American Jobs Creation Act of 2004

Tax Management Summary

Summary of H.R. 4520, American Jobs Creation Act of 2004

By the Tax Management Editorial Staff
Washington, D.C.

The Conference Report for the American Jobs Creation Act of 2004 (H.R. 4520) passed the House on October 7 and the Senate on October 11. President Bush is expected to sign the measure into law, but at press time of this summary, he has not yet signed the Bill. The Bill would repeal the Extraterritorial Income Exclusion Act, which was ruled illegal by the World Trade Organization in 2002. The Bill replaces the extraterritorial income exclusion with a deduction for income attributable to U.S. production activities. Significant tax relief provisions contained within the Bill include a one-year tax break for repatriated foreign dividends, language on deferred compensation arrangements, a wide range of tax shelter provisions, language shutting down abusive sale-in, lease-out (SILO) transactions, and closing the asset expensing SUV loophole.

The following is a discussion of primary tax-related sections of the Bill.

TITLE I--PROVISIONS RELATING TO REPEAL OF EXCLUSION FOR EXTRATERRITORIAL INCOME

Repeal of Exclusion for Extraterritorial Income

The Bill would repeal the exclusion for extraterritorial income that was added in §114 by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000. The Bill would include transitional relief that allows 80% of the pre-repeal ETI benefits for transactions occurring in 2005 and 60% for transactions occurring in 2006. The ETI provision would also remain available for any transaction in the ordinary course of business if made pursuant to a binding contract between the taxpayer and an unrelated person in effect on September 17, 2004 and at all times thereafter.

In addition, any foreign corporation that had elected under §943(e) to be treated as a domestic corporation in order to take advantage of the ETI benefit would be permitted to revoke its election within one year of enactment. There would be no recognition of gain or loss in connection with a revocation under this provision. The Secretary would also be authorized to issue regulations to prevent abuses of this revocation provision.

Effective for transactions occurring after December 31, 2004.
[Bill §101; Code §114 (repealed)]

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Deduction Relating to Income Attributable to United States Production Activities
The Bill would allow a deduction for corporations from taxable income, and for individuals from adjusted gross income, that is equal to a portion of the taxpayer's qualified production activities income (QPAI) for the taxable year. For taxable years beginning in 2005 and 2006, the deduction would be 3% of QPAI, and it would increase to 6% of QPAI for taxable years beginning in 2007, 2008, and 2009; for taxable years beginning after 2009, the deduction would be 9% of QPAI. If the taxpayer's taxable income is less than QPAI, the applicable percentage would be applied to taxable income, rather than QPAI. The deduction would also be limited to 50% of the wages paid by the taxpayer and required to be reported on Form W-2 in the calendar year that ends in the taxable year for which the deduction is claimed. If a corporate taxpayer is a member of an affiliated group (using a modified definition under §1504(a)), all members of the group would be treated as a single taxpayer and the deduction would be allocated among them in proportion to each member's QPAI.

Qualified production activities income would be defined as domestic production gross receipts, reduced by the sum of: (1) costs of goods sold that are allocable to such receipts, (2) other expenses, deductions and losses directly allocable to such receipts, and (3) a ratable share of expenses, deductions and losses that cannot be directly allocated to such receipts or other class of income. Domestic production gross receipts would, in turn, be defined as gross receipts derived from: (1) any sale, exchange, lease, rental, or license of qualifying production property that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part in the United States; (2) any sale, exchange, lease, rental, or license of qualified film produced by the taxpayer; (3) any sale or exchange (but not the transmission or distribution) of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction activities performed in the United States; or (5) engineering or architectural services performed in the United States for construction projects in the United States. Domestic production gross receipts would not, however, include receipts from: (1) the sale of food or beverages prepared by the taxpayer at a retail establishment; and (2) property that is leased, licensed or rented to a related party.

For purposes of the definition of domestic production gross receipts, "qualifying production property" would include tangible personal property, computer software, or sound recordings, and "qualified film" would include any motion picture film or videotape if 50% or more of the total compensation relating to the production of the film (not including residuals and participations) is for services performed in the United States by actors, production personnel, directors, and producers.

Special rules would apply to the domestic production activities of pass-through entities, including S corporations, partnerships, trusts and estates. The deduction would be determined at the shareholder/partner/beneficiary level by taking into account the proportionate share of the entity's QPAI. For purposes of applying the 50% wage limitation, the shareholder/partner/beneficiary who is allocated QPAI is treated as having been allocated wages from the pass-through entity in an amount that is the lesser of: (1) such person's allocable share of wages, as determined under to-be-issued regulations, or (2) twice the QPAI that is actually allocated to such person for the taxable year.

Special rules would also apply to member-owned agricultural and horticultural cooperatives that are governed by Subchapter T. The deduction for QPAI would be claimed at the entity level, and the member's patronage dividend or per-unit retain allocation would be allocated a portion of the deduction that would then reduce the gross income of the member. The cooperative would be required to notify its members of the deductible portion that is allocated to their dividend or allocation. The cooperative would not be unable to claim a dividends-paid deduction for such deductible portion that it allocates to its members.

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The new deduction would be allowed for purposes of the alternative minimum tax.

Finally, any taxpayer that has made the §631(a) election for a taxable year ending on or before the date of enactment to treat the cutting of timber as a sale or exchange may revoke the election without the consent of the IRS for any taxable year ending after that date. Presumably, this provision was added to allow such taxpayers to take advantage of the proposed new deduction.

Effective for taxable years beginning after December 31, 2004.
[Bill §102; Code §§56, 199 (new), 631]

TITLE II--BUSINESS TAX INCENTIVES

Subtitle A--Small Business Expensing

Two-Year Extension of Increased Expensing for Small Businesses

The Bill would extend the increased amount that a taxpayer may deduct, and certain other changes made by JGTRRA, for an additional two years. Thus, the bill would provide that the maximum dollar amount that may be deducted under §179 is $100,000 for property placed in service in taxable years beginning before 2008 ($25,000 for taxable years beginning in 2008 and thereafter). In addition, the $400,000 reduction in limitation amount would apply for property placed in service in taxable years beginning before 2008 ($200,000 for taxable years beginning in 2008 and thereafter). The Bill would also extend, through 2007 (from 2005), the indexing for inflation of both the maximum dollar amount that may be deducted and the $400,000 reduction in limitation amount. The Bill would also include as qualifying property off-the-shelf computer software placed in service in taxable years beginning before 2008. Finally, the Bill would permit taxpayers to revoke expensing elections on amended returns without the consent of the Commissioner with respect to a taxable year beginning before 2008. [Editor's Note: See related provision under Bill §910, below.]

Effective on the date of enactment.
[Bill §201; Code §179]

Subtitle B—Depreciation

Recovery Period for Depreciation of Certain Leasehold Improvements and Restaurant Property

The Bill would provide a statutory 15-year recovery period for qualified leasehold improvement property and qualified restaurant property placed in service before January 1, 2006. The Bill would also require that qualified leasehold improvement property and qualified restaurant property be recovered using the straight-line method.

The Bill would define qualified leasehold improvement property similarly as under present law for purposes of the additional first-year depreciation deduction, with the following modification: if a

lessor makes an improvement that qualifies as qualified leasehold improvement property, that improvement would not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. The Bill would provide exceptions to the subsequent owner rule in the case of death and certain transfers of property that qualify for non-recognition treatment.

The Bill would define qualified restaurant property as any improvement to a building if such improvement is placed in service more than three years after the date such building was first placed in service and more than 50% of the building's square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals.

Effective for property placed in service after the date of enactment.
[Bill §211; Code §168]

Subtitle C--Community Revitalization

Modification of Targeted Areas and Low-Income Communities Designated for New Markets Tax Credit
The Bill would modify the Treasury Secretary's authority to allow the Secretary to designate "targeted populations" as low-income communities for purposes of the new markets tax credit. Under the Bill, a "targeted population" would be defined by reference to §103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 to mean individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate access to loans or equity investments. "Low-income" would mean (1) for a targeted population within a metropolitan area, less than 80% of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80% of the area median family income or 80% of the statewide non-metropolitan area median family income. The Bill would not require a targeted population to be within any census tract and would provide that a population census tract with a population of less than 2,000 would be treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under Code §1391, and is contiguous to one or more low-income communities.

The targeted populations amendment would be effective for designations made after the date of enactment. The low population tracts amendment would apply to investments made after the date of enactment.
[Bill §221; Code §45D]

Expansion of Designated Renewal Community Area Based on 2000 Census Data
The Bill would authorize the HUD Secretary, at the request of all of the governments that nominated a renewal community, to add a contiguous census tract to a renewal community if: (1) the renewal community, including any tract to be added, would have met the renewal community eligibility requirements at the time of the community's original nomination, and any tract to be added has a poverty rate using 2000 census data that exceeds the poverty rate of such tract using 1990 census data; (2) a tract may be added to a renewal community even if the addition of such tract to such community would have caused the community to fail one or more eligibility requirements when originally nominated using 1990 census data, provided that: (a) the renewal community after the inclusion of such tract does not have a population that exceeds 200,000 using

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either 1990 or 2000 census data; (b) such tract has a poverty rate of at least 20% using 2000 census data; and (c) such tract has a poverty rate using 2000 census data that exceeds the poverty rate of such tract using 1990 census data (census tracts that did not have a poverty rate determined by the Bureau of the Census using 1990 data may be added to an existing renewal community without satisfying requirement (c) above); and (3) a tract may be added to an existing renewal community if such tract: (a) has no population using 2000 census data or no poverty rate for such tract is determined by the Bureau of the Census using 2000 census data; (b) such tract is one of general distress; and (c) the renewal community, including such tract, is within the jurisdiction of one or more local governments and has a continuous boundary.

Effective December 21, 2000.
[Bill §222; Code §1400E]

Modification of Income Requirement for Census Tracts Within High Migration Rural Counties

The Bill would provide a special low-income test for high migration rural counties for purposes of the new markets tax credit. Under the Bill, in the case of a census tract located within a high migration rural county, low-income is defined by reference to 85% (rather than 80%) of statewide median family income. For this purpose, a high migration rural county would be any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10% of the population of the county at the beginning of such period.

Effective for investments made after December 31, 2000.
[Bill §223; Code §45D]

Subtitle D--S Corporation Reform and Simplification

Members of Family Treated as 1 Shareholder

The Bill would allow all family members to be treated as one shareholder for purposes of determining the number of shareholders in the S corporation. For purposes of the limitation under §1361 on the number of shareholders in an S corporation, a husband and wife are currently treated as one shareholder, however the Bill would expand this treatment to "all members of the family," defined as the common ancestor, lineal descendants of the common ancestor, and the spouses (or former spouses) of such lineal descendants or common ancestor. However, an individual that is more than six generations removed from the youngest generation of shareholders is not considered a common ancestor.

The Bill would also provide relief under §1362 or inadvertent invalid elections or terminations to the election to have members of a family treated as one shareholder.

Effective for taxable years beginning after December 31, 2004, and for elections and terminations made after December 31, 2004.
[Bill §231; Code §§1361, 1362]

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Increase in Number of Eligible Shareholders to 100
The Bill would increase the limitation under §1361 on the number of shareholders in an S corporation from 75 to 100.

Effective for taxable years beginning after December 31, 2004.
[Bill §232; Code §1361]

Expansion of Bank S Corporation Eligible Shareholders to Include IRAs
The Bill would permit an IRA (including a Roth IRA) to be a shareholder of a bank that is an S corporation to the extent of the bank stock held by the IRA on the date of the Bill's enactment. Under the provision, the individual for whose benefit the IRA is held would be treated as the shareholder.

The Bill would also provide an exemption from the tax under §4975 on prohibited transactions for the sale by an IRA to the IRA beneficiary of bank stock held by the IRA on the date of the Bill's enactment. The exemption would apply to such a sale if: (1) the sale is pursuant to an S corporation election by the bank, (2) the sale is for fair market value and is on terms at least as favorable to the IRA as the terms would be on a sale to an unrelated party, (3) the IRA incurs no commissions, costs or other expenses in connection with the sale, and (4) the stock is sold in a single transaction for cash not later than 120 days after the S corporation election is made.

Effective upon date of enactment.
[Bill §233; Code §§1361, 4975]

Disregard of Unexercised Powers of Appointment in Determining Potential Current Beneficiaries of ESBT
The Bill would narrow the definition of "potential current beneficiaries" of an electing small business trust (ESBT) by directing that the determination of whether a person is a potential current beneficiary be made without regard to any power of appointment to the extent the power of appointment remains unexercised. Therefore, a person who is only entitled to a distribution from an ESBT by virtue of the exercise of a power of appointment would not be a potential current beneficiary as long as the power of appointment remains unexercised.

The Bill would also increase the period during which an ESBT can dispose of S corporation stock after an ineligible shareholder becomes a potential current beneficiary without disqualification from 60 days to one year.

Effective for taxable years beginning after 2004.
[Bill §234; Code §1361]

Transfer of Suspended Losses Incident to Divorce, Etc.
The Bill would provide that in the event S corporation stock is transferred to the shareholder's spouse, or to a former spouse incident to a divorce, any suspended loss or deduction with respect to that stock is treated as incurred by the S corporation with respect to the transferee in the subsequent taxable year.

Effective for taxable years beginning after December 31, 2004.
[Bill §235; Code §1366]

Use of Passive Activity Loss and At-Risk Amounts by Qualified Subchapter S Trust Income Beneficiaries
The Bill would provide that where S corporation stock is held by a qualified subchapter S trust (QSST), any disposition of S corporation stock owned by the QSST would be treated as a disposition by the beneficiary of the trust for purposes of applying the at-risk limitation on deductions under §465 and the passive activity loss limitation under §469.

Effective for transfers made after December 31, 2004.
[Bill §236; Code §1361]

Exclusion of Investment Securities Income from Passive Income Test for Bank S Corporations
The Bill would create an exception to the passive investment income limitation under §1362(d)(3) for banks, bank holding companies and financial holding companies to exclude interest income and dividends on assets required to be held by such entities (i.e., stock in the Federal Reserve Bank, Federal Home Loan Bank, Federal Agricultural Mortgage Bank or participation certificates issued by a Federal Intermediate Credit Bank) from the passive investment income of those entities.

Effective for taxable years beginning after December 31, 2004.
[Bill §237; Code §1362]

Relief from Inadvertently Invalid Qualified Subchapter S Subsidiary Elections and Terminations
The Bill would extend the relief available to inadvertently invalid subchapter S elections and terminations under §1362(f) to qualified subchapter S subsidiary (Qsub) elections and inadvertent terminations, so that inadvertently invalid Qsub elections may be waived by the IRS.

Effective for elections and terminations made after December 31, 2004.
[Bill §238; Code §1362]

Information Returns for Qualified Subchapter S Subsidiaries
The Bill would grant authority to the Treasury Secretary to provide guidance regarding information returns of qualified subchapter S subsidiaries.

Effective for taxable years beginning after December 31, 2004.
[Bill §239; Code §1361]

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Repayment of Loans for Qualifying Employer Securities
The Bill would provide that an employee stock ownership plan (ESOP) would not violate the qualification requirements for qualified pension, profit sharing and stock bonus plans under §401(k), tax credit ESOPs under §409, or the ESOP provisions under §4975(e)(7) due to a distribution with respect to S corporation stock that constitutes qualifying employer securities that is used to make payments on a loan to a leveraged ESOP if used to acquire such qualifying employer securities. This provision, however, would not apply in the case of a distribution paid with respect to an employer security allocated to a participant unless the plan provides that such securities with a fair market value not less than the amount of such distribution are allocated to such participant for the year the distribution would have been allocated to such participant.

Effective for distributions made with respect to S corporation stock after December 31, 2004.
[Bill §240; Code §4975]

Subtitle E--Other Business Incentives

Phaseout of 4.3-Cent Motor Fuel Excise Taxes on Railroads and Inland Waterway Transportation Which Remain in General Fund
The Bill would repeal the 4.3-cents-per-gallon General Fund excise tax rates on diesel fuel used in trains and fuels used in barges operating on the designated inland waterways system over a prescribed phase-out period. The 4.3-cent-per-gallon tax would be reduced by 1 cent per gallon for the first six months of calendar year 2005 (January 1, 2005 through June 30, 2005). The reduction would be 2 cents per gallon from July 1, 2005 through December 31, 2006, and 4.3 cents/gallon thereafter. Thus, the tax would be fully repealed effective January 1, 2007. The 0.1 cent per gallon tax for the LUST Trust Fund is unchanged by the provision.

Effective on January 1, 2005.
[Bill §241; Code §4041]

Modification of Application of Income Forecast Method of Depreciation
The Bill would clarify that, for purposes of computing the allowable deduction for property under the income forecast method of depreciation, participations and residuals may be included in the adjusted basis of the property beginning in the year such property is placed in service, but only if such participations and residuals relate to income to be derived from the property before the close of the tenth taxable year following the year the property is placed in service (as defined in §167(g)(1)(A)). For purposes of the provision, the Bill would define participations and residuals as costs the amount of which, by contract, varies with the amount of income earned in connection with such property.

The Bill also would clarify that the income from the property to be taken into account under the income forecast method is the gross income from such property and that distribution costs are not taken into account for purposes of determining the taxpayer's current and total forecasted income with respect to a property. The Bill would grant authority to the Treasury Department to prescribe appropriate adjustments to the basis of property (and the look-back method) to reflect the treatment of participations and residuals under the provision.

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Effective for property placed in service after the date of enactment.
[Bill §242; Code §167]

Improvements Related to Real Estate Investment Trusts
The Bill would make several modifications to the REIT rules.

Straight debt modification. The Bill would modify the definition of "straight debt" for purposes of the limitation that a REIT may not hold more than 10% of the value of the outstanding securities of a single issuer, to provide more flexibility than the present law rule. In addition, except as provided in regulations, neither such straight debt nor certain other types of securities are considered "securities" for purposes of this rule.

Straight debt securities. The Bill would modify certain straight debt securities provisions. Special rules are provided permitting certain contingencies for purposes of the REIT provision. Any interest or principal will not be treated as failing to satisfy §1361(c)(5)(B)(i) solely by reason of the fact that the time of payment of such interest or principal is subject to a contingency, but only if one of several factors applies. The first type of contingency that is permitted is one that does not have the effect of changing the effective yield to maturity, as determined under §1272, other than a change in the annual yield to maturity, but only if (1) any such contingency does not exceed the greater of 1/4 of one percent or five percent of the annual yield to maturity, or (2) neither the aggregate issue price nor the aggregate face amount of the debt instruments held by the REIT exceeds $1,000,000 and not more than 12 months of unaccrued interest can be required to be prepaid thereunder. Also, the time or amount of any payment is permitted to be subject to a contingency upon a default or the exercise of a prepayment right by the issuer of the debt, provided that such contingency is consistent with customary commercial practice. The Bill would eliminate the present law rule requiring a REIT to own a 20% equity interest in a partnership in order for debt to qualify as "straight debt." The Bill instead would provide new "look-through" rules determining a REIT partner's share of partnership securities, generally treating debt to the REIT as part of the REIT's partnership interest for this purpose, except in the case of otherwise qualifying debt of the partnership. Under the Bill, certain corporate or partnership issues that otherwise would be permitted to be held without limitation under the special straight debt rules described above will not be so permitted if the REIT holding such securities, and any of its taxable REIT subsidiaries (TRSs), holds any securities of the issuer which are not permitted securities (prior to the application of this rule) and have an aggregate value greater than one percent of the issuer's outstanding securities.

Other securities. Except as provided in regulations, the following would also not be considered "securities" for purposes of the rule that a REIT cannot own more than 10% of the value of the outstanding securities of a single issuer: (1) any loan to an individual or an estate, (2) any §467 rental agreement, (as defined in §467(d)), other than with a person described in §856(d)(2)(B), (3) any obligation to pay rents from real property, (4) any security issued by a state or any political subdivision thereof, the District of Columbia, a foreign government, or any political subdivision thereof, or the Commonwealth of Puerto Rico, but only if the determination of any payment received or accrued under such security does not depend in whole or in part on the profits of any entity not described in this category, or payments on any obligation issued by such an entity, (5) any security issued by a real estate investment trust; and (6) any other arrangement that, as determined by the Secretary, is excepted from the definition of a security.

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Safe harbor testing date for certain rents. The Bill would provide specific safe-harbor rules regarding the dates for testing whether 90% of a REIT property is rented to unrelated persons and whether the rents paid by related persons are substantially comparable to unrelated party rents.

Customary services exception. The Bill would prospectively eliminate the safe harbor allowing rents received by a REIT to be exempt from the 100% excise tax if the rents are for customary services performed by the TRS or are from a TRS and are for the provision of certain incidental personal property. Instead, such payments would be free of the excise tax if they satisfy the present law safe-harbor that applies if the REIT pays the TRS at least 150% of the cost to the TRS of providing any services.

