DESCRIPTION OF THE "TAX TECHNICAL CORRECTIONS ACT OF 2005"

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JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "Tax Technical Corrections Act of 2005." The bill was introduced on July 21, 2005, as H.R. 3376 in the House of Representatives and as S. 1447 in the Senate.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Tax Technical Corrections Act of 2005"* (JCX-55-05), July 21, 2005.

TAX TECHNICAL CORRECTIONS

The bill includes technical corrections and other corrections to recently enacted tax legislation. Except as otherwise provided, the amendments made by the technical corrections and other corrections contained in the bill take effect as if included in the original legislation to which each amendment relates.

A. Technical Corrections

Amendments Related to the American Jobs Creation Act of 2004

Deduction relating to income attributable to domestic production activities (manufacturing deduction) (Act sec. 102).−With respect to the W-2 wage limitation on the allowable amount of the domestic production activities deduction, the Act does not require Forms W-2 actually to be filed, and does not specify whether the employees must be the common law employees of the taxpayer. The provision clarifies that a taxpayer may take into account only wages that are paid to the common law employees of the taxpayer and that are reported on a Form W-2 filed with the Social Security Administration no later than 60 days after the extended due date for the Form W-2. Thus, the taxpayer may not take into account wages that were not actually reported. The provision also addresses situations in which the employer uses an agent to report its wages.

The provision clarifies that, in computing qualified production activities income, the domestic production activities deduction itself is not an allocable deduction. The provision also clarifies that no inference is intended with regard to the interpretive relationship between the cost allocation rules provided with respect to the domestic production activities deduction and the cost allocation rules provided with respect to provisions elsewhere in the Act (e.g., incentives to reinvest foreign earnings in the United States). The provision also corrects a reference to "income attributable to domestic production activities" to refer to the defined term "qualified production activities income."

With regard to the definition of "domestic production gross receipts" as it relates to construction performed in the United States and engineering or architectural services performed in the United States for construction projects in the United States, the provision clarifies that the term refers only to gross receipts derived from the construction of real property by a taxpayer engaged in the active conduct of a construction trade or business, or from engineering or architectural services performed with respect to real property by a taxpayer engaged in the active conduct of an engineering or architectural services trade or business.

The provision clarifies that the term does not include gross receipts derived from the lease, rental, license, sale, exchange or other disposition of land.

The provision provides that gross receipts derived from certain contracts to manufacture or produce property for the Federal government are derived from the sale of such property and, therefore, are domestic production gross receipts.

The provision provides that, for purposes of determining the domestic production gross receipts of a partnership and its partners, provided all of the interests in the capital and profits of the partnership are owned by members of a single expanded affiliated group at all times during the taxable year of the partnership, then the partnership and all members of that expanded affiliated group are treated as a single taxpayer during such period. Thus, for example, assume such a partnership engages in an activity with respect to property manufactured by the partners that are members of the expanded affiliated group, and the activity would be treated as a manufacturing activity, but for the fact that the partnership (rather than the partner) conducts the activity. Under this provision, then, the gross receipts derived from the activity are treated as domestic production gross receipts of the partnership for such taxable year. Once the partnership has determined its domestic production gross receipts in this manner, such receipts and the expenses, losses or deductions that are properly allocable to such receipts, and any other items that are allocated to partners, are allocated among the partners in accordance with the requirements of section 199(d)(1) (as amended). Similarly, if a partner engages in such an activity with respect to property manufactured by the partnership, then the gross receipts derived from the activity are treated as domestic production gross receipts of the partner. The treatment of the partners and the partnership as one taxpayer under this rule is only for the purpose of determining domestic production gross receipts.

The provision clarifies that, with respect to the domestic production activities of a partnership or S corporation, the deduction under the Act is determined at the partner or shareholder level. In performing the calculation, each partner or shareholder generally will take into account such person's allocable share of the components of the calculation (including domestic production gross receipts; the cost of goods sold allocable to such receipts; and other expenses, losses, or deductions allocable to such receipts) from the partnership or S corporation as well as any items relating to the partner or shareholder's own qualified production activities, if any.

