TECHNICAL EXPLANATION OF H.R. 1308, THE "TAX RELIEF, SIMPLIFICATION, AND FAIRNESS ACT OF 2003," AS PASSED BY THE HOUSE OF REPRESENTATIVES

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of the
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INTRODUCTION

This document[1], prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of H.R. 1308, the "Tax Relief, Simplification, and Fairness Act of 2003," as passed by the House of Representatives.

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EXPLANATION OF PROVISIONS

TITLE I. ENDING ABUSIVE TAX PRACTICES

A. Modification of the Tax Treatment of Citizenship Relinquishment and Residency Termination (sec. 101 of the bill and secs. 877, 2107, 2501, and 6039G of the Code)

Present Law

Since 1966, special tax rules have applied to a U.S. citizen who relinquishes U.S. citizenship with a principal purpose of avoiding U.S. taxes. These rules are referred to as the "alternative tax regime." In 1996, several significant changes were made to the alternative tax regime. These amendments followed press reports and Congressional hearings indicating that a small number of very wealthy individuals had relinquished their U.S. citizenship to avoid U.S. income, estate, and gift taxes, while nevertheless maintaining significant contacts with the United States.

Under present law, the alternative tax regime applies both to U.S. citizens who relinquish citizenship and long-term residents who terminate residency with a principal purpose of avoiding U.S. taxes. A U.S. citizen who relinquishes citizenship or a long-term resident who terminates residency is treated as having done so with a principal purpose of tax avoidance (and, thus, generally is subject to the alternative tax regime) if: (1) the individual's average annual U.S. Federal income tax liability for the five taxable years preceding citizenship relinquishment or residency termination exceeds $100,000; or (2) the individual's net worth on the date of citizenship relinquishment or residency termination equals or exceeds $500,000. These amounts are adjusted annually for inflation. Certain categories of individuals may avoid being deemed to have a tax avoidance purpose for relinquishing citizenship or terminating residency by submitting a ruling request to the IRS regarding whether the individual relinquished citizenship or terminated residency principally for tax reasons.

Under present law, the Immigration and Nationality Act governs the determination of when a U.S. citizen is treated for U.S. Federal tax purposes as having relinquished citizenship. Similarly, an individual's U.S. residency is considered terminated for U.S. Federal tax purposes when the individual ceases to be a lawful permanent resident under the immigration law (or is treated as a resident of another country under a tax treaty and does not waive the benefits of such treaty). In view of this reliance on immigration-law status, it is possible in many instances for a U.S. citizen or resident to convert his or her Federal tax status to that of a nonresident noncitizen without notifying the IRS.

Under the alternative tax regime, a former citizen or long-term resident is subject to an alternative method of income taxation for 10 years following citizenship relinquishment or residency termination. For the 10-year period, the individual is subject to tax only on U.S.-source income at the rates applicable to U.S. citizens, rather than the rates applicable to noncitizens who are nonresidents. However, for this purpose, U.S.-source income has a broader scope than it does for normal U.S. Federal tax purposes and includes, for example, gain from the sale of U.S. corporate stock or debt obligations. The alternative tax regime applies only if it results in a higher U.S. tax liability than the liability that would result if the individual were taxed as a noncitizen who is a nonresident.

In addition, the alternative tax regime includes special estate and gift tax rules. Under present law, estates of nonresident noncitizens are subject to U.S. estate tax on U.S.-situated property. For these purposes, stock in a foreign corporation generally is not treated as U.S.-situated property, even if the foreign corporation itself owns U.S.-situated property. However, a special estate tax rule (sec. 2107) applies to former citizens and former long-term residents who are subject to the alternative tax regime. Under this rule, certain closely-held foreign stock owned by the former citizen or former long-term resident is includible in his or her gross estate to the extent that the foreign corporation owns U.S.-situated assets, if the former citizen or former long-term resident dies within 10 years of citizenship relinquishment or residency termination. This rule prevents former citizens and former long-term residents who are subject to the alternative tax regime from avoiding U.S. estate tax through the expedient of transferring U.S.-situated assets to a foreign corporation (subject to income tax on any appreciation under section 367). In addition, under the alternative tax regime, the individual is subject to gift tax on gifts of U.S.-situated intangibles, such as U.S. stock, made during the 10 years following citizenship relinquishment or residency termination.

Anti-abuse rules are provided to prevent circumvention of the alternative tax regime through conversion of U.S.-source income or property to foreign-source income or property. Thus, the alternative tax regime applies to foreign property acquired in nonrecognition transactions. Amounts earned by former citizens and former long-term residents through controlled foreign corporations are subject to the alternative tax regime. The 10-year liability period is suspended during any time at which a former citizen's or former long-term resident's risk of loss with respect to property subject to the alternative tax regime is substantially diminished, among other measures.

Individuals subject to the alternative tax regime are required to provide certain tax information, including tax identification numbers, upon relinquishment of citizenship or termination of residency. The penalty for failure to provide the required tax information is the greater of $1,000 or five percent of the tax imposed under the alternative tax regime for the year. In addition, the U.S. Department of State and other governmental agencies are required to provide this information to the IRS.

Under present law, U.S. citizens who relinquish citizenship and long-term residents who terminate residency generally are required to provide information about their assets held at the time of their citizenship relinquishment or residency termination. If the collective fair market value of the former citizen's or former long-term resident's assets exceeds $500,000, then detailed information about the individual's assets must be provided. However, this information generally is required to be provided only once.

Former citizens and former long-term residents who are subject to the alternative tax regime also are required to file annual income tax returns, but only in the event that they owe U.S. Federal income tax. If a tax return is required, the former citizen or former long-term resident is required to provide the IRS with a statement setting forth (generally by category) all items of U.S.-source and foreign-source gross income, but no detailed information with respect to all assets held by the individual.