Hedging rules. The Bill would generally prospectively conform the rules relating to the tax treatment of arrangements engaged in to reduce interest rate risks to the rules included in §1221.

95% of gross income requirement. The Bill would prospectively amend the tax liability owed by the REIT when it fails to meet the 95% of gross income test by applying a taxable fraction based on 95%, rather than 90%, of the REIT's gross income.

Consequences of failure to meet REIT requirements. The Bill would provide that a REIT would avoid disqualification in the event of certain failures of the requirements for REIT status, provided that (1) the failure was due to reasonable cause and not willful neglect; (2) the failure is corrected; and (3) except for certain failures not exceeding a specified de minims amount, a penalty amount is paid.

Certain de minimis asset failures of 5% and 10% tests. One requirement of present law is that, with certain exceptions, (1) not more than 5% of the value of total REIT assets may be represented by securities of one issuer; and (2) a REIT may not hold securities possessing more than 10% of the total voting power or 10% of the total value of the outstanding securities of any one issuer. The requirements must be satisfied each quarter. The Bill would provide that a REIT would not lose its REIT status for failing to satisfy these requirements in a quarter if the failure is due to the ownership of assets the total value of which does not exceed the lesser of (1) 1% of the total value of the REIT's assets at the end of the quarter for which such measurement is done or (2) $10 million; provided in either case that the REIT either disposes of the assets within six months after the last day of the quarter in which the REIT identifies the failure (or such other time period prescribed by the Treasury), or otherwise meets the requirements of those rules by the end of such time period. Under the Bill, if a REIT fails to meet any of the asset test requirements for a particular quarter and the failure exceeds the de minimis threshold described above, then the REIT still would be deemed to have satisfied the requirements if: (1) following the REIT's identification of the failure, the REIT files a schedule with a description of each asset that caused the failure, in accordance with regulations prescribed by the Treasury; (2) the failure was due to reasonable cause and not to willful neglect; (3) the REIT disposes of the assets within six months after the last day of the quarter in which the identification occurred or such other time period as is prescribed by the Treasury (or the requirements of the rules are otherwise met within such period); and (4) the REIT pays a tax on the failure. The Bill would provide that the tax that the REIT would be required to pay on the failure is the greater of: (1) $50,000, or (2) an amount determined (pursuant to regulations) by multiplying the highest rate of tax for corporations under §11, times the net income generated by the assets for the period beginning on the first date of the failure and ending on the date the REIT has disposed of the assets (or otherwise satisfies the requirements). Such taxes are treated as excise taxes, for which the deficiency provisions of the excise tax subtitle of the Code (subtitle F) apply.

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Conforming reasonable cause and reporting standard for failures of income tests. The Bill would conform the reporting and reasonable cause standards for failure to meet the income tests to the new asset test standards. However, the provision does not change the rule under §857(b)(5) that for income test failures, all of the net income attributed to the disqualified gross income is paid as tax.

Other failures. The Bill would add a provision under which, if a REIT fails to satisfy one or more requirements for REIT qualification, other than the 95% and 75% gross income tests and other than the new rules provided for failures of the asset tests, the REIT may retain its REIT qualification if the failures are due to reasonable cause and not willful neglect, and if the REIT pays a penalty of $50,000 for each such failure.

Taxes and penalties paid deducted from amount required to be distributed. The Bill would provide that any taxes or penalties paid under the provision would be deducted from the net income of the REIT in determining the amount the REIT must distribute under the 90% distribution requirement.

Expansion of deficiency dividend procedure. The Bill would expand the circumstances in which a REIT may declare a deficiency dividend, by allowing such a declaration to occur after the REIT unilaterally has identified a failure to pay the relevant amount. Thus, the declaration need not await a decision of the Tax Court, a closing agreement, or an agreement signed by the Secretary of the Treasury.

Effective date. Generally, the Bill would be effective for taxable years beginning after December 31, 2000. However, (1) the new "look through" rules determining a REIT partner's share of partnership securities for purposes of the "straight debt" rules; (2) the provision changing the 90% of gross income reference to 95%, for purposes of the tax liability if a REIT fails to meet the 95% of gross income test; (3) the new hedging definition; (4) the rule modifying the treatment of rents with respect to customary services; and (5) the new rules for correction of certain failures to satisfy the REIT requirements, would be effective for taxable years beginning after the date of enactment.
[Bill §243; Code §§856, 857]

Special Rules for Certain Film and Television Productions

The Bill would provide an election to deduct the cost of qualifying film and television productions in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances. The election would apply only to qualifying film or television productions the aggregate cost of which does not exceed $15 million. This $15 million would be increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.

The Bill would define a qualified film or television production by reference to §168(f)(3) and require that at least 75% of the total compensation expended on the production be for services performed in the United States. The Bill would also provide that as to property which is one or more episodes in a television series, only the first 44 episodes qualify. The Bill would provide that qualified property does not include property as defined by §2257 of title 18 of the U.S. Code.

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Effective for qualifying productions commencing after the date of enactment and sunsets for qualifying productions commencing after December 31, 2008.
[Bill §244; Code §181 (new)]

Provide a Tax Credit for Maintenance of Railroad Track

The Bill would provide a 50% business tax credit for qualified railroad track maintenance expenditures paid or incurred in a taxable year by eligible taxpayers. The credit would be limited to the product of $3,500 times the number of miles of railroad track owned or leased by an eligible taxpayer as of the close of it's taxable year. Qualified railroad track maintenance expenditures would be defined as amounts expended (whether of not chargeable to a capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad. An eligible taxpayer would defined as: (1) any Class II or Class III railroad; and (2) any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to such person. The taxpayer's basis in railroad track would be reduced by the amount of the credit for which this credit is allowed. No portion of the credit may be carried back to any taxable year beginning before January 1, 2005. This credit would apply to qualified railroad track maintenance expenditures paid or incurred during taxable years beginning after December 31, 2004, and before January 1, 2008.

Effective for taxable years beginning after December 31, 2004.
[Bill §245; Code §45G (new)]

Modification of Unrelated Business Income Limitation on Investment in Certain Small Business Investment Companies

The Bill would modify the debt-financed property provisions by excluding from the definition of acquisition indebtedness any indebtedness incurred by a small business investment company licensed under the Small Business Investment Act of 1958 that is evidenced by a debenture (1) issued by such company under §303(a) of the Small Business Investment Act, and (2) held or guaranteed by the Small Business Administration. The exclusion would not apply during any period that any exempt organization (other than a governmental unit) owns more than 25% of the capital or profits interest in the small business investment company, or exempt organizations (including governmental units other than any agency or instrumentality of the United States) own, in the aggregate, 50% or more of the capital or profits interest in such company.

Effective for debt incurred after the date of enactment by small business investment companies licensed after the date of enactment.
[Bill §247; Code §514]

Election to Determine Corporate Tax on Certain International Shipping Activities Using Per Ton Rate

In general. The Bill would generally allow corporations to elect a "tonnage tax" in lieu of the U.S. corporate income tax on taxable income from certain shipping activities. Accordingly, an electing corporation's gross income would not include its income from qualifying shipping activities, and

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electing corporations would be only subject to tax on qualifying shipping activities at the maximum corporate income tax rate on their notional shipping income, which is based on the net tonnage of the corporation's qualifying vessels. However, an electing corporation would be only subject to the tonnage tax to the extent its taxable income from qualifying shipping activities would otherwise have been subject to tax under §§11, 55, 882, 887, or 1201(a). Consequently, a foreign corporation would not subject to tax under the tonnage tax regime to the extent its income from qualifying shipping activities is subject to an exclusion for certain shipping operations by foreign corporations pursuant to §883(a)(1) or pursuant to a treaty obligation of the United States.

Notional shipping income. The Bill would provide that an electing corporation's notional shipping income is the sum of the taxable income from each of its qualifying vessels. The taxable income from each qualifying vessel would be the product of (1) the daily notional taxable income from the operation of the qualifying vessel in United States foreign trade, and (2) the number of days during the taxable year that the electing entity operated such vessel as a qualifying vessel in U.S. foreign trade. A "qualifying vessel" would be described as a self-propelled U.S.-flag vessel of not less than 10,000 deadweight tons used exclusively in U.S. foreign trade.

Items not subject to corporate income tax. The Bill would provide that an electing corporation's gross income would not include the corporation's income from qualifying shipping activities. An entity's qualifying shipping activities would consist of its (1) core qualifying activities, (2) qualifying secondary activities, and (3) qualifying incidental activities. All of an electing entity's core qualifying activities would be excluded from gross income. However, only a portion of an electing corporation's secondary and incidental activities would be treated as qualifying and thus, are excluded from gross income. Core qualifying activities consist of the operation of qualifying vessels in U.S. foreign trade. Secondary activities would generally consist of the active management or operation of vessels in U.S. foreign trade and provisions for vessel, container and cargo-related facilities, other activities of the electing corporation and other members of its group that are an integral part of its business of operating qualifying vessels in U.S. foreign trade, or such other activities as may be prescribed by the Secretary. Incidental activities would be activities that are incidental to core qualifying activities and are not qualifying secondary activities. Each item of loss, deduction, or credit of any taxpayer would be disallowed with respect to any activity the income from which is excluded from gross income under the proposal. An electing corporation's interest expense would be disallowed in the ratio that the fair market value of its qualifying vessels bears to the fair market value of its total assets; special rules would apply for disallowing interest expense in the context of an electing group.

Allocation of credits, income and deductions. The Bill would provide that no deductions would be allowed against the notional shipping income of an electing corporation, and no credit would be allowed against the notional tax imposed under the tonnage tax regime. No deduction would be allowed for any net operating loss attributable to the qualifying shipping activities of a corporation to the extent that such loss is carried forward by the corporation from a taxable year preceding the first taxable year for which such corporation was an electing corporation. For purposes of the proposal, §482 would apply to a transaction or series of transactions between an electing corporation and another person or between an the corporations's qualifying shipping activities and other activities carried on by it.

Dispositions of qualifying vessels. The Bill would provide that if an qualifying vessel operator sells or disposes of a qualifying vessel in an otherwise taxable transaction, at the election of the corporation no gain would be recognized if replacement qualifying vessels are acquired during a limited replacement period except to the extent that the amount realized upon such sale or disposition exceeds the cost of the replacement qualifying vessels. The Bill would provide that in

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the case of replacement qualifying vessels purchased by a qualifying vessel operator which results in the nonrecognition of any part of the gain realized as the result of a sale or other disposition of qualifying vessels, the basis is the cost of such replacement property decreased in the amount of gain not recognized. A qualifying vessel operator would be a corporation that (1) operates one or more qualifying vessels and (2) meets certain requirements with respect to its shipping activities. Special rules would apply in the context of corporate partners in pass-through entities.

Election. The Bill would provide that any qualifying vessel operator could elect into the tonnage tax regime and such election is made in the form prescribed by Treasury. An election would be only effective if made before the due date (including extensions) for filing the corporation's return for such taxable year. However, a qualifying vessel operator, which would be a member of a controlled group, could only make an election into the tonnage tax regime if all qualifying vessel operators that are members of the controlled group could make such an election. Once made, an election would be effective for the taxable year in which it was made and for all succeeding taxable years of the entity until the election is terminated.

Effective for taxable years beginning after the date of enactment.
[Bill §248; Code §§1352-1359 (new)]

Subtitle F--Stock Options and Employee Stock Purchase Plan Stock Options

Exclusion of Incentive Stock Options and Employee Stock Purchase Plan Stock Options from Wages

The Bill would provide specific exclusions from the definitions of Social Security (FICA) and unemployment (FUTA) tax wages for remuneration on account of the transfer of stock pursuant to the exercise of an incentive stock option or under an employee stock purchase plan, or any disposition of such stock. Thus, under the Bill, FICA and FUTA taxes would not apply upon the exercise of a statutory stock option. (The provision would also provide a similar exclusion under the Railroad Retirement Tax Act.) The Bill would also provide that such remuneration is not taken into account for purposes of determining Social Security benefits. In addition, federal income tax withholding would not be required on a disqualifying disposition, nor when compensation is recognized in connection with an employee stock purchase plan discount. Present law reporting requirements would continue to apply.

Effective for stock acquired pursuant to options exercised after the date of enactment.
[Bill §251; Code §§421(b), 423(c), 3121(a), 3231 and 3306(b)]

TITLE III--AGRICULTURAL TAX RELIEF AND INCENTIVES

Subtitle A--Volumetric Ethanol Excise Tax Credit

Alcohol and Biodiesel Excise Tax Credit and Extension of Alcohol Fuels Income Tax Credit

The Bill would eliminate the reduced excise tax rates for most alcohol-blended fuels and substitute two new excise tax credits, the alcohol fuel mixture credit and the biodiesel mixture credit, for the reduced rates. The Bill would coordinate the alcohol fuel mixture excise tax credit, which would be

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available through December 31, 2010, with the current alcohol fuels income tax credit, which would be extended through the same date. The Bill would also coordinate the biodiesel mixture excise tax credit, which would only be available for a sale or use in a period on or before December 31, 2006, with the current alcohol fuels income tax credit by providing that a taxpayer cannot claim income and excise tax credits for the same biodiesel. The Bill would require a taxpayer to obtain specific certifications about biodiesels and agri-biodiesels for purposes of the biodiesel mixture excise tax credit and would require a taxpayer producing or importing certain biodiesels or alcohols to register with the IRS.

If the sum of the two excise tax credits exceeds a taxpayer's §4081 fuels tax liability, the Bill would provide that the taxpayer may file a claim with the IRS to receive payment of the excess, such that the credits would be totally refundable if the taxpayer has no §4081 liability. The Bill would provide for interest on payment claims not made within a specified period, which would be shorter for claims filed electronically. The Bill would reduce the credits to account for the benefit of any such payments. In certain cases, the Bill would impose a tax if a taxpayer claims a credit for alcohol or biodiesel used to produce an alcohol or biodiesel mixture that is subsequently used for a nonqualifying purpose or substance.

The Bill would eliminate the General Fund retention of certain alcohol fuels excise taxes so that the full amount of these taxes would be credited to the Highway Trust Fund.

Generally be effective for fuel sold or used after December 31, 2004. The registration requirement would be effective on April 1, 2005. The extension of the alcohol fuels income tax credit would be effective on the Bill's enactment date. The repeal of the General Fund retention provision for alcohol fuels would be effective for fuel sold or used after September 30, 2004.
[Bill §301; Code §§40, 4041, 4081, 4083, 4101, 6426 (new), 6427, 9503]

Biodiesel Income Tax Credit

The Bill would create a new income tax credit, the biodiesel fuels credit, for certain biodiesel and qualified biodiesel mixtures. The Bill would specify that this credit is the sum of the biodiesel mixture credit and the biodiesel credit, is available only for sales or uses in a taxpayer's trade or business, is treated as a general business credit, and does not apply to any sale or use after December 31, 2006. The Bill would coordinate the credit, which would be includible in gross income, with the biodiesel mixture excise tax credit and the related payment provisions. Under the Bill, a taxpayer could take agri-biodiesel into account for purposes of the credit only if the taxpayer obtained a certification from the agri-biodiesel's producer identifying the product produced. The Bill would impose a tax in certain cases if a taxpayer claims a credit for biodiesel that is subsequently used for nonqualifying purposes or substances.

Effective for fuel produced and sold or used in taxable years ending after December 31, 2004.
[Bill §302; Code §§38, 40A (new), 87, 196]

Information Reporting for Persons Claiming Certain Tax Benefits

The Bill would require persons claiming tax benefits related to alcohol fuels and biodiesel fuels to file returns containing such information about the benefits and coordination of the benefits as the IRS may require to ensure that the benefits are properly administered and used. The Bill would allow the IRS to deny, revoke, or suspend a person's registration to enforce these requirements.

Effective on January 1, 2005.
[Bill §303; Code §4104 (new)]

Subtitle B--Agricultural Incentives

Special Rules for Livestock Sold on Account of Weather-Related Conditions
The Bill would extend the applicable period for a taxpayer to replace certain livestock sold because of drought, flood, or other weather-related conditions from two to four years after the close of the first taxable year in which the taxpayer realizes any part of the gain on the involuntary conversion. Under the Bill, this extension would only be available if the taxpayer establishes, based on the taxpayer's usual business practices, that the taxpayer would not have made the sale but for drought, flood, or other weather-related conditions that caused the area to be eligible for federal assistance. The Bill would also allow the IRS to further extend the replacement period on a regional basis if the weather-related conditions last longer than three years. If property is eligible for the extended replacement period, the Bill would allow a cash-method taxpayer to make a §451(e) deferral election until expiration of the period for reinvesting the property under §1033.

Effective for any taxable year for which a return is due (without regard to extensions) after December 31, 2002.
[Bill §311; Code §§451, 1033]

Payment of Dividends on Stock of Cooperatives Without Reducing Patronage Dividends
The Bill would provide a special rule for certain cooperatives' capital stock dividends. To the extent that the cooperative's organizational documents so provide, the Bill would specify that such dividends would not reduce patronage income or prevent the cooperative from operating on a cooperative basis.

Effective for distributions in taxable years beginning after the date of enactment.
[Bill §312; Code §1388]

Apportionment of Small Ethanol Producer Credit
The Bill would modify the existing tax benefits for ethanol and methanol produced from renewable sources that are used as a motor fuel or blended with other fuels for such use by allowing certain cooperatives to make (on a timely filed return for a taxable year) an irrevocable election to pass the small ethanol producer credit through to their patrons that year. Under the Bill, the credit would be apportioned among eligible patrons based on the quantity or value of business the cooperative does with or for such patrons during the taxable year. The Bill would include in the cooperative's income for the year any credit not so apportioned to patrons. The Bill would include the credit apportioned to a patron in the patron's income for the patron's first taxable year ending on or after the last day of the cooperative's payment period for the taxable year or, if earlier, in the patron's taxable year ending on or after the date the patron received notice of the cooperative's apportionment. If the cooperative's return for a taxable year shows a credit exceeding the cooperative's actual credit for the year, the Bill would treat the excess as an increase in the cooperative's tax for the year to the extent the excess was not apportioned to patrons. The Bill

would not treat the excess as tax imposed for tax credit determination or alternative minimum tax purposes.

Effective for taxable years beginning after the date of enactment.
[Bill §313; Code §40]

Coordinate Farmers and Fishermen Income Averaging and the Alternative Minimum Tax
The Bill would extend to individuals engaged in the fishing trade or business the income averaging election available to individual farmers under current law. The Bill would also provide that a farmer's (or a fisherman's) regular tax liability for computing alternative minimum tax is determined without regard to the income averaging. Thus, the Bill would allow farmers and fishermen to benefit fully from income averaging because the averaging would reduce the regular tax while leaving any alternative minimum tax unchanged.

Effective for taxable years beginning after December 31, 2003.
[Bill §314; Code §§55, 1301]

Capital Gain Treatment Under §631(b) to Apply to Outright Sales by Landowners
The Bill would eliminate the current law requirement that a landowner retain an economic interest in timber cut from the land to be able to treat gains from the sale of the timber as capital under §631(b). Under the Bill, the landowner's outright timber sales would qualify for capital gain treatment in the same manner as sales with a retained economic interest except that the usual tax rule relating to the timing of the income from the timber sale would apply instead of the special §631(b) timing rule.

Effective for timber sales after December 31, 2004.
[Bill §315; Code §631]

Modification To Cooperative Marketing Rules To Include Value Added Processing Involving Animals
The Bill would provide that marketing products of members or other producers includes feeding products of members or other producers to cattle, hogs, fish, chickens, or other animals and selling the resulting animals or animal products.

Effective for taxable years beginning after the date of enactment.
[Bill §316; Code §§521, 1388]

Extension of Declaratory Judgment Procedures to Farmers' Cooperative Organizations
The Bill would extend the declaratory judgment procedures to cooperatives. Such a case would be commenced in the U.S. Tax Court, a U.S. district court, or the U.S. Court of Federal Claims, and such court would have jurisdiction to determine a cooperative's initial or continuing qualification as a farmers' cooperative described in §521.

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Effective for pleadings filed after the date of enactment.
[Bill §317; Code §§521, 7428]

Certain Expenses of Rural Letter Carriers
The Bill would permit rural letter carriers to treat their automobile costs in excess of the amount reimbursed by the U.S. Postal Service as a §67 miscellaneous itemized deduction subject to the 2% floor. As under current law, however, rural letter carriers would not be required to include reimbursements in excess of their actual costs in gross income.