The provision clarifies the treatment provided under the Act of cooperatives and patrons with respect to the deduction under section 199. The provision clarifies that a patron who receives certain payments from an agricultural or horticultural cooperative that are attributable to qualified production activities income is allowed a deduction equal to the portion of the deduction allowed to the cooperative that is attributable to such income. The provision also clarifies that the patron's deduction is allowed in the year that the payment attributable to qualified production activities income is received. The cooperative's taxable income is not reduced under section 1382 by the portion of the payment that does not exceed the portion so deductible by the patron. For purposes of the deduction under section 199, the provision clarifies that agricultural or horticultural marketing cooperatives are treated as having manufactured, produced, grown, or extracted any qualifying production property marketed by the organization which its patrons have so manufactured, produced, grown, or extracted. For purposes of the deduction under section 199, an agricultural or horticultural cooperative is a cooperative engaged in the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural products, or in the marketing of agricultural or horticultural products.

The provision clarifies the definition of an expanded affiliated group, so that a corporation eligible for the deduction with respect to income of a subsidiary must own more than 50 percent, rather than 50 percent or more, of the subsidiary's stock by vote and value.

The provision rewrites the rule that the deduction under section 199 in computing alternative minimum taxable income ("AMTI") is the same as in computing the regular tax, except that, in the case of a corporation, the taxable income limitation is the corporation's AMTI.

The provision clarifies that unrelated business taxable income, rather than taxable income, applies for purposes of section 199(a)(1)(B) in computing the unrelated business income tax under section 511.[2]

The provision clarifies that the deduction under section 199 is not taken into account for purposes of computing taxable income under the rules relating to carryover of net operating losses. Thus, the deduction under section 199 cannot create, or increase the amount of, a net operating loss carryover.

The provision clarifies the authority of the Secretary to prescribe rules to prevent the domestic production activities deduction from being claimed by more than one taxpayer with respect to the same economic activity described in section 199(c)(4)(A)(i).

The provision coordinates the computation of adjusted taxable income of a corporation for purposes of computing a corporation's limitation on the deduction for interest on certain indebtedness with the deduction under section 199. The provision coordinates the computation of taxable income for purposes of computing a corporation's charitable contribution deduction and a taxpayer's deduction for percentage depletion with respect to oil and gas wells with the deduction under section 199.

The provision clarifies that, in applying the effective date of the deduction under section 199, items arising from a taxable year of a partnership, S corporation, estate, or trust beginning before 2005 are not taken into account for purposes of the rules providing that the deduction is determined at the shareholder, partner or similar level and the application of the wage limitation with respect to such entities.

Family members treated as one shareholder of an S corporation (Act sec. 231).−The provision treats the estate of a family member as a member of the family for purposes of determining the number of shareholders.

The provision also conforms the provision relating to certain adopted individuals and foster children with the amendments made by title II of the Working Families Tax Relief Act of 2004.

Transfer of suspended losses incident to divorce (Act sec. 235).−The effective date of section 235 of the Act is corrected to provide that it is effective for transfers after December 31, 2004.

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[2] In computing AMTI of an organization which is a corporation subject to tax under section 511(a), AMTI applies for purposes of section 199(a)(1)(B). In computing AMTI of an organization other than a corporation, the section 199 deduction is the same as for the regular tax. See sec. 199(d)(6).

REIT provisions (Act sec. 243).−The provision clarifies that a REIT may cure *de minimis* failures of asset requirements (other than the requirement that the REIT may not hold more than 10 percent (five percent for certain prior years) of the value of securities of a single issuer, for which failure-specific procedures are provided) by using the same procedures as the REIT may use for larger failures of asset tests.

The provision clarifies that securities of a partnership that are held by a REIT on the date of enactment, and that would have qualified and continue to qualify as straight debt of that partnership under the prior-law rules that required a REIT to hold at least 20 percent of the partnership equity, will continue to so qualify while held by that REIT (or its successor) until the earlier of the disposition or the original maturity date of the securities.

The provision clarifies that the new hedging rules apply to transactions entered into in taxable years beginning after the date of enactment.

The provision clarifies that the new rules that permit the curing of certain REIT failures apply to failures with respect to which the requirements of the new rules are satisfied in taxable years of the REIT beginning after the date of enactment. Similarly, the provision clarifies that the new rules governing deficiency dividends that allow the taxpayer to make a determination by filing a statement with the IRS apply to statements filed in taxable years of the REIT beginning after the date of enactment.

Expensing of certain films and television production costs (Act sec. 244).−The provision clarifies that the $15 million production cost limitation and the 75 percent qualified compensation requirement are determined on an episode-by-episode basis (not an aggregate basis).

The provision adds rules for recapture as ordinary income of the deduction for expensing of certain films and television production costs in a manner similar to the recapture rules applicable to expensing under Code section 179.