Explanation of Provision

In general

The bill provides: (1) objective standards for determining whether former citizens or former long-term residents are subject to the alternative tax regime; (2) tax-based (instead of immigration-based) rules for determining when an individual is no longer a U.S. citizen or long-term resident for U.S. Federal tax purposes; (3) the imposition of full U.S. taxation for individuals who are subject to the alternative tax regime and who return to the United States for extended periods; (4) imposition of U.S. gift tax on gifts of stock of certain closely-held foreign corporations that hold U.S.-situated property; and (5) an annual return-filing requirement for individuals who are subject to the alternative tax regime, for each of the 10 years following citizenship relinquishment or residency termination.

Objective rules for the alternative tax regime

The bill replaces the subjective determination of tax avoidance as a principal purpose for citizenship relinquishment or residency termination under present law with objective rules.[2] Under the bill, a former citizen or former long-term resident would be subject to the alternative tax regime for a 10-year period following citizenship relinquishment or residency termination, unless the former citizen or former long-term resident: (1) establishes that his or her average annual net income tax liability for the five preceding years does not exceed $122,000 (adjusted for inflation after 2003) 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 preceding five years and provides such evidence of compliance as the Secretary of the Treasury may require.

The monetary thresholds under the bill replace the present-law inquiry into the taxpayer's intent. In addition, the bill eliminates the present-law process of IRS ruling requests.

The alternative tax regime does not apply to a former citizen who is a dual citizen or a minor with no substantial contacts with the United States prior to relinquishing citizenship. These exceptions for dual citizens and minors retain the present-law definitions of such individuals found in sections 877(c)(2)(A) and 877(c)(2)(C). If a former citizen or former long-term resident exceeds the monetary thresholds, that person is excluded from the alternative tax regime if he or she falls within one of the specified exceptions (provided that the requirement of certification and proof of compliance with Federal tax obligations is met). These exceptions provide relief to individuals who have never had any substantial connections with the United States, as measured by certain objective criteria, and eliminate IRS inquiries as to the subjective intent of such taxpayers.

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[2] Section 877(a).

In order to be excepted from the application of the alternative tax regime under the bill, whether by reason of falling below the net worth and income tax liability thresholds or qualifying for the dual-citizen or minor exceptions, the former citizen or former long-term resident also is required to certify, under penalties of perjury, that he or she has complied with all U.S. Federal tax obligations for the five years preceding the relinquishment of citizenship or termination of residency and to provide such documentation as the Secretary of the Treasury may require evidencing such compliance (*e.g.*, tax returns, proof of tax payments). Until such time, the individual remains subject to the alternative tax regime. It is intended that the IRS should continue to verify that the information submitted was accurate, and it is intended that the IRS should randomly audit such persons to assess compliance.

Termination of U.S. citizen or long-term resident status for U.S. Federal income tax purposes

Under the bill, an individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes, including for purposes of section 7701(b)(10), 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) files a complete and accurate tax information statement with the IRS.

Sanction for individuals subject to the individual tax regime who return to the United States for extended periods

The bill provides that a former citizen or former long-term resident who is subject to the alternative tax regime and who is present in the United States for more than 30 days in any calendar year during the 10-year period following citizenship relinquishment or residency termination is treated as a U.S. resident for that calendar year and thus is subject to U.S. Federal income tax on a worldwide basis.

Similarly, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any year during the 10-year period following citizenship relinquishment or residency termination, and the individual dies during that year, he or she is treated as U.S. resident, and the individual's worldwide estate is subject to U.S. estate tax. Likewise, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any year during the 10-year period following citizenship relinquishment or residency termination, the individual is subject to U.S. gift tax on any transfer of his or her worldwide assets by gift during that year.

For purposes of these rules, an individual is 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, with no exceptions. The present-law exceptions from being treated as present in the United States for residency purposes[3] do not apply for this purpose.

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[3] Sections 7701(b)(3)(D), 7701(b)(5) and 7701(b)(7)(B)-(D).

Imposition of gift tax with respect to stock of certain closely held foreign corporations

The bill provides that 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 are subject to gift tax, if the gift is made within the 10-year period after citizenship relinquishment or residency termination. The gift tax rule applies if: (1) the former citizen or former long-term resident, before making the gift, directly or indirectly owns 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation; and (2) directly or indirectly, is considered to own more than 50 percent of (a) the total combined voting power of all classes of stock entitled to vote in the foreign corporation, or (b) the total value of the stock of such corporation. If this stock ownership test is met, then taxable gifts of the former citizen or former long-term resident include that proportion of the fair market value of the foreign stock transferred by the individual, at the time of the gift, which the fair market value of any assets owned by such foreign corporation and situated in the United States (at the time of gift) bears to the total fair market value of all assets owned by such foreign corporation (at the time of gift).

This gift tax rule applies to a former citizen or former long-term resident who is subject to the alternative tax regime and who owns stock in a foreign corporation at the time of the gift, regardless of how such stock was acquired (*e.g.*, whether issued originally to the donor, purchased, or received as a gift or bequest).

Annual return

The bill requires former citizens and former long-term residents to file an annual return for each year following citizenship relinquishment or residency termination in which they are subject to the alternative tax regime. The annual return is required even if no U.S. Federal income tax is due. The annual return requires certain information, including information on the permanent home of the individual, the individual's country of residency, the number of days the individual was present in the United States for the year, and detailed information about the individual's income and assets that are subject to the alternative tax regime.

Former citizens and former long-term residents who are subject to the alternative tax regime are required to provide annual income and balance sheet information on their U.S. assets, as well as foreign assets that are subject to U.S. tax under the alternative tax regime. This requirement includes information relating to foreign stock potentially subject to the special estate tax rule of section 2107(b) and the gift tax rules of this bill.

If the individual fails to file the statement in a timely manner or fails correctly to include all the required information, the individual is required to pay a penalty of $5,000. The $5,000 penalty does not apply if it is shown that the failure is due to reasonable cause and not to willful neglect.