Effective for taxable years beginning after 2003.
[Bill §318; Code §162(o)]

Treatment of Certain Income of Cooperatives

Treatment of income from open access transactions. The Bill would provide that income received or accrued by a rural electric cooperative (other than income received or accrued directly or indirectly from a member of the cooperative) from the provision or sale of electric energy transmission services or ancillary services on a nondiscriminatory open access basis under an open access transmission tariff approved or accepted by FERC or under an independent transmission provider agreement approved or accepted by FERC is excluded in determining whether a rural electric cooperative satisfies the 85% test for tax exemption under §501(c)(12). In addition, income is excluded for purposes of the 85% test if it is received or accrued by a rural electric cooperative (other than income received or accrued directly or indirectly from a member of the cooperative) from the provision or sale of electric energy distribution services or ancillary services, provided such services are provided on a nondiscriminatory open access basis to distribute electric energy not owned by the cooperative: (1) to end-users who are served by distribution facilities not owned by the cooperative or any of its members; or (2) generated by a generation facility that is not owned or leased by the cooperative or any of its members and that is directly connected to distribution facilities owned by the cooperative or any of its members.

The term "open access transaction" would be defined as (1) the provision or sale of electric energy transmission services or ancillary services on a nondiscriminatory open access basis: (i) pursuant to an open access transmission tariff filed with and approved by the Federal Energy Regulatory Commission (FERC) (including acceptable reciprocity tariffs), but only if (in the case of a voluntarily filed tariff) the cooperative files a report with FERC within 90 days of enactment of this provision relating to whether or not the cooperative will join a regional transmission organization (RTO); or (ii) under an RTO agreement approved by FERC (including an agreement providing for the transfer of control, but not ownership, of transmission facilities); (2) the provision or sale of electric energy distribution services or ancillary services on a nondiscriminatory open access basis to end-users served by distribution facilities owned by the cooperative or its members; or (3) the delivery or sale of electric energy on a nondiscriminatory open access basis, provided that such electric energy is generated by a generation facility that is directly connected to distribution facilities owned by the cooperative (or its members) which owns the generation facility.

Treatment of income from nuclear decommissioning transactions. The Bill would provide that income received or accrued by a rural electric cooperative from any "nuclear decommissioning transaction" also is excluded in determining whether a rural electric cooperative satisfies the 85%

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test for tax exemption under §501(c)(12). The term "nuclear decommissioning transaction" would be defined as (1) any transfer into a trust, fund, or instrument established to pay any nuclear decommissioning costs if the transfer is in connection with the transfer of the cooperative's interest in a nuclear powerplant or nuclear powerplant unit; (2) any distribution from a trust, fund, or instrument established to pay any nuclear decommissioning costs; or (3) any earnings from a trust, fund, or instrument established to pay any nuclear decommissioning costs.

Treatment of income from asset exchange or conversion transactions. The Bill would provide that gain realized by a tax-exempt rural electric cooperative from a voluntary exchange or involuntary conversion of certain property is excluded in determining whether a rural electric cooperative satisfies the 85% test for tax exemption under §501(c)(12). This provision would only apply to the extent that: (1) the gain would qualify for deferred recognition under §1031 (relating to exchanges of property held for productive use or investment) or §1033 (relating to involuntary conversions); and (2) the replacement property that is acquired by the cooperative pursuant to §1031 or §1033 constitutes property that is used, or to be used, for the purpose of generating, transmitting, distributing, or selling electricity or natural gas.

Treatment of income from load loss transactions. Tax-exempt rural electric cooperatives. The Bill would provide that income received or accrued by a tax-exempt rural electric cooperative from a "load loss transaction" is treated under §501(c)(12) as income collected from members for the sole purpose of meeting losses and expenses of providing service to its members. Therefore, income from load loss transactions would be treated as member income in determining whether a rural electric cooperative satisfies the 85% test for tax exemption under §501(c)(12). The Bill would also provide that income from load loss transactions does not cause a tax-exempt electric cooperative to fail to be treated for Federal income tax purposes as a mutual or cooperative company under the fundamental cooperative principles described above. The term "loss transaction" would be generally defined as any wholesale or retail sale of electric energy (other than to a member of the cooperative) to the extent that the aggregate amount of such sales during a seven-year period beginning with the "start-up year" does not exceed the reduction in the amount of sales of electric energy during such period by the cooperative to members. For purposes of this provision, the "start-up year" would be defined in the Bill as the first year that the cooperative offers nondiscriminatory open access or, if later and at the election of the cooperative, the calendar year that includes the date of enactment of this provision.

Taxable electric cooperatives. The Bill would provide that the receipt or accrual of income from load loss transactions by taxable electric cooperatives is treated as income from patrons who are members of the cooperative. Thus, income from a load loss transaction would be excludible from the taxable income of a taxable electric cooperative if the cooperative distributes such income pursuant to a pre-existing contract to distribute the income to a patron who is not a member of the cooperative. The Bill would also provide that income from load loss transactions does not cause a taxable electric cooperative to fail to be treated for federal income tax purposes as a mutual or cooperative company under the fundamental cooperative principles described above.

Effective for taxable years beginning after the date of enactment.
[Bill §319; Code §501]

Exclusion for Payments to Individuals Under National Health Service Corps Loan Repayment Program and Certain State Loan Repayment Programs

The Bill would exclude from gross income and employment taxes education loan repayments

provided by the National Health Service Corps Loan Repayment Program (under which the recipient of the loan repayment is obligated to provide medical services in certain geographic areas) and those state programs which are eligible for funds under the Public Health Service Act. The Bill would also provide that such repayments are not taken into account as wages in determining Social Security benefits.

Effective for amounts received in taxable years beginning after December 31, 2003.
[Bill §320; Code §108]

Modification of Safe Harbor Rules for Timber REITs
The Bill would provide a safe-harbor, under which certain sales of REIT timber property would not be considered sales of property held for sale in the ordinary course of business. Under the Bill a sale of a real estate asset by a REIT would not be a prohibited transaction if the following six requirements are met: (1) the asset must have been held for at least four years in the trade or business of producing timber; (2) the aggregate expenditures made by the REIT (or a partner of the REIT) during the four-year period preceding the date of sale that are includible in the basis of the property (other than timberland acquisition expenditures) and that are directly related to the operation of the property for the production of timber or for the preservation of the property for use as timberland must not exceed 30% of the net selling price of the property; (3) the aggregate expenditures made by the REIT (or a partner of the REIT) during the four-year period preceding the date of sale that are includible in the basis of the property and that are not directly related to the operation of the property for the production of timber or the preservation of the property for use as timberland must not exceed 5% of the net selling price of the property; (4) the REIT either (a) does not make more than seven sales of property (other than sales of foreclosure property or sales to which §1033 applies) or (b) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property sold during the year (other than sales of foreclosure property or sales to which §1033 applies) does not exceed 10% of the aggregate bases (as determined for purposes of computing earnings and profits) of property of all assets of the REIT as of the beginning of the year; (5) substantially all of the marketing expenditures with respect to the property are made by persons who are independent contractors (as defined by §856(d)(3)) with respect to the REIT and from whom the REIT does not derive any income; and (6) the sales price on the sale of the property cannot be based in whole or in part on income or profits of any person, including income or profits derived from the sale of such properties.

Capital expenditures counted towards the 30% limit are those expenditures that are includible in the basis of the property (other than timberland acquisition expenditures), and that are directly related to operation of the property for the production of timber, or for the preservation of the property for use as timberland. These capital expenditures are those incurred directly in the operation of raising timber (i.e., silviculture), as opposed to capital expenditures incurred in the ownership of undeveloped land. In general, these capital expenditures incurred directly in the operation of raising timber include capital expenditures incurred by the REIT to create an established stand of growing trees. A stand of trees is considered established when a target stand exhibits the expected growing rate and is free of non-target competition (e.g., hardwoods, grasses, brush, etc.) that may significantly inhibit or threaten the target stand survival.

The costs commonly incurred during stand establishment are: (1) site preparation including manual or mechanical scarification, manual or mechanical cutting, disking, bedding, shearing, raking, piling, broadcast and windrow/pile burning (including slash disposal costs as required for stand establishment); (2) site regeneration including manual or mechanical hardwood coppice; (3)

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chemical application via aerial or ground to eliminate or reduce vegetation; (4) nursery operating costs including personnel salaries and benefits, facilities costs, cone collection and seed extraction, and other costs directly attributable to the nursery operations (to the extent such costs are allocable to seedlings used by the REIT); (5) seedlings including storage, transportation and handling equipment; (6) direct planting of seedlings; and (7) initial stand fertilization, up through stand establishment.

Other examples of capital expenditures incurred directly in the operation of raising timber include construction cost of road to be used for managing the timber land (including for removal of logs or fire protection), environmental costs (i.e., habitat conservation plans), and any other post stand establishment capital costs (e.g., "mid-term fertilization costs)." Capital expenditures counted towards the 5% limit are those capital expenditures incurred in the ownership of undeveloped land that are not incurred in the direct operation of raising timber (i.e., silviculture). This category of capital expenditures includes: (1) expenditures to separate the REIT's holdings of land into separate parcels; (2) costs of granting leases or easements to cable, cellular or similar companies; (3) costs in determining the presence or quality of minerals located on the land; (4) costs incurred to defend changes in law that would limit future use of the land by the REIT or a purchaser from the REIT; (5) costs incurred to determine alternative uses of the land (e.g., recreational use); and (6) development costs of the property incurred by the REIT (e.g., engineering, surveying, legal, permit, consulting, road construction, utilities, and other development costs for use other than to grow timber). Costs that are not includible in the basis of the property are not counted towards either the 30% or 5% requirements.

Effective for taxable years beginning after the date of enactment.
[Bill §321; Code §§856, 857, 1033]

Expensing of Reforestation Expenditures

The Bill would permit up to $10,000 of qualified reforestation expenditures to be deducted in the year paid or incurred (i.e., expensed). The proposal also would repeal the reforestation tax credit.

Effective for expenditures paid or incurred after the date of enactment.
[Bill §322; Code §§46, 48, 50, 194, 7703]

Subtitle C--Incentives for Small Manufacturers

Net Income From Publicly Traded Partnerships Treated as Qualifying Income of Regulated Investment Company

The Bill would modify the 90% test with respect to income of a RIC to include income derived from an interest in a publicly traded partnership. The Bill would also modify the look-through rule for partnership income of a RIC so that it applies only to income from a partnership other than a publicly traded partnership. The Bill would provide that the limitation on ownership and the limitation on composition of assets that apply to other investments of a RIC also apply to RIC investments in publicly traded partnership interests. The Bill would provide that the special rule for publicly traded partnerships under the passive loss rules (requiring separate treatment) would apply to a RIC holding an interest in a publicly traded partnership, with respect to items attributable to the interest in the publicly traded partnership.

Effective for taxable years beginning after the date of enactment.
[Bill §331; Code §§512, 851, 7704]

Charitable Contribution Deduction for Certain Expenses Incurred in Support of Native Alaskan Subsistence Whaling
The Bill would allow individuals to claim a deduction under §170(j) not exceeding $10,000 per taxable year for certain expenses incurred in carrying out sanctioned whaling activities. The deduction would be available only to an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities. The deduction would be available for reasonable and necessary expenses paid by the taxpayer during the taxable year for: (1) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities; (2) the supplying of food for the crew and other provisions for carrying out such activities; and (3) the storage and distribution of the catch from such activities. The Bill would provide that the Secretary will issue guidance requiring that the taxpayer substantiate whaling expenses for which a deduction is claimed by maintaining appropriate written records with respect to the time, place, date, amount, and nature of the expense, as well as the taxpayer's eligibility for the deduction, and that (to the extent provided by the Secretary) such substantiation be provided as part of the taxpayer's income tax return.

For purposes of the proposal, the term "sanctioned whaling activities" means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission.

Effective for contributions made after December 31, 2004.
[Bill §335; Code §170]

Modification of Depreciation Allowance for Aircraft
The Bill would provide criteria under which certain noncommercial aircraft may qualify for the extended placed-in-service date allowed under present law for property having an extended production period. Qualifying aircraft would be eligible for the additional first-year depreciation deduction if placed in service before January 1, 2006. In order to qualify, the aircraft must: (1) be acquired by the taxpayer during the applicable time period as under present law; (2) meet the appropriate placed-in-service date requirements; (3) not be tangible personal property used in the trade or business of transporting persons or property (except for agricultural or firefighting purposes); (4) be purchased by a purchaser who, at the time of the contract for purchase, has made a nonrefundable deposit of the lesser of 10% of the cost or $100,000; and (5) have an estimated production period exceeding four months and a cost exceeding $200,000.

Effective as if included in the amendments made by the 2002 Job Creation and Worker Assistance Act, §101, which applies to property placed in service after September 10, 2001. However, because the property described by the Bill qualifies for the additional first-year depreciation deduction under present law if placed in service prior to January 1, 2005, the Bill would modify the treatment only of property placed in service during calendar year 2005.
[Bill §336; Code §168]

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Modification of Placed in Service Rule for Bonus Depreciation Property
The Bill would provide a special rule in the case of multiple units of property subject to the same lease. In such cases, property would qualify as placed in service on the date of sale if it is sold within three months after the final unit is placed in service, so long as the period between the time the first and last units are placed in service does not exceed 12 months.

Effective for property sold after June 4, 2004.
[Bill §337; Code §168]

Expensing of Capital Costs Incurred in Complying with Environmental Protection Agency Sulfur Regulations
The Bill would permit small business refiners to claim an immediate deduction (i.e., expensing) for up to 75% of the costs paid or incurred for the purpose of complying with the Environmental Protection Agency's (EPA) Highway Diesel Fuel Sulfur Control Requirements. Qualifying expenditures would be those expenditures paid or incurred with respect to a facility beginning January 1, 2003, and ending the earlier of the date that is one year after the date on which the taxpayer must comply with applicable EPA regulation or December 31, 2009.

For these purposes a small business refiner would be a taxpayer who is within the business of refining petroleum products employs not more than 1,500 employees directly in refining and has less than 205,000 barrels per day (average) of total refinery capacity. In any case in which refinery through-put or retained production of the refinery differs substantially from its average daily output of refined product, capacity would be measured by reference to the average daily output of refined product. The deduction would be reduced, pro rata, for taxpayers with capacity in excess of 155,000 barrels per day.

Effective for expenses paid or incurred after December 31, 2002.
[Bill §338; Code §179B (new)]

Credit for Production of Low Sulfur Diesel Fuel
The Bill would provide that a small business refiner may claim credit equal to five cents per gallon for each gallon of low sulfur diesel fuel produced during the taxable year that is in compliance with the Environmental Protection Agency's (EPA) Highway Diesel Fuel Sulfur Control Requirements. The total production credit claimed by the taxpayer would be limited to 25% of the capital costs incurred to come into compliance with the EPA diesel fuel requirements. The taxpayer's basis in such property would be reduced by the amount of production credit claimed. In the case of a qualifying small business refiner that is owned by a cooperative, the cooperative would allowed to elect to pass any production credits to patrons of the organization.

For these purposes a small business refiner would be a taxpayer who is in the business of refining petroleum products, employs not more than 1,500 employees directly in refining and has less than 205,000 barrels per day (average) of total refinery capacity. In any case in which refinery through-put or retained production of the refinery differs substantially from its average daily output of refined product, capacity would be measured by reference to the average daily output of refined product. The amount of credit a taxpayer may claim would be reduced, pro rata, for taxpayers with capacity in excess of 155,000 barrels per day.

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Qualifying expenditures would be those expenditures paid or incurred with respect to a facility beginning January 1, 2003, and ending the earlier of the date that is one year after the date on which the taxpayer must comply with applicable EPA regulation or December 31, 2009.

Effective for expenses paid or incurred after December 31, 2002.
[Bill §339; Code §45H (new)]

Expansion of Qualified Small-Issue Bond Program

The Bill would increase the maximum allowable amount of total capital expenditures by an eligible business or a related party in the same municipality or county during the six-year measurement period from $10 million to $20 million. As under present law, no more than $10 million of bond financing may be outstanding at any time for property of an eligible business (including related parties) located in the same municipality or county. Other present-law limits (for example, the $40 million per borrower limit) continue to apply.

Effective for bonds issued after September 30, 2009.
[Bill §340; Code §144]

Oil and Gas From Marginal Wells

The Bill would create a new, $3-per-barrel credit for the production of qualified crude oil and a $0.50 credit per 1,000 cubic feet of qualified natural gas production, provided that the production is from a "qualified marginal well." The Bill would define a qualified marginal well as a domestic well: (1) production from which is treated as marginal production for purposes of the Code percentage depletion rules; or (2) that during the taxable year had average daily production of not more than 25 barrel equivalents and produces water at a rate of not less than 95% of total well effluent. The Bill would allow a maximum amount of production on which credit could be claimed is 1,095 barrels or barrel equivalents.

The Bill would provide that the credit is not available to production occurring if the reference price of oil exceeds $18 ($2.00 for natural gas) and is reduced proportionately for reference prices between $15 and $18 ($1.67 and $2.00 for natural gas). The Bill would determine reference prices on a one-year look-back basis.

In the case of production from a qualified marginal well which is eligible for the credit allowed under §29 for the taxable year, the Bill would allow no marginal well credit unless the taxpayer elects not to claim the §29 credit for the well. The Bill would treat the credit as a general business credit; except that unused credits would be carried back for up to five years instead of one year, and the number of years to which the amounts are carried would be 25, instead of 21, and 24, instead of 20. The Bill would provide that the credit is indexed for inflation for taxable years beginning in a calendar year after 2005.

Effective for production in taxable years beginning after December 31, 2004.
[Bill §341; Code §45I (new)]

TITLE IV--TAX REFORM AND SIMPLIFICATION FOR UNITED STATES BUSINESSES

Interest Expense Allocation Rules
The Bill would modify the present-law interest expense allocation rules which apply for purposes of computing the foreign tax credit limitation by providing a one-time election under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally would be determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis as if all members of the worldwide group were a single corporation.

If a group makes this election, the taxable income of the domestic members of a worldwide affiliated group from sources outside the United States would be determined by allocating and apportioning the third-party interest expense of those domestic members to foreign-source income in an amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide third-party interest expense multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated group, over (2) the third-party interest expense incurred by foreign members of the group to the extent such interest would be allocated to foreign sources if the provision's principles were applied separately to the foreign members of the group.

For purposes of the Bill's elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group (as that term is defined under present law for interest allocation purposes) as well as all controlled foreign corporations that, in the aggregate, either directly or indirectly, would be members of such an affiliated group if §1504(b)(3) did not apply (i.e., in which at least 80% of the vote and value of the stock of such corporations is owned by one or more other corporations included in the affiliated group). If an affiliated group would make this election, the taxable income from sources outside the United States of domestic group members generally would be determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80% or greater owned domestic corporations (i.e., corporations that are part of the affiliated group under present-law §864(e)(5)(A) as modified to include insurance companies) and certain controlled foreign corporations were attributable to a single corporation.

In addition, if an affiliated group elects to apply the Bill's elective rules based on worldwide fungibility, the present-law rules regarding the treatment of tax-exempt assets and the basis of stock in nonaffiliated 10% owned corporations apply on a worldwide affiliated group basis.

The common parent of the domestic affiliated group must make the worldwide affiliated group election. It must be made for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election would apply to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election was made and all subsequent taxable years, unless revoked with the consent of the IRS.

The Bill would allow taxpayers to apply the present-law bank group rules to exclude certain financial institutions from the affiliated group for interest allocation purposes under the worldwide

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fungibility approach. The provision also provides a one-time financial institution group election that expands the present-law bank group.

Under the Bill, at the election of the common parent of the pre-election worldwide affiliated group, the interest expense allocation rules would be applied separately to a subgroup of the worldwide affiliated group that consists of (1) all corporations that are part of the present-law bank group, and (2) all financial corporations. For this purpose, a corporation is a financial corporation if at least 80% of its gross income is financial services income (as described in §904(d)(2)(C)(i) and the regulations thereunder) that is derived from transactions with unrelated persons.

For these purposes, items of income or gain from a transaction or series of transactions are disregarded if a principal purpose for the transaction or transactions is to qualify any corporation as a financial corporation.

The common parent of the pre-election worldwide affiliated group would have to make the election for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group includes a financial corporation. Once made, the election would apply to the financial institution group for the taxable year and all subsequent taxable years. In addition, the provision provides anti-abuse rules under which certain transfers from one member of a financial institution group to a member of the worldwide affiliated group outside of the financial institution group are treated as reducing the amount of indebtedness of the separate financial institution group. The provision would provide regulatory authority with respect to the election to provide for the direct allocation of interest expense in circumstances in which such allocation is appropriate to carry out the purposes of the provision, prevent assets or interest expense from being taken into account more than once, or address changes in members of any group (through acquisitions or otherwise) treated as affiliated under this provision.

