

## I. TAX TECHNICAL CORRECTIONS ACT OF 2007

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

### **Amendment related to the Tax Relief and Health Care Act of 2006**

**Individuals with long-term unused credits under the alternative minimum tax (Act sec. 402 of Division A).**—Under present law, an individual's minimum tax credit allowable for any taxable year beginning after December 20, 2006, and before January 1, 2013, is not less than the “AMT refundable credit amount.” The AMT refundable credit amount is the greater of (1) the lesser of \$5,000 or the long-term unused minimum tax credit, or (2) 20 percent of the long-term unused minimum tax credit. The long-term unused minimum tax credit for any taxable year means the portion of the minimum tax credit attributable to the adjusted net minimum tax for taxable years before the 3rd taxable year immediately preceding the taxable year (assuming the credits are used on a first-in, first-out basis). In the case of an individual whose adjusted gross income for a taxable year exceeds the threshold amount (within the meaning of section 151(d)(3)(C)), the AMT refundable credit amount is reduced by the applicable percentage (within the meaning of section 151(d)(3)(B)). The additional credit allowable by reason of this provision is refundable.

The provision amends the definition of the AMT refundable credit amount. The provision provides that the AMT refundable credit amount (before any reduction by reason of adjusted gross income) is an amount (not in excess of the long-term unused minimum tax credit) equal to the greater of (1) \$5,000, (2) 20 percent of the long-term unused minimum tax credit, or (3) the AMT refundable credit amount (if any) for the prior taxable year (before any reduction by reason of adjusted gross income).

The provision may be illustrated by the following example: Assume an individual, whose adjusted gross income for all taxable years is less than the threshold amount, has a long-term unused minimum tax credit for 2007 of \$100,000 and has no other minimum tax credits. The individual's AMT refundable credit amount under present law is \$20,000 in 2007, \$16,000 in 2008, \$10,240 in 2009, \$8,192 in 2010, \$6,554 in 2011, and \$5,243 in 2012. Under the provision, the individual's AMT refundable credit amount is \$20,000 for 2007 (as under present law), and in each of the taxable years 2008 thru 2011 the AMT refundable credit amount is also \$20,000. The minimum tax credit in 2012 is zero.

### **Amendments related to Title XII of the Pension Protection Act of 2006 (Provisions Relating to Exempt Organizations)**

**Tax-free distributions from individual retirement plans for charitable purposes (Act sec. 1201).**—Under the provision, when determining the portion of a distribution that would otherwise be includible in income, the otherwise includible amount is determined as if all amounts were distributed from all of the individual's IRAs.

**Contributions of appreciated property by S corporations (Act sec. 1203).**—Under present law (sec. 1366(d)), the amount of losses and deductions which a shareholder of an S corporation may take into account in any taxable year is limited to the shareholder's adjusted basis in his stock and indebtedness of the corporation. The provision provides that this basis limitation does not apply to a contribution of appreciated property to the extent the shareholder's pro rata share of the contribution exceeds the shareholder's pro rata share of the adjusted basis of the property. Thus, the basis limitation of section 1366(d) does not apply to the amount of deductible appreciation in the contributed property. The provision does not apply to contributions made in taxable years beginning after December 31, 2007.

For example, assume that in taxable year 2007, an S corporation with one shareholder makes a charitable contribution of a capital asset held more than one year with an adjusted basis of \$200 and a fair market value of \$500. Assume the shareholder's adjusted basis of the stock (as determined under section 1366(d)(1)(A)) is \$300. For purposes of applying the limitation under section 1366(d) to the contribution, the limitation does not apply to the \$300 of appreciation and since the \$300 adjusted basis of the stock exceeds the \$200 adjusted basis of the contributed property, the limitation does not apply at all to the contribution. Thus, the shareholder is treated as making a \$500 charitable contribution. The shareholder reduces the basis of the S corporation stock by \$200 to \$100 (pursuant to section 1367(a)(2)).

**Recapture of tax benefit for charitable contributions of exempt use property not used for an exempt use (Act sec. 1215).**—The Act permits a charitable deduction in the amount of the fair market value (not the donor's basis) for tangible personal property if an officer of the donee organization certifies upon disposition of the donated property that the use of the property was related to the purpose or function constituting the basis of the donee's tax-exempt status. It was not intended that the donee's use, though so related, not also be substantial. The provision adds to the certification requirement that the officer certify that use of the property by the donee was substantial.

