

Effective Date

The provision is effective for taxable years beginning after December 31, 1997.

B. Amendments to Title II of the 1997 Act Relating to Education Incentives

1. Clarifications to HOPE and Lifetime Learning credits (sec. 4(a) of the bill, sec. 201 of the 1997 Act, and secs. 25A and 6050S of the Code)

Present Law

Individual taxpayers are allowed to claim a nonrefundable HOPE credit against Federal income taxes up to $1,500 per student for qualified tuition and fees paid during the year on behalf of a student (i.e., the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer) who is enrolled in a post-secondary degree or certificate program at an eligible post-secondary institution on at least a half-time basis. The HOPE credit is available only for the first two years of a student's post-secondary education. The credit rate is 100 percent of the first $1,000 of qualified tuition and fees and 50 percent on the next $1,000 of qualified tuition and fees. The HOPE credit amount that a taxpayer may otherwise claim is phased out for taxpayers with modified adjusted gross income (AGI) between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). For taxable years beginning after 2001, the $1,500 maximum HOPE credit amount and the AGI phase-out range will be indexed for inflation. The HOPE credit is available for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date.

If a student is not eligible for the HOPE credit (or in lieu of claiming a HOPE credit with respect to a student), individual taxpayers are allowed to claim a nonrefundable Lifetime Learning credit against Federal income taxes equal to 20 percent of qualified tuition and fees paid during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or a dependent. In contrast to the HOPE credit, the student need not be enrolled on at least a half-time basis in order to be eligible for the Lifetime Learning credit, which is available for an unlimited number of years of post-secondary training. For expenses paid before January 1, 2003, up to $5,000 of qualified tuition and fees per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and fees per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $2,000). The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased out over the same modified AGI phase-out range as applies for purposes of the HOPE credit. The Lifetime Learning credit is available for expenses paid after June 30, 1998, for education furnished in academic periods beginning after such date.

Section 6050S provides that certain educational institutions and other taxpayers engaged in a trade or business must file information returns with the IRS and certain individual taxpayers, as required by regulations prescribed by the Secretary of the Treasury, containing information on individuals who made payments for qualified tuition and related expenses or to whom reimbursements or refunds were made of such expenses.

Explanation of Provision

The bill clarifies that the maximum HOPE credit amount will be indexed for inflation occurring after the year 2000, by increasing the cap on qualified tuition and related expenses subject to the 100-percent credit rate and the cap on such tuition and related expenses subject to the 50-percent credit rate, and both caps will be rounded down to the closest multiple of $100.[2] The first taxable year for which the inflation adjustment may be made to increase the caps on qualified tuition and related expenses will be 2002.

In addition, the bill clarifies that, under section 6050S, information returns containing information with respect to qualified tuition and fees must be filed by a person that is not an eligible educational institution only if such person is engaged in a trade or business of making payments to any individual under an insurance arrangement as reimbursements or refunds (or similar payments) of qualified tuition and related expenses. As under present law, section 6050S also will require the filing of information returns by persons engaged in a trade or business if, in the course of such trade or business, the person receives from any individual interest aggregating $600 or more for any calendar year on one or more qualified education loans.

[2] Some printed versions of the 1997 Act incorrectly provided that the caps will be rounded down to the closest multiple of $1,000.

Effective Date

The provision is effective as if included in the 1997 Act, i.e., for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date.

2. Education IRAs (sec. 4(c) of the bill, sec. 213 of the 1997 Act, and sec. 530 of the Code)

Present Law

Section 530 provides that taxpayers may establish "education IRAs," meaning certain trusts or custodial accounts created exclusively for the purpose of paying qualified higher education expenses of a named beneficiary. Annual contributions to education IRAs may not exceed $500 per designated beneficiary, and may not be made after the designated beneficiary reaches age 18. Contributions to an education IRA may not be made by certain high-income taxpayers—i.e., the contribution limit is phased out for taxpayers with modified adjusted gross income between $95,000 and $110,000 ($150,000 and $160,000 for taxpayers filing joint returns). No contribution may be made to an education IRA during any year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary.

Until a distribution is made from an education IRA, earnings on contributions to the account generally are not subject to tax.[3] In addition, distributions from an education IRA are excludable from gross income to the extent that the distribution does not exceed qualified higher education expenses incurred by the beneficiary during the year the distribution is made (provided that a HOPE credit or Lifetime Learning credit is not claimed with respect to the beneficiary for the same taxable year). The earnings portion of an education IRA distribution not used to pay qualified higher education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.[4] However, the additional 10-percent tax does not apply if a distribution is made of excess contributions above the $500 limit (and any earnings attributable to such excess contributions) if the distribution is made on or before the date that a return is required to be filed (including extensions of time) by the contributor for the year in which the excess contribution was made. In addition, section 530 allows tax-free rollovers of account balances from an education IRA benefiting one family member to an education IRA benefiting another family member. Section 530 is effective for taxable years beginning after December 31, 1997.

Explanation of Provision

Consistent with the legislative history to the 1997 Act, any balance remaining in an education IRA will be deemed to be distributed within 30 days after the date that the named beneficiary

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[3] However, education IRAs are subject to the unrelated business income tax ("UBIT") imposed by section 511.

[4] This 10-percent additional tax does not apply if a distribution from an education IRA is made on account of the death, disability, or scholarship received by the designated beneficiary.

reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

The bill further provides that the additional 10-percent tax will not apply to the distribution of any contribution to an education IRA made during a taxable year if such distribution is made on or before the date that a return is required to be filed (including extensions of time) by the *beneficiary* for the taxable year during which the contribution was made (or, if the beneficiary is not required to file such a return, April 15th of the year following the taxable year during which the contribution was made).

The bill also clarifies that, under rules contained in present-law section 72, distributions from education IRAs are treated as representing a pro-rata share of the principal (i.e., contributions) and accumulated earnings in the account.[5]

In addition, because the 1997 Act allows taxpayers to redeem U.S. Savings Bonds and be eligible for the exclusion under present-law section 135 (as if the proceeds were used to pay qualified higher education expenses) provided the proceeds from the redemption are contributed to an education IRA (or to a qualified State tuition program defined under section 529) on behalf of the taxpayer, the taxpayer's spouse, or a dependent, the provision conforms the definition of "eligible educational institution" under section 135 to the broader definition of that term under present-law section 530 (and section 529). Thus, for purposes of section 135, as under present-law sections 529 and 530, the term "eligible educational institution" is defined as an institution which (1) is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) and (2) is eligible to participate in Department of Education student aid programs.

Effective Date

The provision is effective as if included in the 1997 Act, i.e., for taxable years beginning after December 31, 1997.

[5] For example, if an education IRA has a total balance of $10,000, of which $4,000 represents principal (i.e., contributions) and $6,000 represents earnings, and if a distribution of $2,000 is made from such an account, then $800 of that distribution will be treated as a return of principal (which under no event is includible in the gross income of the distributee) and $1,200 of the distribution will be treated as accumulated earnings. In such a case, if qualified higher education expenses of the beneficiary during the year of the distribution are a least equal to the $2,000 total amount of the distribution (i.e., principal plus earnings), then the entire earnings portion of the distribution will be excludible under section 530, provided that a Hope credit or Lifetime Learning credit is not claimed for that same taxable year on behalf of the beneficiary. If however, the qualified higher education expenses of the beneficiary for the taxable year are less than the total amount of the distribution, then only a portion of the earnings will be excludable from gross income under section 530. Thus, in the example discussed above, if the beneficiary incurs only $1,500 of qualified higher education expenses in the year that a $2,000 distribution is made, then only $900 of the earnings will be excludable from gross income under section 530 (i.e., an exclusion will be provided for the pro-rate portion of the earnings, based on the ratio that the $1,500 of qualified higher education expenses bears to the $2,000 distribution) and the remaining $300 of the earnings portion of the distribution will be includible in the distributee's gross income.

3. Treatment of cancellation of certain student loans (sec. 4(e) of the bill, sec. 225 of the 1997 Act, and sec. 108(f) of the Code)

Present Law

Under present law, an individual's gross income does not include forgiveness of loans made by tax-exempt educational organizations if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance outstanding student loans and the student is not employed by the lender organization. The exclusion applies only if the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers. In addition, the student's work must fulfill a public service requirement.

Explanation of Provision

The bill clarifies that the forgiveness of loans made by tax-exempt educational organizations and other tax-exempt organizations to refinance any existing student loan may be excludable from gross income. However, the bill requires that such refinancing loans must be made pursuant to a program of the refinancing organization (e.g., school or private foundation) that requires the student to fulfill a public service work requirement.

Effective Date

The provision is effective as of August 5, 1997, the date of enactment of the 1997 Act.

C. Amendments to Title III of the 1997 Act Relating to Savings Incentives

1. Conversions of IRAs into Roth IRAs (sec. 5(b) of the bill, sec. 302 of the 1997 Act and secs. 408A and 72(t) of the Code)

Present Law

A taxpayer with adjusted gross income of less than $100,000 may convert a present-law deductible or nondeductible IRA into a Roth IRA at any time. The amount converted is includible in income in the year of the conversion, except that if the conversion occurs in 1998, the amount converted is includible in income ratably over the 4-year period beginning with the year in which the conversion occurs.[6] The 10-percent tax on early withdrawals does not apply to conversions of IRAs into Roth IRAs. The 5-year holding period for converted amounts begins from the year of the conversion.