Effective for taxable years beginning after December 31, 2008.
[Bill §401; Code §864]

Recharacterization of Overall Domestic Loss
The Bill would apply a "re-sourcing of income" rule to U.S.-source income in cases in which a taxpayer's foreign tax credit limitation has been reduced as a result of an overall domestic loss. Under the Bill, a portion of the taxpayer's U.S.-source income for each succeeding taxable year is recharacterized as foreign-source income in an amount equal to the lesser of: (1) the amount of the un-recharacterized overall domestic losses for years prior to such succeeding taxable year, and (2) 50% of the taxpayer's U.S.-source income for such succeeding taxable year.

Overall domestic loss would be defined as any domestic loss to the extent it offsets foreign-source taxable income for the current taxable year or for any preceding taxable year by reason of a loss carryback. For this purpose, a domestic loss means the amount by which the U.S.-source gross income for the taxable year is exceeded by the sum of the deductions properly apportioned or allocated thereto, determined without regard to any loss carried back from a subsequent taxable year. Under the Bill, an overall domestic loss would not include any loss for any taxable year unless the taxpayer elected to use foreign tax credit for such taxable year.

Any U.S.-source income recharacterized under the provision would be allocated among and increase the various foreign tax credit separate limitation categories in the same proportion that

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those categories were reduced by the prior overall domestic losses, in a manner similar to the recharacterization rules for separate limitation losses.

The IRS would be granted authority to prescribe regulations to coordinate the operation of the overall foreign loss recapture rules with the operation of the overall domestic loss recapture rules added by the provision.

Effective for losses for taxable years beginning after December 31, 2006.
[Bill §402; Code §904]

Look-Thru Rules to Apply to Dividends from Noncontrolled §902 Corporations
The Bill would apply the look-through approach to dividends paid by a foreign corporation in which the taxpayer owns at least 10% of the stock by vote and which is not a controlled foreign corporation ("10/50 company") regardless of the year in which the earnings and profits out of which the dividend is paid were accumulated. If the IRS determines that a taxpayer has inadequately substantiated that it assigned a dividend from a 10/50 company to the proper foreign tax credit limitation category, the dividend is treated as passive category income for foreign tax credit "basketing" purposes.

Effective for taxable years beginning after December 31, 2002. Transition rules would allow the use of pre-effective-date foreign tax credits associated with a 10/50-company separate limitation category in post-effective-date years. Look-through principles similar to those applicable to post-effective-date dividends from a 10/50 company apply to determine the appropriate foreign tax credit limitation category or categories with respect to carrying forward foreign tax credits into future years. The IRS would be authorized to issue regulations addressing the carryback of foreign tax credits associated with a dividend from a 10/50 company to pre-effective-date years.
[Bill §403; Code §904]

Reduction to Two Foreign Tax Credit Baskets
The Bill would generally reduce the number of foreign tax credit limitation categories to two: passive category income and general category income. Other income is included in one of the two categories, as appropriate. For example, shipping income generally falls into the general limitation category, whereas high withholding tax interest generally could fall into the passive income or the general limitation category, depending on the circumstances. Dividends from a DISC or former DISC, income attributable to certain foreign trade income, and certain distributions from a FSC or former FSC all are assigned to the passive income limitation category. The provision does not affect the separate computation of foreign tax credit limitations under special provisions of the Code relating to, for example, treaty-based sourcing rules or specified countries under §901(j).

In the case of a member of a financial services group or any other person predominantly engaged in the active conduct of a banking, insurance, financing or similar business, the Bill treats income meeting the definition of financial services income as general category income. Under the provision, a financial services group is an affiliated group that is predominantly engaged in the active conduct of a banking, insurance, financing or similar business. For this purpose, the definition of an affiliated group under §1504(a) is applied, but expanded to include certain insurance companies (without regard to whether such companies are covered by an election under §1504(c)(2)) and foreign corporations. In determining whether such a group is

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predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, only the income of members of the group that are U.S. corporations or controlled foreign corporations in which such U.S. corporations own (directly or indirectly) at least 80% of total voting power and value of the stock are taken into account.

The Bill does not alter the present law interpretation of what it means to be a "person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business" for purposes of the Code so that other provisions that rely on this same concept are not affected. For example, under the "accumulated deficit rule" of §952(c)(1)(B), Subpart F income inclusions of a U.S. shareholder attributable to a "qualified activity" of a controlled foreign corporation may be reduced by the amount of the U.S. shareholder's pro rata share of certain prior year deficits attributable to the same qualified activity. In the case of a qualified financial institution, qualified activity consists of any activity giving rise to foreign personal holding company income, but only if the controlled foreign corporation was predominantly engaged in the active conduct of a banking, financing, or similar business in both the year in which the corporation earned the income and the year in which the corporation incurred the deficit. Similarly, in the case of a qualified insurance company, qualified activity consists of activity giving rise to insurance income or foreign personal holding company income, but only if the controlled foreign corporation was predominantly engaged in the active conduct of an insurance business in both the year in which the corporation earned the income and the year in which the corporation incurred the deficit. For this purpose, "predominantly engaged in the active conduct of a banking, insurance, financing, or similar business" is defined under present law by reference to the use of the term for purposes of the separate foreign tax credit limitations. The present-law meaning of "predominantly engaged" for purposes of §952(c)(1)(B) remains unchanged under the provision.

The IRS must specify the treatment of financial services income received or accrued by pass-through entities that are not members of a financial services group under regulations generally consistent with those currently in effect.

The Bill would also address the treatment of creditable foreign taxes imposed on amounts that do not constitute income under U.S. tax principles (so-called "base difference" items). The Bill would treat such foreign taxes as imposed on general limitation income. Any such taxes arising in taxable years beginning after December 31, 2004, but before January 1, 2007 (when the number of limitation categories is reduced to two), are treated as imposed on either general limitation income or financial services income, at the taxpayer's election. Once made, this election applies to all such taxes for the taxable years described above and is revocable only with IRS consent.

Effective generally for taxable years beginning after December 31, 2006. Taxes paid or accrued in a taxable year beginning before January 1, 2007, and carried to any subsequent taxable year are treated as if this provision were in effect on the date such taxes were paid or accrued. The Bill would, accordingly, assign such taxes to one of the two foreign tax credit limitation categories, as appropriate. The IRS is to provide rules for the allocation of income with respect to taxes carried back to pre-effective-date years (in which more than two limitation categories are in effect). The provisions concerning "base difference" items are effective for taxes arising in taxable years beginning after December 31, 2004.
[Bill §404; Code §904]

Attribution of Stock Ownership Through Partnerships to Apply in Determining §§902 and 960 Credits

The Bill would clarify that a domestic corporation is entitled to claim deemed-paid foreign tax credits with respect to a foreign corporation that is held indirectly through a foreign or domestic partnership, provided that the domestic corporation owns (indirectly through the partnership) 10% or more of the foreign corporation's voting stock. No inference is intended as to the treatment of such deemed-paid foreign tax credits under present law. The Bill would also clarify that both individual and corporate partners (or estate or trust beneficiaries) may claim direct foreign tax credits with respect to their proportionate shares of taxes paid or accrued by a partnership (or estate or trust).

Effective for taxes of foreign corporations for taxable years of such corporations beginning after the date of enactment.
[Bill §405; Code §§902, 960]

Clarification of Treatment of Certain Transfers of Intangible Property
The Bill would provide that deemed payments under §367(d) are treated as royalties for purposes of applying the separate limitation categories of the foreign tax credit.

Effective for amounts treated as received on or after August 5, 1997.
[Bill §406; Code §367]

U.S. Property Not to Include Certain Assets of Controlled Foreign Corporation
The Bill would add two exceptions from the definition of U.S. property for determining current income inclusion by a U.S. 10% shareholder with respect to an investment in U.S. property by a controlled foreign corporation.

The first exception generally applies to securities acquired and held by a controlled foreign corporation in the ordinary course of its trade or business as a dealer in securities. The exception applies only if the controlled foreign corporation dealer: (1) accounts for the securities as securities held primarily for sale to customers in the ordinary course of business; and (2) disposes of such securities (or such securities mature while being held by the dealer) within a period consistent with the holding of securities for sale to customers in the ordinary course of business.

The second exception generally applies to the acquisition by a controlled foreign corporation of obligations issued by a U.S. person that is not a domestic corporation and that is not (1) a U.S. 10% shareholder of the controlled foreign corporation, or (2) a partnership, estate or trust in which the controlled foreign corporation or any related person is a partner, beneficiary or trustee immediately after the acquisition by the controlled foreign corporation of such obligation.

Effective for taxable years of foreign corporations beginning after December 31, 2004, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.
[Bill §407; Code §956]

Translation of Foreign Taxes
The Bill would provide taxpayers (other than regulated investment companies using the accrual method of accounting) an election to translate foreign income taxes into U.S. dollar amounts using

the exchange rates as of the time such taxes are paid, provided the foreign income taxes would be denominated in a currency other than the taxpayer's functional currency. Any election would apply to the taxable year for which the election is made and to all subsequent taxable years unless revoked with the consent of the IRS. The Bill also authorizes the IRS to issue regulations that apply the election to foreign income taxes attributable to a qualified business unit.

Effective for taxable years beginning after December 31, 2004.
[Bill §408; Code §986]

Repeal of Withholding Tax on Dividends from Certain Foreign Corporations
The Bill would eliminate the secondary withholding tax with respect to dividends paid by certain foreign corporations. The secondary withholding tax occurs when a foreign corporation derives 25% or more of its gross income as income effectively connected with a U.S. trade or business for the three-year period ending with the close of the taxable year preceding the declaration of a dividend, then a portion of any dividend paid by the foreign corporation to its shareholders is treated as U.S. source income and, in the case of dividends paid to foreign shareholders, is subject to the 30% withholding tax.

Effective for payments made after December 31, 2004.
[Bill §409; Code §871]

Equal Treatment of Interest Paid by Foreign Partnerships and Foreign Corporations
The Bill would treat interest paid by foreign partnerships in a manner similar to the treatment of interest paid by foreign corporations. The change would apply only to foreign partnerships that are predominantly engaged in the active conduct of a trade or business outside the United States. Under the Bill, interest paid by such a foreign partnership would be treated as U.S. source income only if the interest is paid by a U.S. trade or business conducted by the partnership or is allocable to income that is treated as effectively connected with the conduct of a U.S. trade or business.

Effective for taxable years beginning after December 31, 2003.
[Bill §410; Code §861]

Treatment of Certain Dividends of Regulated Investment Companies
The Bill would provide that a regulated investment company (RIC) that earns certain interest income that would not be subject to U.S. tax if earned by a foreign person directly would be permitted, to the extent of such income (less allocable expenses), to designate a dividend it pays as derived from such interest income. A foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, as if the foreign person had earned the interest directly, provided that the foreign person is not a U.S. person, a controlled foreign corporation, a 10% shareholder of the debtor, or in a country with inadequate exchange of information to prevent tax evasion by U.S. persons.

Similarly, a RIC that earns an excess of net short-term capital gains over net long-term capital losses, which excess would not be subject to U.S. tax if earned by a foreign person, generally may, to the extent of such excess, designate a dividend it pays as derived from such excess. A

foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, as if the foreign person had realized the excess directly.

The Bill would also provide that the estate of a foreign decedent is exempt from U.S. estate tax on a transfer of stock in the RIC in the proportion that the assets held by the RIC are debt obligations, deposits, or other property that would generally be treated as situated outside the United States if held directly by the estate, such as bank deposits that produce interest exempt from withholding tax, portfolio debt obligations, certain original issue discount obligations, and debt obligations of a domestic corporation that are treated as giving rise to foreign source income.

Effective for RIC taxable years beginning after December 31, 2004, and before January 1, 2008, for estate taxes for estates of decedents dying after December 31, 2004, and before January 1, 2008, and for RICs with respect to §897 (relating to U.S. real property interests) after December 31, 2004, and before January 1, 2008.
[Bill §411; Code §§871, 881, 897, 1441, 1442, and 2105]

Look-Thru Treatment for Sales of Partnership Interests
The Bill would treat the sale by a controlled foreign corporation of a partnership interest as a sale of the proportionate share of partnership assets attributable to such interest for purposes of determining Subpart F foreign personal holding company income. This rule would apply only to partners owning directly, indirectly, or constructively at least 25% of a capital or profits interest in the partnership. The sale of a partnership interest by a controlled foreign corporation that meets this ownership threshold would constitute Subpart F income only to the extent that a proportionate sale of the underlying partnership assets attributable to the partnership interest would constitute Subpart F income. The IRS would be authorized to prescribe regulations to prevent abuse.

Effective for taxable years of foreign corporations beginning after December 31, 2004, and taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.
[Bill §412; Code §954]

Repeal of Foreign Personal Holding Company Rules and Foreign Investment Company Rules
The Bill would: (i) eliminate the rules applicable to foreign personal holding companies and foreign investment companies; (ii) exclude foreign corporations from the application of the personal holding company rules; and (iii) include, as Subpart F foreign personal holding company income, personal services contract income that is subject to the present-law foreign personal holding company rules.

Effective for taxable years of foreign corporations beginning after December 31, 2004, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.
[Bill §413; Code §§542, 551-558, 954, 1246, 1247]

Determination of Foreign Personal Holding Company Income with Respect to Transactions in Commodities

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The Bill would change the tests used to determine whether income from commodity hedging transactions and from the sale of commodities is excluded from the foreign personal holding company income category of Subpart F income. Instead of the existing standard of whether the hedging transaction is reasonably necessary to the business and in the manner in which the business is customarily and usually conducted by others, the test would become, similar to §1221(b)(2)(A)(i), whether the transaction was entered into in the ordinary course of business to manage risk of price changes or currency fluctuations with respect to ordinary property or §1231(b) property and, if so, whether the transaction was clearly identified as such by the end of the day as provided in §1221(a)(7). Also, instead of the existing standard for gains and losses in sales of commodities of whether substantially all of the controlled foreign corporation's commodities business is active, the test would become whether substantially all of the controlled foreign corporation's commodities are property described in §1221(a)(1), (2), or (8) as stock in trade or inventory, real or depreciable property used in the business, or supplies of a type regularly consumed in the ordinary course of the taxpayer's business. In addition, certain commodities gains and losses attributable to home country activities that are excluded by existing law in determining the Subpart F income of securities dealers would also be excluded in applying the substantially all test.

Effective for transactions entered into after December 31, 2004.
[Bill §414; Code §954]

Modifications to Treatment of Aircraft Leasing and Shipping Income

The Bill would repeal the category of foreign base company shipping income as a component of Subpart F income that is potentially taxable to U.S. shareholders and would enact a "safe harbor" whereby income from leasing an aircraft or vessel in foreign commerce would be treated as active business income (rather than rents includible in Subpart F income) if active leasing expenses, as determined under regulations, are not less than 10% of the profit on the lease.

Effective for taxable years of foreign corporations beginning after December 31, 2004, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.
[Bill §415; Code §954]

Modification of Exceptions Under Subpart F for Active Financing

For purposes of expanding banking or financing income excepted from attribution to U.S. shareholders under Subpart F, the Bill would treat an activity as conducted directly by an eligible controlled foreign corporation or qualified business unit in its home country if the activity is (i) performed in that country, (ii) by employees of a related person, itself an eligible controlled foreign corporation with the same home country, and (iii) for arm's length compensation treated by the related person as earned in its home country for purposes of the home country's tax laws.

Effective for taxable years of foreign corporations beginning after December 31, 2004, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.
[Bill §416; Code §954]

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Ten-Year Foreign Tax Credit Carryover; One-Year Foreign Tax Credit Carryback
The Bill would replace the current-law two-year carryback and five-year carryforward for excess foreign tax credits. The revised law would limit the excess foreign tax credit carryback period to one year and extend the carryforward period to 10 years.

Effective in the case of the limited carryback period for excess foreign tax credits arising in taxable years beginning after the date of enactment; effective in the case of the extension of the carryforward period for excess foreign tax credits that may be carried to any taxable years ending after the date of enactment.
[Bill §417; Code §§904, 907]

Modification of the Treatment of Certain REIT Distributions Attributable to Gain from Sales or Exchanges of U.S. Real Property Interests
The Bill would change the treatment of a capital gain distribution by a REIT to a foreign owner so that it is no longer treated as income effectively connected with the conduct of a trade or business within the United States (requiring a U.S. federal income tax return to be filed) and, instead, is treated as a REIT dividend that is not a capital gain and not subject to branch profits tax, provided that (1) the distribution is received with respect to a class of stock that is regularly traded on an established securities market located in the United States and (2) the foreign investor does not own more than 5% of the class of stock at any time during the taxable year within which the distribution is received.

Effective for taxable years beginning after the date of enactment.
[Bill §418; Code §§897, 857]

Exclusion of Income Derived from Certain Wagers on Horse Races and Dog Races from Gross Income of Nonresident Alien Individuals
The Bill would exclude from gross income winnings paid to a nonresident alien resulting from a legal wager initiated outside the United States in a parimutuel pool on a live horse or dog race in the United States, regardless of whether the pool is a separate foreign pool or a merged U.S.-foreign pool.

Effective for wagers made after the date of enactment.
[Bill §419; Code §872]

Limitation of Withholding Tax for Puerto Rico Corporations
The Bill would lower the withholding income tax rate on U.S. source dividends paid to a corporation created or organized in Puerto Rico from 30% to 10%, to create parity with the generally applicable 10% withholding tax imposed by Puerto Rico on dividends paid to U.S. corporations. The lower rate applies only if the same local ownership and activity requirements are met that are applicable to corporations organized in other possessions receiving dividends from corporations organized in the United States. If the generally applicable 10% withholding tax rate imposed by Puerto Rico on dividends paid to U.S. corporations increases to greater than 10%, the U.S. withholding rate on dividends to Puerto Rico corporations reverts to 30%.

Effective for dividends paid after the date of enactment.
[Bill §420; Code §§881, 1442]

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Foreign Tax Credit Under Alternative Minimum Tax
The Bill would repeal the 90% limitation on the utilization of the AMT foreign tax credit.

Effective for taxable years beginning after December 31, 2004.
[Bill §421; Code §§53, 59]

Incentives to Reinvest Foreign Earnings in United States
The Bill would provide an 85% dividends-received deduction for certain dividends received by a U.S. corporation from a controlled foreign corporation (CFC). At the taxpayer's election, this deduction would be available for dividends received either during the taxpayer's first taxable year beginning on or after the date of enactment or during the taxpayer's last taxable year beginning before such date. Dividends received after the election period would be taxed in the normal manner under present law. The deduction would not apply to distributions of earnings previously taxed under Subpart F, except to the extent that the Subpart F inclusions result from the payment of a dividend by one CFC to another CFC within a certain chain of ownership during the election period. To prevent self-financed dividends, the eligible amount would be reduced by the increase in certain related party debt.

The deduction would be subject to a number of limitations. First, it would apply only to repatriations in excess of the taxpayer's average repatriation level over three of the five most recent taxable years ending on or before June 30, 2003. Second, the amount of dividends eligible for the deduction would be limited to the greatest of: (1) $500 million; (2) the amount of earnings shown as permanently invested outside the United States on the taxpayer's most recent audited financial statement which is certified on or before June 30, 2003; or (3) in the case of an applicable financial statement that fails to show a specific amount of such earnings, but that does show a specific amount of tax liability attributable to such earnings, the amount of such earnings determined by grossing up the tax liability at a 35% rate. Third, dividends qualifying for the deduction would have to be invested in the United States pursuant to a plan approved by the senior management and board of directors of the corporation claiming the deduction.

No foreign tax credit (or deduction) would be allowed for foreign taxes attributable to the deductible portion of any dividend received during the taxable year for which an election under the provision was in effect. In addition, the income attributable to the nondeductible portion of a qualifying dividend could not be offset by net operating losses, and the tax attributable to such income generally could not be offset by credits (other than foreign tax credits and AMT credits) and could not reduce the alternative minimum tax otherwise owed by the taxpayer. No deduction under §243 or §245 would be allowed for any dividend for which a deduction was allowed under the provision.

Effective for a taxpayer's first taxable year beginning on or after the date of enactment, or the taxpayer's last taxable year beginning before such date, at the taxpayer's election. The deduction is not allowed for dividends received in any taxable year beginning one year or more after the date of enactment.
[Bill §422; Code §965 (new)]

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Delay in Effective Date of Final Regulations Governing Exclusion of Income from International Operation of Ships or Aircraft
The Bill would delay the effective date of regulations promulgated in T.D. 9087, 68 Fed. Reg. 51393 (8/26/03), relating to income derived by foreign corporations from the international operation of ships or aircraft. As so delayed, the effective date of the regulations would be taxable years of a foreign corporation seeking qualified foreign corporation status beginning after September 24, 2004.