**Contributions of fractional interests in tangible personal property (Act sec. 1218).**—The Act added an income tax provision providing for treatment of contributions of fractional interests in tangible personal property. A special valuation rule is provided under this rule that creates unintended consequences under the estate and gift tax. The provision therefore strikes the special valuation rule for estate and gift tax purposes.

**Time for assessment of penalty relating to substantial and gross valuation misstatements attributable to incorrect appraisals (Act section 1219).**—Section 1219 of the Act added a penalty for substantial and gross valuation misstatements attributable to incorrect appraisals (Code sec. 6695A). First, the Act omitted to apply the penalty with respect to substantial valuation misstatements for estate and gift tax purposes, and the provision clarifies that the penalty applies for such purposes. Second, in the cross references for the penalty, the language of Code section 6696(d)(1), relating to the time period for assessment of the penalty, was not properly described. The provision adds a cross reference to section 6695A in section 6696(d).

**Expansion of the base of tax on private foundation net investment income (Act sec. 1221).**—The Act expands the base of the tax on net investment income of private foundations.

The provision clarifies that capital gains from appreciation are included in this tax base. This clarification conforms the statutory language to the technical explanation.

**Public disclosure of information relating to unrelated business income tax returns (Act sec. 1225).**—The Act added a provision requiring that section 501(c)(3) organizations make publicly available their unrelated business income tax returns. However, as drafted, the requirement that, with respect to a Form 990, an organization make publicly available only the last three years of returns (sec. 6104(d)(2)) does not apply to disclosure of Form 990-T, because Form 990-T is required by section 6011, not by section 6033. The provision clarifies that the 3-year limitation on making returns publicly available applies to Form 990-T. The provision clarifies that the IRS is required to make Form 990-T publicly available, subject to redaction procedures applicable to Form 990 under section 6104(b).

**Donor advised funds (Act 1231).**—The Act imposed excise taxes in the event of certain taxable distributions (Code sec. 4966) and on the provision of certain prohibited benefits (sec. 4967), but does not cross refer to these provisions in the section 4962 definition of qualified first tier taxes for purposes of tax abatement (though a cross reference to them is included in section 4963). The provision adds a cross reference to them in Code section 4962 (relating to abatement).

**Excess benefit transactions involving supporting organizations (Act sec. 1242).**—New Code section 4958(c)(3) provides that certain transactions involving supporting organizations are treated as excess benefit transactions for purposes of the intermediate sanctions rules. Under the Code, certain organizations described in Code sections 501(c)(4), (5) or (6) are treated as supported organizations, although they are not public charities or safety organizations. The provision provides that the excess benefit transaction rules of the Act generally do not apply to transactions between a supporting organization and its supported organization that is described in section 501(c)(4), (5), or (6).

### **Amendments related to the Tax Increase Prevention and Reconciliation Act of 2005**

**Look-through treatment and regulatory authority (Act sec. 103(b)).**—Under the Act, for taxable years beginning after 2005 and before 2009, dividends, interest (including factoring income which is treated as equivalent to interest under sec. 954(c)(1)(E)), rents, and royalties received by one controlled foreign corporation (“CFC”) from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to non-subpart F income of the payor (the “TIPRA look-through rule”).

The provision clarifies the treatment of deficits in earnings and profits. Under the provision, the TIPRA look-through rule does not apply to any interest, rent, or royalty to the extent that such interest, rent, or royalty creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another CFC. The provision parallels the rule applicable to interest, rents, or royalties that would otherwise qualify for exclusion from foreign personal holding company income under the “same country” exception (sec. 954(c)(3)(B)). Thus interest, rents, and royalties will be treated as subpart F income, notwithstanding the general TIPRA look-through rule, if the payment creates or increases a deficit of the payor corporation and that deficit is from an activity that could reduce the payor’s

subpart F income under the accumulated deficit rule (sec. 952(c)(1)(B)), or could reduce the income of a qualified chain member under the chain deficit rule (sec. 952(c)(1)(C)). For example, under the provision, items that do not qualify for the “same country” exception because they meet the terms of section 954(c)(3)(B) will also not qualify under the TIPRA look-through rule.

**Modification of active business definition under section 355 (Act sec. 202).**—The provision revises Code sections 355(b)(2)(A) and 355(b)(3) to reflect that the provision modifying the active business definition that was enacted by section 202 of the Act was made permanent by section 410 of the Tax Relief and Health Care Act of 2006. Conforming amendments are made as a result of this change.