Present law does not contain a specific rule addressing what happens if an individual dies during the 4-year spread period for 1998 conversions.

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[6] If the conversion is accomplished by means of a withdrawal and a rollover into a Roth IRA, the 4-year rule applies if the withdrawal is made during 1998 and the rollover occurs within 60 days of the withdrawal. In such a case, the 4-year period begins with the year in which the withdrawal was made. For purposes of this discussion, such coversions are treated as occurring in 1998.

Explanation of Provision

Distributions of converted amounts within 5 years

The bill modifies the rules relating to conversions of IRAs into Roth IRAs in order to prevent taxpayers from receiving premature distributions from a Roth conversion IRA (i.e., before the lapse of 5 years) while retaining the benefits of 4-year income averaging and the nonpayment of the early withdrawal tax.

Under the bill, if converted amounts are withdrawn within the 5-year period beginning with the year of the conversion, then, to the extent attributable to amounts that were includible in income due to the conversion, the amount withdrawn is subject to (1) the 10-percent early withdrawal tax,[7] and (2) in the case of conversions to which the 4-year income inclusion rule applies, an additional 10-percent tax.[8] Any withdrawal from a Roth IRA which contains converted amounts (called a "Roth Conversion IRA") within the 5-year period beginning with the year of the conversion is deemed to come first from the amounts that were includible in income as a result of the conversion.

To assist in applying these rules, it is anticipated that appropriate forms will be developed to clearly differentiate Roth Conversion IRAs from other Roth IRAs and, for taxpayers who make conversions in more than one year, to differentiate Roth Conversion IRAs for different years so that taxpayers will be able to easily maintain separate IRAs for conversion amounts for each year in which a conversion is made and to facilitate reporting with respect to such IRAs by trustees and custodians.

Special rules apply in the event that separate Roth IRAs are not maintained. In the case of a Roth IRA which contains conversion contributions and other contributions, or conversion contributions from more than one year, the 5-year period begins with the most recent taxable year for which a conversion contribution was made.[9] For purposes of determining the amount of a withdrawal attributable to amounts includible in income due to a conversion, all Roth IRAs with the same 5-year holding period are aggregated.

In order to assist individuals who erroneously convert IRAs into Roth IRAs or otherwise wish to change the nature of an IRA contribution, contributions to an IRA (and earnings thereon) may be transferred from any IRA to another IRA by the due date for the taxpayer's return for the year of the contribution (including extensions). Any such transferred contributions will be treated as if contributed to the transferee IRA (and not to the transferor IRA).

The following example illustrates the application of the proposed rules.

> *Example:* Taxpayer A has a nondeductible IRA with a value of $100 (and no other IRAs). The $100 consists of $75 of contributions and $25 of earnings. A converts the IRA into a Roth IRA in 1998. As a result of the conversion, $25 is includible in

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[7] The otherwise available exceptions to the early withdrawal tax, e.g., for distributions after age 59–½, apply.

[8] This additional tax is intended to recapture the benefit of deferring the income inclusion of the converted amounts. The converted amounts are still includible in income under the 4-year rule; that is, there is no acceleration of the income inclusion.

[9] This same rule applies for purposes of determining whether a distribution from a Roth IRA is a qualified distribution.

income ratably over 4 years ($6.25 per year). The 10-percent early withdrawal tax does not apply to the conversion. (It is anticipated that when A opens the account, it will be designated as a 1998 Roth Conversion IRA.) At the beginning of 1999, the value of the account is $110, and A makes a withdrawal of $45. $25 of the withdrawal is treated as attributable entirely to amounts that were includible in income due to the conversion. Upon withdrawal, the $25 is not includible in income, nor is the 4-year income inclusion affected. However, the $25 is subject to the 10-percent tax on early withdrawals (unless an exception applies) and an additional 10-percent tax to recapture the benefit of the 4-year income inclusion. The remaining $20 of the distribution is not includible in income nor subject to the early withdrawal tax because it is considered as a return of contributions under the ordering rule generally applicable to Roth IRAs. Subsequent withdrawals would be subject to the ordering rule generally applicable to Roth IRAs.

Effect of death on 4-year spread

Under the bill, in general, any amounts remaining to be included in income as a result of a 1998 conversion would be includible in income on the final return of the taxpayer. If the surviving spouse is the beneficiary of the Roth IRA, the spouse could continue the deferral by including the remaining amounts in his or her income over the remainder of the 4-year period.

Effective Date

The provision is effective as if included in the 1997 Act, i.e., for taxable years beginning after December 31, 1997.

2. Penalty-free distributions for education expenses and purchase of first homes (sec. 5(c) of the bill, secs. 203 and 303 of the 1997 Act, and sec. 402 of the Code)

Present Law

The 10-percent early withdrawal tax does not apply to distributions from an IRA if the distribution is for first-time homebuyer expenses, subject to a $10,000 life-time cap, or for higher education expenses. These exceptions do not apply to distributions from employer-sponsored retirement plans. A distribution from an employer-sponsored retirement plan that is an "eligible rollover distribution" may be rolled over to an IRA. The term "eligible rollover distribution" means any distribution to an employee of all or a portion or the balance to the credit of the employee in a qualified trust. Distributions from cash or deferred arrangements made on account of hardship are eligible rollover distributions. An eligible rollover distribution which is not transferred directly to another retirement plan or an IRA is subject to 20-percent withholding on the distribution.

Explanation of Provision

Under present law, participants in employer-sponsored retirement plans can avoid the early withdrawal tax applicable to such

plans by rolling over hardship distributions to an IRA and withdrawing the funds from the IRA. The bill modifies the rules relating to the ability to roll over hardship distributions from employer-sponsored retirement plans to an IRA in order to prevent the avoidance of the 10-percent early withdrawal tax. The bill provides that distributions from cash or deferred arrangements made on account of hardship of the employee are not eligible rollover distributions and may not be rolled over to any IRA. Such distributions would not be subject to the 20-percent withholding applicable to eligible rollover distributions.

Effective Date

The provision is effective as if included in the 1997 Act, i.e., for taxable years beginning after December 31, 1997.

3. Limits based on modified adjusted gross income (sec. 5(b) of the bill, sec. 302(a) of the 1997 Act and sec. 72(t) of the Code)

Present Law

The $2,000 Roth IRA maximum contribution limit is phased out for individual taxpayers with adjusted gross income ("AGI") between $95,000 and $110,000 and for married taxpayers filing a joint return with AGI between $150,000 and $160,000. The maximum deductible IRA contribution is phased out between $0 and $10,000 of AGI in the case of married couples filing a separate return.

Explanation of Provision

The bill clarifies the phase-out range for the Roth IRA maximum contribution limit for a married individual filing a separate return and conforms it to the range for deductible IRA contributions. Under the bill, the phase-out range for married individuals filing a separate return is $0 to $10,000 of AGI.

Effective Date

The provision is effective as if included in the 1997 Act, i.e., for taxable years beginning after December 31, 1997.

4. Contribution limit to Roth IRAs (sec. 5(b) of the bill, sec. 302 of the 1997 Act, and sec. 408A(c) of the Code)

Present Law

An individual who is an active participant in an employer-sponsored plan may deduct annual IRA contributions up to the lesser of $2,000 or 100 percent of compensation if the individual's adjusted gross income ("AGI") does not exceed certain limits. For 1998, the limit is phased-out over the following ranges of AGI: $30,000 to $40,000 in the case of a single taxpayer and $50,000 to $60,000 in the case of married taxpayers. An individual who is not an active participant in an employer-sponsored retirement plan (and whose spouse is not an active participant) may deduct IRA contributions up to the limits described above without limitation

based on income. An individual who is not an active participant in an employer-sponsored retirement plan (and whose spouse is such an active participant) may deduct IRA contributions up to the limits described above if the AGI of the such individuals filing a joint return does not exceed certain limits. The limit is phased for out for such individuals with AGI between $150,000 and $160,000.

An individual may make nondeductible contributions up to the lesser of $2,000 or 100 percent of compensation to a Roth IRA if the individual's AGI does not exceed certain limits. An individual may make nondeductible contributions to an IRA to the extent the individual does not or cannot make deductible contributions to an IRA or contributions to a Roth IRA. Contributions to all an individual's IRAs for a taxable year may not exceed $2,000.

Explanation of Provision

The bill clarifies the intent of the Act that an individual may contribute up to $2,000 a year to all the individual's IRAs. Thus, for example, suppose an individual is not eligible to make deductible IRA contributions because of the phase-out limits, and is eligible to make a $1,000 Roth IRA contribution. The individual could contribute $1,000 to the Roth IRA and $1,000 to anondeductible IRA.

Effective Date

The provision is effective as if included in the 1997 Act, i.e., for taxable years beginning after December 31, 1997.

5. Limitations for active participation in an IRA (sec. 5(a) of the bill, sec. 301(b) of the 1997 Act, and sec. 219(g) of the Code)

Present Law

Under present law, if a married individual (filing a joint return) is an active participant in an employer-sponsored retirement plan, the $2,000 IRA deduction limit is phased out over the following levels of adjusted gross income ("AGI"):

	In dollars
Taxable years beginning in:	
1997	$40,000–50,000
1998	50,000–60,000
1999	51,000–61,000
2000	52,000–62,000
2001	53,000–63,000
2002	54,000–64,000
2003	60,000–70,000
2004	65,000–75,000
2005	70,000–80,000
2006	75,000–85,000
2007	80,000–100,000

An individual is not considered an active participant in an employer-sponsored retirement plan merely because the individual's spouse is an active participant. The 2,000 maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, is phased out for taxpayers with AGI between 150,000 and 160,000.