Railroad track maintenance credit (Act sec. 245).−For purposes of the rule that prevents the claiming of the credit by more than one eligible taxpayer with respect to the same mile of track, the provision clarifies that Class II and Class III railroads that operate track under a lease are not required to obtain assignment from the track owner in order to utilize or assign the credit. Under the provision, the credit is limited in respect of the total number of miles of track (1) owned or leased by the Class II or Class III railroad and (2) assigned to the Class II or Class III railroad for purposes of the credit.

Election to determine corporate tax on certain international shipping activities using per ton rate (Act sec. 248).−The provision strikes as deadwood the rule added by the Act regarding the operation of a qualifying vessel by a non-electing corporation that is a member of an electing group.

The provision clarifies section 1354(b) to provide that an election to determine income tax on certain international shipping activities using a per ton rate is timely if made on or before the due date (including extensions) for filing the tax return for the relevant taxable year.

Volumetric ethanol excise tax credit (Act sec. 301).−The Act repeals the reduced tax rates for alcohol fuels and taxable fuels to be blended with alcohol. The provision makes a conforming amendment to eliminate the refund provision based on those reduced rates (Code sec. 6427(f)).

Computation of foreign tax credit in determining alternative minimum tax by farmers and fisherman using income averaging (Act sec. 314).−The provision clarifies that in computing the regular tax for purposes of determining the alternative minimum tax of a farmer or fisherman using income averaging, the foreign tax credit does not need to be recomputed.

Reforestation expensing recapture (Act sec. 322).−The provision clarifies that the amortization provision applies to trusts and estates, but the deduction applies to estates (and not to trusts).

The provision provides that Code section 1245 is expanded to provide recapture rules for the new expensing provisions of Code section 194(b) (reforestation).

Depreciation allowance for aircraft (Act sec. 336).−Present-law rules for additional first-year depreciation provide criteria under which certain noncommercial aircraft, and certain property having longer production periods (as described in Code section 168(k)(2)(B)), can qualify for the extended placed-in-service date. The provision clarifies that property acquired and placed in service during 2005 pursuant to a written binding contract which was entered into after May 5, 2003, and before January 1, 2005, is eligible for 50-percent additional first-year depreciation deduction.

Recharacterization of overall domestic loss (Act sec. 402).**--**The provision clarifies that, in a case in which an overall domestic loss is used as a carryback, the requirement in Code section 904(g)(2) that the taxpayer have elected the benefits of the foreign tax credit applies to the taxable year in which the loss is used.

Look-through rules to apply to dividends from noncontrolled section 902 corporations (Act sec. 403).−The provision adds a transition rule under which a taxpayer may elect not to apply the Act's look-through rules to taxable years beginning before January 1, 2005.

Repeal of foreign personal holding company rules and foreign investment company rules (Act sec. 413).−The provision repeals as deadwood Code section 532(b)(2), which coordinated the foreign personal holding company and accumulated earnings tax regimes, and instead provides that in computing a corporation's accumulated taxable income, a deduction is allowed in the amount of any income of the corporation that resulted in an inclusion for a U.S. shareholder under Code section 951(a). In the case of a corporation that is otherwise subject to the accumulated earnings tax on a gross basis (under Treas. Reg. sec. 1.535-1(b)), appropriate adjustments are made to this deductible amount to take into account deductions that may have reduced the inclusion under Code section 951(a), but which would not otherwise have been allowable in computing accumulated taxable income. For example, in the case of a corporation that is generally subject to the accumulated earnings tax on a gross basis, if Code section 954(b)(5) has had the effect of reducing the amount of a subpart F inclusion, it would be

appropriate to reduce accumulated taxable income by the amount that would have been included under Code section 951(a) without applying Code section 954(b)(5).

Modifications to treatment of aircraft leasing and shipping (Act. sec. 415).−The provision clarifies that, for purposes of the foreign tax credit limitation as in effect for taxable years beginning before January 1, 2007, shipping income was defined to include income that meets the definition of foreign base company shipping income as in effect before the definition was repealed under section 415 of the Act. The repeal is effective for taxable years of foreign corporations beginning after December 31, 2004, and taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Application of FIRPTA to distributions from REITS (Act sec. 418).−The provision clarifies that the new rules providing an exception from FIRPTA do not apply to regulated investment companies ("RICs"), but only to real estate investment trusts ("REITs").

The provision clarifies that the period of time during which a foreign shareholder may not have held more than five percent of the class of stock with respect to which the distribution is made is the one-year period ending on the date of the distribution.

