

**DESCRIPTION OF THE
"TAX TECHNICAL CORRECTIONS ACT OF 2003"**

Prepared by the Staff
of the
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 2003." The bill was introduced on December 8, 2003, as H.R. 3654 in the House of Representatives, and on December 9, 2003, as S. 1984 in the Senate.

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TAX TECHNICAL CORRECTIONS

Except as otherwise provided, the technical corrections contained in the bill generally are effective as if included in the originally enacted related legislation.

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

Dividends taxed at capital gain rates.--Section 302 of the Jobs and Growth Tax Relief Act of 2003 generally provides that qualified dividend income of taxpayers other than corporations is taxed at the same tax rates as net capital gain. The bill makes the following corrections to section 302 of the Act:

The provision clarifies that the determination of net capital gain (under section 1(h)(1)(D)(i)), for purposes of determining the amount taxed at the 25-percent rate, is made without regard to qualified dividend income.

The provision clarifies that the extraordinary dividend rule applies to trusts and estates as well as individuals.

The provision rewrites portions of the provisions relating to the treatment of dividends received from a regulated investment company ("RIC") or a real estate investment trust ("REIT") to set forth the rules directly rather than be reference to rules applicable to dividends received by corporate shareholders.

The provision provides that distributions by a RIC or REIT of earnings and profits accumulated prior to becoming a RIC or REIT that are made in order to qualify the corporation as a RIC or REIT may be treated as qualified dividend income to the shareholders.

The provision extends the 60-day period for notifying shareholders of the amount of the qualified dividend income distributed by a RIC or REIT for taxable years ending on or before November 30, 2003, to the date the 1099-DIV for 2003 is required.

The provision provides that, in the case of partnerships, S corporations, common trust funds, trusts, and estates, section 302 of the Act applies to taxable years ending after December 31, 2002, except that dividends received by the entity prior to January 1, 2003, are not treated as qualified dividend income. The Act provided a similar rule in the case of RICs and REITs.

Satisfaction of certain holding period requirements if stock is acquired on the day before ex-dividend date.--Under several similar holding period requirements relating to the tax consequences of receiving dividends, a taxpayer who acquires stock the day before the ex-dividend date cannot satisfy these holding period requirements with respect to the dividend. The bill modifies the stock holding period requirements to permit taxpayers to satisfy the requirements when they acquire stock on the day before the ex-dividend date of the stock. Specifically, section 7(d) of the bill modifies the holding period requirement for the dividends-received deduction under Code section 246(c) (as modified by section 1015 of the Taxpayer Relief Act of 1997) by changing from 90 days to 91 days (and from 180 days to 181 days in the case of certain dividends on preferred stock) the period within which a taxpayer may satisfy the requirement. In addition, section 7(f) of the bill modifies the holding period requirement for

foreign tax credits with respect to dividends under Code section 901(k) (enacted in section 1053 of the Taxpayer Relief Act of 1997) by changing from 30 days to 31 days (and from 90 days to 91 days in the case of certain dividends on preferred stock) the period within which a taxpayer may satisfy the requirement. Section 2(a)(2) of the bill modifies the holding period requirement for dividends to be taxed at the tax rates applicable to capital gain under Code section 1(h)(11) (enacted in section 302 of the Jobs and Growth Tax Relief Reconciliation Act of 2003) by changing from 120 days to 121 days (and from 180 days to 181 days in the case of certain dividends on preferred stock, under section 7(d) of the bill) the period within which a taxpayer may satisfy the requirement. Each part of the provision is effective as if included in the underlying related legislation (i.e., sections 1015 and 1053 of the Taxpayer Relief Act of 1997 and section 302 of the Jobs and Growth Tax Relief Reconciliation Act of 2003, respectively).

Amendments Related to the Job Creation and Worker Assistance Act of 2002

Bonus depreciation.-- Section 101 of the Job Creation and Worker Assistance Act of 2002 provides generally for 30-percent additional first-year depreciation, and provides a binding contract rule in determining property that qualifies for it. The requirements that must be satisfied in order for property to qualify include that (1) the original use of the property must commence with the taxpayer on or after September 11, 2001, (2) the taxpayer must purchase the property after September 10, 2001, and before September 11, 2004, and (3) no binding written contract for the acquisition of the property is in effect before September 11, 2001 (or, in the case of self-constructed property, manufacture, construction, or production of the property does not begin before September 11, 2001). In addition, the Act provides a special rule in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property is treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. The Act did not specifically address the syndication of a lease by the lessor.