Effective on the date of enactment.
[Bill §423]

Study of Earnings Stripping Provisions
The Bill would require the Treasury Department to conduct a study of the earnings stripping rules, including a study of the effectiveness of these rules in preventing the shifting of income outside the United States, and whether any deficiencies in these rules have the effect of placing U.S.-based businesses at a competitive disadvantage relative to their foreign-based counterparts. This study is to include specific recommendations for improving these rules and is to be submitted to the Congress not later than June 30, 2005.

Effective on the date of enactment.
[Bill §424]

TITLE V--DEDUCTION OF STATE AND LOCAL GENERAL SALES TAXES

The Bill would provide that, at the election of the taxpayer, an itemized deduction could be taken for state and local general sales taxes in lieu of the itemized deduction provided under present law for state and local income taxes.

Taxpayers would possess two options with respect to the determination of the state and local sales tax deduction amount. Taxpayers could deduct the total amount of general state and local sales taxes paid by accumulating receipts showing sales taxes paid. Alternatively, taxpayers could use tables created by the Treasury Secretary. The tables would be based on average consumption by taxpayers on a state by state basis taking into account filing status, number of dependents, adjusted gross income and rates of state and local general sales taxation. Taxpayers who would use the tables could, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats and other items specified by the Secretary. Sales taxes for items that may be added to the tables would not be reflected in the tables themselves.

The term "general sales tax" would mean a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items. However, in the case of items of food, clothing, medical supplies, and motor vehicles, the fact that the tax would not apply with respect to some or all of such items would not be taken into account in determining whether the tax applies with respect to a broad range of classes of items, and the fact that the rate of tax applicable with respect to some or all of such items would be lower than the general rate of tax shall not be taken into account in determining whether the tax is imposed at one rate. Except in the case of a lower rate of tax applicable with respect to food, clothing, medical supplies, or motor vehicles, no deduction shall be

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allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess shall be disregarded and the general rate shall be treated as the rate of tax.

A compensating use tax with respect to an item would be treated as a general sales tax, provided such tax is complimentary to a general sales tax and a deduction for sales taxes is allowable with respect to items sold at retail in the taxing jurisdiction that are similar to such item.

Effective for taxable years beginning after December 31, 2003 and prior to January 1, 2006.
[Bill §501; Code §164]

TITLE VII--MISCELLANEOUS PROVISIONS

Brownfields Demonstration Program for Qualified Green Building and Sustainable Design Projects
The Bill would create a new category of exempt-facility bond--the qualified green building and sustainable design project bond. A "qualified green bond" would be defined as any bond issued as part of an issue that finances a project designated by the Secretary, after consultation with the EPA, as a green building and sustainable design project that meets the following criteria: (1) at least 75% of the square footage of the commercial buildings that are part of the project is registered for the U.S. Green Building Council's LEED certification and is reasonably expected (at the time of designation) to meet such certification; (2) the project includes a brownfield site; (3) the project receives at least $5 million in specific state or local resources; and (4) the project includes at least 1 million square feet of building or at least 20 acres of land. The bill would require that each project be nominated by a State or local government within 180 days after the date of enactment.

Qualified green bonds would not be subject to the state bond volume limitations, but there would be a national aggregate limitation of $2 billion of bonds that the Secretary could allocate to qualified projects. Such bonds would be currently refundable if certain conditions were met, but could not be advance refunded.

Effective for bonds issued after December 31, 2004, and before October 1, 2009.
[Bill §701; Code §142]

Exclusion from UBTI of Gain or Loss on Sale of Certain Brownfield Sites
The Bill would provide an exclusion from UBTI for the gain or loss from a qualified sale, exchange, or other disposition of a "qualifying brownfield property" by an eligible tax exempt organization or qualifying partnership. The exclusion generally would be available with respect to properties acquired between January 1, 2005, and December 31, 2009. The Bill also would provide an exception from the debt-financed property rules for such properties.

To qualify for the exclusion, the taxpayer would have to: (1) acquire a qualifying brownfield property from an unrelated person; (2) pay or incur eligible remediation expenditures exceeding the greater of $550,000 or 12% of the fair market value of the property at the time such property was acquired (determined as if the property were not contaminated); and (3) transfer the

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remediated site to an unrelated person in a transaction constituting a sale, exchange, or other disposition for Federal income tax purposes, and which meets other conditions.

An eligible taxpayer would not include an organization that is: (1) itself potentially liable under CERCLA with respect to the property; (2) affiliated with any other person that is potentially liable thereunder through any direct/indirect familial relationship or any contractual, corporate, or financial relationship; or (3) the result of a reorganization of a business entity that was so potentially liable.

The amount of gain or loss excludible from UBTI would not be limited to or based on the increase or decrease in value of the property that is attributable to the taxpayer's expenditure of eligible remediation expenditures. Also, the exclusion would not apply to any amount treated as gain that is ordinary income with respect to §1245 or §1250 property, including any amount deducted as a §198 expense that is subject to the recapture rules of §198(e), if the taxpayer had deducted such amount in computing its UBTI.

The Bill also provides special rules for qualifying partnerships and for multiple properties.

Effective for gain or loss on the sale, exchange, or other disposition of property acquired by the taxpayer during the period beginning January 1, 2005, and ending December 31, 2009.
[Bill §702; Code §§512, 514]

Above-the-Line Deduction for Attorney's Fees and Costs Incurred in Certain Civil Rights Suits

The Bill would provide an above-the-line deduction for attorney's fees and costs paid by, or on behalf of, a taxpayer in connection with any action involving a claim of unlawful discrimination, certain claims against the federal Government, or a private cause of action under the Medicare Secondary Payer statute. The amount deductible could not exceed the amount includible in the taxpayer's gross income for the taxable year on account of the judgment or settlement (whether by suit or agreement and whether as a lump sum or periodic payments) resulting from such claim.

Effective for fees and costs paid after the date of enactment with respect to any judgment or settlement occurring after such date.
[Bill §703; Code §62]

Seven-Year Recovery Period for Motorsport Racetrack Complexes

The Bill would provide a statutory 7-year recovery period for MACRS depreciation purposes for permanent motorsport racetrack complexes, which would include land improvements and support facilities, but would not include transportation equipment, warehouses, administrative buildings, hotels, or motels.

Effective for property placed in service after the date of enactment and before January 1, 2008.
[Bill §704; Code §168]

Distributions to Shareholders from Policyholders Surplus Account of Life Insurance Companies

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Under current law, any direct or indirect distribution to shareholders from an existing policyholders surplus account of a stock life insurance company is subject to tax at the corporate rate in the taxable year of the distribution. Distributions are treated as first made out of the shareholders surplus account (if any), then out of the policyholders surplus account, and lastly out of other accounts.

The Bill would suspend for a stock life insurance company's taxable years beginning after December 31, 2004, and before January 1, 2007, the application of the rules imposing income tax on distributions to shareholders from the policyholders surplus account. The Bill also would reverse the order in which distributions reduce the various accounts, so that distributions would be treated as first made out of the policyholders surplus account (if any), then out of the shareholders surplus account, and lastly out of other accounts.
[Bill §705; Code §815]

Certain Alaska Natural Gas Pipeline Property Treated as 7-Year Property
The Bill would establish a seven-year recovery period and a class life of 22 years for any Alaska natural gas pipeline system placed in service after December 31, 2013. Qualified systems placed in service prior to January 1, 2014, may elect to treat the system as placed in service before January 1, 2014.

Effective for property placed in service after December 31, 2004.
[Bill §706; Code §168]

Extension of Enhanced Oil Recovery Credit to Certain Alaska Facilities
The Bill would provide that expenses in connection with the construction of certain natural gas processing plants would be qualified enhanced oil recovery costs eligible for the enhanced oil recovery credit.

Effective for costs paid or incurred in tax years beginning after December 31, 2004.
[Bill §707; Code §43]

Method of Accounting for Naval Shipbuilders
The Bill would provide that certain naval ship contracts can be accounted for using the 40/60 percentage-of-completion/capitalized cost method during the first five taxable years of the contract.

Effective for contracts with respect to which the construction commencement date occurs after the date of enactment.
[Bill §708; Revenue Act of 1987 §10203]

Modification of Minimum Cost Requirement for Transfer of Excess Pension Assets
The Bill would provide that certain employers would not fail the minimum cost requirement if, instead of any reduction of health coverage as permitted by the regulations, the employer reduces applicable employer cost by an amount not in excess of the reduction in costs that would have occurred if the employer had made the maximum permissible reduction under the regulations.

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Effective for taxable years ending after the date of enactment.
[Bill §709; Code §420]

Expansion of Credit for Electricity Produced from Certain Renewable Resources
Additional qualifying resource and facilities. The Bill would define five new qualifying resources for the generation of electricity: open-loop biomass (including agricultural livestock waste nutrients), geothermal energy, solar energy, small irrigation power, and municipal solid waste. The Bill would also define refined coal as a qualifying resource.

Under the Bill, qualifying open-loop biomass facilities would be facilities using biomass to produce electricity that are placed in service before January 1, 2006. Qualifying agricultural livestock waste nutrient facilities would be facilities using agricultural livestock waste nutrients to produce electricity that are placed in service after the date of enactment and before January 1, 2006. The installed capacity of a qualified agricultural livestock waste nutrient facility would be not less than 150 kilowatts. Qualifying geothermal energy facilities would be facilities using geothermal deposits to produce electricity that are placed in service after the date of enactment and before January 1, 2006. Qualifying solar energy facilities would be facilities using solar energy to generate electricity that are placed in service after the date of enactment and before January 1, 2006. A qualifying geothermal energy facility or solar energy facility may not have claimed any credit under Code §48. A qualified small irrigation power facility would be a facility originally placed in service after the date of enactment and before January 1, 2006. A small irrigation power facility would be a facility that generates electric power through an irrigation system canal or ditch without any dam or impoundment of water. The installed capacity of a qualified facility would be not less than 150 kilowatts and less than five megawatts. Landfill gas would be defined as methane gas derived from the biodegradation of municipal solid waste. Trash combustion facilities would be facilities that burn municipal solid waste to produce steam to drive a turbine for the production of electricity. Qualifying landfill gas facilities and qualifying trash combustion facilities would include facilities used to produce electricity placed in service after the date of enactment and before January 1, 2006. A qualifying refined coal facility would be a facility placed in service after the date of enactment and before January 1, 2009.

Credit period and credit rates. In general, under the Bill, as under present law, taxpayers would be able to claim the credit at a rate of 1.5 cents per kilowatt-hour (indexed for inflation and currently 1.8 cents per kilowatt-hour) for 10 years of production commencing on the date the facility is placed in service. In the case of open-loop biomass facilities, (including agricultural livestock waste nutrients), geothermal energy, solar energy, small irrigation power, landfill gas facilities, and trash combustion facilities the 10-year credit period would be reduced to five years commencing on the date the facility is placed in service. In general, for facilities placed in service before January 1, 2005, the Bill would provide that the credit period would commence on January 1, 2005. In the case of a closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the credit period would begin no earlier than the date of enactment. Under the Bill, a qualified refined coal facility would be able to claim credit at a rate of $4.375 per ton (indexed for inflation after 1992) of refined coal sold to a unrelated person. In the case of open-loop biomass facilities (including agricultural livestock waste nutrients), small irrigation power, landfill gas facilities, and trash combustion facilities, the otherwise allowable credit amount would be reduced by one-half.

Credit claimants and treatment of other subsidies. Under the Bill, a lessee or operator would be able to claim the credit in lieu of the owner of the qualifying facility in the case of qualifying open-

loop biomass facilities originally placed in service on or before the date of enactment and in the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass. In addition, the Bill would provide that for all qualifying facilities, other than closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, any reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits could not exceed 50%. In the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, there would be no reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits. The Bill would provide that no facility that previously claimed or currently claims credit under §29 would be a qualifying facility for purposes of §45.

The amendments made by the conference report would not apply with respect to any poultry waste facility placed in service prior to January 1, 2005. Such facilities placed in service after December 31, 2004, generally may qualify for credit as animal livestock waste nutrient facilities.

Effective for electricity produced and sold from qualifying facilities after the date of enactment in taxable years ending after the date of enactment. With respect to open-loop biomass facilities placed in service prior to January 1, 2005, effective for electricity produced and sold after December 31, 2004.
[Bill §710; Code §45]

Certain Business Related Credits Allowed Against Regular and Minimum Tax
Generally, business tax credits may not exceed the excess of the taxpayer's income tax liability over the tentative minimum tax (or, if greater, 25% of the regular tax liability). Credits in excess of the limitation may be carried back one year and carried over for up to 20 years. The tentative minimum tax is an amount equal to specified rates of tax imposed on the excess of the alternative minimum taxable income over an exemption amount. To the extent the tentative minimum tax exceeds the regular tax, a taxpayer is subject to the alternative minimum tax.

The Bill would treat the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to: (1) for taxable years beginning after December 31, 2004, the alcohol fuels credit determined under §40; and (2) the §45 credit for electricity produced from a facility (placed in service after the date of enactment) during the first four years of production beginning on the date the facility is placed in service.
[Bill §711; Code §38]

TITLE VIII--REVENUE PROVISIONS

Subtitle A--Provisions to Reduce Tax Avoidance Through Individual and Corporate Expatriation

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Tax Treatment of Expatriated Entities and Their Foreign Parents
The Bill would apply special tax consequences to two categories of inversion transactions undertaken by domestic corporations. In the first category of transaction, involving an 80% identity of stock ownership: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity; (2) the former shareholders of the U.S. corporation hold 60% or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50% ownership (i.e., the "expanded affiliated group") does not conduct substantial business activities in the entity's country of incorporation compared to the total worldwide business activities of the expanded affiliated group. The Bill would deny the intended tax benefits of this type of inversion by deeming the top-tier foreign corporation to be a domestic corporation for all purposes of the Internal Revenue Code.

The second category of inversion transactions would be identical to the first category except that the identity of stock ownership only needs to be 60% (but less than 80%). For these inversion transactions, the foreign corporation would be treated as foreign, but any applicable corporate-level "toll charges" for establishing the inverted structure could not be offset by tax attributes such as net operating losses or foreign tax credits. This rule would apply for the 10-year period following the transaction and would apply to any provision that requires recognition of corporate-level income or gain with respect to the transfer of stock, licenses or other assets as part of the inversion transaction.

Inversion transactions would also include transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership, provided that: (1) after the acquisition former partners of the partnership own at least 60% of the stock of the entity; and (2) the terms of the basic definition are met.

Effective for transactions occurring after March 4, 2003 in taxable years ending after March 4, 2003.
[Bill §801; Code §7874 (new)]

Excise Tax on Stock Compensation of Insiders in Expatriated Corporations
The Bill would subject specified holders of stock options and other stock-based compensation to an excise tax upon the occurrence of certain inversion transactions. The Bill would impose an excise tax on the value of specified stock compensation held (directly or indirectly) by or for the benefit of a disqualified individual, or a member of such individual's family, at any time during the 12-month period beginning six months before the corporation's expatriation date. The rate of the tax would equal the maximum rate of tax on the adjusted net capital gain of an individual. Therefore, the excise tax rate would 15% for 2005 through 2008 and 20% for taxable years beginning after December 31, 2008. Specified stock compensation would be treated as held for the benefit of a disqualified individual if such compensation is held by an entity, e.g., a partnership or trust, in which the individual, or a member of the individual's family, has an ownership interest. A disqualified individual would be any individual who, with respect to a corporation, is, at any time during the 12-month period beginning on the date which is six months before the expatriation date, subject to the requirements of §16(a) of the Securities and Exchange Act of 1934 with respect to the corporation, or any member of the corporation's expanded affiliated group, or who would be subject to such requirements if the corporation (or member) were an issuer of equity securities referred to in §16(a).

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The Bill would provide that the excise tax would be imposed on a disqualified individual of an expatriated corporation only if gain (if any) is recognized in whole or part by any shareholder by reason of a corporate inversion transaction (as defined in §801 of the Bill). The Bill would provide exceptions to the excise tax.

Specified stock compensation would be defined as payment (or right to payment) granted by the expatriated corporation (or by any member of the expanded affiliated group which includes such corporation) to any person in connection with the performance of services by a disqualified individual for such corporation or member if the value of such payment or right is based on (or determined by reference to) the value (or change in value) of stock in such corporation (or any such member). The Bill would exclude from this definition a statutory stock option or any payment or right from a qualified retirement plan or annuity, tax-sheltered annuity, simplified employee pension or SIMPLE retirement account.

Under the Bill, the excise tax would also apply to any payment by the expatriated corporation or any member of the expanded affiliated group made to an individual, directly or indirectly, in respect of the tax, and any payment made in respect of the tax would be includible in the income of the individual but would not be deductible by the corporation. The Bill would provide that, to the extent a disqualified individual is also a covered employee under §162(m), the $1,000,000 limit on the deduction allowed for employee remuneration for such employee would be reduced by the amount of any payment (including reimbursements) made in respect of the tax under the provision.

Effective as of March 4, 2003, except that periods before March 4, 2003, would not be taken into account in applying the excise tax to specified stock compensation held or cancelled during the six-month period before the expatriation date.
[Bill §802; Code §§162, 4985 (new)]

Reinsurance of United States Risks in Foreign Jurisdictions

The Bill would clarify that §845 authorizes the Treasury Secretary to allocate items among the parties to a reinsurance agreement, recharacterize items, or make any other adjustment, in order to reflect the proper "amount, source and character" of the items for each party. Section 845 currently refers only to "source and character" of such items. No inference would be intended that present law does not provide this authority with respect to reinsurance agreements.

Effective for any risk reinsured after the date of enactment.
[Bill §803; Code §845]

Revision of Tax Rules on Expatriation of Individuals

The Bill would replace the current law subjective determination of the tax-motivated relinquishment of citizenship or the termination of residency with objective rules. Under the Bill, a former citizen or former long-term resident would be subject to the alternative tax regime of §877(b) for a 10-year period following citizenship relinquishment or residency termination, unless the former citizen or long-term resident: (1) establishes that his or her average annual net income tax for the five preceding years does not exceed $124,000 (adjusted for inflation after 2004) and his or her net worth does not exceed $2 million, or alternatively satisfies limited, objective exceptions for dual citizens and minors who have had no substantial contact with the United States; and (2) certifies under penalties of perjury that he or she has complied with all U.S. federal tax obligations for the

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preceding five years and provides any required evidence of compliance. Dual citizens and minors would be able to qualify for the exclusion from the alternative tax regime if they have never had substantial connections with the United States, as measured by certain objective criteria, and satisfy the requirement for certification and proof of compliance with U.S. tax obligations.

Under the Bill, an individual would continue to be treated as a U.S. citizen or long-term resident for U.S. federal tax purposes until the individual: (1) gives notice of an expatriating act or termination of residency (with the requisite intent to relinquish citizenship or terminate residency) to the Secretary of State or the Secretary of Homeland Security, respectively; and (2) provides a statement in accordance with §6039G.

The alternative tax regime would not apply to any expatriating individual for any taxable year if such individual is present in the United States for more than 30 days in the calendar year ending in such taxable year. Such individual would be treated as a U.S. citizen or resident for that taxable year and therefore would be taxed on his or her worldwide income, would be treated as a U.S. resident for purposes of U.S. estate tax, and would be subject to U.S. gift tax on any transfer by gift during that taxable year. For purposes of these rules, an individual would be treated as present in the United States on any day if such individual is physically present in the United States at any time during that day. The present-law exceptions from being treated as present in the United States for residency purposes generally would not apply.

Gifts of stock of certain closely held foreign corporations by a former citizen or former long-term resident who is subject to the alternative tax regime would be subject to gift tax under the Bill, if the gift is made within the 10-year period after citizenship relinquishment or residency termination.

The Bill would require expatriating individuals to file an annual return for each year in which they are subject to the alternative tax regime. The annual return would be required even if no U.S. federal income tax is due. An individual who fails to file the statement in a timely manner or fails correctly to include all the required information would be subject to a penalty of $10,000 unless it is shown that the failure is due to reasonable cause and not to willful neglect.

Effective for individuals who relinquish citizenship or terminate long-term residency after June 3, 2004.
[Bill §804; Code §§877, 2107, 7701, 6039G]

Reporting of Taxable Mergers and Acquisitions
The Bill would require an acquiring corporation (or acquired corporation if so provided by the Secretary) in any corporate acquisition in which a shareholder of the acquired corporation must recognize gain to file an information return describing the acquisition, listing the names and addresses of each shareholder that must recognize gain, listing the amount of money and fair market value of other property transferred to each such shareholder, and providing any other information prescribed by the Secretary. The Bill would require the acquiring corporation to furnish to each shareholder (or nominee) whose name is listed in the return, on or before January 31 of the calendar year following the transaction, a written statement showing the name, address, and phone number of the information contact of the acquiring corporation, the information provided on the return relevant to that shareholder, and any other information prescribed by the Secretary. If a person holds stock as a nominee for another person, the Bill would require the nominee to furnish to that person with the information provided by the corporation. The Bill would extend the current

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penalties for failing to comply with information reporting requirements to any failure to comply with these requirements.