The provision clarifies that if a corporation became a member of a separate affiliated group as a result of one or more transactions in which gain or loss was recognized in whole or in part, any trade or business conducted by such corporation (at the time that such corporation became such a member) is treated for purposes of section 355(b)(2) as acquired in a transaction in which gain or loss was recognized in whole or in part. Accordingly, such an acquisition is subject to the provisions of section 355(b)(2)(C), and may qualify as an expansion of an existing active trade or business conducted by the distributing corporation or the controlled corporation, as the case may be.

The provision clarifies that the Treasury Department shall prescribe regulations that provide for the proper application of sections 355(b)(2)(B), (C), and (D) in the case of any corporation that is tested for active business under the separate affiliated group rule, and that modify the application of section 355(a)(3)(B) in the case of such a corporation in a manner consistent with the purposes of the provision.

The provision further clarifies that the rule regarding the application of the new rules to determine the continued qualification under section 355 of a distribution that occurred before the effective date of the new rules, shall apply only if such application results in continued qualification and is not intended to require application of the new rules in a manner that would disqualify any distribution that satisfied the active business requirements of section 355 under prior law that was applicable to the distribution.

**Computation of tax for individuals with income excluded under the foreign earned income exclusion (Act sec. 515).**—The provision clarifies that in computing the tentative minimum tax on nonexcluded income, the computation of tax is made before reduction for the alternative minimum tax foreign tax credit. This conforms the computation of the tentative minimum tax to the computation of the regular tax, so that both computations are made before the application of the foreign tax credit.

The provision also corrects an error in present law in the case where a taxpayer has net capital gain in excess of taxable income. Under the provision, if a taxpayer’s net capital gain (within the meaning of section 1(h)) exceeds taxable income, in computing the tax on the taxable income as increased by the excluded income, the amount of net capital gain which otherwise be taken into account is reduced by the amount of that excess. The excess first reduces the amount of net capital gain without regard to qualified dividend income, and then qualified dividend

income. Also, in computing adjusted net capital gain, unrecaptured section 1250 gain, and 28-percent rate gain, the amount of the excess is treated in the same manner as an increase in the long-term capital loss carried to the taxable year.

Similar rules apply in computing the tentative minimum tax where a taxpayer's net capital gain exceeds the taxable excess.

The provision is effective for taxable years beginning after December 31, 2006.

The following examples illustrate the provision:

**Example 1.**—For taxable year 2007, an unmarried individual has \$80,000 excluded from gross income under section 911(a), \$30,000 gain from the sale of a capital asset held more than one year, and \$20,000 deductions. The taxpayer's taxable income is \$10,000. Under the provision, the regular tax is the excess of (i) the amount of tax computed under section 911(f)(1)(A)(i) on taxable income of \$90,000 (\$10,000 taxable income plus \$80,000 excluded income), over (ii) the amount of tax computed under section 911(f)(1)(A)(ii) on taxable income of \$80,000 (excluded income). In applying section 1(h) to determine the tax under section 911(f)(1)(A)(i), the net capital gain and the adjusted net capital gain are each \$10,000. The regular tax is \$1,500, which is equal to a tax at the rate of 15 percent on \$10,000 of adjusted net capital gain.

**Example 2.**—For taxable year 2007, an unmarried individual has \$90,000 excluded from gross income under section 911(a), \$5,000 gain from the sale of a capital asset held more than one year, \$25,000 unrecaptured section 1250 gain, and \$20,000 deductions. The taxpayer's taxable income is \$10,000. Under the provision, the regular tax is the excess of (i) the amount of tax computed under section 911(f)(1)(A)(i) on taxable income of \$100,000 (\$10,000 taxable income plus \$90,000 excluded income), over (ii) the amount of tax computed under section 911(f)(1)(A)(ii) on taxable income of \$90,000 (excluded income). In applying section 1(h) to determine the tax under section 911(f)(1)(A)(i), the net capital gain is \$10,000. \$5,000 is unrecaptured section 1250 gain (\$25,000 less \$20,000) and \$5,000 is adjusted net capital gain. The regular tax is \$2,000, which is equal to a tax at the rate of 15 percent on \$5,000 of adjusted net capital gain and a tax at the rate of 25 percent on \$5,000 of unrecaptured section 1250 gain.