Explanation of Provision

The bill clarifies the intent of the Act relating to the AGI phase-out ranges for married individuals who are active participants in employer-sponsored plans and the AGI phase-out range for spouses of such active participants as described above.

Effective Date

The provision is effective as if included in the 1997 Act, i.e., for taxable years beginning after December 31, 1997.

D. Amendments to Title III of the 1997 Act Relating to Capital Gains

1. Individual capital gains rate reductions (sec. 5(d) of the bill, sec. 311 of the 1997 Act, and sec. 1(h) of the Code)

Present Law

The 1997 Act provided lower capital gains rates for individuals. Generally, the 1997 Act reduced the maximum rate on the adjusted net capital gain of an individual from 28 percent to 20 percent and provided a 10-percent rate for the adjusted net capital gain otherwise taxed at a 15-percent rate. The "adjusted net capital gain" means the net capital gain determined without regard to certain gain for which the 1997 Act provided a higher maximum rate of tax. The 1997 Act generally retained a 28-percent maximum rate for the long-term capital gain from collectibles, certain long-term capital gain included in income from the sale of small business stock, and the net capital gain determined by including all capital gains and losses properly taken into account after July 28, 1997, from property held more than one year but not more than 18 months and all capital gains and losses properly taken into account for the portion of the taxable year before May 7, 1997. In addition, the 1997 Act provided a maximum rate of 25 percent for the long-term capital gain attributable to real estate depreciation ("unrecaptured section 1250 gain").

The amounts taxed at the 28- and 25-percent rates may not exceed the individual's net capital gain and also are reduced by amounts otherwise taxed at a 15-percent rate.

Under the provisions of the 1997 Act, net short-term capital losses and long-term capital loss carryovers reduce the amount of adjusted net capital gain before reducing amounts taxed at the maximum 25- and 28-percent rates.

The 1997 Act failed to coordinate the new multiple holding periods with certain provisions of the Code.

Explanation of Provision

Under the bill, the "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain.

"28-percent rate gain" means the amount of net gain attributable to collectibles gains and losses, an amount of gain equal to the gain excluded from gross income on the sale of certain small business

stock under section 1202,[10] long-term capital gains and losses properly taken into account after July 28, 1997, from property held more than one year but not more than 18 months, the net short-term capital loss for the taxable year and the long-term capital loss carryover to the taxable year. Long-term capital gains and losses properly taken into account before May 7, 1997, also are included in computing 28-percent rate gain.

"Unrecaptured section 1250 gain" means the amount of long-term capital gain (not otherwise treated as ordinary income) which would be treated as ordinary income if section 1250 recapture applied to all depreciation (rather than only to depreciation in excess of straight-line depreciation) from property held more than 18 months (one year for amounts properly taken into account after May 6, 1997, and before July 29, 1997).[11] The unrecaptured section 1250 depreciation is reduced (but not below zero) by the excess (if any) of amount of losses taken into account in computing 28-percent gain over the amount of gains taken into account in computing 28-percent rate gain.

The bill contains several conforming amendments to co-ordinate the multiple holding periods with other provisions of the Code. Inherited property (sec. 1223 (11) and (12)) and certain patents (sec. 1235) are deemed to have a holding period of more than 18 months, allowing the 10- and 20-percent rates to apply. The bill clarifies that the amount treated as long-term capital gain or loss on a section 1256 contract is treated as attributable to property held for more than 18 months. Rules similar to the short sale holding period rules of section 1233 (b) and (d) and the holding period rules of section 1092(f) will apply where the applicable property is held more than 1 year but not more than 18 months. Amounts treated as ordinary income by reason of section 1231(c) will be allocated among categories of net section 1231 gain in accordance with IRS forms or regulations.

The bill reorders the rate structure under sections 1(h)(1) and 55(b)(3) without any substantive change.

The bill makes minor technical changes, including a provision to reduce the minimum tax preference on certain small business stock to 28 percent, beginning in 2006.[12]

Effective Date

The provision applies to taxable years ending after May 6, 1997.

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[10] For example, assume an individual has $300,000 gain from the sale of qualified stock in a small business corporation and $120,000 of the gain (50 percent of $240,000) is excluded from gross income under section 1202, as limited by section 1202(b). The $180,000 of gain included in gross income is included in the computation of net capital gain, and $120,000 of that gain is taken into account in computing 28-percent rate gain. The maximum effective regular tax rate on the $240,000 of gain to which the 50-percent section 1202 exclusion applies is 14 percent and the maximum rate on the remaining $60,000 of gain is 20 percent.

[11] In the case of a disposition of a partnership interest held more than 18 months, the amount of the individual's long-term capital gain which would be treated as ordinary income under section 751(a) if section 1250 applied to all depreciation, will be taken into account in computing unrecaptured section 1250 gain.

[12] Thus, the maximum rate under the minimum tax will be 17.92% (.64 times 28%).

2. Rollover of gain from sale of qualified stock (sec. 5(f) of the bill, sec. 313 of the 1997 Act, and sec. 1045 of the Code)

Present Law

The 1997 Act provided that gain from the sale of qualified small business stock held by an individual for more than six months can be "rolled over" tax-free to other qualified small business stock.

Explanation of Provision

Under the bill, a partnership or an S corporation can roll over gain from qualified small business stock held more than six months if (and only if) all the interests in the partnership or S corporation are held by individuals or estates[13] at all times during the taxable year.

Effective Date

The provision applies to sales on or after August 5, 1997, the date of enactment of the 1997 Act.

3. Exclusion of gain on the sale of a principal residence owned and used less than two years (sec. 5(e) of the bill, sec. 312(a) of the 1997 Act, and sec. 121 of the Code)

Present Law

Under present law, a taxpayer generally is able to exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned the residence and used it as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or unforeseen circumstances is able to exclude a fraction of the taxpayer's realized gain equal to the fraction of the two years that the requirements are met.

Explanation of Provision

The legislative history of the 1997 Act indicates that the intent of the exclusion of gain on the sale of a principal residence was to reduce to a small number of higher income taxpayers, those who would have to refer to records in determining income tax consequences of transactions related to their house.[14] Therefore, the bill clarifies that an otherwise qualifying taxpayer who fails to satisfy the two-year ownership and use requirements is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return), not the fraction of the realized gain, which is equal to the fraction of the two years that the ownership and use requirements are met. For example, an unmarried taxpayer who owns and uses a principal residence for one year then

[13] The term "estate" is intended to include both the estate of a decedent and the estate of an individual in bankruptcy.

[14] See H. Rept. 105–148, p. 347.

sells at realized gain of $500,000 may exclude $125,000 of gain (one-half of $250,000) not $250,000 of gain (one-half of the realized gain). Similarly, an unmarried taxpayer who owns and uses a principal residence for one year then sells at a realized gain of $50,000 may exclude the entire $50,000 of gain because it is less than one half of $250,000. The exclusion is not limited to $25,000 (one-half of the $50,000 realized gain).

Effective Date

The provision is effective as if included in section 312 of the 1997 Act.

4. Effective date of the exclusion of gain on the sale of a principal residence (sec. 5(e) of the bill, sec. 312(d)(2) of the 1997 Act, and sec. 121 of the Code)

Present law

The exclusion for gain on sale of a principal residence under the 1997 Act generally applies to sales or exchanges occurring after May 6, 1997. A taxpayer may elect, however, to apply prior law to a sale or exchange (1) made before the date of enactment of the Act, (2) made after the date of enactment pursuant to a binding contract in effect on such date, or (3) where a replacement residence was acquired on or before the date of enactment (or pursuant to a binding contract in effect on the date of enactment) and the prior-law rollover provision would apply. The 1997 Act is unclear regarding transactions that occurred on the date of enactment.

Explanation of Provision

The bill clarifies that a taxpayer may elect to apply prior law with respect to a sale or exchange on the date of enactment of section 312 of the 1997 Act (August 5, 1997).

Effective Date

The provision is effective as if included in section 312 of the 1997 Act.

E. Amendments to Title V of the 1997 Act Relating to Estate and Gift Taxes

1. Clarification of effective date for indexing of generation-skipping exemption (sec. 6(a) of the bill, secs. 501(d) and (f) of the 1997 Act, and sec. 2631(c) of the Code)

Present Law

The 1997 Act provided for the indexation of the $1 million exemption from generation-skipping transfers effective for decedents dying after December 31, 1998.

Explanation of Provision

The bill clarifies that the indexing of the exemption from generation-skipping transfers is effective with respect to all generation-

skipping transfers (i.e., direct skips, taxable terminations, and taxable distributions) made after 1998.

Effective Date

The provision is effective for generation-skipping transfers made after December 31, 1998.