The provision clarifies that the new rules apply to any distribution of a REIT that is treated as a deduction for a taxable year of the REIT beginning after the date of enactment.

Incentives to reinvest foreign earnings in the United States (Act sec. 422).−The provision amends Code section 965(a)(2)(B) to clarify that distributions made indirectly through tiers of controlled foreign corporations are eligible for the benefits of Code section 965 only if they originate with a dividend received by one controlled foreign corporation from another controlled foreign corporation in the same chain of ownership described in Code section 958(a). Thus, the first dividend in the sequence cannot be a portfolio dividend received by a controlled foreign corporation, for example.

The provision clarifies that for purposes of determining the amount of excess dividends eligible for the deduction, only cash dividends received during the elected taxable year are taken into account under Code section 965(b)(2)(A). (The base-period amounts described in Code section 965(b)(2)(B) include non-cash dividends, as well as cash dividends and certain other amounts.)

The provision also provides the Treasury Secretary with explicit regulatory authority to prevent the avoidance of the purposes of Code section 965(b)(3), which reduces the amount of eligible dividends in certain cases in which an increase in related-party indebtedness has occurred after October 3, 2004. Regulations issued pursuant to this authority may include rules to provide that cash dividends are not taken into account under Code section 965(a) to the extent attributable to the direct or indirect transfer of cash or other property from a related person to a controlled foreign corporation (including through the use of intervening entities or capital contributions). It is expected that this authority, which supplements existing principles relating to the treatment of circular flows of cash, will be used to prevent the application of the deduction in the case of a dividend that is effectively funded by the U.S. shareholder or its affiliates that are not controlled foreign corporations. It is anticipated that dividends will be treated as attributable

to a related-party transfer of cash or other property under this authority only in cases in which the transfer is part of an arrangement undertaken with a principal purpose of avoiding the purposes of the related-party debt rule of Code section 965(b)(3).

For example, if a U.S. shareholder, as part of a plan to avoid the purposes of Code section 965(b)(3), contributes cash or other property to a controlled foreign corporation and then has the controlled foreign corporation pay a dividend to the U.S. shareholder (either to meet the base period repatriation level or as a dividend described in Code section 965(a)), or has the controlled foreign corporation lend the cash or other property to another controlled foreign corporation which then pays a dividend to the U.S. shareholder, regulations issued under this authority may require the U.S. shareholder to reduce its Code section 965(a) qualifying dividends by the amount of cash or other property contributed. In addition, if as part of a plan to avoid the purposes of Code section 965(b)(3), a U.S. shareholder makes a loan to a controlled foreign corporation after October 3, 2004, such controlled foreign corporation pays a dividend to the U.S. shareholder, and then the U.S. shareholder disposes of the stock of the controlled foreign corporation, such that the U.S. shareholder is not related to the controlled foreign corporation on the last day of the U.S. shareholder's election year, regulations issued under this authority may require the U.S. shareholder to reduce its Code section 965(a) qualifying dividends by the amount of the loan. It is anticipated that many other transfers of cash or other property will not be regarded as effectively funding dividend repatriations for purposes of this regulatory authority. For example, if a U.S. shareholder, in the ordinary course of its trade or business, transfers cash or other property to a controlled foreign corporation in exchange for property or the provision of services, such a transfer will not be considered to have a principal purpose of avoiding the purposes of Code section 965(b)(3). Similarly, a transfer of cash or other property to a controlled foreign corporation for purposes of providing initial or ongoing working capital to the controlled foreign corporation or expanding the controlled foreign corporation's operations will not be considered to have a principal purpose of avoiding the purposes of Code section 965(b)(3). In addition, a transfer by a U.S. shareholder in repayment of an obligation owed to a controlled foreign corporation will not be considered to have a principal purpose of avoiding the purposes of Code section 965(b)(3), absent special circumstances indicating that the U.S. shareholder is using the repayment effectively to fund the dividend repatriation. It is expected that these special circumstances would not be found to exist in cases involving the repayment of short-term debt (i.e., debt with a term of no more than three years).