The provision clarifies that property qualifying for additional first-year depreciation does not include any property if the user or a related party to the user or owner of such property had a written binding contract in effect for the acquisition of the property at any time before September 11, 2001 (or, in the case of self-constructed property, the manufacture, construction, or production of the property began before September 11, 2001). For example, if a taxpayer sells to a related party property that was under construction prior to September 11, 2001, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to September 11, 2001, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer sells property and leases the property back in a sale-leaseback arrangement, and the lessee had a binding written contract in effect for the acquisition of such property prior to September 11, 2001, then the lessor is not entitled to the additional first-year depreciation deduction.

In addition, the provision provides that if property is originally placed in service by a lessor (including by operation of section Code 168(k)(2)(D)(i)), such property is sold within three months after the date that the property was placed in service, and the user of such property

does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

Five-year carryback of net operating losses ("NOLs").-- Section 102 of the Job Creation and Worker Assistance Act of 2002 temporarily extends the NOL carryback period to five years (from two years, or three years in certain cases) for NOLs arising in taxable years ending in 2001 and 2002. The Act was enacted in March 2002, after some taxpayers had filed returns for 2001.

The provision (1) clarifies that only the NOLs arising in taxable years ending in 2001 and 2002 qualify for the 5-year period, and (2) provides that any election to forego any carrybacks of NOLs arising in 2001 or 2002 can be revoked prior to November 1, 2002. The provision also allows taxpayers until November 1, 2002, to use the tentative carryback adjustment procedures of section 6411 for NOLs arising in 2001 and 2002 (without regard to the 12-month limitation in section 6411). In addition, the provision clarifies that an election to disregard the 5-year carryback for certain NOLs is treated as timely made if made before November 1, 2002 (notwithstanding that section 172(j) requires the election to be made by the due date (including extensions) for filing the taxpayer's return for the year of the loss). The corrections are consistent with the April 15, 2002, letter sent by the Chairman and Ranking Member of the House Ways and Means Committee and Senate Finance Committee, as well as the guidance issued by the IRS pursuant to the Congressional letter (Rev. Proc. 2002-40, 2002-23 I.R.B. 1, May 22, 2002).

The provision also makes several clerical changes to the NOL provisions relating to the alternative minimum tax.

New York Liberty Zone bonus depreciation.-- Section 301 of the Job Creation and Worker Assistance Act of 2002 provides tax benefits for the area of New York City damaged in terrorist attacks on September 11, 2001 (an area defined in the provision and named the New York Liberty Zone). Under these rules, an additional first-year depreciation deduction is allowed equal to 30 percent of the adjusted basis of qualified New York Liberty Zone ("Liberty Zone") property. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year. In addition, the Act provides a special rule in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. The Act did not specifically address the syndication of a lease by the lessor.

The provision clarifies that property qualifying for additional first-year depreciation does not include any property if the user or a related party to the user or owner of such property had a written binding contract in effect for the acquisition of the property at any time before September 11, 2001 (or in the case of self constructed property the manufacture, construction, or production of the property began before September 11, 2001). In addition, the provision provides that if property is originally placed in service by a lessor (including by operation of section 168(k)(2)(D)(i)), such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

New York Liberty Zone expensing.-- Section 301 of the Job Creation and Worker Assistance Act of 2002 increases the amount a taxpayer may expense under section 179 to the lesser of \$35,000 or the amount of Liberty Zone property placed in service for the year. In addition, section 301(a) of the Act states that if property qualifies for both the general additional first-year depreciation and Liberty Zone additional first-year depreciation, it is deemed to be eligible for the general additional first-year depreciation and is not considered Liberty Zone property (i.e., only one 30-percent additional first-year depreciation deduction is allowed). Because only Liberty Zone property is eligible for the increased section 179 expensing amount, this rule has the unintended consequence of denying the increased section 179 expensing to Liberty Zone property. The provision corrects this unintended result (such that qualifying Liberty Zone property qualifies for both the 30-percent additional first-year depreciation and the additional section 179 expensing).

Provide election out of Liberty Zone five-year depreciation for leasehold improvements.--Code section 1400L(c), as added by section 301 of the Job Creation and Worker Assistance Act of 2002, provides for a 5-year recovery period for depreciation of qualified New York Liberty Zone leasehold improvement property that is placed in service after September 10, 2001, and before January 1, 2007 (and meets certain other requirements). Unlike the rules relating to bonus depreciation and to Liberty Zone bonus depreciation property (see Code sections 168(k)(2)(C)(iii) and 1400L(b)(2)(C)(iv)), which permit a taxpayer to elect out, this 5-year depreciation rule is not elective. The provision adds a rule permitting taxpayers to elect out of the 5-year recovery period.