Effective for acquisitions after the date of enactment.
[Bill §805; Code §§6043A, 6724 (new)]

Studies
The Bill would require Treasury to conduct and submit to Congress studies: examining the effectiveness of the transfer pricing rules of §482, with an emphasis on transactions involving intangible property service contracts or leases and the effectiveness of the documentation and penalty rules of §6662; (2) income tax treaties to which the United States is a party, with a view toward identifying any inappropriate reductions in withholding tax or opportunities for abuse that may exist; and (3) the impact of the provisions of this bill on inversion transactions. The Bill would require the Secretary to submit the transfer pricing and tax treaty studies to Congress no later than June 30, 2005, while it would require submission of the inversion transaction study no later than December 31, 2006.
[Bill §806]

Subtitle B--Tax Shelter Proposals

Part I--Taxpayer-Related Provisions

Penalty for Failing to Disclose Reportable Transactions
The Bill would create a new penalty for any person who fails to include with any return or statement any required information with respect to a reportable transaction. The new penalty would apply without regard to whether the transaction ultimately results in an understatement of tax, and applies in addition to any accuracy-related penalty that may be imposed. The Bill would not define the terms listed transaction or reportable transaction, nor does it explain the type of information that must be disclosed in order to avoid the imposition of a penalty. Rather, the Bill would authorize the Treasury Department to define a listed transaction and a reportable transaction under §6011. The penalty for failing to disclose a reportable transaction would be $10,000 in the case of a natural person and $50,000 in any other case. The amount would be increased to $100,000 and $200,000, respectively, if the failure is with respect to a listed transaction. The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the IRS would be able to rescind (or abate) the penalty only if rescinding the penalty would promote compliance with the tax laws and effective tax administration. There will be no taxpayer right to appeal a refusal to rescind a penalty.

Effective for returns and statements the due date for which is after the date of enactment.
[Bill §811; Code §6707A (new)]

Modifications to the Accuracy-Related Penalties for Listed Transactions and Reportable Transactions Having a Significant Tax Avoidance Purpose
The Bill would modify the present-law accuracy related penalty by replacing the rules applicable to tax shelters with a new accuracy-related penalty that applies to listed transactions and reportable

transactions with a significant tax avoidance purpose. The penalty rate and defenses available to avoid the penalty would vary depending on whether the transaction was adequately disclosed. In general, a 20% accuracy-related penalty would be imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction. The only exception to the penalty would be if the taxpayer satisfies a more stringent reasonable cause and good faith exception. The strengthened reasonable cause exception would be available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment. If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception would not be available (i.e., a strict-liability penalty applies), and the taxpayer would be subject to an increased penalty rate equal to 30% of the understatement. The penalty would be applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. A penalty would not be imposed with respect to any portion of an understatement if it shown that there was reasonable cause for such portion and the taxpayer acted in good faith.

A taxpayer may (but would not be required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer would not be able to rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a disqualified tax advisor, or (2) is a disqualified opinion.

Effective for taxable years ending after the date of enactment.
[Bill §812; Code §6662A (new)]

Tax Shelter Exception to Confidentiality Privileges Relating to Taxpayer Communications
The Bill would modify the rule relating to corporate tax shelters by making it applicable to all tax shelters, whether entered into by corporations, individuals, partnerships, tax-exempt entities, or any other entity. Accordingly, communications with respect to tax shelters would not be subject to the confidentiality provision of the Code that otherwise applies to a communication between a taxpayer and a federally authorized tax practitioner.

Effective with respect to communications made on or after the date of enactment.
[Bill §813; Code §7525(b)]

Statute of Limitations for Unreported Listed Transactions
The Bill would extend the statute of limitations with respect to a listed transaction if a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction which is required to be included (under §6011) with such return or statement. The statute of limitations with respect to such a transaction would not expire before the date which is one year after the earlier of (1) the date on which the Secretary is furnished the information so required, or (2) the date that a material advisor (as defined in §6111) satisfies the list maintenance requirements (as defined by §6112) with respect to a request by the Treasury Secretary. For example, if a taxpayer engaged in a transaction in 2005 that becomes a listed transaction in 2007 and the taxpayer fails to disclose such transaction in the manner required by the regulations, then the transaction would be subject to the extended statute of limitations.

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Effective for taxable years with respect to which the period for assessing a deficiency did not expire before the date of enactment.
[Bill §814; Code §6501(c)]

Disclosure of Reportable Transactions by Material Advisors
The Bill would do away with current §6111 rules for registration of tax shelters, instead requiring each material advisor for a reportable transaction (as defined in new §6707A), including a listed transaction, to timely file an information return identifying and describing the transaction, describing any potential tax benefits expected to result from it, and providing other information the Secretary may prescribe. Would define a "material advisor" as a person (1) who provides material aid, assistance, or advice about organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and (2) who directly or indirectly derives gross income over $250,000 (or $50,000 if substantially all of the tax benefits from the reportable transaction are provided to natural persons) or another amount prescribed by the Secretary. Also, would authorize the Secretary to prescribe regulations that provide (1) that only one material advisor must file the information return if two or more would otherwise be required to do so for a reportable transaction, (2) exemptions from the revised §6111 requirements, and (3) other rules as may be necessary or appropriate to carry out the purposes of this section. Effective for transactions with respect to which material aid, assistance, or advice referred to in new §6111 is provided after the date of enactment.

The Bill would do away with the current penalty for failure to register tax shelters, instead imposing a penalty on any material advisor who fails to file an information return, or who files a false or incomplete information return, with respect to a reportable transaction (as defined in new §6707A). The Bill would provide for a penalty amount of $50,000 for any failure, except that for a penalty regarding a listed transaction, the amount is the greater of either $200,000 or 50% (75% in the case of an intentional failure or act) of the gross income of such person for aid, assistance, or advice that is provided regarding the transaction before the date the information return that includes the transaction is filed. Instead of a reasonable cause defense, would allow for rescission (as provided in new §6707A(d)) of the penalty if rescission would promote compliance with the requirements of the Code and effective tax administration.

Effective for returns the due date for which is after the date of enactment.
[Bill §§815, 816; Code §§6111, 6707]

Investor Lists and Modification of Penalty for Failure to Maintain Investor Lists
The Bill would amend current §6112 list maintenance rules to require each material advisor, as defined under revised §6111, for a reportable transaction, even if not required to file a return under §6111, to maintain a list that identifies each person with respect to whom the advisor acted as a material advisor regarding the reportable transaction (i.e., advisees) and that contains other information the Secretary may require. The Bill would require that the Secretary's request for inspection of the list be in writing. Also, the Bill would permit, instead of requiring, the Secretary to prescribe regulations that provide that only one material advisor must maintain the list if two or more are otherwise required to do.

Effective for transactions with respect to which material aid, assistance, or advice referred to in new §6111 is provided after the date of enactment.

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The Bill would do away with the penalty for failing to register tax shelters and, instead, would impose a revised penalty on any material advisor who fails to meet the requirements of §6112, as revised. The Bill would modify the penalty for failing to maintain the required list by making it time-sensitive, substantially increasing it, and removing the cap on the penalty amount. Thus, a material advisor who must maintain an investor list and who fails to maintain it, maintains an incomplete list, or has maintained a list but does not make it available to the Secretary upon written request within 20 business days after the request, would be subject to a $10,000 per day penalty after the 20th day. The Bill would also make a reasonable cause exception available for a failure on any day.

Effective for requests made after the date of enactment.
[Bill §§815, 817; Code §§6112, 6708]

Penalties on Promoters of Tax Shelters
The Bill would enhance the penalty amount if the activity for which the §6700 penalty is imposed involves a statement regarding the tax benefits of participating in a plan or arrangement if the person knows or has reason to know that the statement is false or fraudulent as to any material matter. The enhanced penalty would equal 50% of the gross income derived by the person from the activity and would not apply to a gross valuation overstatement.

Effective for activities after the date of enactment.
[Bill §818; Code §6700(a)]

Modifications to the Definition of the Substantial Understatement
The Bill would modify the definition of "substantial" for corporations to provide that a corporation, excluding an S corporation or a personal holding company, has a substantial understatement of income tax if the amount of the understatement for the taxable year exceeds the lesser of (1) 10% of the tax required to be shown on the return for the taxable year (or, if greater, $10,000) or (2) $10 million. The Bill would also remove the requirement that the Secretary prescribe a list of positions that do not have substantial authority, and would authorize, but not require, the Secretary to publish such a list.

Effective for taxable years beginning after the date of enactment.
[Bill §819; Code §6662(d)]

Actions to Enjoin Conduct With Respect to Tax Shelters and Reportable Transactions
The Bill would extend the authority to obtain injunctions to actions or failures to act subject to penalty under §6707, as amended, for the reporting of reportable transactions and under §6708, as amended, for the keeping of lists of advisees, and to actions or failures to act in violation of any requirement under regulations issued under 31 U.S.C. §330, related to practice before the Treasury (Circular 230).

Effective on the day after the date of enactment.
[Bill §820; Code §7408]

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Penalty for Failure to Report Interests in Foreign Financial Accounts
The Bill would add to the existing penalty a civil penalty of up to $10,000 that could be imposed, without regard to willfulness, on any person who violates the reporting requirement. The maximum penalty for willful violations would increase to the greater of $100,000 or 50% of the transaction amount or the account balance. The added penalty would not apply if income from the account were properly reported on the income tax return and there was reasonable cause for the failure to report.

Effective for violations occurring after the date of enactment.
[Bill §821; 31 U.S.C. §5321(a)(5)]

Regulation of Individuals Practicing Before the Department of Treasury
The Bill would expand the sanctions that the Treasury may impose on individuals practicing before the Treasury. First, the Bill would expressly permit censure as a sanction. Second, the Bill would permit the imposition of monetary penalties as a sanction on the representative, and on the representative's employer if the employer knew, or reasonably should have known, of the conduct. The Bill would limit the monetary penalties to the gross income derived (or to be derived) from the conduct giving rise to the penalty, and would provide that the monetary penalties may be in addition to, or in lieu of, any suspension, disbarment, or censure.

Effective for actions taken after the date of enactment.
[Bill §822; 31 U.S.C. §330]

Part II--Other Provisions

Treatment of Stripped Interests in Bond and Preferred Stock Funds, etc.
The Bill would authorize the Treasury Department to promulgate regulations that, in appropriate cases, apply rules that are similar to the present-law rules for stripped bonds and stripped preferred stock to direct or indirect interests in an entity or account substantially all of the assets of which consist of bonds (as defined in §1286(e)(1)), preferred stock (as defined in §305(e)(5)(B)), or any combination thereof. The Bill would apply only to cases in which the present-law rules for stripped bonds and stripped preferred stock do not already apply to such interests.

This provision of the Bill would be effective for purchases and dispositions after the date of enactment.
[Bill §831; Code §§305, 1286]

Minimum Holding Period for Foreign Tax Credit on Withholding Taxes On Income Other Than Dividends
The Bill would expand the present-law disallowance of foreign tax credits to include credits for gross-basis foreign withholding taxes with respect to any item of income or gain from property if the taxpayer who receives the income or gain has not held the property for more than 15 days (within a 31-day testing period), exclusive of periods during which the taxpayer is protected from risk of loss. The Bill would not apply to foreign tax credits that are subject to the present-law disallowance with respect to dividends. The Bill also would not apply to certain income or gain that

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is received with respect to property held by active dealers. Rules similar to the present-law disallowance for foreign tax credits with respect to dividends would apply to foreign tax credits that are subject to the proposal. In addition, the proposal would authorize the Treasury Department to issue regulations providing that the proposal does not apply in appropriate cases.

This provision of the Bill would be effective for amounts that are paid or accrued more than 30 days after the date of enactment.
[Bill §832; Code §901]

Treatment of Partnership Loss Transfers and Partnership Basis Adjustments
The Bill would limit the ability to transfer losses among partners and provide special rules for transfers of interests in certain investment partnerships.

The Bill would provide that built-in loss in property contributed to a partnership may be taken into account only by the contributing partner and that, for purposes of determining the amount of items allocated to the other partners, the basis of the contributed property is its fair market value at the time of contribution. When the contributing partner's interest is transferred or liquidated, the partnership's adjusted basis in contributed property would be its fair market value as of the date of contribution under the Bill; the built-in loss therefore would be eliminated.

Except in the case of an "electing investment partnership," the Bill would require application of the §743 basis adjustment rules if a partnership interest is transferred and the partnership's adjusted basis in its property exceeds the property's fair market value by more than $250,000. An "electing investment partnership," defined in the Bill, would not be required to make the §743 basis adjustment. In the case of the transfer of an interest in an "electing investment partnership," however, the Bill would disallow the transferee partner's distributive share of losses from the sale or exchange of partnership property, except to the extent it is established that those losses exceed any loss recognized by the transferor (or any prior transferor to the extent not fully offset by a prior disallowance under this rule). The Bill would provide that losses disallowed under this rule do not decrease the transferee partner's basis in the partnership interest, and that the rule applies without regard to any termination of the partnership under §708(b)(1)(B). In the case of a basis reduction in property distributed to the transferee partner in a nonliquidating distribution, the Bill would require that the amount of the transferor's loss taken into account be reduced by the amount of the basis reduction. The Bill would require an "electing investment partnership" to furnish to any transferee partner the information necessary to enable the partner to compute the amount of losses disallowed.

The Bill would require application of the §734 basis adjustment rules if there is a distribution of property to a partner and a downward adjustment of more than $250,000 would be made to the basis of partnership assets if a §754 election were in effect.

The Bill would provide that a securitization partnership is not required to make a §743 basis adjustment to partnership property when a partnership interest is transferred or a §734 basis adjustment when a partnership interest is distributed.

The Bill would empower the Treasury Secretary to prescribe regulations appropriate to carry out these provisions.

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Effective for contributions, distributions, and transfers after the date of enactment.
[Bill §833; Code §§704(c), 734, 743, 6031]

No Reduction of Basis Under §734 in Stock Held by Partnership in Corporate Partner
The Bill would provide that if a §734 basis adjustment is made on a distribution of partnership property in liquidation of a partner's interest, the partnership, in applying the §755 basis allocation rules to the distribution, may not decrease the basis of stock in a corporation (or a person related to a corporation) that is a partner in the partnership. The Bill would provide that the partnership must, instead, allocate to other partnership property the basis decrease that (absent this rule) would result from the allocation rules. The Bill would require the partnership to recognize gain to the extent the amount of basis decrease required to be allocated to other partnership property exceeds the basis of such other property.

Effective for distributions after the date of enactment.
[Bill §834; Code §755]

Repeal of Special Rules for FASITs, Etc.
The Bill would repeal special rules for FASITs and would provide a transition period for existing FASITs, pursuant to which the repeal of the FASIT rules generally does not apply to any FASIT in existence on the date of enactment to the extent that regular interests issued by the FASIT prior to such date continue to remain outstanding in accordance with their original terms.

For purposes of the REMIC rules, the Bill would also modify the definitions of REMIC regular interests, qualified mortgages, and permitted investments so that certain types of real estate loans and loan pools can be transferred to, or purchased by, a REMIC. Specifically, the Bill would modify the definition of a REMIC "regular interest" to provide that an interest in a REMIC does not fail to qualify as a regular interest solely because the specified principal amount of such interest or the amount of interest accrued on such interest could be reduced as a result of the nonoccurrence of one or more contingent payments with respect to one or more reverse mortgages loans, as defined below, that are held by the REMIC, provided that on the startup day for the REMIC, the REMIC sponsor reasonably believes that all principal and interest due under the interest will be paid at or prior to the liquidation of the REMIC. For this purpose, a reasonable belief concerning ultimate payment of all amounts due under an interest is presumed to exist if, as of the startup day, the interest receives an investment grade rating from at least one nationally recognized statistical rating agency.

In addition, the Bill would make three modifications to the definition of a "qualified mortgage." First, the definition would include an obligation principally secured by real property which represents an increase in the principal amount under the original terms of an obligation, provided such increase: (1) is attributable to an advance made to the obligor pursuant to the original terms of the obligation; (2) occurs after the REMIC startup day; and (3) is purchased by the REMIC pursuant to a fixed price contract in effect on the startup day. Second, the definition would include reverse mortgage loans and the periodic advances made to obligors on such loans. For this purpose, a "reverse mortgage loan" would be defined as a loan that: (1) is secured by an interest in real property; (2) provides for one or more advances of principal to the obligor (each such advance giving rise to a "balance increase"), provided such advances are principally secured by an interest in the same real property as that which secures the loan; (3) may provide for a contingent payment

at maturity based upon the value or appreciation in value of the real property securing the loan; (4) provides for an amount due at maturity that cannot exceed the value, or a specified fraction of the value, of the real property securing the loan; (5) provides that all payments under the loan are due only upon the maturity of the loan; and (6) matures after a fixed term or at the time the obligor ceases to use as a personal residence the real property securing the loan. Third, the definition would provide that, if more than 50% of the obligations transferred to, or purchased by, the REMIC are (1) originated by the United States or any state (or any political subdivision, agency, or instrumentality of the United States or any state) and (2) principally secured by an interest in real property, then each obligation transferred to, or purchased by, the REMIC would be treated as secured by an interest in real property.

In addition, the Bill would modify the definition of a "permitted investment" to include intangible investment property held as part of a reasonably required reserve to provide a source of funds for the purchase of obligations described above as part of the modified definition of a "qualified mortgage."

Effective on January 1, 2005, but a transition period is provided for existing FASITs.
[Bill §835; Code §860H-§860L (repealed)]

Limitation on Transfer or Importation of Built-in Losses
The Bill would provide that if a net built-in loss is imported into the U.S in a tax-free organization or reorganization from persons not subject to U.S. tax, the basis of each property so transferred is its fair market value. Under the Bill, a net built-in loss would be treated as imported into the U.S. if the aggregate adjusted bases of property received by a transferee corporation exceeds the fair market value of the properties transferred. In the case of a transfer by a partnership (either domestic or foreign), this provision would apply as if each partner had transferred such partner's proportionate share of the property of such partnership.

The Bill would provide that if the aggregate adjusted bases of property contributed by a transferor (or by a control group of which the transferor is a member) to a corporation exceed the aggregate fair market value of the property transferred in a tax-free incorporation, the transferee's aggregate bases of the property generally is limited to the aggregate fair market value of the transferred property. Under the proposal, any required basis reduction would be allocated among the transferred properties in proportion to their built-in-loss immediately before the transaction. The Bill would permit the transferor and transferee to elect to limit the basis in the stock received by the transferor to the aggregate fair market value of the transferred property, in lieu of limiting the basis in the assets transferred. The Bill would require that such election be included with the tax returns of the transferor and transferee for the taxable year in which the transaction occurs and, once made, shall be irrevocable.

Effective for transactions after the date of enactment.
[Bill §836; Code §§334, 362]

Clarification of Banking Business for Purposes of Determining Investment of Earnings in United States Property
The Bill would provide that the exception from the definition of U.S. property under §956 for deposits with persons carrying on the banking business is limited to deposits with: (1) any bank (as

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defined by §2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. §(c))), without regard to paragraphs (C) and (G) of paragraph (2) of such section); or (2) any other corporation with respect to which a bank holding company (as defined by §2(a) of such Act) or financial holding company (as defined by §2(p) of such Act) owns directly or indirectly more than 80% by vote or value of the stock of such corporation.

Effective on the date of enactment.
[Bill §837; Code §956]

Denial of Deduction for Interest on Underpayments Attributable to Undisclosed Reportable Transactions
The Bill would disallow a deduction for interest on any underpayment of tax attributable to an understatement arising from an undisclosed reportable avoidance transaction or an undisclosed listed transaction.

Effective for underpayments attributable to transactions entered into in taxable years beginning after the date of enactment.
[Bill §838; Code §163]

Clarification of Rules for Payment of Estimated Tax for Certain Deemed Asset Sales
The Bill would clarify §338(h)(13) to provide that the exception for estimated tax purposes with respect to tax attributable to a deemed asset sale does not apply with respect to a qualified stock purchase for which a §338(h)(10) election is made. The Bill would provide that estimated tax for a qualified stock purchase transaction eligible for a §338(h)(10) election would be determined based on the stock sale unless and until there is an agreement of the parties to make a §338(h)(10) election. If there is an agreement at the time of the sale to make a §338(h)(10) election, then under the Bill the estimated tax would be computed based on an asset sale, computed from the date of the sale. If there is an agreement after the sale to make a §338(h)(10) election then under the Bill the estimated tax would be recomputed based on the asset sale election.