Effective Date

The bills apply to individuals who relinquish citizenship or terminate long-term residency after February 27, 2003.

B. Suspension of Tax-Exempt Status of Terrorist Organizations (sec. 102 of the bill and sec. 501 of the Code)

Present Law

Under present law, the Internal Revenue Service generally issues a letter revoking recognition of an organization's tax-exempt status only after (1) conducting an examination of the organization, (2) issuing a letter to the organization proposing revocation, and (3) allowing the organization to exhaust the administrative appeal rights that follow the issuance of the proposed revocation letter. In the case of an organization described in section 501(c)(3), the revocation letter immediately is subject to judicial review under the declaratory judgment procedures of section 7428. To sustain a revocation of tax-exempt status under section 7428, the IRS must demonstrate that the organization is no longer entitled to exemption. There is no procedure under present law for the IRS to suspend the tax-exempt status of an organization.

To combat terrorism, the Federal government has designated a number of organizations as terrorist organizations or supporters of terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945.

Explanation of Provision

The bill suspends the tax-exempt status of an organization that is exempt from tax under section 501(a) for any period during which the organization is designated or identified by U.S. Federal authorities as a terrorist organization or supporter of terrorism. The bill also makes such an organization ineligible to apply for tax exemption under section 501(a). The period of suspension runs from the date the organization is first designated or identified (or from the date of enactment of the bill, whichever is later) to the date when all designations or identifications with respect to the organization have been rescinded pursuant to the law or Executive order under which the designation or identification was made.

The bill describes a terrorist organization as an organization that has been designated or otherwise individually identified (1) as a terrorist organization or foreign terrorist organization under the authority of section 212(a)(3)(B)(vi)(II) or section 219 of the Immigration and Nationality Act; (2) in or pursuant to an Executive order that is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive order that refers to the bill and is issued under the authority of any Federal law if the organization is designated or otherwise individually identified in or pursuant to such Executive order as supporting or engaging in terrorist activity (as defined in section 212(a)(3)(B) of the Immigration and Nationality Act) or supporting terrorism (as defined in section 140(d)(2) of the Foreign Relations Authorization Act, Fiscal Years 1988 and 1989). During the period of suspension, no deduction is allowed under the bill for any contribution to a terrorist organization under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522.

No organization or other person may challenge, under section 7428 or any other provision of law, in any administrative or judicial proceeding relating to the Federal tax liability of such organization or other person, the suspension of tax-exemption, the ineligibility to apply for tax-exemption, a designation or identification described above, the timing of the period of suspension, or a denial of deduction described above. The suspended organization may maintain other suits or administrative actions against the agency or agencies that designated or identified the organization, for the purpose of challenging such designation or identification (but not the suspension of tax-exempt status under this provision).

If the tax-exemption of an organization is suspended and each designation and identification that has been made with respect to the organization is determined to be erroneous pursuant to the law or Executive order making the designation or identification, and such erroneous designation results in an overpayment of income tax for any taxable year with respect to such organization, a credit or refund (with interest) with respect to such overpayment shall be made. If the operation of any law or rule of law (including res judicata) prevents the credit or refund at any time, the credit or refund may nevertheless be allowed or made if the claim for such credit or refund is filed before the close of the one-year period beginning on the date that the last remaining designation or identification with respect to the organization is determined to be erroneous.

The bill directs the IRS to update the listings of tax-exempt organizations to take account of organizations that have had their exemption suspended and to publish notice to taxpayers of the suspension of an organization's tax-exemption and the fact that contributions to such organization are not deductible during the period of suspension.

Effective Date

The bill is effective for designations made before, on, or after the date of enactment.

C. Sense of the Congress that Tax Reform is Needed to Address the Issue of Corporate Expatriation (sec. 103 of the bill)

Present Law

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income is generally deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F[4] and the passive foreign investment

[4] Secs. 951-964.

company rules.[5] A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether repatriated as an actual dividend or included under one of the anti-deferral regimes.

Explanation of Provision

The bill finds that the U.S. tax laws are overly complex and burdensome, placing domestically owned companies at a competitive disadvantage relative to foreign-owned companies, and thus creating an incentive for domestically owned companies to become foreign-owned, via inversion or otherwise. The bill expresses the Sense of the Congress "that passage of legislation to fix the underlying problems with our tax laws is essential and should occur as soon as possible, so United States corporations will not face the current pressures to engage in inversion transactions."

Effective Date

The provision is effective on the date of enactment.

[5] Secs. 1291-1298.

TITLE II. RELIEF FOR FOREIGN SERVICE AND ASTRONAUTS

A. Exclusion of Gain on Sale of a Principal Residence by a Member of the Foreign Service (sec. 201 of the bill and sec. 121 of the Code)

Present Law

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000, if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to members of the uniformed services or the Foreign Service of the United States.

Explanation of Provision

Under the bill, an individual may elect to suspend for a maximum of five years the five-year test period for ownership and use during certain absences due to service in the Foreign Service of the United States. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to five years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty in the Foreign Service of the United States. For these purposes, qualified official extended duty is any period of extended duty in the Foreign Service of the United States while serving at a place of duty at least 150 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 180 days or for an indefinite period. The election may be made with respect to only one property for a suspension period.

Effective Date

The provision is effective for sales or exchanges after May 6, 1997.

B. Extension of Certain Tax Relief Provisions to Astronauts (sec. 202 of the bill and secs. 101, 692, and 2201 of the Code)

Present Law

In general

The Victims of Terrorism Tax Relief Act of 2001 (the "Victims Bill") provided certain income and estate tax relief to individuals who die from wounds or injury incurred as a result of the terrorist attacks against the United States on September 11, 2001, and April 19, 1995 (the bombing of the Alfred P. Murrah Federal Building in Oklahoma City) or as a result of illness incurred due to an attack involving anthrax that occurred on or after September 11, 2001, and before January 1, 2002.