Interest rate for defined benefit plan funding requirements.--Section 405(c) of the Job Creation and Worker Assistance Act of 2002 increases the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes from 85 percent to 100 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the applicable plan year begins. The provision makes conforming changes so that this rule applies for purposes of notices and reporting required under Title IV of ERISA with respect to underfunded plans.

Exclusion for employer-provided adoption assistance.--The provision corrects an incorrect reference in a technical correction to a provision relating to the exclusion for employer-provided adoption assistance.

Amendments Related to the Economic Growth and Tax Relief Reconciliation Act of 2001

Coverdell education savings accounts.--The provision corrects the application of a conforming change to the rule coordinating Coverdell education savings accounts with Hope and Lifetime Learning credits and qualified tuition programs. The conforming change was made in connection with the expansion of Coverdell education savings accounts to elementary and secondary education expenses in section 401 of the Economic Growth and Tax Relief Reconciliation Act of 2001.

Base period for cost-of-living adjustments to Indian employment credit rule.--The Indian employment credit is not available with respect to an employee whose wages exceed \$30,000 (Code sec. 45A). For years after 1994, this \$30,000 amount is adjusted for cost-of-

living increases at the same time and in the same manner as cost-of-living adjustments to the dollar limits on qualified retirement plan benefits and contributions under Code section 415. Section 611 of the Economic Growth and Tax Relief Reconciliation Act of 2001 increases the dollar limits under Code section 415 and adds a new base period for making cost-of-living adjustments. The provision clarifies that the pre-existing base period applies for purposes of the Indian employment credit.

Rounding rule for retirement plan benefit and contribution limits.--Section 611 of the Economic Growth and Tax Relief Reconciliation Act of 2001 increases the dollar limits on qualified retirement plan benefits and contributions under Code section 415, and adds a new rounding rule for cost-of-living adjustments to the dollar limit on annual additions to defined contribution plans. This new rounding rule is in addition to a pre-existing rounding rule that applies to benefits payable under defined benefit plans. The provision clarifies that the pre-existing rounding rule applies for purposes of other Code provisions that refer to Code section 415 and do not contain a specific rounding rule.

Excise tax on nondeductible contributions.--Under section 614 of the Economic Growth and Tax Relief Reconciliation Act of 2001, the limits on deductions for employer contributions to qualified retirement plans do not apply to elective deferrals, and elective deferrals are not taken into account in applying the deduction limits to other contributions. The provision makes a conforming change to the Code provision that applies an excise tax to nondeductible contributions.

SIMPLE plan contributions for domestic or similar workers.-- Section 637 of the Economic Growth and Tax Relief Reconciliation Act of 2001 provides an exception to the application of the excise tax on nondeductible retirement plan contributions in the case of contributions to a SIMPLE IRA or SIMPLE section 401(k) plan that are nondeductible solely because they are not made in connection with a trade or business of the employer (e.g., contributions on behalf of a domestic worker). Section 637 of that Act did not specifically modify the present-law requirement that compensation for purposes of determining contributions to a SIMPLE plan must be wages subject to income tax withholding, even though wages paid to domestic workers are not subject to income tax withholding. The provision revises the definition of compensation for purposes of determining contributions to a SIMPLE plan to include wages paid to domestic workers, even though such amounts are not subject to income tax withholding.

Rollovers among various types of retirement plans.--Section 641 of the Economic Growth and Tax Relief Reconciliation Act of 2001 expanded the rollover rules to allow rollovers among various types of tax-favored retirement plans. The provision makes a conforming change to the cross-reference to the rollovers rules in the Code provision relating to qualified retirement annuities.

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

Disclosure of return information in connection with terrorist incident.--Section 201 of the Victims of Terrorism Tax Relief Act of 2001 permits the IRS to disclose return information (other than taxpayer return information) to law enforcement agencies engaged in the response to or investigation of any terrorist incident, threat, or activity (sec. 6103(i)(7)(A) of the

Code). If the taxpayer's identity (name, address, and taxpayer identification number) was provided by the taxpayer or his representative, for example, on a tax return, that information is taxpayer return information. As a result, the IRS could not identify the person about whom information is being submitted because the identity would be taxpayer return information.

The provision clarifies Code section 6103(i)(7)(A) to permit the disclosure of taxpayer identity in a manner similar to 6103(i)(7)(B)(iv), which permits the disclosure of identity to intelligence agencies as part of the information available to such agencies regarding terrorist activities.