The provision also clarifies the definition of "applicable financial statement" under Code section 965(c)(1). In the case of a U.S. shareholder that is required to file a financial statement with the Securities and Exchange Commission (or is included in such a statement filed by another person), the provision clarifies that the applicable financial statement is the most recent audited annual statement that was so filed and certified on or before June 30, 2003. For purposes of this rule, a restatement of a previously filed and certified financial statement that occurs after June 30, 2003 does not alter the statement's status as having been filed and certified on or before June 30, 2003. In addition, the provision clarifies that the term "applicable financial statement" includes the notes that form an integral part of the financial statement; other materials, including work papers or materials that may be filed for some purposes with a financial statement but that do not form an integral part of such statement, may not be relied upon for purposes of producing an earnings or tax number under the provision. For example, if a note that is an integral part of an applicable financial statement states that the U.S. shareholder has not provided for deferred

taxes on $1 billion of undistributed earnings of foreign subsidiaries because such earnings are intended to be reinvested permanently (or indefinitely) abroad, the U.S. shareholder's limit under Code section 965(b)(1) is $1 billion. If an applicable financial statement does not show a specific earnings or tax amount described in Code section 965(b)(1)(B) or (C), a taxpayer cannot rely on underlying work papers or other materials that are not a part of the financial statement to derive such an amount. If an applicable financial statement states that an earnings or tax amount is indeterminate (or that determination of a specific amount of earnings or taxes is not feasible), then the earnings or tax amount so described is treated as being zero. A specific earnings or tax amount can be relied upon for purposes of Code section 965(b)(1) as long as such amount is presented on the applicable financial statement as satisfying the indefinite reversal criterion of Accounting Principles Board Opinion 23 ("APB 23") relating to deferred taxes on undistributed foreign earnings, and is disclosed as required under Financial Accounting Standards Board Statement 109 ("FAS 109"), regardless of whether the exact words "permanently reinvested" are used, and regardless of whether APB 23 or FAS 109 is cited by name.

The provision also clarifies that the expense disallowance rule of Code section 965(d)(2) applies only to deductions for expenses that are directly allocable to the deductible portion of the dividend. For these purposes, an expense is "directly allocable" if it relates directly to generating the dividend income in question. Thus, deductions for direct expenses such as certain legal and accounting fees and stewardship costs are disallowed under this provision. Deductions for indirect expenses such as interest, research and experimentation costs, sales and marketing costs, state and local taxes, general and administrative costs, and depreciation and amortization are not disallowed under this provision.

In addition, the provision clarifies that foreign taxes that are not allowed as foreign tax credits by reason of Code section 965(d) do not give rise to income inclusions under Code section 78.

The provision also clarifies that under Code section 965(e)(1), the only foreign tax credits that may be used to reduce the tax on the nondeductible portion of a dividend are credits for foreign taxes that are attributable to the nondeductible portion of the dividend. Credits for other foreign taxes cannot be used to reduce the tax on the nondeductible portion of the dividend.

The provision also clarifies Code section 965(f) to provide that an election to apply Code section 965 is timely if made on or before the due date (including extensions) for filing the tax return for the relevant taxable year.

Treatment of deduction for State and local sales taxes under the alternative minimum tax (Act sec. 501).−The provision clarifies that the itemized deduction for State and local sales taxes does not apply in calculating alternative minimum taxable income.

Naval shipbuilding (Act sec. 708).−The provision provides that the five-taxable year period for use of the 40/60 percentage-of-completion/capitalized cost method is determined with respect to the construction commencement date, not the contract commencement date. The provision further provides that any change of accounting method required by the provision is not subject to section 481.

Expansion of credit for electricity produced from certain renewable resources (Act sec. 710).−The provision provides that the five-year credit period applicable to open-loop biomass facilities that were originally placed in service before the date of enactment begins on January 1, 2005.

The provision clarifies that open-loop biomass resources include both cellulosic and lignin waste material.

The provision strikes as deadwood the credit eligibility rule for government-owned poultry waste facilities, as such facilities placed in service after the date of enactment are provided for under the rules for agricultural livestock waste nutrient facilities.

The provisions clarifies that, for the purpose of section 45, a qualified landfill gas facility does not include a facility that uses gas that was produced at a facility, the production from which is, or was previously, allowed a credit under section 29 for the production of landfill gas.

The provision clarifies that the Act did not change the determination of whether property is eligible for a five-year recovery period under section 168(e)(3)(B)(vi)(I).

The provision provides that poultry waste facilities placed in service on or before the date of enactment are unaffected by the new provision relating to agricultural livestock waste nutrient facilities.

Tax treatment of expatriated entities and their foreign parents (Act sec. 801).−The provision clarifies that the inversion gain rule of Code section 7874(a)(1) does not apply to an entity that is an expatriated entity with respect to an entity that is treated as a domestic corporation under Code section 7874(b).