Income tax relief

The Victims Bill extended relief similar to the present-law treatment of military or civilian employees of the United States who die as a result of terrorist or military activity outside the United States to individuals who die as a result of wounds or injury which were incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, and individuals who die as a result of illness incurred due to an attack involving anthrax that occurs on or after September 11, 2001, and before January 1, 2002. Under the Victims Bill, such individuals generally are exempt from income tax for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury occurred.[6] The exemption applies to these individuals whether killed in an attack (e.g., in the case of the September 11, 2001, attack in one of the four airplanes or on the ground) or in rescue or recovery operations.

Present law provides a minimum tax relief benefit of $10,000 to each eligible individual regardless of the income tax liability of the individual for the eligible tax years. If an eligible individual's income tax for years eligible for the exclusion under the provision is less than $10,000, the individual is treated as having made a tax payment for such individual's last taxable year in an amount equal to the excess of $10,000 over the amount of tax not imposed under the provision.

Subject to rules prescribed by the Secretary, the exemption from tax does not apply to the tax attributable to (1) deferred compensation which would have been payable after death if the individual had died other than as a specified terrorist victim, or (2) amounts payable in the taxable year which would not have been payable in such taxable year but for an action taken after September 11, 2001. Thus, for example, the exemption does not apply to amounts payable from a qualified plan or individual retirement arrangement to the beneficiary or estate of the individual. Similarly, amounts payable only as death or survivor's benefits pursuant to deferred compensation preexisting arrangements that would have been paid if the death had occurred for another reason are not covered by the exemption. In addition, if the individual's employer makes adjustments to a plan or arrangement to accelerate the vesting of restricted property or the payment of nonqualified deferred compensation after the date of the particular attack, the exemption does not apply to income received as a result of that action.[7] Also, if the individual's beneficiary cashed in savings bonds of the decedent, the exemption does not apply. On the other hand, the exemption does apply, for example, to a final paycheck of the individual or dividends on stock held by the individual when paid to another person or the individual's estate after the date of death but before the end of the taxable year of the decedent (determined without regard to

[6] Present law does not provide relief from self-employment tax liability.

[7] Such amounts may, however, be excludable from gross income under the death benefit exclusion provided in section 102 of the Victims Bill.

the death). The exemption also applies to payments of an individual's accrued vacation and accrued sick leave.

The tax relief does not apply to any individual identified by the Attorney General to have been a participant or conspirator in any terrorist attack to which the provision applies, or a representative of such individual.

Exclusion of death benefits

The Victims Bill generally provides an exclusion from gross income for amounts received if such amounts are paid by an employer (whether in a single sum or otherwise[8]) by reason of the death of an employee who dies as a result of wounds or injury which were incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, or as a result of illness incurred due to an attack involving anthrax that occurs on or after September 11, 2001, and before January 1, 2002. Subject to rules prescribed by the Secretary, the exclusion does not apply to amounts that would have been payable if the individual had died for a reason other than the attack. The exclusion does apply, however, to death benefits provided under a qualified plan that satisfy the incidental benefit rule.

For purposes of the exclusion, self-employed individuals are treated as employees. Thus, for example, payments by a partnership to the surviving spouse of a partner who died as a result of the September 11, 2001, attacks may be excludable under the provision.

The tax relief does not apply to any individual identified by the Attorney General to have been a participant or conspirator in any terrorist attack to which the provision applies, or a representative of such individual.

Estate tax relief

Present law provides a reduction in Federal estate tax for taxable estates of U.S. citizens or residents who are active members of the U.S. Armed Forces and who are killed in action while serving in a combat zone (sec. 2201). This provision also applies to active service members who die as a result of wounds, disease, or injury suffered while serving in a combat zone by reason of a hazard to which the service member was subjected as an incident of such service.

In general, the effect of section 2201 is to replace the Federal estate tax that would otherwise be imposed with a Federal estate tax equal to 125 percent of the maximum State death tax credit determined under section 2011(b). Credits against the tax, including the unified credit of section 2010 and the State death tax credit of section 2011, then apply to reduce (or eliminate) the amount of the estate tax payable.

Generally, the reduction in Federal estate taxes under section 2201 is equal in amount to the "additional estate tax." The additional estate tax is the difference between the Federal estate

[8] Thus, for example, payments made over a period of years could qualify for the exclusion.

tax imposed by section 2001 and 125 percent of the maximum State death tax credit determined under section 2011(b) as in effect prior to its repeal by the Economic Growth and Tax Relief Reconciliation Act of 2001.

The Victims Bill generally treats individuals who die from wounds or injury incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, or as a result of illness incurred due to an attack involving anthrax that occurred on or after September 11, 2001, and before January 1, 2002, in the same manner as if they were active members of the U.S. Armed Forces killed in action while serving in a combat zone or dying as a result of wounds or injury suffered while serving in a combat zone for purposes of section 2201. Consequently, the estates of these individuals are eligible for the reduction in Federal estate tax provided by section 2201. The tax relief does not apply to any individual identified by the Attorney General to have been a participant or conspirator in any terrorist attack to which the provision applies, or a representative of such individual.

The Victims bill also changes the general operation of section 2201, as it applies to both the estates of service members who qualify for special estate tax treatment under present and prior law and to the estates of individuals who qualify for the special treatment only under the Act. Under the Victims bill, the Federal estate tax is determined in the same manner for all estates that are eligible for Federal estate tax reduction under section 2201. In addition, the executor of an estate that is eligible for special estate tax treatment under section 2201 may elect not to have section 2201 apply to the estate. Thus, in the event that an estate may receive more favorable treatment without the application of section 2201 in the year of death than it would under section 2201, the executor may elect not to apply the provisions of section 2201, and the estate tax owed (if any) would be determined pursuant to the generally applicable rules.