### **Amendments related to the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users**

**Timing of claims for excess alternative fuel (not in a mixture) credit (Act sec. 11113).**—Present law provides that the alternative fuel (not in a mixture) credit is refundable. Code section 6427(i)(3) permits claims to be filed on a weekly basis with respect to alcohol, biodiesel, and alternative fuel mixtures if certain requirements are met. This rule, however, does not refer to the alternative fuel credit (for alternative fuel not in a mixture). The provision clarifies that the same rules for filing claims with respect to fuel mixtures apply to the alternative fuel credit.

**Definition of alternative fuel (Act sec. 11113).**—Code section 6426(d)(2) defines alternative fuel to include “liquid hydrocarbons from biomass” for purposes of the alternative fuel excise tax credit and payment provisions under sections 6426 and 6427. The statute does

not define liquid hydrocarbons, which has led to questions as to whether it is permissible for such a fuel to contain other elements, such as oxygen, or whether the fuel must consist exclusively of hydrogen and carbon. It was intended that biomass fuels such as fish oil, which is not exclusively made of hydrogen and carbon, qualify for the credit. The provision changes the reference in section 6426 from “liquid hydrocarbons” to “liquid fuel” for purposes of the alternative fuel excise tax credit and payment provisions.

### **Amendments related to the Energy Policy Act of 2005**

**Credit for production from advanced nuclear power facilities (Act sec. 1306).**—The provision clarifies that the national capacity limitation of 6,000 megawatts represents the total number of megawatts that the Secretary has authority to allocate under section 45J.

**Clarify limitation on the credit of installing alternative fuel refueling property (Act sec. 1342).**—The present-law credit for qualified alternative fuel vehicle refueling property for a taxable year is limited to \$30,000 per property subject to depreciation, and \$1,000 for other property (sec. 30C(b)). The provision clarifies that the \$30,000 and \$1,000 limitations apply to all alternative fuel vehicle refueling property placed in service by the taxpayer at a location. The provision is consistent with similar deduction limitations imposed under section 179A(b)(2)(A) (relating to the deduction for clean-fuel vehicles and certain refueling property).

In addition, Code section 30C(c)(1) provides that qualified alternative fuel vehicle refueling property has the meaning given to the term by section 179A(d). However, section 179A(d) defines a different term. The provision modifies the language of section 30C(c)(1) to refer to the correct term.

**Clarify that research eligible for the energy research credit is qualified research (Act sec. 1351).**—The energy research credit is available with respect to certain amounts paid or incurred to an energy research consortium. The provision clarifies that the credit is available with respect to such amounts paid or incurred to an energy research consortium provided they are used for energy research that is qualified research.

**Double taxation of rail and inland waterway fuel resulting from the use of dyed fuel on which the Leaking Underground Storage Tank Trust Fund tax has already been imposed; off-highway business use (Act sec. 1362).**—Section 4081(a)(2)(B) of the Code imposes tax at the Leaking Underground Storage Tank Trust Fund financing tax rate of 0.1 cent per gallon on diesel fuel at the time it is removed from a terminal. Section 4082(a) provides that none of the generally applicable exemptions other than the exemption for export apply to this removal even if the fuel is dyed. When dyed fuel is used or sold for use in a diesel powered highway vehicle or train (sec. 4041), or such fuel is subject to the inland waterway tax (sec. 4042), the Code inadvertently imposes the Leaking Underground Storage Tank Trust Fund tax a second time. Section 6430 prohibits the refund of taxes imposed at the Leaking Underground Storage Tank Trust Fund financing rate, except in the case of fuel destined for export. The provision eliminates the imposition of the 0.1 cent tax a second time if the Leaking Underground Storage Tank Trust Fund financing tax rate previously was imposed under section 4081. The provision permits a refund in the amount of the Leaking Underground Storage Tank Trust Fund financing rate if such tax was imposed a second time under 4041 or 4042 from October 1, 2005

through the date of enactment. The provision also clarifies that off-highway business use is not exempt from the Leaking Underground Storage Tank Trust Fund Financing rate. For administrative reasons associated with collecting the tax, the off-highway business use clarification is effective for fuel sold for use or used after the date of enactment.