Effective for qualified stock purchase transactions that occur after the date of enactment.
[Bill §839; Code §338(h)]

Recognition of Gain from the Sale of a Principal Residence Acquired in a Like-Kind Exchange Within Five Years of Sale
The Bill would make the exclusion of gain from the sale of a principal residence inapplicable to property acquired in a like-kind exchange during the five-year period before the sale. Thus, the exclusion of gain would not apply if the principal residence was acquired in a like-kind exchange in which any gain was not recognized within the previous five years.

Effective for sales or exchanges after the date of enactment.
[Bill §840; Code §121]

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Prevention of Mismatching of Interest and Original Issue Discount Deductions and Income Inclusions in Transactions with Related Foreign Persons
The Bill would provide that deductions for amounts accrued but unpaid (whether by U.S. or foreign persons) to related controlled foreign corporations (CFCs) or passive foreign investment companies (PFICs) would be allowable only to the extent that the amounts accrued by the payor are, for U.S. tax purposes, currently includible in the income of the direct or indirect U.S. owners of the related foreign corporation under the relevant inclusion rules. Deductions that have accrued but are not allowable would, under the Bill, be allowed when the amounts are paid.

For purposes of determining the amount of the deduction allowable, the Bill would provide that the extent that an amount attributable to original issue discount (OID) or an item is includible in the income of a U.S. person would be determined without regard to (1) properly allocable deductions of the related foreign corporation, and (2) qualified deficits of the related foreign corporation under §952(c)(1)(B).

The Bill would grant the Secretary regulatory authority to exempt transactions from these rules, including any transactions entered into by the payor in the ordinary course of a trade or business in which the payor is predominantly engaged, and (in the case of items other than OID) in which the payment of the accrued amounts occurs shortly after its accrual.

This provision of the Bill would be effective for payments accrued on or after the date of enactment.
[Bill §841; Code §§163, 267]

Deposits Made to Suspend Running of Interest on Potential Underpayments
The Bill would create a provision allowing a taxpayer to deposit cash with the IRS that may subsequently be used to pay an underpayment of income, gift, estate, generation-skipping, or certain excise taxes, and such deposit will not be considered a payment of tax until such time as the deposit is used to pay a tax. The Bill would provide that: (1) underpayment interest is not charged for the period, and to the extent that, the underpayment is deposited with the IRS; and (2) any deposited amounts that are not used to pay a tax may be withdrawn by the taxpayer, with interest at the applicable federal rate, to the extent the deposited amounts are attributable to a disputable tax.

Effective for deposits made after the date of enactment.
[Bill §842; Code §6603 (new)]

Partial Payment of Tax Liability in Installment Agreements
The Bill would clarify that the IRS is authorized to enter into installment agreements with taxpayers for less than full payment of the tax liability over the life of the agreement, so long as the IRS reviews such agreements at least every two years to determine whether the changed financial condition of the taxpayer warrants an increase in the value of the taxpayer's payments.

Effective for agreements entered into on or after the date of enactment.
[Bill §843; Code §6159]

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Affirmation of Consolidated Return Regulation Authority
The Bill would provide that, in exercising its authority under §1502, the Treasury Secretary may issue consolidated return regulations that would treat corporations filing consolidated returns differently than corporations filing separate returns. However, the amendment would clarify that it is not intended to overturn the result in Rite Aid Corp. v. U.S., 255 F.3d 1357 (Fed. Cir. 2001).

Effective for taxable years beginning before, on, or after the date of enactment.
[Bill §844; Code §1502]

Expanded Disallowance of Deduction for Interest on Convertible Debt
The Bill would expand the disallowance of interest deductions on certain corporate convertible or equity-linked debt that is payable in (or by reference to the value of) equity to include interest on corporate debt payable in (or by reference to the value of) any equity held by the issuer or any party related to the issuer in any other person, whether or not such equity represents more than a 50% ownership interest in such person. In this case, the basis of the equity would be increased by the amount of the disallowed interest deduction. The Bill would also direct the Treasury Secretary to issue regulations to address the increase in basis for the disallowed interest deduction.

The Bill would not apply to debt issued by an active securities dealer (or related party) if the debt is payable in (or by reference to the value of) equity held by the dealer in his capacity as a dealer.

Effective for debt instruments issued after October 3, 2004.
[Bill §845; Code §163]

Part III--Leasing

Reform of Tax Treatment of Certain Leasing Arrangements
The Bill would modify the recovery period for qualified technological equipment, computer software, and §197 intangibles leased to a tax-exempt entity; the recovery period would be the longer of (i) the property's class life or (ii) 125% of the "lease term." The Bill would alter the definition of "lease term" for purposes of the 125% rule to include all service contracts and other similar arrangements that follow a lease of property and are part of the same transaction as the lease. For purposes of determining if a lease to a tax-exempt entity satisfies the present-law five-year exception for leases of qualified technological equipment, the Bill would provide that the term of a lease does not include an option of the lessee to renew or extend the lease (subject to a 24-month limit on the period of aggregate renewals or extensions that can be excluded from the term of the lease).
[Bill §847; Code §§167, 168, 197]

Limitation on Deductions Allocable to Property Used by Governments or Other Tax-Exempt Entities
The Bill would provide that a taxpayer leasing property to a tax-exempt entity generally may not claim deductions from the lease transaction in excess of the taxpayer's gross income from the lease for that taxable year, unless (i) the tax-exempt lessee does not monetize its lease obligations, (ii) the taxpayer maintains substantial equity in the leased property, (iii) the lessee

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does not bear more than a minimal risk of loss, and (iv) the lessee does not have an option to purchase the leased property for any stated price other than fair market value (with certain exceptions). The Bill would provide that any deductions disallowed under this rule are carried forward and treated as deductions related to the lease in the following year (subject to the same limitations), and that a taxpayer may deduct previously disallowed deductions when the taxpayer disposes of its interest in the property. The Bill would not apply to certain transactions involving property with respect to which the low-income housing credit or the rehabilitation credit is allowable.
[Bill §848; Code §470 (new)]

Effective Date

The leasing provisions would be generally effective for leases entered into after March 12, 2004, with an exception for qualified transportation property.
[Bill §849]

Subtitle D--Other Revenue Provisions

Qualified Tax Collection Contracts

The Bill would permit the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities and to arrange payment of those taxes by the taxpayers. Where the taxpayer cannot pay in full immediately, the Bill would permit the private debt collection company to offer the taxpayer an installment agreement providing for full payment of the taxes over five years, and to obtain the taxpayer's financial information and provide this information to the IRS for further processing and action if the taxpayer cannot make full payment within five years. The Bill would permit up to 25% of the amounts collected to be used for IRS collection enforcement activities, and also would create a revolving fund from the amounts collected to pay the private debt collection companies.

Effective on the date of enactment.
[Bill §881; Code §§6306 (new), 7433A (new), 7809, 7811]

Treatment of Charitable Contributions of Patents and Similar Property

The Bill would provide that, if a taxpayer contributes a patent or other intellectual property (other than certain copyrights or inventory) to a charitable organization, the taxpayer's initial charitable deduction is limited to the lesser of the taxpayer's basis in the contributed property or the fair market value of the property. In addition, the taxpayer would be permitted to deduct, as a charitable deduction, certain additional amounts in the year of contribution or in subsequent taxable years based on a specified percentage of the qualified donee income received or accrued by the charitable donee with respect to the contributed property. For this purpose, "qualified donee income" would include the net income received or accrued by the donee that properly would be allocable to the intellectual property itself (as opposed to the activity in which the intellectual property is used).

The amount of any additional charitable deduction would be calculated as a sliding-scale percentage of qualified donee income received or accrued by the charitable donee that properly

would be allocable to the contributed property to the applicable taxable year of the donor, determined on a sliding scale ranging from 100% of the qualified donee income in the first taxable year ending on or after the contribution to 10% in the 12th taxable year after the contribution.

An additional charitable deduction would be allowed only to the extent that the aggregate of the amounts that are calculated pursuant to the sliding-scale exceed the amount of the deduction claimed upon the contribution of the patent or intellectual property.

No charitable deduction would be permitted with respect to any revenues or income received or accrued by the charitable donee after the expiration of the legal life of the patent or intellectual property, or after the tenth anniversary of the date the contribution was made by the donor.

The taxpayer would be required to inform the donee at the time of the contribution that the taxpayer intends to treat the contribution as a contribution subject to the Bill's additional charitable deduction provisions. In addition, the taxpayer would have to obtain written substantiation from the donee of the amount of any qualified donee income properly allocable to the contributed property during the charity's taxable year. The donee would be required to file an annual information return that reports the qualified donee income and other specified information relating to the contribution. In instances where the donor's taxable year differs from the donee's taxable year, the donor would base its additional charitable deduction on the qualified donee income of the charitable donee properly allocable to the donee's taxable year that ends within the donor's taxable year.

Under the Bill, additional charitable deductions would not be available for patents or other intellectual property contributed to a private foundation, other than a private operating foundation or certain other §170(b)(1)(E) private foundations.

Further, the Bill would provide that the Secretary may prescribe regulations or other guidance to carry out the Bill's purposes, including providing for the determination of amounts to be treated as qualified donee income in certain cases where the donee would use the donated property to further its exempt activities or functions, or as may be necessary or appropriate to prevent the avoidance of the Bill's purposes.

Effective for contributions made after June 3, 2004.
[Bill §882; Code §170]

Increased Reporting for Noncash Charitable Contributions
The Bill would require increased donor reporting for certain charitable contributions of property other than cash, inventory, publicly traded securities, or certain vehicles. The Bill would extend to all C corporations the present law requirement, applicable to an individual, closely-held corporation, personal service corporation, partnership, or S corporation, that the donor must obtain a qualified appraisal of the property if the amount of the deduction claimed exceeds $5,000. The Bill would also provide that if the amount of the contribution of property exceeds $500,000, then the donor (whether an individual, partnership, or corporation) would have to attach the qualified appraisal to the donor's tax return. For purposes of the dollar thresholds under the proposal, property and all similar items of property donated to one or more donees would be treated as one property.

The Bill would provide that a donor that fails to substantiate a charitable contribution of property, as required by the Secretary, would be denied a charitable contribution deduction. If the donor is a

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partnership or S corporation, the deduction would be denied at the partner or shareholder level. The denial of the deduction would not apply if it is shown that such failure is due to reasonable cause and not to willful neglect.

The Bill would provide that the Secretary may prescribe such regulations as may be necessary or appropriate to carry out the Bill's purposes, including regulations that may provide that some or all of the requirements of the Bill would not apply in appropriate cases.

Effective for contributions made after June 3, 2004.
[Bill §883; Code §170]

Donations of Motor Vehicles, Boats, and Airplanes
Under the Bill, the amount of deduction for charitable contributions of vehicles (generally including automobiles, boats, and airplanes for which the claimed value exceeds $500 and excluding inventory property) would depend upon the use of the vehicle by the donee organization. If the donee organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction would not exceed the gross proceeds received from the sale.

The Bill would impose new substantiation requirements for contributions of vehicles for which the claimed value exceeds $500 (excluding inventory). A deduction would not be allowed unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgement by the donee. The acknowledgement would have to contain the name and taxpayer identification number of the donor and the vehicle identification number (or similar number) of the vehicle. In addition, if the donee sells the vehicle without performing a significant intervening use or material improvement of such vehicle, the acknowledgement would have to provide a certification that the vehicle was sold in an arm's length transaction between unrelated parties, and would have to state the gross proceeds from the sale and that the deductible amount may not exceed such gross proceeds. In all other cases, the acknowledgement would have to contain a certification of the intended use or material improvement of the vehicle and the intended duration of such use, and a certification that the vehicle will not be transferred in exchange for money, other property, or services before completion of such use or improvement. The donee would have to notify the Secretary of the information contained in an acknowledgement, in a time and manner provided by the Secretary. An acknowledgement would be considered contemporaneous if provided within 30 days of sale of a vehicle that is not significantly improved or materially used by the donee, or, in all other cases, within 30 days of the contribution.

A penalty would apply if a donee organization knowingly furnishes a false or fraudulent acknowledgement, or knowingly fails to furnish an acknowledgement in the manner, at the time, and showing the required information. In the case of an acknowledgement provided within 30 days of sale of a vehicle that would not be significantly used or materially improved by the donee, the penalty would be the greater of the product of the highest rate of tax specified in §1 and the sales price stated on the acknowledgement or the gross proceeds from the sale of the vehicle. For all other acknowledgements, the penalty would be the greater of the product of the highest rate of tax specified in §1 and the claimed value of the vehicle or $5,000.

The Bill would provide that the Secretary will prescribe such regulations or other guidance as may be necessary to carry out the Bill's purposes. The Secretary also may prescribe regulations or other guidance that would exempt sales of vehicles that are in direct furtherance of the donee's

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charitable purposes from the requirement that the donor may not deduct an amount in excess of the gross proceeds from the sale, and the requirement that the donee certify that the vehicle will not be transferred in exchange for money, other property, or services before completion of a significant use or material improvement by the donee.

Effective for contributions made after December 31, 2004.
[Bill §884; Code §170]

Treatment of Nonqualified Deferred Compensation Plans
The Bill would provide that all amounts deferred under a nonqualified deferred compensation (NQDC) plan for all taxable years would be currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied. If the requirements of the provision are not satisfied, in addition to current income inclusion, interest at the underpayment rate plus 1% would be imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income also would be subject to a 20% additional tax. Current income inclusion, interest, and the additional tax would only apply to the participants who do not meet the requirements of the bill.

Distributions from an NQDC plan may be allowed only upon (1) separation from service; (2) death; (3) a specified time (or pursuant to a fixed schedule); (4) change in control of a corporation; (5) occurrence of an unforeseeable emergency; or (6) if the participant becomes disabled. An NQDC plan may not allow distributions other than upon the permissible distribution events and, except as provided in regulations by the Secretary, may not permit acceleration of a distribution. The definitions of various terms are discussed below.

In the case of a "specified employee" who separates from service, distributions may not be made earlier than six months after the date of the separation from service or upon death. Specified employees are "key employees" of publicly-traded corporations. Key employees are defined in §416(i)(1) and generally include officers having annual compensation greater than $130,000 (adjusted for inflation and limited to 50 employees), 5% owners, and 1% owners having annual compensation from the employer greater than $150,000.

Amounts payable at a specified time or pursuant to a fixed schedule must be specified under the plan at the time of deferral. Amounts payable upon the occurrence of an event are not treated as amounts payable at a specified time.

Distributions upon a change in the ownership or effective control of a corporation, or in the ownership of a substantial portion of the assets of a corporation, may be made only to the extent provided by the Secretary. The Bill requires the Secretary to issue guidance defining change of control within 90 days after the date of enactment.

An "unforeseeable emergency" is defined as (1) a severe financial hardship to the participant resulting from an illness or accident of the participant or the participant's spouse or dependent; (2) loss of the participant's property due to casualty; or (3) other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the participant's control. The amount of the distribution must be limited to the amount needed to satisfy the emergency plus taxes. Distributions may not be allowed to the extent that the hardship may be relieved through

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reimbursement or compensation by insurance or otherwise, or by liquidation of the participant's assets (to the extent the liquidation would not itself cause a severe financial hardship).

A participant is considered disabled if he or she (1) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months; or (2) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the participant's employer.

Except as provided in regulations, no accelerations of distributions would be allowed. In general, changes in the form of distribution that accelerate payments are subject to the rule prohibiting acceleration of distributions. However, the Secretary would be required to provide limited exceptions to the prohibition on accelerated distributions, such as when the accelerated distribution is required for reasons beyond the control of the participant and the distribution is not elective.

The Bill would require that a plan must provide that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer is made no later than the close of the preceding taxable year, or at such other time as provided in Treasury regulations. In the case of any performance-based compensation based on services performed over a period of at least 12 months, the election may be made no later than six months before the end of the service period.

The time and form of distributions would have to be specified at the time of initial deferral. A plan could specify the time and form of payments that are to be made as a result of a distribution event (e.g., a plan could specify that payments upon separation of service will be paid in lump sum within 30 days of separation from service) or could allow participants to elect the time and form of payment at the time of the initial deferral election. If a plan allows participants to elect the time and form of payment, the election is subject to the rules regarding initial deferral elections under the bill.

A plan could allow changes in the time and form of distributions subject to certain requirements. An NQDC plan could allow a subsequent election to delay the timing or form of distributions only if (1) the plan requires that such election cannot be effective for at least 12 months after the date on which the election is made; (2) except in the case of elections relating to distributions on account of death, disability or unforeseeable emergency, the plan requires that the additional deferral with respect to which such election is made is for a period of not less than five years from the date such payment would otherwise have been made; and (3) the plan requires that an election related to a distribution to be made upon a specified time may not be made less than 12 months prior to the date of the first scheduled payment.

Assets set aside in a trust to pay nonqualified deferred compensation would be treated as property transferred in connection with the performance of services under §83--whether or not they are available to satisfy the claims of general creditors--if the assets or the trust are located outside of the United States or if the assets are later transferred outside of the United States. Any subsequent increases in the value of, or any earnings on, such assets would be treated as additional transfers of property. Interest at the underpayment rate plus one percentage point would be imposed on the underpayments that would have occurred had the amounts set aside been includible in income for the taxable year in which first deferred or, if later, the first taxable year not

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subject to a substantial risk of forfeiture. The amount required to be included in income also would be subject to the 20% tax. The bill does not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in the foreign jurisdiction.

A transfer of property in connection with the performance of services under §83 also would occur as to compensation deferred under a NQDC plan if the plan provides that upon a change in the employer's financial health, assets will be restricted to the payment of nonqualified deferred compensation. The transfer of property occurs as of the earlier of when the assets are so restricted or when the plan provides that assets will be restricted. The Bill would apply in the case of plan that provides that upon a change in financial health, assets will be transferred to a rabbi trust. Any subsequent increases in the value of, or any earnings with respect to, such assets are treated as additional transfers of property. Interest at the underpayment rate plus 1% is imposed on the underpayments and the amount required to be included in income is subject to the additional 20% tax.

An NQDC plan is any plan that provides for the deferral of compensation other than to a qualified employer plan or any bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plan.

The Bill does not apply to any §457(e)(12) plans that were in existence as of May 1, 2004, were providing nonelective deferred compensation on that date, and received a favorable determination letter on or before May 1, 2004. If the plan has a material change in the class of individuals eligible to participate in the plan after May 1, 2004, the Bill would apply to compensation provided under the plan after the date of such change.

Interest imposed would be treated as interest on an underpayment of tax. Income (whether actual or notional) attributable to nonqualified deferred compensation would be treated as additional deferred compensation. Any amount included in gross income under the Bill would not be required to be included in gross income later than the time provided in the Bill. The Bill would not affect the rules regarding the timing of an employer's deduction for nonqualified deferred compensation.

Except as provided by the Secretary, employer aggregation rules would apply.

Amounts required to be included in income under the proposal would be subject to reporting and federal income tax withholding requirements.

The Bill also would require annual reporting to the IRS of amounts deferred. Such amounts would have to be reported on an individual's Form W-2 (or Form 1099) for the year deferred even if the amount is not currently includible in income for that taxable year.

Amounts deferred in taxable years beginning before January 1, 2005, would be subject to the provision if the plan under which the deferral is made is materially modified after October 3, 2004.

No later than 60 days after the date of enactment, the Secretary would be required to issue guidance providing a limited period of time during which an NQDC plan adopted before December 31, 2004, could, without violating the requirements of the bill relating to distributions, accelerations, and elections (1) be amended to permit that a participant may terminate participation in the plan, or cancel an outstanding deferral election with respect to amounts deferred after December 31, 2004, if such amounts are includible in income as earned, or if later, when not subject to a

substantial risk of forfeiture; or (2) be amended to conform with the provision as to amounts deferred after December 31, 2004.

Effective for amounts deferred in taxable years beginning after December 31, 2004. Earnings on amounts deferred before the effective date would be subject to the Bill.
[Bill §885; Code §409A (new)]

Extend the Present-Law Intangible Amortization Provisions to Acquisitions of Sports Franchises

The Bill would provide for the extension of the 15-year recovery period for intangible assets to franchises to engage in professional sports and any intangible asset acquired in connection with the acquisition of such a franchise (including player contracts). The Bill would provide for the repeal of the special rules under §1245(a)(4) and make other conforming changes.

Effective for property acquired after the date of enactment and the amendment to §1245 would be applicable to franchises acquired after the date of enactment.
[Bill §886; Code §§197, 1056, 1245, 1253]

Modification of Continuing Levy on Payments to Federal Venders

The Bill would modify §6331 to permit an IRS levy of up to 100% of a federal payment to a vendor of goods or services to the federal government.