Under the Victims bill, section 2201 no longer reduces Federal estate tax by the amount of the additional estate tax. Instead, the Victims bill provides that the Federal estate tax liability of eligible estates is determined under section 2001 (or section 2101, in the case of decedents who were neither residents nor citizens of the United States), using a rate schedule that is equal to 125 percent of the pre-EGTRRA maximum State death tax credit amount. This rate schedule is used to compute the tax under section 2001(b) or section 2101(b) (i.e., both the tentative tax under section 2001(b)(1) and section 2101(b), and the hypothetical gift tax under section 2001(b)(2) are computed using this rate schedule). As a result of this provision, the estate tax is unified with the gift tax for purposes of section 2201 so that a single graduated (but reduced) rate schedule applies to transfers made by the individual at death, based upon the cumulative taxable transfers made both during lifetime and at death.

In addition, while the Victims bill provides an alternative reduced rate table for purposes of determining the tax under section 2001(b) or section 2101(b), the amount of the unified credit nevertheless is determined as if section 2201 did not apply, based upon the unified credit as in effect on the date of death. For example, in the case of victims of the September 11, 2001, terrorist attack, the applicable unified credit amount under section 2010(c) would be determined by reference to the actual section 2001(c) rate table.

Explanation of Provision

The bill extends the exclusion from income tax, the exclusion for death benefits, and the estate tax relief available under the Victims of Terrorism Tax Relief Act of 2001 to astronauts who lose their lives on a space mission (including the individuals who lost their lives in the space shuttle Columbia disaster).

Effective Date

The provision is generally effective for qualified individuals whose lives are lost in the line of duty after December 31, 2002.

TITLE III. HEALTH PROVISIONS

A. Add Vaccines Against Hepatitis A to the List of Taxable Vaccines (sec. 301 of the bill and sec. 4132 of the Code)

Present Law

A manufacturer's excise tax is imposed at the rate of 75 cents per dose[9] on the following vaccines routinely recommended for administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, varicella (chicken pox), rotavirus gastroenteritis, and streptococcus pneumoniae. The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. This program provides a substitute Federal, "no fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers. All persons immunized after September 30, 1988, with covered vaccines must pursue compensation under this Federal program before bringing civil tort actions under State law.

Explanation of Provision

The bill adds any vaccine against hepatitis A to the list of taxable vaccines.

Effective Date

The provision is effective for vaccines sold beginning on the first day of the first month beginning more than four weeks after the date of enactment.

B. Expand Human Clinical Trials Expenses Qualifying for the Orphan Drug Tax Credit (sec. 302 of the bill and sec. 280C of the Code)

Present Law

Taxpayers may claim a 50-percent orphan drug tax credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions, generally those that afflict less than 200,000 persons in the United States. Qualifying expenses are those paid or incurred by the taxpayer after the date on which the drug is designated as a potential treatment for a rare disease or disorder by the Food and Drug Administration ("FDA") in accordance with section 526 of the Federal Food, Drug, and Cosmetic Act.

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[9] Sec. 4131

Explanation of Provision

The bill expands qualifying expenses to include those expenses related to human clinical testing incurred after the date on which the taxpayer files an application with the FDA for designation of the drug under section 526 of the Federal Food, Drug, and Cosmetic Act as a potential treatment for a rare disease or disorder. As under present law, the credit may only be claimed for such expenses related to drugs designated as a potential treatment for a rare disease or disorder by the FDA in accordance with section 526 of such Act. This expansion is repealed for such expenses incurred after December 31, 2010.

Effective Date

The provision is effective for expenditures paid or incurred after the date of enactment.

TITLE IV. ENVIRONMENTAL PROVISION

A. Pilot Project for Forest Conservation Activities (sec. 401 of the bill)

Present Law

Tax-exempt bonds

In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (section 103). Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called "private activity bonds." The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

Private activities eligible for financing with tax-exempt private activity bonds

Present law includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities. Both capital expenditures and limited working capital expenditures of charitable organizations described in section 501(c)(3) of the Code may be financed with tax-exempt bonds ("qualified 501(c)(3) bonds").

States or local governments may issue tax-exempt "exempt-facility bonds" to finance property for certain private businesses. Business facilities eligible for this financing include transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, local district heating or cooling, and hazardous waste disposal facilities); privately owned and/or operated low-income rental housing;[10] and certain private facilities for the local furnishing of electricity or gas. A further provision allows tax-exempt financing for "environmental enhancements of hydro-electric generating facilities." Tax-exempt financing also is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers ("qualified small-issue bonds"), local redevelopment activities ("qualified redevelopment bonds"), and eligible empowerment zone and enterprise community businesses. Tax-exempt private activity bonds also may be issued to finance limited non-business purposes: certain student loans and mortgage loans for owner-occupied housing ("qualified mortgage bonds" and "qualified veterans' mortgage bonds").

[10] Residential rental projects must satisfy low-income tenant occupancy requirements for a minimum period of 15 years.

With the exception of qualified 501(c)(3) bonds, private activity bonds may not be issued to finance working capital requirements of private businesses. In most cases, the aggregate volume of tax-exempt private activity bonds that may be issued in a State is restricted by annual volume limits.

Several additional restrictions apply to the issuance of tax-exempt bonds. First, private activity bonds (other than qualified 501(c)(3) bonds) may not be advance refunded. Governmental bonds and qualified 501(c)(3) bonds may be advance refunded one time. An advance refunding occurs when the refunded bonds are not retired within 90 days of issuance of the refunding bonds.