**Exemption from the Leaking Underground Storage Tank Trust Fund financing rate for aircraft and vessels engaged in foreign trade (Act sec. 1362).**—Fuel supplied in the United States for use in aircraft engaged in foreign trade is exempt from U.S. customs duties and internal revenue taxes, so long as, where the aircraft is registered in a foreign State, the State of registry provides substantially reciprocal privileges for U.S.-registered aircraft. However, the Energy Policy Act of 2005 imposed, without exemption, the Leaking Underground Storage Tank Trust Fund financing rate on all taxable fuels, except in the case of export. As a result, aviation fuel is no longer exempt from the Leaking Underground Storage Tank Trust Fund financing rate. According to the State Department, almost all of the United States’ bilateral air services agreements contain provisions exempting from taxation all fuel supplied in the territory of one party for use in the aircraft of the other party. The United States has interpreted these provisions to prohibit the taxation, in any form, of aviation fuel supplied in the United States to the aircraft of airlines of the foreign countries that are parties to these air services agreements. The amendment provides that fuel for use in vessels (including civil aircraft) employed in foreign trade or trade between the United States and any of its possessions is exempt from the Leaking Underground Storage Tank Trust Fund financing rate.

#### **Amendments related to the American Jobs Creation Act of 2004**

**Interaction of rules relating to credit for low sulfur diesel fuel (Act sec. 339).**—Section 45H of the Code allows a credit at the rate of 5 cents per gallon for low sulfur diesel fuel produced at certain small business refineries. The aggregate credit with respect to any refinery is limited to 25 percent of the costs of the type deductible under section 179B of the Code. Section 179B allows a deduction for 75 percent of certain costs paid or incurred with respect to these refineries. The basis of the property is reduced by the amount of any credit determined with respect to any expenditure (sec. 45H(d)). Further, no deduction is allowed for the expenses otherwise allowable as a deduction in an amount equal to the amount of the credit under section 45H (sec. 280C(d)). The interaction of these provisions is unclear, and the basis reduction and deduction denial rules may have an unintentionally duplicative effect. Under the provision, deductions are denied in an amount equal to the amount of the credit under section 45H, and the provisions of present law reducing basis and denying a deduction are repealed.

**Eliminate the open-loop biomass segregation requirement in section 45(c)(3)(A)(ii) (Act sec. 710).**—For purposes of the credit for electricity produced from certain renewable resources, section 45(c)(3)(A)(ii) defines open-loop biomass to include any solid, nonhazardous, cellulosic waste material or any lignin material that is segregated from other waste materials, and that meets other requirements. The Act added municipal solid waste to the category of qualified energy resources giving rise to the credit. Thus, both open-loop biomass and municipal solid waste can be treated as qualified energy resources. The provision therefore strikes the requirement that open-loop biomass be segregated from other waste materials in order to be treated as qualified energy resources.

**Clarification of proportionate limitation applicable to closed-loop biomass (Act sec. 710).**—Section 45(d)(2)(B)(ii) provides that when closed-loop biomass is co-fired with other fuels, the credit is limited to the otherwise allowable credit multiplied by the ratio of the thermal content of the closed-loop biomass to the thermal content of all fuel used. This limitation duplicates a similar limitation in section 45(a), which provides that the credit is equal to 1.5 cents multiplied by the kilowatt hours of electricity produced by the taxpayer from qualified energy resources (and meeting other criteria). The present-law section 45(a) rule has the effect of limiting the credit (or duration of the credit) to the appropriate portion of the fuel that constitutes qualified energy resources, in the situations in which qualified energy resources are permitted to be co-fired with each other, or are permitted to be co-fired with other fuels. The provision clarifies that the limitation applies only once, not twice, to closed-loop biomass co-fired with other fuels, by striking the duplicate limitation in section 45(d)(2)(B)(ii).

**Treatment of partnerships under the limitation on deductions allocable to property used by governments or other tax-exempt entities (Act sec. 848).**—Code section 470 generally applies loss deferral rules in the case of property leased to tax-exempt entities. This rule applies with respect to tax-exempt use property, which for this purpose generally has the meaning given to the term by section 168(h) (with exceptions specified in section 470(c)(2)). The manner of application of section 470 in the case of property owned by a partnership in which a tax-exempt entity is a partner is unclear.

The provision provides that tax-exempt use property does not include any property that would be tax-exempt use property solely by reason of section 168(h)(6). The provision refers to section 7701(e) for circumstances in which a partnership is treated as a lease to which section 168(h) applies. Thus, if a partnership is recharacterized as a lease pursuant to section 7701(e), and a provision of section 168(h) (other than section 168(h)(6)) applies to cause the property characterized as leased to be treated as tax-exempt use property, then the loss deferral rules of section 470 apply.