2. Coordination between unified credit and family-owned business exclusion (sec. 6(b)(1) of the bill, sec. 502 of the 1997 Act, and sec. 2033A(a) of the Code)

Present Law

The 1997 Act effectively increased the amount of lifetime gifts and transfers at death that are exempt from unified estate and gift tax from $600,000 to $1,000,000 over the period 1997 to 2006, through increases in an individual's unified credit. In addition, the Act provided a limited exclusion for certain family-owned business interests. The exclusion for family-owned business interests may be taken only to the extent that the exclusion for family-owned business interests, plus the amount effectively exempted by the unified credit, does not exceed $1.3 million. As a result, for years after 1998, the maximum amount of exclusion for family-owned business interests is reduced by increases in the dollar amount of transfers effectively exempted through the unified credit.

Because the structure of the Act increases the unified credit over time (until 2006) while decreasing over the same period the benefit of the closely-held business exclusion, the estate tax on estates with family-owned businesses increases over time until 2006. This increase in estate tax results from the fact that increases in the unified credit provide a benefit at the decedent's lowest estate tax brackets, while the exclusion for family-owned businesses provides a benefit at the decedent's highest estate tax brackets.

Explanation of Provision

The bill revises the rules correlating the increase in the unified credit with a decrease in the lower family-owned business exclusion such that there is neither an increase nor a decrease in the total estate tax on estates holding family-owned businesses as increases in the unified credit are phased in. The bill achieves this result by decreasing the amount of tax benefit provided by the exclusion for family-owned business interests in a given year (as compared to the benefit provided in 1998) by an amount exactly equal to the increase in the dollar amount of the unified credit ("the applicable credit amount") in that year over the amount of unified credit provided in 1998 (i.e., $202,050). Thus, for example, in 2006, when the unified credit is $345,800, the tax benefit provided by the exclusion for family-owned business interests will be reduced by $143,750 (i.e., $345,800 minus $202,050).

The computation is made as follows. First, one must compute the decrease in tentative estate tax liability (under Code section 2001(c)) that would result if the estate were entitled to an exclusion of $675,000. (This amount will vary from taxpayer to taxpayer, depending upon the size of the estate, because of different marginal

estate tax rates.) This amount then is reduced by the amount of increase in the unified credit since 1998. The resulting number is the "maximum credit equivalent benefit." The maximum qualified family-owned business exclusion available to the estate ("the exclusion limitation") is equal to the amount of exclusion that will reduce the estate's tax liability by the maximum credit equivalent benefit.

For example, assume that an individual dies in 2006 with an estate of $1.4 million, and the executor elects the application of the qualified family-owned business exclusion. Under Code section 2001(c), an estate of $1.4 million (after all deductions but before application of the unified credit) would have a tentative estate tax liability of $512,800. If this estate were entitled to an exclusion of $675,000, the tentative estate tax liability would be only $239,050 (a decrease of $273,750). For decedents dying in 2006, the unified credit will be equal to $345,800 (an increase of $143,750 over the 1998 unified credit amount of $202,050). Thus, this estate's maximum credit equivalent benefit would be equal to $273,750 minus $143,750, or $130,000. To determine the amount of qualified family-owned business exclusion available to the estate in 2006, a calculation would be made to determine the amount of exclusion that would provide the estate with $130,000 in tax savings. An estate of $1,090,244 would have a tentative tax liability of $382,800, which is exactly $130,000 less than the $512,800 tentative estate tax liability on a $1.4 million estate, as determined above. Thus, a maximum qualified family-owned business exclusion of $309,756 (i.e., $1.4 million minus $1,090,244) would be available for a decedent dying in 2006 with a $1.4 million estate.

If the estate in the above example includes qualified family-owned business interests of at least $309,756, the estate may utilize the entire exclusion, and its Federal estate tax liability would be calculated as follows. The taxable estate would be equal to $1,090,244 (i.e., $1,400,000 minus $309,756), resulting in a tentative tax of $382,800 (based on the rate schedule set forth in Code sec. 2001(c)). For decedents dying in 2006, a unified credit of $345,800 is allowed. Thus, the Federal estate tax liability for this estate would be equal to $37,000 (i.e., $382,800 minus $345,800), less any other applicable credits, such as the credit for State death taxes.

Under this formula, the Federal estate tax liability (before application of credits other than the unified credit) for any estate of $1.4 million that has at least $675,000 in qualified family-owned business interests always will be $37,000, regardless of the year in which the decedent dies. For example, if the decedent instead died in 2000, this formula would yield a maximum qualified family-owned business exclusion of $626,282, which would result in a taxable estate of $773,718, and a tentative tax of $257,550. After applying the unified credit amount that is allowed in 2000, i.e., $220,550, the Federal estate tax liability would be equal to $37,000, less any other applicable credits.

Effective Date

The provision is effective for decedents dying after December 31, 1997.

3. Clarification of businesses eligible for family-owned business exclusion (sec. 6(b)(2) of the bill, sec. 502 of the 1997 Act, and sec. 2033A(b)(3) of the Code)

Present Law

In order to be eligible to exclude from the gross estate a portion of the value of a family-owned business, the sum of (1) the adjusted value of family-owned business interests includible in the decedent's estate, and (2) the amount of gifts of family-owned business interests to family members of the decedent that are not included in the decedent's gross estate, must exceed 50 percent of the decedent's adjusted gross estate.

Explanation of Provision

The bill clarifies the formula for determining the amount of gifts of family-owned business interests made to members of the decedent's family that are not otherwise includible in the decedent's gross estate.

Effective Date

The provision is effective with respect to decedents dying after December 31, 1997.

4. Clarification of interest on installment payment of estate tax on holding companies (sec. 6(c) of the bill, sec. 503 of the 1997 Act, and secs. 6166(b)(7)(A) and 6166(b)(8)(A) of the Code)

Present Law

Where certain conditions are met, a decedent's estate may elect to pay the estate tax attributable to certain closely-held businesses over a 14-year period. The 1997 Act provided for a 2-percent interest rate on the estate tax on first $1 million in taxable value of interests in qualified closely-held businesses, and a rate equal to 45 percent of the regular deficiency rate on the amount in excess of the portion eligible for the 2-percent rate, but also provided that none of interest on the deferred payment of estate taxes would be deductible for income or estate tax purposes. Interests in holding companies and non-readily-tradeable business interests are not eligible for the 2-percent rate.

Explanation of Provision

The bill clarifies that deferred payments of estate tax on holding companies and non-readily-tradable business interests do not qualify for the 2-percent interest rate, but instead are subject to a rate of 45 percent of the regular deficiency rate. Such interest payments are not deductible for income or estate tax purposes.

Effective Date

The provision generally is effective for decedents dying after December 31, 1997.

5. Clarification on declaratory judgment jurisdiction of U.S. Tax Court regarding installment payment of estate tax (sec. 6(d) of the bill, sec. 505 of the 1997 Act, and sec. 7479(a) of the Code)

Present Law

Where certain conditions are met, a decedent's estate may elect to pay estate tax attributable to certain closely-held businesses over a 14-year period. The 1997 Act provided that the U.S. Tax Court would have jurisdiction to determine whether the estate of a decedent qualifies for the 14-year installment payment of estate tax.

Explanation of Provision

The bill clarifies that the jurisdiction of the U.S. Tax Court to determine whether an estate qualifies for installment payment of estate tax on closely-held businesses extends to determining which businesses in an estate are eligible for the deferral.

Effective Date

The provision is effective for decedents dying after the date of enactment of the 1997 Act.

6. Clarification of rules governing revaluation of gifts (sec. 6(e) of the bill, sec. 506 of the 1997 Act, and sec. 2504(c) of the Code)

Present Law

The valuation of a gift becomes final for gift tax purposes after the statute of limitations on any gift tax assessed or paid has expired. The 1997 Act extended that rule to apply for estate tax purposes, provided for a lengthened statute of limitations for gift tax purposes if certain information is not disclosed with the gift tax return, and provided jurisdiction to the U.S. Tax Court to determine the value of any gift.

Explanation of Provision

The bill clarifies that in determining the amount of taxable gifts made in preceding calendar periods, the value of prior gifts is the value of such gifts as finally determined, even if no gift tax was assessed or paid on that gift. For this purpose, final determinations include, e.g., the value reported on the gift tax return (if not challenged by the IRS prior to the expiration of the statute of limitations), the value determined by the IRS (if not challenged through the declaratory judgment procedure by the taxpayer), the value determined by the courts, or the value agreed to by the IRS and the taxpayer in a settlement agreement.

Effective Date

The provision is effective with respect to gifts made after the date of enactment of the 1997 Act.

F. Amendments to Title VII of the 1997 Act Relating to Incentives for the District of Columbia (sec. 7 of the bill, sec. 701 of the 1997 Act, and secs. 1400, 1400B and 1400C of the Code)

Present Law

Designation of D.C. Enterprise Zone

Certain economically depressed census tracts within the District of Columbia are designated as the "D.C. Enterprise Zone," within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Enterprise Zone for purposes of the wage credit, expensing, and tax-exempt financing incentives include all census tracts that presently are part of the D.C. enterprise community and census tracts within the District of Columbia where the poverty rate is not less than 20 percent. The D.C. Enterprise Zone designation generally will remain in effect for five years for the period from January 1, 1998, through December 31, 2002.

Empowerment zone wage credit, expensing, and tax-exempt financing

The following tax incentives generally are available in the D.C. Enterprise Zone: (1) a 20-percent wage credit for the first $15,000 of wages paid to D.C. residents who work in the D.C. Enterprise Zone; (2) an additional $20,000 of expensing under Code section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities.