Expatriation of individuals (Act sec. 804).−The provision clarifies that the exception to the requirement of minimal prior physical presence in the United States is both for (i) teachers, students, athletes, and foreign government individuals, and (ii) individuals receiving medical attention.

The provision clarifies that the Act does not create an additional requirement that an individual file a statement under section 6039G if such a filing was not already required under present law.

The provision clarifies that taxpayers who lose citizenship or terminate long-term resident status will continue to be treated for Federal tax purposes as citizens or long-term residents until they meet the notice and information reporting requirements of section 7701(n).

Penalty for failure to disclose reportable transactions (Act sec. 811).−The provision clarifies that the penalty for failing to disclose participation in a reportable transaction applies to returns and statements that are filed after the date of enactment, without regard to the original or extended due date for such return or statement.

Accuracy-related penalties for listed transactions and reportable transactions with a significant tax avoidance purpose (Act sec. 812).−The provision clarifies that underpayments

attributable to an understatement resulting from participation in a listed transaction or a reportable transaction with a significant tax avoidance purpose are not subject to accuracy-related penalties under section 6662 to the extent that an accuracy-related penalty under section 6662A is imposed upon such underpayment.[3] The provision clarifies that accuracy-related penalties under section 6662A do not apply to underpayments to which a fraud penalty under section 6663 is applied.

The provision clarifies that, with respect to disqualified opinions, the strengthened reasonable cause exception to section 6662A penalties does not apply to the opinion of a tax advisor if (1) the opinion was provided to the taxpayer before the date of enactment, (2) the opinion relates to a transaction entered into before the date of enactment, and (3) the tax treatment of items relating to the transaction was included on a return or statement filed by the taxpayer before the date enactment.

Statute of limitations for unreported listed transactions (Act sec. 814).−The Act provides that the statute of limitations with respect to an undisclosed listed transaction does not expire until one year after the earlier of (1) the date on which the Secretary is furnished the required information, or (2) the date on which a material advisor satisfies the list maintenance requirements with respect to a request by the Secretary. The provision clarifies that a "material advisor" for this purpose includes either a material advisor as defined in section 6111(b)(1) or, in the case of material aid, assistance, or advice rendered on or before the date of enactment, a material advisor as defined in Treasury regulations under section 6112.[4]

Material advisor list maintenance requirement and penalty (Act sec. 815).−The provision clarifies that the penalty under section 6708 for failing to comply with the section 6112 list maintenance requirements applies to both (1) material advisors with respect to reportable transactions under present-law section 6112, and (2) organizers and sellers of potentially abusive tax shelters under prior-law section 6112.[5]

Minimum holding period for withholding taxes on gain and income other than dividends (Act sec. 832).−The provision clarifies that the exception from the minimum holding period for certain withholding taxes paid by registered or licensed brokers and dealers on income and gain from securities also apply to gain from the sale of stock.

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[3] However, in the case of underpayments resulting from substantial valuation misstatements, the accuracy-related penalty under section 6662A does not apply to the extent that the accuracy-related penalty under section 6662 is applied to such underpayments (i.e., the section 6662 penalty amount is increased under section 6662(h) because the substantial valuation misstatement is determined to be a gross valuation misstatement).

[4] See Treas. Reg. sec. 301.6112-1(c)(2).

[5] This provision also would clarify the determination of the date on which a material advisor satisfies the list maintenance requirements for purposes of the extended statute of limitations for undisclosed listed transactions under section 814 of the Act.

Disallowance of certain partnership loss transfers (Act sec. 833).−The provision redrafts the wording of the provision relating to basis adjustments to undistributed partnership property in Code section 734(b) to clarify that it applies in the case of a distribution of property to a partner by a partnership with respect to which there is a substantial basis reduction.

Repeal of special rules for FASITs and modifications to rules for REMICs (Act sec. 835).−The provision clarifies that, if more than 50 percent of the obligations transferred to, or purchased by, a REMIC are originated by a government entity and are principally secured by an interest in real property, then each obligation originated by a government entity and transferred to, or purposed by, the REMIC is treated as principally secured by an interest in real property. Thus, the provision more closely aligns this rule with the "principally secured" standard that generally is provided by the definition of a qualified mortgage, and the provision clarifies that the treatment of obligations as principally secured by an interest in real property under this rule does not extend to obligations that are not originated by a government entity.