Issuance of private activity bonds is subject to restrictions on use of proceeds for the acquisition of land and existing property, use of proceeds to finance certain specified facilities (e.g., airplanes, skyboxes, other luxury boxes, health club facilities, gambling facilities, and liquor stores) and use of proceeds to pay costs of issuance (e.g., bond counsel and underwriter fees). Additionally, the term of the bonds generally may not exceed 120 percent of the economic life of the property being financed and certain public approval requirements (similar to requirements that typically apply under State law to issuance of governmental debt) apply under Federal law to issuance of private activity bonds. Present and prior law precludes substantial users of property financed with private activity bonds from owning the bonds to prevent their deducting tax-exempt interest paid to themselves. Finally, owners of most private-activity-bond-financed property are subject to special "change-in-use" penalties if the use of the bond-financed property changes to a use that is not eligible for tax-exempt financing while the bonds are outstanding.

Taxation of income from timber harvesting

In general, gross income for Federal income tax purposes means all income from whatever source derived, including gross income derived from a trade or business. An organization exempt from taxation generally is subject to tax on its unrelated business taxable income, generally defined to mean gross income (less deductions) derived from a trade or business, the conduct of which is not substantially related to the exercise or performance of the organization's exempt purposes or functions, that is regularly carried on by the organization. Special unrelated trade or business income rules applicable to the cutting of timber are contained in sections 512(b)(5) and 631. Under these rules, the determination of whether income derived from the cutting of timber constitutes unrelated trade or business income depends upon a variety of factors.

Explanation of Provision

Exempt facility bonds

The bill permits the Evergreen Forest Trust[11] to acquire forest and forest land in the State of Washington using up to $250 million of tax-exempt bonds. The bill creates a new category of tax-exempt bonds, the qualified forest conservation bond. A qualified forest conservation bond means any bond issued as part of an issue if: (1) 95 percent or more of the net proceeds of such issue are to be used for qualified project costs; (2) such bond is an obligation of the State of Washington or any political subdivision thereof and is issued for the Evergreen Forest Trust; and (3) such bond is issued before October 1, 2004.

Qualified project costs include the cost of acquisition by the Evergreen Forest Trust, from an unrelated person, of forest and forest land that are located in the State of Washington and that, at the time of acquisition or immediately thereafter, are subject to a conservation restriction. Qualified project costs also include interest on the qualified forest conservation bonds for the three-year period beginning on the date of issuance of such bonds, and credit enhancement fees that constitute qualified guarantee fees.

Subject to the following exceptions and modifications, issuance of these tax-exempt bonds is subject to the general rules applicable to issuance of exempt-facility private activity bonds:

(1) Issuance of the bonds is not subject to the aggregate annual State private activity bond volume limits (section 146);

(2) The restrictions on acquisition of land and existing property do not apply (section 147(c) and (d));

(3) For purposes of section 147(b) (relating to the rule that maturity may not exceed 120 percent of economic life) the land and standing timber acquired with the proceeds of the bonds is treated as having an economic life of 35 years; and

(4) Interest on the bonds is not a preference item for purposes of the alternative minimum tax preference for private activity bond interest (section 57(a)(5)).

Qualified forest conservation bonds may be currently refunded if certain circumstances are met, but may not be advance refunded.

Exclusion of certain income from income tax

Under the bill, income, gains, deductions, losses, or credits from a qualified harvesting activity conducted by the Evergreen Forest Trust are not subject to tax or taken into account for

[11] The Evergreen Forest Trust is a nonprofit corporation incorporated on February 25, 2000, under chapter 24.03 of the Revised Code of Washington, recognized as an organization described under section 501(c)(3) on May 11, 2001.

Federal income tax purposes. A qualified harvesting activity means the sale, lease, or harvesting of standing timber on land acquired by the trust with the qualified forest conservation bond proceeds and pursuant to a qualified conservation plan. The exclusion of income derived from a qualified harvesting activity generally applies so long as the trust retains its status as a nonprofit entity organized and operated for charitable and conservation purposes, and the qualified forest conservation bonds are outstanding and qualify as section 142 bonds.

Timber cutting and the sale or lease of timber is not a qualified harvesting activity during any period the trust fails to satisfy certain organizational requirements (i.e., it ceases to be a qualified organization). Further, timber cutting and the sale or lease of timber is not a qualified harvesting activity to the extent the timber cutting exceeds certain prescribed limits. For this purpose, the average annual area of timber harvested cannot exceed 2.5 percent of the total area of the land acquired with the qualified forest conservation bonds, and the quantity of timber removed from the land cannot violate sustained-yield principles (i.e., the removal of timber cannot diminish the forest's timber yield potential on an ongoing basis). Certain deviations from these restrictions are permitted to protect the forest from catastrophic danger.

A qualified conservation plan means a multiple use plan (a) designed and administered primarily for specific conservation purposes, including the protection of wildlife, fish, timber, scenic attributes, recreation, and soil and water quality of the forest and forest land, (b) mandates that forest conservation is the single-most significant use of the forest and land, and (c) requires that timber harvesting be consistent with restoring and maintaining the forest to its historic condition as to types and ages of trees, preventing damage from fire, insect and disease, promoting certain forestry management research, and protecting or preserving wildlife, fish, and open space.

The Evergreen Forest Trust remains a qualified organization so long as (a) it is a nonprofit entity organized and operated exclusively for charitable purposes, specifically with respect to forest lands and other renewable resources, (b) more than one half of the value of property of which consists of forest and forest lands acquired with the qualified forest conservation bonds, (c) it periodically conducts public education programs, (d) its board satisfies certain board composition requirements designed to ensure that it represents public conservation interests, (e) a supermajority vote is required to approve and amend the trust's qualified conservation plan, and (f) upon dissolution, the trust's assets must be dedicated to a qualified conservation organization exempt from tax under section 501(c)(3) or a governmental unit.

Once the qualified forest conservation bonds are no longer outstanding (or cease to qualify as section 142 bonds), the trust is liable for a recapture of tax benefits (plus interest) it derived from the bill's special exclusion rules, to the extent the trust's harvesting activities exceeded the 2.5 percent average annual area limitation.

Effective Date

The provision is effective for obligations issued after the date of enactment.