Zero-percent capital gains rate

A zero-percent capital gains rate applies to capital gains from the sale of certain qualified D.C. Zone assets held for more than five years. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent. Only capital gain that is attributable to the 10-year period beginning December 31, 1997, and ending December 31, 2007, is eligible for the zero-percent rate.

First-time homebuyer tax credit

First-time homebuyers of a principal residence in the District are eligible for a tax credit of up to $5,000 of the amount of the purchase price, except that the credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000–$130,000 for joint filers). The credit is available with respect to property purchased after the date of enactment and before January 1, 2001.

Explanation of Provision

Eligible census tracts

The bill clarifies that the determination of whether a census tract in the District of Columbia satisfies the applicable poverty criteria for inclusion in the D.C. Enterprise Zone for purposes of the

wage credit, expensing, and special tax-exempt financing incentives (poverty rate of not less than 20 percent) or for purposes of the zero-percent capital gains rate (poverty rate of not less than 10 percent), is based on 1990 decennial census data. Thus, data from the 2000 decennial census will not result in the expansion or other reconfiguration of the D.C. Enterprise Zone.

First-time homebuyer credit

The bill clarifies that, for purposes of the first-time homebuyer credit, a "first-time homebuyer" means any individual if such individual (and, if married, such individual's spouse) did not have a present ownership interest in a principal residence in the District of Columbia during the one-year period ending on the date of the purchase of the principal residence to which the credit applies.

In addition, the bill clarifies that the term "purchase price" means the adjusted basis of the principal residence on the date the residence is purchased. A newly constructed residence is treated as purchased by the taxpayer on the date the taxpayer first occupies such residence.

The bill clarifies that the first-time homebuyer credit is a nonrefundable personal credit and provides that the first-time homebuyer credit is claimed after the credits described in Code sections 25 (credit for interest on certain home mortgages) and 23 (adoption credit).

Further, the bill clarifies that the first-time homebuyer credit is available only for property purchased after August 4, 1997, and before January 1, 2001. Thus, the credit is available to first-time home purchasers who acquire title to a qualifying principal residence on or after August 5, 1997, and on or before December 31, 2000, irrespective of the date the purchase contract was entered into.

Effective Date

The provision is effective as of August 5, 1997, the date of enactment of the 1997 Act.

G. Amendments to Title IX of the 1997 Act Relating to Miscellaneous Provisions

1. Clarification of effect of certain transfers to Highway Trust Fund (sec. 8(a) of the bill, sec. 901 of the 1997 Act, and sec. 9503 of the Code)

Present Law

The 1997 Act provided for the transfer of an additional 4.3 cents per gallon of the highway motor fuels tax revenues from the General Fund to the Highway Trust Fund, and provided that revenues transferred to the Trust Fund under this provision could not be used in a manner resulting in changes in direct spending. The 1997 Act further changed the dates by which certain taxes would be required to be deposited with the Treasury in fiscal year 1998.

Explanation of Provision

The bill clarifies that the tax deposit delays included in the provisions affecting transfers to the Highway Trust Fund, like the revenue transfers themselves, do not affect direct spending from the Trust Fund.

Effective Date

The provision is effective as if included in the 1997 Act.

2. Clarification of Mass Transit Account portions of highway motor fuels taxes (sec. 8(b) of the bill, sec. 907 of the 1997 Act, and sec. 9503 of the Code)

Present Law

The 1997 Act provided for the transfer to the Highway Trust Fund of revenues attributable to a General Fund fuels tax rate of 4.3 cents per gallon. That Act further enacted reduced rates, based on energy content, for propane, liquefied natural gas, compressed natural gas, and methanol produced from natural gas. When deposited in the Highway Trust Fund, revenues from the taxes on each of these products are divided between the Trust Fund's Highway Account and the Mass Transit Account.

Explanation of Provision

The bill clarifies that the Mass Transit Account portion of the highway motor fuels taxes generally is 2.86 cents per gallon and that taxes on the four fuels eligible for reduced rates are divided between the Highway Account and the Mass Transit Account in the same proportion as is the tax on gasoline.

Effective Date

The provision is effective as if included in the 1997 Act.

3. Combined employment tax reporting demonstration project (sec. 8(c) of the bill, sec. 976 of the 1997 Act, and sec. 6103(d)(5) of the Code)

Present Law

Traditionally, Federal tax forms are filed with the Federal Government and State tax forms are filed with individual States. This necessitates duplication of items common to both returns. Some States have recently been working with the IRS to implement combined State and Federal reporting of certain types of items on one form as a way of reducing the burdens on taxpayers. The State of Montana and the IRS have cooperatively developed a system to combine State and Federal employment tax reporting on one form. The one form would contain exclusively Federal data, exclusively State data, and information common to both: the taxpayer's name, address, TIN, and signature.

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure

is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the Internal Revenue Service ("IRS") to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

Implementation of the combined Montana-Federal employment tax reporting project had been hindered because the IRS interprets section 6103 to apply that provision's restrictions on disclosure to information common to both the State and Federal portions of the combined form, although these restrictions would not apply to the State with respect to the State's use of State-requested information if that information were supplied separately to both the State and the IRS.

The 1997 Act permits implementation of a demonstration project to assess the feasibility and desirability of expanding combined reporting in the future. There are several limitations on the demonstration project. First, it is limited to the State of Montana and the IRS. Second, it is limited to employment tax reporting. Third, it is limited to disclosure of the name, address, TIN, and signature of the taxpayer, which is information common to both the Montana and Federal portions of the combined form. Fourth, it is limited to a period of five years.

Explanation of Provision

The bill permits Montana to use this information as if it had collected it separately by eliminating Federal penalties for disclosure of this information. The bill also corrects a cross-reference to the provision.

Effective Date

The provision is effective on the date of enactment of the 1997 Act (August 5, 1997), and will expire on the date five years after the date of enactment of the 1997 Act.

H. Amendments to Title X of the 1997 Act Relating to Revenue-Raising Provisions

1. Exception from constructive sales rules for certain debt position (sec. 9(a)(1) of the bill, sec. 1001(a) of the 1997 Act, and sec. 1259(b)(2) of the Code)

Present Law

A taxpayer is required to recognize gain (but not loss) upon entering into a constructive sale of an "appreciated financial position," which generally includes an appreciated position with respect to any stock, debt instrument or partnership interest. An exception is provided for positions with respect to debt instruments that have an unconditionally payable principal amount, that are not convertible into the stock of the issuer or a related person, and the interest on which is either fixed, payable at certain variable rates or based on certain interest payments on a pool of mortgages.

Explanation of Provision

The bill clarifies that, to qualify for the exception for positions with respect to debt instruments, the position must either itself meet the requirements as to unconditional principal amount, non-convertibility and interest terms or, alternatively, be a hedge of a position meeting these requirements. A hedge for this purpose includes any position that reduces the taxpayer's risk of interest rate or price changes or currency fluctuations with respect to another position.

Effective Date

The provision is generally effective for constructive sales entered into after June 8, 1997.

2. Definition of forward contract under constructive sales rules (sec. 9(a)(2) of the bill, sec. 1001(a) of the 1997 Act, and sec. 1259(d)(1) of the Code)

Present Law

A constructive sale of an appreciated financial position generally results when the taxpayer enters into a forward contract to deliver the same or substantially identical property. A forward contract for this purpose is defined as a contract that provides for delivery of a substantially fixed amount of property at a substantially fixed price.

Explanation of Provision

The bill clarifies that the definition of a forward contract includes a contract that provides for cash settlement with respect to a substantially fixed amount of property at a substantially fixed price.

Effective Date

The provision is generally effective for constructive sales entered into after June 8, 1997.

3. Treatment of mark-to-market gains of electing traders (sec. 9(a)(3) of the bill, sec. 1001(b) of the 1997 Act, and sec. 475(f)(1)(D) of the Code)

Present Law

Securities and commodities traders may elect application of the mark-to-market accounting rules. Gain or loss recognized by an electing taxpayer under these rules is treated as ordinary gain or loss.

Under the Self-Employment Contributions Act ("SECA"), a tax is imposed on an individual's net earnings from self-employment ("NESE"). Gain or loss from the sale or exchange of a capital asset is excluded from NESE.

A publicly-traded partnership generally is treated as a corporation for Federal tax purposes. An exception to this rule applies if 90 percent or more of the partnership's gross income consists of

passive-type income, which includes gain from the sale or disposition of a capital asset.

Explanation of Provision

The bill clarifies that gain or loss of a securities or commodities trader that is treated as ordinary solely by reason of election of mark-to-market treatment is not treated as other than gain or loss from a capital asset for purposes of determining NESE for SECA tax purposes or for purposes of determining whether the passive-type income exception to the publicly-traded partnership rules is met.

Effective Date

The provision applies to taxable years of electing securities and commodities traders ending after the date of enactment of the 1997 Act.

4. Special effective date for constructive sale rules (sec. 9(a)(4) of the bill, sec. 1001(d) of the 1997 Act, and sec. 1259 of the Code)

Present Law

The constructive sales rules contain a special effective date provision for decedents dying after June 8, 1997, if (1) a constructive sale of an appreciated financial position occurred before such date, (2) the transaction remains open for not less than two years, (3) the transaction remains open at any time during the three years prior to the decedent's death, and (4) the transaction is not closed within the 30-day period beginning on the date of enactment of the 1997 Act. If the requirements of the special effective date provision are met, both the appreciated financial position and the transaction resulting in the constructive sale are generally treated as property constituting rights to receive income in respect of a decedent under section 691. However, gain with respect to a position in a constructive sale transaction that accrues after the transaction is closed is not included in income in respect of a decedent.