Effective on the date of enactment.
[Bill §887; Code §6331(h)]

Modification of Straddle Rules

The Bill would modify the straddle rules in three respects: (1) permit taxpayers to identify offsetting positions of a straddle; (2) provide a special rule to clarify the present-law treatment of certain physically settled positions of a straddle; and (3) repeal the stock exception from the straddle rules.

Identified straddles. The Bill would generally permit taxpayers to identify the offsetting positions that are components of a straddle at the time the taxpayer enters into a transaction that creates a straddle, including an unbalanced straddle. If there is a loss with respect to any identified position that is part of an identified straddle, the Bill would provide that the general straddle loss deferral rules would not apply to such loss. Instead, the basis of each of the identified positions that offset the loss position in the identified straddle would be increased by an amount that bears the same ratio to the loss as the unrecognized gain (if any) with respect to such offsetting position bears to the aggregate unrecognized gain with respect to all positions that offset the loss position in the identified straddle. Any loss with respect to an identified position that is part of an identified straddle would not otherwise be taken into account by the taxpayer or any other person to the extent that the loss increases the basis of any identified positions that offset the loss position in the identified straddle.

In addition, the Bill would provide authority to issue regulations that would specify: (1) the proper methods for clearly identifying a straddle as an identified straddle (and identifying positions as

positions in an identified straddle), (2) the application of the identified straddle rules for a taxpayer that fails to properly identify the positions of an identified straddle, and (3) provide an ordering rule for dispositions of less than an entire position that is part of an identified straddle.

Physically settled straddle positions. The Bill would clarify the present-law straddle rules with respect to taxpayers that settle a position that is part of a straddle by delivering property to which the position relates. Specifically, the Bill would clarify that the present-law straddle loss deferral rules treat as a two-step transaction the physical settlement of a straddle position that, if terminated, would result in the realization of a loss. With respect to the physical settlement of such a position, the taxpayer would be treated as having terminated the position for its fair market value immediately before the settlement. The taxpayer then would be treated as having sold at fair market value the property used to physically settle the position.

Stock exception repeal. The Bill would eliminate the exception from the straddle rules for stock (other than the exception relating to qualified covered call options). Thus, offsetting positions comprised of actively traded stock and a position with respect to substantially similar or related property generally would constitute a straddle.

Dividends-received deduction holding period. The Bill would modify the required 46- or 91-day holding period for the dividends-received deduction by providing that the holding period would not include any time during which the shareholder is protected from the risk of loss otherwise inherent in the ownership of any equity interest if the shareholder obtains such protection by writing an in-the-money call option on the dividend-paying stock.

Effective for positions established on or after the date of enactment.
[Bill §888; Code §§246, 1092]

Extension of IRS User Fees
The Bill would extend the statutory authorization for these user fees from December 31, 2004 until September 30, 2014.

Effective for requests made after the date of enactment.
[Bill §891; Code §7528(c)]

Prohibition on Nonrecognition of Gain Through Complete Liquidation of Holding Company
The Bill would treat as a dividend any distribution of earnings by an "applicable holding company" to a foreign corporation in a complete liquidation. The Bill would define "applicable holding company" as a domestic corporation (i) that is the common parent of an affiliated group, (ii) stock of which is directly owned by the distributee foreign corporation, (iii) substantially all of the assets of which are stock in other members of the affiliated group, and (iv) that has been in existence for less than five years. The Bill would authorize the Secretary to issue regulations preventing the abuse of this provision.

Effective for distributions occurring on or after the date of enactment.
[Bill §893; Code §332]

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Effectively Connected Income to Include Certain Foreign Source Income
The Bill would expand each category of foreign-source income of a non-resident alien individual or foreign corporation that is treated as effectively connected with a U.S. trade or business to include economic equivalents of such income, i.e., economic equivalents of certain foreign-source (1) rents and royalties, (2) dividends and interest, and (3) income on sales or exchanges of goods in the ordinary course of business. Therefore such economic equivalents would be treated as U.S. effectively connected income in the same circumstances as such treatment applies to foreign-source rents, royalties, dividends, interest or inventory sales. For example, foreign-source dividend and interest equivalents would be treated as U.S.-effectively connected income if they are attributable to a U.S. office of: (1) a foreign person in the active conduct of a banking, financing or similar business within the United States; or (2) a foreign corporation whose principal business is trading in stocks or securities for its own account.

Effective for taxable years beginning after the date of enactment.
[Bill §894; Code §864]

Recapture of Overall Foreign Losses on Sale of Controlled Foreign Corporation Stock
The Bill would apply the special overall foreign loss recapture rule currently applicable to dispositions of foreign trade or business assets to the disposition of stock in a controlled foreign corporation (CFC) controlled by the taxpayer. Therefore, a disposition of CFC stock by a controlling shareholder would result in the recognition of foreign-source income equal to the lesser of (1) the fair market value of the stock over its adjusted basis, or (2) the amount of prior unrecaptured overall foreign losses. Such income would be re-sourced as U.S. source income for the foreign tax credit limitation, without being limited to 50% of the taxpayer's foreign-source income in the year of the disposition. This recapture rule would not extend to certain internal restructurings, such as contributions to corporations or partnerships (under §§351 and 721), certain stock and asset reorganizations where the controlling shareholder's underlying indirect interest in the CFC does not change, and certain liquidations and reorganizations within a consolidated group. However, any gain, such as boot, recognized in such a transaction would trigger recapture to the extent of the gain.

Effective for dispositions after the date of enactment.
[Bill §895; Code §904]

Recognition of Cancellation of Indebtedness Income Realized on Satisfaction of Debt with Partnership Interest
The Bill would impose a rule for partnerships similar to the §108(e)(8) repeal of the stock-for-indebtedness exception for corporations. The Bill would provide that when a partnership transfers a capital or profits interest in the partnership to a creditor in satisfaction of partnership debt, the partnership recognizes cancellation of indebtedness income in the amount that would be recognized if the debt were satisfied with money equal to the fair market value of the partnership interest. Under the Bill, this rule would apply to nonrecourse debt as well as recourse debt. The Bill would also require that any cancellation of indebtedness income recognized under this rule be allocated solely among the partners that held interests in the partnership immediately before the debt was satisfied.

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Effective for cancellations of indebtedness occurring on or after the date of enactment.
[Bill §896; Code §108]

Denial of Installment Sale Treatment for All Readily Tradable Debt

The Bill would deny installment sale treatment to sales in which the taxpayer receives indebtedness that is readily tradable under present-law rules, regardless of the nature of the issuer. For example, if the taxpayer receives readily tradable debt of a partnership in a sale, the partnership debt is treated as payment on the installment note, and the installment method is unavailable to the taxpayer. (Present law prohibits the use of the installment method only if the taxpayer sells property in exchange for readily tradable indebtedness issued by a corporation or a government or political subdivision.)

Effective for sales on or after the date of enactment.
[Bill §897; Code §453]

Modification of Treatment of Transfers to Creditors in Divisive Reorganizations

The Bill would limit the amount of money or other property that a corporation can distribute to its creditors without recognizing gain under §361(b) to the basis of the assets contributed to a controlled corporation in a divisive reorganization. In addition, the Bill would provide that acquisitive reorganizations under §368(a)(1)(D) are no longer subject to the liabilities assumption rules of §357(c).

Effective for transactions in connection with a reorganization occurring on or after the date of enactment.
[Bill §898; Code §§357, 361]

Clarification of Definition of Nonqualified Preferred Stock

The Bill would clarify the definition of nonqualified preferred stock to ensure that stock for which there is not a real and meaningful likelihood of actually participating in the earnings and profits of the corporation is included in the definition of preferred stock. For example, instruments that are preferred on liquidation and that are entitled to the same dividends as may be declared on common stock would not escape being nonqualified preferred stock by reason of that right if the corporation does not in fact pay dividends either to its common or preferred stockholders. As another example, stock that entitles the holder to a dividend that is the greater of 7% or the dividends common shareholders receive would not avoid being preferred stock if the common shareholders are not expected to receive dividends greater than 7%. The Bill would not affect the characterization of stock under present law that has terms providing for unlimited dividends or participation rights but, based on all the facts and circumstances, is limited and preferred as to dividends and does not participate in corporate growth to any significant extent.

Effective for transactions after May 14, 2003.
[Bill §899; Code §351]

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Modification of Definition of Controlled Group of Corporations
The Bill would define a brother-sister controlled group as two or more corporations if five or fewer persons who are individuals, estates, or trusts own (or constructively own) stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote, or more than 50% of the total value of all stock, taking into account the stock ownership of each person only to the extent the stock ownership is identical with respect to each corporation. The Bill would apply only for purposes of §1561, currently relating to corporate tax brackets, the accumulated earnings credit, and the minimum tax; the Bill would not affect other Code sections or other provisions that utilize or refer to the §1563 brother-sister corporation controlled group test for other purposes.

Effective for taxable years beginning after the date of enactment.
[Bill §900; Code §1563]

Establish Specific Class Lives for Utility Grading Costs
The Bill would assign a class life to depreciable electric and gas utility clearing and grading costs incurred to locate transmission and distribution lines and pipelines. The Bill would include these assets in the asset classes of the property to which the clearing and grading costs relate (generally, asset class 49.14 for electric utilities and asset class 49.24 for gas utilities, giving these assets a recovery period of 20 years and 15 years, respectively).

Effective for property placed in service after the date of enactment.
[Bill §901; Code §168]

Provide Consistent Amortization Period for Intangibles
The Bill would modify the treatment of start-up and organizational expenditures. A taxpayer would be allowed to elect to deduct up to $5,000 of start-up and $5,000 of organizational expenditures in the taxable year in which the trade or business begins. However, each $5,000 amount is reduced (but not below zero) by the amount by which the cumulative cost of start-up or organizational expenditures exceeds $50,000, respectively. Start-up and organizational expenditures that are not deductible in the year in which the trade or business begins would be amortized over a 15-year period consistent with the amortization period for §197 intangibles.

Effective for start-up and organizational expenditures incurred after the date of enactment. Start-up and organizational expenditures that are incurred on or before the date of enactment would continue to be eligible to be amortized over a period not to exceed 60 months. However, all start-up and organizational expenditures related to a particular trade or business, whether incurred before or after the date of enactment, would be considered in determining whether the cumulative cost of start-up or organizational expenditures exceeds $50,000.
[Bill §902; Code §195]

Freeze of Provision Regarding Suspension of Interest Where Secretary Fails to Contact Taxpayer
The accrual of certain penalties and interest is suspended if one year after the filing of the tax return the IRS has not sent the taxpayer within such one-year period a notice specifically stating the taxpayer's liability and the basis for the liability. With respect to taxable years beginning before January 1, 2004, the one-year period is increased to 18 months. Interest and penalties resume 21

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days after the IRS sends the required notice to the taxpayer. The provision is applied separately with respect to each item or adjustment. The provision does not apply where a taxpayer has self-assessed the tax. The suspension only applies to taxpayers who file a timely tax return. The provision applies only to individuals and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. The Bill would make the 18-month rule permanent. It would also add gross misstatements and listed and reportable transactions to the list of provisions to which the suspension of interest rules do not apply.

Effective for taxable years beginning after December 31, 2003, except the addition of listed and reportable transactions applies to interest accruing after October 3, 2004.
[Bill §903; Code §6404(g)]

Increase in Withholding from Supplemental Wage Payments in Excess of $1 Million
The Bill would provide that once annual supplemental wage payments to an employee exceed $1 million, any additional supplemental wage payments to the employee in that year would be subject to withholding at the highest income tax rate (35% for 2005), regardless of any other withholding rules and regardless of the employee's Form W-4. This rule would apply only for purposes of wage withholding. Other types of withholding (such as pension withholding and backup withholding) would not be affected.

Effective for payments made after December 31, 2004.
[Bill §904]

Treatment of Sale of Stock Acquired Pursuant to Exercise of Stock Options to Comply with Conflict-of-Interest Requirements
The Bill would provide that an eligible person who, in order to comply with federal conflict of interest requirements, would be required to sell shares of stock acquired pursuant to the exercise of a statutory stock option would be treated as satisfying the statutory holding period requirements, regardless of how long the stock was actually held. An eligible person generally would include an officer or employee of the executive branch of the federal government (and any spouse or minor or dependent children whose ownership in property is attributable to the officer or employee). Because the sale would not be treated as a disqualifying disposition, the individual would receive capital gain treatment on any resulting gains. Such gains would be eligible for deferral treatment under §1043. The employer granting the option would not be allowed a deduction upon the sale of the stock by the individual.

Effective for sales after the date of enactment.
[Bill §905; Code §421]

Application of Basis Rules to Nonresident Aliens
The Bill would modify the present rules under which certain retirement plan contributions made by nonresident aliens and not previously taxed are treated as basis. The Bill would not include employer or employee contributions in basis if: (1) the employee was a nonresident alien at the time of performance of the services with respect to which the contribution was made; (2) the contribution is with respect to compensation for labor or personal services from sources without the United States; and (3) the contribution was not subject to income tax (and would have been

subject to income tax if paid as cash compensation when the services were rendered) under the laws of the United States or any foreign country. Earnings on employer or employee contributions would not be included in basis if: (1) the earnings are paid or accrued with respect to any employer or employee contributions which were made with respect to compensation for labor or personal services; (2) the employee was a nonresident alien at the time the earnings were paid or accrued; and (3) the earnings were not subject to income tax under the laws of the United States or any foreign country. The Bill would not change the rules applicable to calculation of basis with respect to contributions or earnings while an employee is a U.S. resident.

The Bill would create no inference: (1) that, under prior law, there was basis for earnings not previously subject to tax; (2) that the new rule would apply in any case to create tax jurisdiction with respect to wages, fees, and salaries otherwise exempt under §893; or (3) that the new rule would apply where contrary to any valid U.S. agreement or treaty that provides an exemption for income.

The Bill would authorize the IRS to issue regulations to carry out the purposes of the new rule, including regulations treating contributions as not subject to income tax under the laws of any foreign country under appropriate circumstances.

The Bill would also change the rules for determining basis in property received in connection with the performance of services in the case of an individual who was a nonresident alien at the time of the performance of services, if the property is treated as income from sources outside the United States. In that case, the individual's basis in the property would not include any amount that was not subject to income tax (and would have been subject to income tax if paid as cash compensation when the services were performed) under the laws of the United States or any foreign country.

Effective for distributions on or after the date of enactment.
[Bill §906; Code §72]

Limitation of Employer Deduction for Certain Entertainment Expenses

The Bill would provide that, in the case of specified individuals, the exceptions to the general entertainment expense disallowance rule for expenses treated as compensation or includible in income apply only to the extent of the amount of expenses treated as compensation or includible in income. The Bill would define specified individuals as individuals who are subject to the requirements of §16(a) of the Securities and Exchange Act of 1934, or would be subject to such requirements if the employer or service recipient were an issuer of equity securities referred to in §16(a) of that Act. Such individuals generally include officers (as defined by §16(a)), directors, and 10%-or-greater owners of private and publicly-held companies. Thus, the Bill would provide that no deduction is allowed with respect to expenses for (1) a nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility (e.g., an airplane) used in connection with such activity to the extent that such expenses exceed the amount treated as compensation or includible in income for the individual.

Effective for expenses incurred after the date of enactment.
[Bill §907, Code §274(e)]

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Residence and Source Rules Relating to United States Possessions
The Bill would provide that, for U.S. possessions, the term "bona fide resident" means a person who meets a two-part test for the taxable year with respect to Guam, American Samoa, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands. First, the taxpayer must be present in the U.S. possession for 183 days in each taxable year. Second, an individual: (1) must not have a tax home outside such possession during the taxable year; and (2) must not have a closer connection to the United States or a foreign country during such year. The determination as to whether a person is present for any day would be made under the principles of §7701(b). The Treasury would have authority to provide exceptions to the residence test for individuals, such as military personnel and fisheries workers, whose extended absence from a possession does not have a tax avoidance purpose. The Bill would also provide that for all purposes of the Code (except as provided in regulations): (1) the principles for determining whether income is U.S. source would be applicable for determining whether income is possession source; and (2) the principles for determining whether income is effectively connected to a U.S. trade or business would be applicable for determining whether income is effectively connected to a possession trade or business. However, any income treated as U.S. source income or as effectively connected with a U.S. trade or business would not be treated as income from within any U.S. possession or as effectively connected with a trade or business within any such possession.

The Bill would require that a U.S. citizen be a resident in a U.S. possession during the entire taxable year to qualify for an exemption from U.S. tax under §§931-935. A taxpayer would be required to file a notice in the first taxable year the taxpayer is claiming bona fide residency in a U.S. possession. If a taxpayer claimed such residency during any of the individual's three taxable years ending before the first taxable year ending after the date of enactment, the individual would be required to file a notice that he or she is claiming bona fide residence in the current taxable year. There would be a penalty of $1,000 for the failure to file such notice or to comply with the any filing required by regulation under §7654(e).

Generally effective for taxable years ending after the date of enactment. The first part of the two-part residency test (the 183-day test) would be effective for taxable years beginning after the date of enactment. The rule that income treated as U.S. source income or as income effectively connected with a U.S. trade or business cannot also be possession source income or income effectively connected with a possession source trade or business would be effective for income earned after the date of enactment.
[Bill §908; Code §§937, 6688 (new)]

Sales or Dispositions to Implement Federal Energy Regulatory Commission or State Electric Restructuring Policy
The Bill would allow a taxpayer to elect to recognize qualified gain from a qualifying electric transmission transaction ratably over an eight-taxable-year period beginning in the year of sale if the amount realized from that sale is used to purchase exempt utility property within the applicable (four-year) period (the "reinvestment property"). If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain would be recognized, to the extent of such excess, in the year of the qualifying electric transmission transaction. Any remaining realized gain would be recognized ratably over the eight-year period.

The Bill would define a qualifying electric transmission transaction as the sale or other disposition of property used by the taxpayer in the trade or business of providing electric transmission services, or of an ownership interest in such an entity to an independent transmission company,

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before 2007. In general, an independent transmission company would be defined as: (1) an independent transmission provider approved by the FERC; (2) a person (i) who the FERC determines under §203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider before the close of the period specified in such authorization, but not later than January 1, 2007; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission provider, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).

The Bill would define exempt utility property as (1) property used in the trade or business of generating, transmitting, distributing, or selling electricity, or producing, transmitting, distributing, or selling natural gas, or (2) controlling stock in a corporation whose principal trade or business consists of the activities described in (1).

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the Bill would allow any member of the affiliated group to purchase the reinvestment property (in lieu of the taxpayer).

If a taxpayer were to elect the application of this provision, then the statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain eligible for the provision is realized, attributable to such gain would not expire less than three years from the date the Secretary of the Treasury is notified by the taxpayer of the reinvestment or an intention not to reinvest. An electing taxpayer would be required to attach a statement to that effect in the tax return for the taxable year in which the transaction takes place in the manner prescribed by the Treasury Secretary. The election would be binding for that and all subsequent taxable years. An electing taxpayer also would have to attach a statement identifying the reinvestment property in the prescribed manner. The installment sale rules would not apply to any qualifying electric transmission transaction for which the election is made.

Effective for transactions after the date of enactment, in taxable years ending after such date.
[Bill §909; Code §451]

Expansion of Limitation on Depreciation of Certain Passenger Automobiles

The Bill would reduce (from $100,000 (indexed for inflation)) to $25,000 the maximum amount that a small business owner may deduct under §179 with respect to the cost of a sport utility vehicle purchased for use in the business. The Bill would thereby close the so-called "SUV loophole," which had allowed small business owners with a sufficiently small amount of annual investment to expense (write off), for tax years beginning in 2003 through 2005, up to $100,000 (compared to $25,000 for other tax years) of the cost of business equipment, including sport utility vehicles weighing more than 6,000 pounds, placed in service during the tax year. Under the Bill, vehicles subject to the $25,000 limit generally would include four-wheeled passenger vehicles that are not subject to the §280F luxury automobile depreciation limit and are rated at 14,000 pounds or less gross vehicle weight. However, the Bill would exclude from the definition of sport utility vehicle: (i) vehicles designed to seat more than nine persons behind the driver's seat, (ii) vehicles equipped with an open cargo area or a covered box not readily accessible from the passenger compartment, of at least six feet in interior length, and (iii) vehicles that have an integral enclosure fully enclosing

the driver compartment and load carrying device, do not have seating behind the driver's seat, and have no body section protruding more than 30 inches ahead of the leading edge of the windshield.

Effective for property placed in service after the date of enactment.
[Bill §910; Code §179]

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