TITLE V. RELIEF AND EQUITY FOR SMALL BUSINESSES

A. Simplification of Excise Tax Imposed on Bows and Arrows (sec. 501 of the bill and sec. 4161 of the Code)

Present Law

The Code imposes an excise tax of 11 percent on the sale by a manufacturer, producer or importer of any bow with a draw rate of 10 pounds or more.[12] An excise tax of 12.4 percent is imposed on the sale by a manufacturer or importer of any shaft, point, nock, or vane designed for use as part of an arrow which after its assembly (1) is over 18 inches long, or (2) is designed for use with a taxable bow (if shorter than 18 inches).[13] No tax is imposed on finished arrows. An 11-percent excise tax also is imposed on any part of an accessory for taxable bows and on quivers for use with arrows (1) over 18 inches long or (2) designed for use with a taxable bow (if shorter than 18 inches).[14]

Explanation of Provision

The bill increases the minimum draw weight for a taxable bow from 10 pounds to 30 pounds. The bill also imposes an excise tax of 12 percent on arrows generally. An arrow for this purpose is defined as an arrow shaft to which additional components are attached. The present law 12.4-percent excise tax on certain arrow components is unchanged by the proposal. The bill provides that the 12-percent excise tax on arrows will not apply if the arrow contains an arrow shaft that was subject to the tax on arrow components. Finally, the bill subjects certain broadheads (a type of arrow point) to an excise tax equal to 11 percent of the sales price instead of 12.4 percent.

Effective Date

The provision is effective for articles sold by the manufacturer, producer, or importer 90 days after the date of enactment.

B. Capital Gains Treatment to Apply to Outright Sales of Timber by Landowner (sec. 502 of the bill and sec. 631(b) of the Code)

Present Law

Under present law, a taxpayer disposing of timber held for more than one year is eligible for capital gains treatment in three situations. First, if the taxpayer sells or exchanges timber that is a capital asset (sec. 1221) or property used in the trade or business (sec. 1231), the gain generally is long-term capital gain; however, if the timber is held for sale to customers in the taxpayer's

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[12] Sec. 4161(b)(1)(A).

[13] Sec. 4161(b)(2).

[14] Sec. 4161(b)(1)(B).

business, the gain will be ordinary income. Second, if the taxpayer disposes of the timber with a retained economic interest, the gain is eligible for capital gain treatment (sec. 631(b)). Third, if the taxpayer cuts standing timber, the taxpayer may elect to treat the cutting as a sale or exchange eligible for capital gains treatment (sec. 631(a)).

Explanation of Provision

Under the bill, in the case of a sale of timber by the owner of the land from which the timber is cut, the requirement that a taxpayer retain an economic interest in the timber in order to treat gains as capital gain under section 631(b) does not apply. Outright sales of timber by the landowner will qualify for capital gains treatment in the same manner as sales with a retained economic interest qualify under present law, except that the usual tax rules relating to the timing of the income from the sale of the timber will apply (rather than the special rule of section 631(b) treating the disposal as occurring on the date the timber is cut).

Effective Date

The provision is effective for sales of timber after the date of enactment.

C. Repeal Excise Tax on Fishing Tackle Boxes (sec. 503 of the bill and sec. 4162 of the Code)

Present Law

Under present law, a 10-percent manufacturer's excise tax is imposed on specified sport fishing equipment. Examples of taxable equipment include fishing rods and poles, fishing reels, artificial bait, fishing lures, line and hooks, and fishing tackle boxes. Revenues from the excise tax on sport fishing equipment are deposited in the Sport Fishing Account of the Aquatic Resources Trust Fund. Monies in the fund are spent, subject to an existing permanent appropriation, to support Federal-State sport fish enhancement and safety programs.

Explanation of Provision

The excise tax on fishing tackle boxes is repealed.

Effective Date

The provision is effective beginning 30 days after the date of enactment.

D. Modify At-Risk Rules for Publicly Traded Nonrecourse Debt (sec. 504 of the bill and sec. 465(b)(6) of the Code)

Present Law

Present law provides an at-risk limitation on losses from business and income-producing activities, applicable to individuals and certain closely held corporations.[15] Under the at-risk

[15] Sec. 465.

rules, a taxpayer generally is not considered at risk with respect to borrowed amounts if the taxpayer is not personally liable for repayment of the debt (e.g., nonrecourse loans), and in certain other circumstances.

In the case of the activity of holding real property, however, an exception is provided for qualified nonrecourse financing that is secured by real property used in the activity.[16] The qualified nonrecourse financing rules require, among other things, that the financing be borrowed by the taxpayer from a qualified person or from certain governmental entities. For this purpose, a qualified person is one that is actively and regularly engaged in the business of lending money (and that is not a related person with respect to the taxpayer, is not a person from whom the taxpayer acquired the property or a related person, and is not a person that receives a fee with respect to the taxpayer's investment or a related person.[17] A related person is one with certain types of relationships to the taxpayer defined by statute.[18] The qualified nonrecourse financing rules also require that the financing be secured by real property used in the activity.[19]

Explanation of Provision

The bill modifies the rules relating to qualified nonrecourse financing to provide that, in the case of an activity of holding real property, a taxpayer is considered at risk with respect to the taxpayer's share of certain financing that is not borrowed from a person that is regularly engaged in the business of lending money, and that is not secured by real property used in the activity, if the financing is qualified publicly traded debt.

The financing may not be borrowed from a person that is a related person with respect to the taxpayer, that is a person from whom the taxpayer acquired the property or a related person, or that is a person that receives a fee with respect to the taxpayer's investment or a related person.

Qualified publicly traded debt generally means any debt instrument that is readily tradable on an established securities market. However, qualified publicly traded debt does not include any debt instrument, the yield to maturity on which equals or exceeds the applicable Federal rate of interest for the calendar month in which it is issued, plus 5 percentage points. The applicable Federal rate is the rate determined under section 1274(d) with respect to the term of the debt instrument. Under the bill, it is intended that "readily tradable on an established securities market" have the same meaning as under section 453(f)(5).