Explanation of Provision

The bill clarifies the special effective date rule to provide that the rule does not apply if the constructive sale transaction is closed at any time prior to the end of the 30th day after the date of enactment of the 1997 Act.

Effective Date

The provision is effective for decedents dying after June 8, 1997.

5. Treatment of certain corporate distributions (sec. 9(b) of the bill, sec. 1012 of the 1997 Act, and secs. 355(e)(3)(A)(iv) and 358(c) of the Code)

Present Law

The 1997 Act (sec. 1012(a)) requires a distributing corporation ("distributing") to recognize corporate level gain on the distribution of stock of a controlled corporation ("controlled") under section 355 of the Code if, pursuant to a plan or series of related transactions, one or more persons acquire a 50-percent or greater interest (defined as 50 percent or more of the voting power or value of the stock) of either the distributing or controlled corporation (Code sec. 355(e)). Certain transactions are excepted from the definition of acquisition for this purpose, including, under section 355(e)(3)(A)(iv), the acquisition by a person of stock in a corporation if shareholders owning directly or indirectly stock possessing more than 50 percent of the voting power and more than 50 percent of the value of the stock in distributing or any controlled corporation before such acquisition own directly or indirectly stock possessing such vote and value in such distributing or controlled corporation after such acquisition.[15]

The 1997 Act (sec. 1012(b)(1)) also provides that, except as provided in regulations, section 355 shall not apply to the distribution of stock from one member of an affiliated group of corporations (as defined in section 1504(a)) to another member of such group (an intragroup spin-off) if such distribution is part of a such a plan or series of related transactions pursuant to which one or more persons acquire stock representing a 50-percent or greater interest in a distributing or controlled corporation, determined after the application of the rules of section 355(e).

In addition, the 1997 Act (sec. 1012(c)) provides that in the case of any distribution of stock of one member of an affiliated group of corporations to another member under section 355, the Treasury Department has regulatory authority under section 358(c) to provide adjustments to the basis of any stock in a corporation which is a member of such group, to reflect appropriately the proper treatment of such distribution.

The effective date (Act section 1012(d)(1)) states that the forgoing provisions of the Act apply to distributions after April 16, 1997, pursuant to a plan (or series of related transactions) which involves an acquisition occurring after such date (unless certain transition provisions apply).

Explanation of Provision

Acquisition of a 50-percent or greater interest

The bill clarifies that the acquisitions described in Code section 355(e)(3)(A) are disregarded in determining whether there has been an acquisition of a 50-percent or greater interest in a corporation. However, other transactions that are part of a plan or series of re-

[15] This exception (as certain other exceptions) does not apply if the stock held before the acquisition was acquired pursuant to a plan (or series of related transactions) to acquire a 50-percent or greater interest in the distributing or a controlled corporation.

lated transactions could result in an acquisition of a 50-percent or greater interest.

In the case of acquisitions under section 355(e)(3)(A)(iv), the provision clarifies that the acquisition of stock in the distributing corporation or any controlled corporation is disregarded to the extent that the percentage of stock owned directly or indirectly in such corporation by each person owning stock in such corporation immediately before the acquisition does not decrease.

Example: Shareholder A owns 10 percent of the vote and value of the stock of corporation D (which owns all of corporation C). There are nine other equal shareholders of D. A also owns 100 percent of the vote and value of the stock of unrelated corporation P. D distributes C to all the shareholders of D. Thereafter, pursuant to a plan or series of related transactions, D (worth 100x) merges with corporation P (worth 900x). After the merger, each of the former shareholders of corporation D owns stock of the merged entity reflecting the vote and value attributable to that shareholder's respective 10 percent former stock ownership of D. Each of the former shareholders of D owns 1 percent of the stock of the merged corporation, except that shareholder A (who owned 100 percent of corporation P and 10 percent of corporation D before the merger) now owns 91 percent of the stock of the merged corporation. In determining whether a 50-percent or greater interest in D has been acquired, the interest of each of the continuing shareholders is disregarded only to the extent there has been no decrease in such shareholder's direct or indirect ownership. Thus, the 10 percent interest of A, and the 1 percent interest of each of the nine other former shareholders of D, is not counted. The remaining 81 percent ownership of the merged corporation, representing a decrease of nine percent in the interests of each of the nine former shareholders other than A, is counted in determining the extent of an acquisition. Therefore, a 50-percent or greater interest in D has been acquired.

Treasury regulatory authority

The bill also clarifies that the regulatory authority of the Treasury Department under section 358(c) applies to distributions after April 16, 1997, without regard to whether a distribution involves a plan (or series of related transactions) which involves an acquisition. As stated in the Statement of Managers to the 1997 Act, with respect to the Treasury Department regulatory authority under section 358(c) as applied to intragroup spin-off transactions that are not part of a plan or series of related transactions that involve an acquisition of a 50-percent of greater interest under new section 355(f), it is expected that any Treasury regulations will be applied prospectively, except in cases to prevent abuse.

Effective Date

The provision generally is effective for distributions after April 16, 1997.

6. Certain preferred stock treated as "boot"—statute of limitations (sec. 9(c)(1) of the bill, sec. 1014 of the 1997 Act, and sec. 354(a) of the Code).

Present law

Under the 1997 Act, certain preferred stock received in otherwise tax-free transactions is treated as "other property." Exchanges of stock in certain recapitalizations of family-owned corporations are excepted from this rule. A family-owned corporation is defined as any corporation if at least 50 percent of the total voting power and value of the stock of such corporation is owned by the same family for five years preceding the recapitalization. In addition, a recapitalization does not qualify for the exception if the same family does not own 50 percent of the total voting power and value of the stock throughout the three-year period following the recapitalization.

Explanation of Provision

Under the bill, the statutory period for the assessment of any deficiency attributable to a corporation failing to be a family-owned corporation shall not expire before the expiration of three years after the date the Secretary of the Treasury is notified by the corporation (in such manner as the Secretary may prescribe) of such failure, and such deficiency may be assessed before the expiration of such three-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

Effective Date

The provision applies to transactions after June 8, 1997.

7. Certain preferred stock treated as "boot"—treatment of transferor (sec. 9(c)(2) of the bill, sec. 1014 of the 1997 Act, and sec. 351(g) of the Code)

Present Law

The 1997 Act amended section 351 of the Code to provide that in the case of a person who transfers property to a controlled corporation and receives nonqualified preferred stock, section 351(b) will apply to such person. Section 351(b) provides that if section 351(a) of the Code would apply to an exchange but for the fact that there is received, in addition to stockpermitted to be received under section 351(a), other property or money, then gain but no loss to such recipient shall be recognized. The Statement of Managers to the 1997 Act states that if nonqualified preferred stock is received, gain but not loss shall be recognized.

Explanation of Provision

The bill clarifies that section 351(b) applies to a transferor who transfers property in a section 351 exchange and receives nonqualified preferred stock in addition to stock that is not treated as "other property" under that section. Thus, if a transferor received only nonqualified preferred stock but the transaction in the aggre-

gate otherwise qualified as a section 351 exchange, such a transferor would recognize loss and the basis of the nonqualified preferred stock and of the property in the hands of the transferee corporation would reflect the transaction in the same manner as if that particular transferor had received solely "other property" of any other type. The provision does not override the application of section 267 or any other provision that would disallow or defer the recognition of a loss. As under the 1997 Act, the nonqualified preferred stock continues to be treated as stock received by a transferor for purposes of qualification of a transaction under section 351(a), unless and until regulations may provide otherwise.

Effective Date

The provision applies to transactions after June 8, 1997.

8. Establish IRS continuous levy and improve debt collection (sec. 9(d) of the bill, sec. 1024 of the 1997 Act, and sec. 6331 of the Code)

Present Law

If any person is liable for any internal revenue tax and does not pay it within 10 days after notice and demand by the IRS, the IRS may then collect the tax by levy upon all property and rights to property belonging to the person, unless there is an explicit statutory restriction on doing so. A levy is the seizure of the person's property or rights to property. A levy on salary and wages is continuous from the date it is first made until the date it is fully paid or becomes unenforceable.

The 1997 Act provides that a continuous levy is also applicable to non-means tested recurring Federal payments and specified wage replacement payments.

Explanation of Provision

The bill clarifies that the IRS must approve the use of a continuous levy before it may take effect.

Effective Date

The provision is effective for levies issued after the date of enactment of the 1997 Act (August 5, 1997).

9. Clarification regarding aviation gasoline excise tax (sec. 9(e) of the bill, sec. 1031 of the 1997 Act, and sec. 6421(f) of the Code)

Present Law

Before enactment of the 1997 Act, aviation gasoline was subject to a 19.3-cents-per-gallon tax rate, with 15 cents per gallon being deposited in the Airport and Airway Trust Fund and 4.3 cents per gallon being retained in the General Fund. The 1997 Act extended the 15-cents-per-gallon rate for 10 years, through September 30, 2007, and expanded deposits to the Trust Fund to include revenues from the 4.3-cents-per-gallon rate. The tax does not apply to fuel

used in flight segments outside the United States or to flight segments from the United States to foreign countries.