Importation or transfer of built-in losses (Act sec. 836).−The provision provides that on the tax-free liquidation of a corporation, the fair market value basis rule applies only to property described in section 362(e)(1)(B), i.e., property which became subject to U. S. income tax on the liquidation. The provision is drafted to conform the scope of the liquidation rule to the rule applicable to transfers of property by shareholders to corporations.

The provision provides that the election under section 362(e)(2)(C) to apply the basis limitation to the transferor's stock basis is made at such time and in such form and manner as the Secretary may prescribe, and, once made, is irrevocable.

Sale of principal residence following section 1031 exchange (Act sec. 840).−The provision clarifies that the exclusion under section 121 is denied on the sale or exchange of a principal residence by a taxpayer who did not recognize gain under section 1031 on the exchange in which the residence was acquired (or a by person whose basis in the residence is determined in whole or in part with reference to the basis of the residence in the hands of that taxpayer). The provision also makes a clerical change to the numbering of paragraphs.

Limitation on deductions allocable to property used by tax-exempt entities (Act sec. 849).−The Act establishes rules to limit deductions that are allocable to tax-exempt use property. For this purpose, the Act generally defines "tax-exempt use property" by reference to the definition provided in section 168(h). Section 168(h) generally provides that tax-exempt use property includes tangible property that is leased to a tax-exempt entity, as well as certain property owned by a partnership that has a tax-exempt partner and provides for certain special allocations. The provision clarifies that the deduction limitation rules established by the Act apply without regard to whether the tax-exempt use property is treated as such by reason of a lease or otherwise (e.g., because the property is owned by a partnership that has a tax-exempt partner and provides for certain special allocations). In the case of property treated as tax-exempt use property other than by reason of a lease, the provision clarifies that the deduction limitation rules generally are effective for property acquired after March 12, 2004.

Aviation fuel (Act sec. 853).−Section 853 of the Act moved the taxation of jet fuel (aviation-grade kerosene) from section 4091 to section 4081 of the Code and repealed section

4091. The termination date for the 21.8 cent per gallon rate for noncommercial aviation jet fuel was inadvertently omitted from the Act. The provision clarifies that after September 30, 2007, the rate for jet fuel used in noncommercial aviation will be 4.3 cents per gallon.

The provision clarifies that users of aviation fuel in commercial aviation are required to be registered with the IRS in order for the 4.3-cents-per-gallon rate to apply (including for purposes of the self-assessment of tax by commercial aircraft operators).

Reporting with respect to donations of motor vehicles, boats and airplanes (Act sec. 884).−The provision clarifies that the acknowledgement by the donee organization is to include whether the donee organization provided any goods or services in consideration of the vehicle, and a description and good faith estimate of the value of any such goods or services, or, if the goods or services consist solely of intangible religious benefits, a statement to that effect.

Nonqualified deferred compensation plans (Act sec. 885).−The provision clarifies that the additional tax and interest under the nonqualified deferred compensation provision of the Act are not treated as payments of regular tax for alternative minimum tax purposes. The provision also clarifies that the application of the rule providing that certain additional deferrals must be for a period of not less than five years is not limited to the first payment for which deferral is made. The provision also clarifies that Treasury Department guidance providing a limited period during which plans can conform to the requirements applies to plans adopted before January 1, 2005. The provision also clarifies that the effective date of the funding provisions relating to offshore trusts and financial triggers is January 1, 2005. Thus, for example, amounts set aside in an offshore trust before such date for the purpose of paying deferred compensation and plans providing for the restriction of assets in connection with a change in the employer's financial health are subject to the funding provisions on January 1, 2005. Under the provision, not later than 90 days after the date of enactment of this provision, the Secretary of the Treasury shall issue guidance under which a nonqualified deferred compensation plan which is in violation of the requirements of the funding provisions relating to offshore trusts and financial triggers will be treated as not violating such requirements if the plan comes into conformance with such requirements during a limited period as specified by the Secretary in guidance. For example, trusts or assets set aside outside of the United States that would otherwise result in income inclusion and interest under the provision as of January 1, 2005, may be modified to come into conformance with the provision during the limited period of time as specified by the Secretary.

Modification of treatment of transfers to creditors in divisive reorganizations (Act sec. 898).−The provision clarifies that the amount of the adjusted basis of property that is taken into account for purposes of Code section 361(b)(3) is reduced by the liabilities assumed (within the meaning of Code section 357(c)).