Effective Date

The provision is effective for debt instruments issued after the date of enactment.

[16] Sec. 465(b)(6).

[17] Sec. 49(a)(1)(D)(iv).

[18] Sec. 465(b)(3)(C).

[19] Sec. 465(b)(6)(A).

TITLE VI. FARMER EQUITY PROVISIONS

A. Special Rules for Livestock Sold on Account of Weather-Related Conditions (sec. 601 of the bill and secs. 1033 and 451 of the Code)

Present Law

Generally, a taxpayer recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

Under section 1033, gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the applicable period. The taxpayer's basis in the replacement property generally is the same as the taxpayer's basis in the converted property, decreased by the amount of any money or loss recognized on the conversion, and increased by the amount of any gain recognized on the conversion.

The applicable period for the taxpayer to replace the converted property begins with the date of the disposition of the converted property (or if earlier, the earliest date of the threat or imminence of requisition or condemnation of the converted property) and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized (the "replacement period"). Special rules extend the replacement period for certain real property and principle residences damaged by a Presidentially declared disaster to three years and four years, respectively, after the close of the first taxable year in which gain is realized.

Section 1033(e) provides that the sale of livestock (other than poultry) that is held for draft, breeding, or dairy purposes in excess of the number of livestock that would have been sold but for drought, flood, or other weather-related conditions is treated as an involuntary conversion. Consequently, gain from the sale of such livestock could be deferred by reinvesting the proceeds of the sale in similar property within a two-year period.

In general, cash-method taxpayers report income in the year it is actually or constructively received. However, section 451(e) provides that a cash-method taxpayer whose principal trade or business is farming who is forced to sell livestock due to drought, flood, or other weather-related conditions may elect to include income from the sale of the livestock in the taxable year following the taxable year of the sale. This elective deferral of income is available only if the taxpayer establishes that, under the taxpayer's usual business practices, the sale would not have occurred but for drought, flood, or weather-related conditions that resulted in the area being designated as eligible for Federal assistance. This exception is generally intended to put taxpayers who receive an unusually high amount of income in one year in the position they would have been in absent the weather-related condition.

Explanation of Provision

The bill extends the applicable period for a taxpayer to replace livestock sold on account of drought, flood, or other weather-related conditions from two years to four years after the close of the first taxable year in which any part of the gain on conversion is realized. The extension is only available if the taxpayer establishes that, under the taxpayer's usual business practices, the sale would not have occurred but for drought, flood, or weather-related conditions that resulted in the area being designated as eligible for Federal assistance. In addition, the Secretary of the Treasury is granted authority to further extend the replacement period on a regional basis should the weather-related conditions continue longer than 3 years. Also, for property eligible for the bill's extended replacement period, the bill provides that the taxpayer can make an election under section 451(e) until the period for reinvestment of such property under section 1033 expires.

Effective Date

The provision is effective for any taxable year with respect to which the due date (without regard to extensions) for the return is after December 31, 2002.

B. Coordinate Farmers Income Averaging and the Alternative Minimum Tax (sec. 602 of the bill and sec. 55 of the Code)

Present Law

An individual taxpayer engaged in a farming business as defined by section 263A(e)(4) may elect to compute his or her current year tax liability by averaging, over the prior three-year period, all or a portion of his or her taxable income from the trade or business of farming. The averaging election is not coordinated with the alternative minimum tax. Thus, some farmers may become subject to the alternative minimum tax solely as a result of the averaging election.

Explanation of Provision

The bill coordinates farmers income averaging with the alternative minimum tax. Under the bill, a farmer would owe alternative minimum tax only to the extent he or she would owe alternative minimum tax had averaging not been elected. This result is achieved by excluding the impact of the election to average farm income from the calculation of both regular tax and tentative minimum tax, solely for the purpose of determining alternative minimum tax.

Effective Date

The bill is effective for taxable years beginning after December 31, 2002.

C. Payment of Dividends on Stock of Cooperatives Without Reducing Patronage Dividends (sec. 603 of the bill and sec. 1388 of the Code)

Present Law

Under present law, cooperatives generally are treated similarly to pass-through entities in that a cooperative is not subject to corporate income tax to the extent the cooperative timely pays patronage dividends. In general, patronage dividends are comprised of amounts that are paid to patrons (1) on the basis of the quantity or value of business done with or for patrons, (2) under a valid enforceable written obligation to the patron that was in existence before the cooperative received such amounts, and (3) which are determined by reference to the net earnings of the cooperative from business done with or for patrons.

Treasury Regulations provide that net earnings are reduced by dividends paid on capital stock or other proprietary capital interests (referred to as the "dividend allocation rule").[20] The effect of this rule is to reduce the amount of earnings that a cooperative can treat as patronage income and, thus, the amount that the cooperative can deduct as patronage dividends.

Explanation of Provision

The bill provides a special rule for dividends on capital stock of a cooperative. To the extent provided in organizational documents of the cooperative, dividends on capital stock do not reduce patronage income.

Effective Date

The provision is effective for distributions made in taxable years beginning after the date of enactment.

[20] Treas. Reg. sec. 1.1388-1(a)(1).

TITLE VII. SOCIAL SECURITY HOLD HARMLESS PROVISION

A. No Impact on Social Security Trust Funds Under Title II of the Social Security Act (sec. 703 of the bill)

Present Law

Present law provides for the transfer of Social Security taxes and certain self-employment taxes to the Social Security trust funds. In addition, the income tax collected with respect to a portion of Social Security benefits included in gross income is transferred to the Social Security trust funds.

Explanation of Provision

The bill provides that any amounts to be transferred to any trust fund under Title II of the Social Security Act are determined as if this bill has not been enacted. This will ensure that the income and balances of those Social Security trust funds are not reduced as a result of this bill.

Effective Date

The provision is effective on the date of enactment.