Explanation of Provision

The bill clarifies the application of the gasoline tax refund provisions to aviation gasoline used in flight segments outside the United States and to flight segments from the United States to foreign countries.

Effective Date

The provision is effective as if included in the 1997 Act.

10. Clarification of requirement that registered fuel terminals offer dyed fuel (sec. 9(f) of the bill, sec. 1032 of the 1997 Act, and sec. 4101 of the Code)

Present Law

The 1997 Act provides that fuel terminals are eligible to register to handle non-tax-paid diesel fuel and kerosene only if the terminal operator offers both undyed (taxable) and dyed (nontaxable) fuel.

Explanation of Provision

The bill clarifies that the Code requires terminals eligible to handle non-tax-paid diesel to offer dyed diesel fuel and terminals eligible to handle non-tax-paid kerosene (including diesel fuel #1 and kerosene-type aviation fuel) to offer dyed kerosene. The provision does not require that a terminal offer for sale kerosene as a condition of receiving diesel fuel on a non-tax-paid basis. Similarly, the provision does not require terminals that sell only kerosene to offer diesel fuel as a condition of receiving non-tax-paid kerosene.

Effective Date

The provision is effective as if included in the 1997 Act.

11. Clarification of provision expanding the limitations on deductibility of premiums and interest with respect to life insurance, endowment and annuity contracts (sec. 9(i) of the bill, sec. 1084 of the 1997 Act, and sec. 264 of the Code)

Present Law

Master contracts

The 1997 Act provided limitations on the deductibility of interest and premiums with respect to life insurance, endowment and annuity contracts. Under the pro rata interest disallowance provision added by the Act, an exception is provided for any policy or contract owned by an entity engaged in a trade or business, covering an individual who is an employee, officer or director of the trade or business at the time first covered. The exception applies to any policy or contract owned by an entity engaged in a trade or business, which covers one individual who (at the time first insured under the policy or contract) is (1) a 20-percent owner of the entity,

or (2) an individual (who is not a 20-percent owner) who is an officer, director or employee of the trade or business.[16] The provision is silent as to the treatment of coverage of such an individual under a master contract.

Reporting

The provision does not apply to any policy or contract held by a natural person; however, if a trade or business is directly or indirectly the beneficiary under any policy or contract, the policy or contract is treated as held by the trade or business and not by a natural person. In addition, the provision includes a reporting requirement. Specifically, the provision provides that the Treasury Secretary shall require such reporting from policyholders and issuers as is necessary to carry out the rule applicable when the trade or business is directly or indirectly the beneficiary under any policy or contract held by a natural person. Any report required under this reporting requirement is treated as a statement referred to in Code section 6724(d)(1) (relating to information returns). The provision does not specifically refer to Code section 6724(d)(2) (relating to payee statements).

Explanation of Provisions

Master contracts

The bill clarifies that if coverage for each insured individual under a master contract is treated as a separate contract for purposes of sections 817(h), 7702, and 7702A of the Code, then coverage for each such insured individual is treated as a separate contract, for purposes of the exception to the pro rata interest disallowance rule for a policy or contract covering an individual who is a 20-percent owner, employee, officer or director of the trade or business at the time first covered. A master contract does not include any contract if the contract (or any insurance coverage provided under the contract) is a group life insurance contract within the meaning of Code section 848(e)(2). No inference is intended that coverage provided under a master contract, for each such insured individual, is not treated as a separate contract for each such individual for other purposes under present law.

Reporting

The bill clarifies that the required reporting to the Treasury Secretary is an information return (within meaning of sec. 6724(d)(1)), and any reporting required to be made to any other person is a payee statement (within the meaning of sec. 6724(d)(2)). Thus, the $50-per-report penalty imposed under sections 6722 and 6723 of the Code for failure to file or provide such an information return or payee statement applies. It is clarified that the Treasury Secretary may require reporting by the issuer or policyholder of any relevant information either by regulations or by any other appropriate guidance (including but not limited to publication of a form).

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[16] The exception also applies in the case of a joint-life policy or contract under which the sole insureds are a 20-percent owner and the spouse of the 20-percent owner. A joint-life contract under which the sole insured are a 20-percent owner and his or her spouse is the only type of policy or contract with more than one insured that comes within the exception.

Effective Date

The provision is effective as if included in the 1997 Act.

12. Clarification to the definition of modified adjusted gross income for purposes of the earned income credit phaseout (sec. 9(j) of the bill, sec. 1085(d) of the 1997 Act, and sec. 32(c) of the Code)

Present Law

The earned income credit ("EIC") is phased out above certain income levels. For individuals with earned income (or modified adjusted gross income ("modified AGI"), if greater) in excess of the beginning of the phaseout range, the maximum credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or modified AGI, if greater) in excess of the beginning of the phaseout range. For individuals with earned income (or modified AGI, if greater) in excess of the end of the phaseout range, no credit is allowed. The definition of modified AGI used for the phase out of the earned income credit is the sum of: (1) AGI with certain losses disregarded, and (2) certain nontaxable amounts not generally included in AGI. The losses disregarded are: (1) net capital losses (if greater than zero); (2) net losses from trusts and estates; (3) net losses from nonbusiness rents and royalties; (4) 75 percent of the net losses from business, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses.[17] The nontaxable amounts included in modified AGI which are generally not included in AGI are: (1) tax-exempt interest; and (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements (but only if not rolled over into similar vehicles during the applicable rollover period).

Explanation of Provision

The bill clarifies that the two nontaxable amounts that are added to adjusted gross income to compute modified AGI for purposes of the EIC phaseout are additions to adjusted gross income and not disregarded losses.

Effective Date

The provision is effective for taxable years beginning after December 31, 1997.

I. Amendments to Title XI of the 1997 Act Relating to Foreign Provisions (sec. 10(b) of the bill, sec. 1121 of the 1997 Act, and sec. 1298 of the Code)

Present Law

Special attribution rules apply to the extent that the effect is to treat stock of a passive foreign investment company ("PFIC") as

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[17] The 1997 Act increased the amount of net losses from business, computed separately with respect to sole proprietorships (other than farming), sole proprietorships in farming, and other businesses disregarded from 50 percent to 75 percent.

owned by a U.S. person. In general, if 50 percent or more in value of the stock of a corporation is owned (directly or indirectly) by or for any person, such person is considered as owning a proportionate part of the stock owned directly or indirectly by or for such corporation, determined based on the person's proportionate interest in the value of such corporation's stock. However, this 50-percent limitation does not apply in the case of a corporation that is a PFIC. Accordingly, a person that is a shareholder of a PFIC is considered as owning a proportionate part of the stock owned directly or indirectly by or for such PFIC, without regard to whether such shareholder owns at least 50 percent of the PFIC's stock by value.

A corporation is not treated as a PFIC with respect to a shareholder during the qualified portion of the shareholder's holding period for the stock of such corporation. The qualified portion of the shareholder's holding period generally is the portion of such period which is after the effective date of the 1997 Act and during which the shareholder is a United States shareholder (as defined in sec. 951(b)) and the corporation is a controlled foreign corporation.

If a corporation is not treated as a PFIC with respect to a shareholder for the qualified portion of such shareholder's holding period, it is unclear whether the attribution rules that apply with respect to stock owned by or for such corporation apply without regard to the requirement that the shareholder own 50 percent or more of the corporation's stock.

Explanation of Provision

The bill clarifies that the attribution rules apply without regard to the provision that treats a corporation as a non-PFIC with respect to a shareholder for the qualified portion of the shareholder's holding period. Accordingly, stock owned directly or indirectly by or for a corporation that is not treated as a PFIC for the qualified portion of the shareholder's holding period nevertheless is attributed to such shareholder, regardless of the shareholder's ownership percentage of such corporation.

Effective Date

The provision is effective for taxable years of U.S. persons beginning after December 31, 1997 and taxable years of foreign corporations ending with or within such taxable years of U.S. persons.

J. Amendments to Title XII of the 1997 Act Relating to Simplification Provisions

1. Travel expenses of Federal employees participating in a Federal criminal investigation (sec. 11(a) of the bill, sec. 1204 of the 1997 Act, and sec. 162 of the Code)

Present Law

Unreimbursed ordinary and necessary travel expenses paid or incurred by an individual in connection with temporary employment away from home (e.g., transportation costs and the cost of meals and lodging) are generally deductible, subject to the two-percent floor on miscellaneous itemized deductions. Travel expenses paid or

incurred in connection with indefinite employment away from home, however, are not deductible. A taxpayer's employment away from home in a single location is indefinite rather than temporary if it lasts for one year or more; thus, no deduction is permitted for travel expenses paid or incurred in connection with such employment (sec. 162(a)). If a taxpayer's employment away from home in a single location lasts for less than one year, whether such employment is temporary or indefinite is determined on the basis of the facts and circumstances.

The 1997 Act provided that the one-year limitation with respect to deductibility of expenses while temporarily away from home does not include any period during which a Federal employee is certified by the Attorney General (or the Attorney General's designee) as traveling on behalf of the Federal Government in a temporary duty status to investigate or provide support services to the investigation of a Federal crime. Thus, expenses for these individuals during these periods are fully deductible, regardless of the length of the period for which certification is given (provided that the other requirements for deductibility are satisfied).