Amendment Related to the Community Renewal Tax Relief Act of 2000

Tax treatment of options and securities futures contracts.-- The provision clarifies that the Secretary of the Treasury has the authority to prescribe regulations regarding the status of an option or a contract the value of which is determined directly or indirectly by reference to an index which becomes (or ceases to be) a narrow-based security index (as defined in Code section 1256(g)(6)). This authority includes, but is not limited to, regulations that provide for preserving the status of such an option or contract as appropriate.

Amendments Related to the Taxpayer Relief Act of 1997

Qualified tuition programs.--Section 211 of the Taxpayer Relief Act of 1997 modified Code section 529(c)(5), relating to gift tax rules for qualified tuition programs, but did not include in the statutory language the requirement that, upon a change in the designated beneficiary of the program, the new beneficiary must be a member of the family of the old beneficiary for gift taxes not to apply. The legislative history for the provision stated that the new beneficiary had to be of the same generation as the old beneficiary and a member of the family of the old beneficiary for gift taxes not to apply. The provision clarifies that the gift taxes apply unless the new beneficiary is of the same (or higher) generation than the old beneficiary and is a member of the family of the old beneficiary.

Coverdell education savings accounts.--The provision corrects section 530(d)(4)(B)(iii), relating to Coverdell education savings accounts, by substituting for the undefined term "account holder" the defined term "designated beneficiary."

Constructive sale exception.--Section 1001(a) of the Taxpayer Relief Act of 1997 provides an exception from constructive sale treatment for any transaction that is closed before the end of the thirtieth day after the close of the taxable year in which the transaction was entered into, provided certain requirements are met after closing the transaction (Code section 1259(c)(3)). In the case of positions that are reestablished following a closed transaction but prior to satisfying the requirements for the exception from constructive sale treatment, the exception applies in a similar manner if the reestablished position itself is closed and similar requirements are met after closing the reestablished position. The provision clarifies that the exception applies in the same manner to all closed transactions, including reestablished positions that are closed.

Airline ticket tax.--Beginning with calendar year 2003, the domestic flight segment portion of the airline ticket tax is adjusted for inflation annually. The provision clarifies that, in

the case of amounts paid for transportation before the beginning of the year in which the transportation is to occur, the rate of tax is the rate in effect for the calendar year in which the amount is paid. The provision is effective for flight segments beginning after December 31, 2002.

Amendment Related to the Small Business Job Protection Act of 1996

S corporation post-termination transition period.--Shareholders of an S corporation whose status as an S corporation terminates are allowed a period of time after the termination (the post-termination transition period ("PTTP")) to utilize certain of the benefits of S corporation status. The shareholders may claim losses and deductions previously suspended due to lack of stock or debt basis up to the amount of the stock basis as of the last day of the PTTP (sec. 1366(d)). Also, shareholders may receive cash distributions from the corporation during the PTTP that are treated as returns of capital to the extent of any balance in the S corporation's accumulated adjustments account ("AAA") (sec. 1371(e)).

The PTTP generally begins on the day after the last day of the corporation's last tax year as an S corporation and ends on the later of the day which is one year after such last day or the due date for filing the return for such last year as an S corporation (including extensions). Section 1307 of the Small Business Job Protection Act of 1996 added a new 120-day PTTP following an audit of the corporation that adjusts an S corporation item of income, loss, or deduction arising during the most recent period while the corporation was an S corporation. This provision was enacted to allow the tax-free distribution of any additional income determined in the audit.

As a result of the 1996 legislation, an S corporation shareholder might take the position that an audit adjustment allows the shareholder to utilize suspended losses and deductions in excess of the amount of the audit deficiency. For example, assume that, at the end of the one-year PTTP following the termination of a corporation's S corporation status, a shareholder has \$1 million of suspended losses in the corporation. Later, the shareholder purchases additional stock in the corporation for \$1 million. The corporation's audit determines a \$25,000 increase in the S corporation's income. Although the \$25,000 increase in income would allow \$25,000 of suspended losses to be allowed, the shareholder might take the position that the entire \$1,000,000 of suspended losses could be utilized during the 120-day PTTP following the end of the audit. Similarly, an S corporation that had failed to distribute the entire amount in its AAA during the one-year PTTP following the loss of S corporation status might argue that it could distribute that amount, in addition to the amount determined in the audit, during the 120-day period following the audit.

The provision provides that the 120-day PTTP added by the 1996 Act does not apply for purposes of allowing suspended losses to be deducted (since the increased income determined in the audit can be offset with the losses), and allows tax-free distributions of money by the corporation during the 120-day period only to the extent of any increase in the AAA by reason of adjustments from the audit.

Clerical amendments

The bill makes a number of clerical and typographical amendments to the Code.