Nonqualified preferred stock (Act sec. 899).−The provision clarifies that the "real and meaningful likelihood" requirement under the Act (which applies so that stock shall not be treated as participating in corporate growth to any significant extent unless there is a "real and meaningful likelihood" of the shareholder actually participating in the earnings and growth of the corporation) applies also for purposes of determining whether stock is not stock that is "limited and preferred as to dividends."

Consistent amortization period for intangibles and treatment of partnership organizational expenses (Act sec. 902).−The provision corrects the reference to "taxpayers" to refer to "partnerships" in the rules relating to deduction or amortization of partnership organizational expenses.

FERC restructuring (Act sec. 909).−The provisions clarifies that the definition of independent transmission company includes a person whose transmission facilities are 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 December 31, 2006.

Amendment Related to the Working Families Tax Relief Act of 2004

Uniform definition of child (Act secs. 201, 203 and 207).−The provision makes conforming amendments, consistent with those enacted with respect to various other provisions, for purposes of health savings accounts, the dependent care credit, and dependent care assistance programs. Under the conforming amendments, an individual may qualify as a dependent for these limited purposes without regard to whether the individual has gross income that exceeds an otherwise applicable gross income limitation or is married and files a joint return. In addition, such an individual who is treated as a dependent under these conforming amendment provisions is not subject to the general rule that a dependent of a taxpayer shall be treated as having no dependents for the taxable year of such individual beginning in such calendar year.

The provision clarifies Code section 152(e) to permit a divorced or legally separated custodial parent to waive, by written declaration, his or her right to claim a child as a dependent for purposes of the dependency exemption and child credit (but not with respect to other child-related tax benefits). By means of the waiver, the noncustodial parent is granted the right to claim the child as a dependent for these purposes.

Amendment Related to the Jobs and Growth Tax Relief Reconciliation Act of 2003

Bonus depreciation (Act sec. 201).−The provision corrects the reference to a date in the rules applicable to qualified New York Liberty Zone property so that it refers to the January 1, 2005, date in the corresponding rule for additional first-year depreciation in Code section 168(k).

Amendments Related to the Victims of Terrorism Tax Relief Act of 2001

Rules relating to disclosure of taxpayer return information (Act sec. 201).−The provision corrects cross references within the disclosure rules (Code section 6103) relating to disclosure to the National Archives and Records Administration.

Amendments Related to the Transportation Equity Act for the 21st Century (TEA 21) (1998)

Coastal Wetlands sub-account (Act sec. 9005).−Section 9005(b)(3) of TEA 21 redesignated Code section 9504(b)(2)(B), referring to the purposes of the Coastal Wetlands Planning, Protection and Restoration Act, as section 9504(b)(2)(C), but did not cross reference the limitation for such purposes of taxes on gasoline used in the nonbusiness use of small-engine

outdoor power equipment. The provision makes a conforming cross-reference amendment (sec. 9504(b)(2)).

Amendments Related to the Taxpayer Relief Act of 1997

Tentative carryback and refund adjustments and treatment of carrybacks or adjustments for certain unused deductions (Act sec. 1055).−The provision corrects a reference in rules relating to tentative carryback and refund adjustments to refer to coordination rules in Code section 6611(f)(4)(B). The provision also corrects a reference in rules relating to carrybacks or adjustments of certain unused deductions to refer to the filing date within the meaning of Code section 6611(f)(4)(B).

Notice of certain transfers to foreign persons (Act sec. 1144).−The provision corrects the omission of a conjunction in the description of transfers that are generally subject to certain information reporting requirements.

Clerical amendments

The provisions include clerical and typographical amendments to the Code, which are effective upon enactment.

B. Other Corrections

Amendments Related to the American Jobs Creation Act of 2004

Expansion of bank S corporation eligible shareholders to include IRAs (Act sec. 233).−The provision expands the provision in the Act allowing certain bank stock to be held by an IRA (or to be sold by an IRA to the beneficiary) to include stock in a depository holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act). A depository holding company includes a bank holding company and a thrift holding company.

Exclusion of investment securities income from passive income test for bank S corporations (Act sec. 237).−The provision expands the rule in the Act which provides that, in the case of a bank, bank holding company, or financial holding company, certain interest and dividend income is not treated as passive under the S corporation passive investment income rules. Under the provision, this rule applies to a bank and to a depository holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act). A depository holding company includes a bank holding company and a thrift holding company.

Information returns for qualified subchapter S subsidiaries (Act sec. 239).−The provision provides that a qualified subchapter S subsidiary is recognized as a separate entity for purposes of making information returns, except as otherwise provided by the Treasury Department.