Explanation of Provision

The bill clarifies that prosecuting a Federal crime or providing support services to the prosecution of a Federal crime is considered part of investigating a Federal crime.

Effective Date

The provision is effective for amounts paid or incurred with respect to taxable years ending after the date of enactment of the 1997 Act.

2. Effective date for provisions relating to electing large partnerships, partnership returns required on magnetic media, and treatment of partnership items of individual retirement arrangements (sec. 11(c) of the bill and sec. 1226 of the 1997 Act)

Present Law

Rules for simplified flowthrough and simplified audit procedures for electing large partnerships, as well as a March 15 due date for furnishing information to partners of an electing large partnership, were added to present law by the 1997 Act. The 1997 Act also added a rule providing that partnership returns are required on magnetic media, and modified the treatment of partnership items of individual retirement arrangements. The 1997 Act statement of managers provided that these provisions apply to partnership taxable years beginning after December 31, 1997. The statute provided that the rules for simplified flowthrough for electing large partnerships apply to partnership taxable years beginning after December 31, 1997 (Act sec. 1221(c)), although the statute also provided that all the provisions apply to partnership taxable years ending on or after December 31, 1997 (Act sec. 1226).

Explanation of Provision

The bill provides that these provisions apply to partnership taxable years beginning after December 31, 1997.

Effective Date

The provision is effective as if enacted in the 1997 Act.

K. Amendments to Title XVI of the 1997 Act Relating to Technical Corrections

1. Application of requirements for SIMPLE IRAs in the case of mergers and acquisitions (sec. 15(a)(1) of the bill, sec. 1601(d)(1) of the 1997 Act, and sec. 408(p)(2) of the Code)

Present Law

If an employer maintains a qualified plan and a SIMPLE IRA in the same year due to an acquisition, disposition or similar transaction the SIMPLE IRA is treated as a qualified salary reduction arrangement for the year of the transaction and the following calendar year provided rules similar to the special coverage rules of section 410(b)(6)(C) apply. There is a similar provision with respect to an employer who, because of an acquisition, disposition or similar transaction, fails to be an eligible employer because such employer employs more than 100 employees. In this situation, the employer is treated as an eligible employer for two years following the transaction provided rules similar to the coverage rules of section 410(b)(6)(C)(i) apply.

Explanation of Provision

The bill conforms the treatment applicable to SIMPLE IRAs upon acquisition, disposition or similar transaction for purposes of (1) the 100 employee limit, (2) the exclusive plan requirement, and (3) the coverage rules for participation. In the event of such a transaction, the employer will be treated as an eligible employer and the arrangement will be treated as a qualified salary reduction arrangement for the year of the transaction and the two following years, provided rules similar to the rules of section 410(b)(6)(C)(i)(II) are satisfied and the arrangement would satisfy the requirements to be a qualified salary reduction arrangement after the transaction if the trade or business that maintained the arrangement prior to the transaction had remained a separate employer.

Effective Date

The provision is effective as if included in the Small Business Job Protection Act of 1996.

2. Treatment of Indian tribal governments under section 403(b) (sec. 15(a)(2) of the bill, sec. 1601(d)(4)(a) of the 1997 Act, and sec. 403(b) of the Code)

Present Law

Any 403(b) annuity contract purchased in a plan year beginning before January 1, 1995, by an Indian tribal government is treated as purchased by an entity permitted to maintain a tax-sheltered annuity plan. Such contracts may be rolled over into a section 401(k) plan maintained by the Indian tribal government in accordance with the rollover rules of section 403(b)(8). An employee participating in a 403(b) annuity contract of the Indian tribal government may roll over amounts from such contract to a section 401(k) plan maintained by the Indian tribal government whether or not the annuity contract is terminated.

Explanation of Provision

The bill clarifies that an employee participating in a 403(b)(7) custodial account of the Indian tribal government may roll over amounts from such account to a section 401(k) plan maintained by the Indian tribal government.

Effective Date

The provision is effective as if included in the Small Business Job Protection Act of 1996.

TECHNICAL CORRECTIONS TO OTHER TAX LEGISLATION

A. Allow Deduction for Unused Employer Social Security Credit (sec. 16 of the bill, sec. 13443 of the Omnibus Budget Reconcilement Act of 1993, and sec. 196 of the Code)

Present Law

The general business credit ("GBC") consists of various individual tax credits (including the employer social security credit of Code section 45B) allowed with respect to certain qualified expenditures and activities. In general, the various individual tax credits contain provisions that prohibit "double benefits," either by denying deductions in the case of expenditure-related credits or by requiring income inclusions in the case of activity-related credits. Unused credits may be carried back one year and carried forward 20 years. Section 196 allows a deduction to the extent that certain portions of the GBC expire unused after the end of the carryforward period. Section 196 does not allow a deduction to the extent that the portion of the GBC that expires unused after the end of the carryforward period relates to the employer social security credit.

Explanation of Provision

The bill allows a deduction to the extent that the portion of the GBC relating to the employer social security credit expires unused after the end of the carryforward period.

Effective Date

The provision is effective as if included in the Omnibus Budget Reconciliation Act of 1993.

B. Treatment of Certain Stapled REITs (sec. 17 of the bill, sec. 136(c) of the Tax Reform Act of 1984, and sec. 269B of the Code)

Present Law

Only one level of tax generally applies to an entity that qualifies as a real estate investment trust (a "REIT"). Section 269B(a)(3), as added by the Tax Reform Act of 1984, provides that in order to determine whether an entity qualifies as a REIT, all stapled entities are treated as one entity. Section 269B(a)(3) does not apply to entities that were stapled entities on June 30, 1983.

Explanation of Provision

The bill clarifies that the grandfather rule provided by the Tax Reform Act of 1984 for entities stapled on June 30, 1983, applies to each period after June 30, 1983, during which such entities are stapled entities, whether or not such entities were stapled entities for all periods after June 30, 1983. No inference is intended as to the application of any aspect of any grandfather rule by reason of the bill.

Effective Date

The provision is effective as if included in the Tax Reform Act of 1984.

III. VOTE OF THE COMMITTEE

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made concerning the vote on the motion to report the bill. The bill (H.R. 2645) was ordered favorably reported, without amendment, by voice vote on October 9, 1997, with a quorum present.

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with clause 7(a) of Rule XIII of the Rules of the House of Representatives, the following statement is made concerning the estimated budget effects of the bill as reported.

The bill, as reported, is estimated to have no effect on the budget.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with subdivision (B) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the Committee states that the provisions of the bill as reported involve no new or increased budget authority.

Tax expenditures

In compliance with subdivision (B) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the Committee states that the provisions of the bill as reported involve no new or increased tax expenditures.

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with subdivision (C) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, requiring cost estimate prepared by the Congressional Budget Office, the Committee advises that the Congressional Budget Office has submitted the following statement on this bill.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, October 17, 1997.

Hon. BILL ARCHER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed H.R. 2645, the Tax Technical Corrections Act of 1997, as ordered reported by the House Committee on Ways and Means on October 9, 1997. CBO estimates that this bill would cause no change in federal government receipts. The proposed legislation contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act of 1995, and would impose no direct costs on state, local, or tribal governments. Because enacting H.R. 2645 could affect receipts, pay-as-you-go procedures would apply to the bill.

H.R. 2645 would make technical corrections related to the Taxpayer Relief Act of 1997. None of the provisions would have a significant impact on the budget.

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The projected changes in direct spending through 2007 are shown in the following table. For purposes of enforcing pay-as-you-go procedures, however, only the effects in the budget year and the succeeding four year as counted.

PAY-AS-YOU-GO CONSIDERATIONS

[By fiscal year, in millions of dollars]

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Changes in outlays	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Changes in receipts	0	0	0	0	0	0	0	0	0	0

[1] Not Applicable.

If you wish further details, please feel free to contact me or your staff may wish to contact Alyssa Trzeszkowski.

Sincerely,

JUNE E. O'NEILL, *Director.*

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to subdivision (A) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was the result of the Committee's oversight activities concerning a technical review of provisions in the Taxpayer Relief Act of 1997 and other tax legislation that the Committee concluded that it is appropriate to enact the provisions contained in the bill as reported.

B. Summary of Findings and Recommendations of the Committee on Government Reform and Oversight

With respect to subdivision (D) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the Committee advises that no oversight findings or recommendations have been submitted to this Committee by the Committee on Government Reform and Oversight with respect to the provisions contained in the bill.

C. Constitutional Authority Statement

With respect to clause 2(l)(4) of Rule XI of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 7 ("All bills for raising revenue shall originate in the House of Representatives") and Section 8 ("The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts . . . of the United States"), and from the 16th Amendment to the Constitution.

D. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the provisions of the bill do not impose any new Federal mandate on the private sector nor any new Federal intergovernmental mandate. Thus, the provisions of the bill do not affect the competitive balance between the private sector and State, local, and tribal governments.

E. Applicability of House Rule XXI5(c)

Rule XXI5(c) of the Rules of the House of Representatives provides, in part, that "No bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase shall be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increase within the meaning of the rule.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, in order to expedite the business of the House of Representatives, it is appropriate to forgo the requirement of clause 3 of Rule XIII of the Rules of the House of Representatives (relating to showing changes in existing law made by the bill as reported).