Under section 7701(e)(2), a partnership may be treated as a lease, taking into account all relevant factors, including factors similar to those set forth in section 7701(e)(1) (relating to service contracts treated as leases). In the case of property of a partnership in which a tax-exempt entity is a partner, factors similar to those in section 7701(e)(1) (and in the legislative history of that section) that are relevant in determining whether a partnership is properly treated as a lease of property held by the partnership include (1) a tax-exempt partner maintains physical possession or control or holds the benefits and burdens of ownership with respect to such property, (2) there is insignificant equity investment by any taxable partner, (3) the transfer of such property to the partnership does not result in a change in use of such property, (4) such property is necessary for the provision of government services, (5) a disproportionately large portion of the deductions for depreciation with respect to such property are allocated to one or more taxable partners relative to such partner's risk of loss with respect to such property or to such partner's allocation of other partnership items, and (6) amounts payable on behalf of the tax-exempt partner relating to the property are defeased or funded by set-asides or expected set-asides. It is intended that Treasury regulations or guidance may provide additional factors that can be taken into account in determining whether a partnership with taxable and tax-exempt partners is an arrangement that resembles a lease of property under which section 470 defers the allowance of losses.



The provision is effective as if included in the provision of the American Jobs Creation Act of 2004 to which it relates. It is not intended that the provision supercede the rules set forth by the Treasury Department in Notice 2005-29, 2005-13 I.R.B. 796, Notice 2006-2, 2006-2 I.R.B. 1, and Notice 2007-4, 2007-1 I.R.B. 260, with respect to the application of section 470 in the case of partnerships for taxable years of partnerships beginning in 2004, 2005, and 2006. These notices state that the Internal Revenue Service will not apply section 470 to disallow losses associated with property that is treated as tax-exempt use property solely as a result of the application of section 168(h)(6), and that abusive transactions involving partnerships an other pass-through entities remain subject to challenge by the Internal Revenue Service under other provisions of the tax law. Accordingly, for partnership taxable years beginning in 2004, 2005, and 2006, the Internal Revenue Service may apply section 470 to a partnership that would be treated as a lease under section 7701(e)(2).

**Treatment of losses on positions in identified straddles (Act sec. 888).**—Under Code section 1092, the term “straddle” means offsetting positions in actively traded personal property. Generally, a loss on a position in a straddle may be recognized only to the extent the amount of the loss exceeds the unrecognized gain (if any) in offsetting positions in the straddle (sec. 1092(a)(1)(A)). Special rules for identified straddles provide a different treatment of losses and also provide that any position that is not part of an identified straddle is not treated as offsetting with respect to any position that is part of the identified straddle. A taxpayer is permitted to treat a straddle as an identified straddle only if, among other requirements, the straddle is not part of a larger straddle.

Before the enactment of the Act, the rules for treating a straddle as an identified straddle required that all the positions of the straddle were acquired on the same day and either that all of the positions were disposed of on the same day in a taxable year or that none of the positions were disposed of as of the close of the taxable year. A loss on a position in an identified straddle was not subject to the loss deferral rule described above but instead was taken into account when all the positions making up the straddle were disposed of.

The Act changed the rules for identified straddles by providing, among other things, that if there is a loss on a position in an identified straddle, the loss is applied to increase the basis of the offsetting positions in that identified straddle. Under section 1092(a)(2)(A)(ii), the basis of each offsetting position in an identified straddle is increased by an amount that equals the product of the amount of the loss multiplied by the ratio of the amount of unrecognized straddle period gain in that offsetting position to the aggregate amount of unrecognized straddle period gain in all offsetting positions. The Act also provided that any loss described in section 1092(a)(2)(A)(ii) is not otherwise taken into account for Federal tax purposes.

The Act left unclear the treatment of a loss on a position in an identified straddle in at least two circumstances: first, when there are no offsetting positions in the identified straddle with unrecognized straddle period gain, and, second, when an offsetting position in the identified straddle is or has been a liability to the taxpayer.

The provision addresses the treatment of losses in these two circumstances. In general, the provision reaffirms that a loss on a position in an identified straddle is not permitted to be recognized currently and also is not permanently disallowed.

The provision provides that if the application of section 1092(a)(2)(A)(ii) does not result in a basis increase in any offsetting position in the identified straddle (because there is no unrecognized straddle period gain in any offsetting position), the basis of each offsetting position in the identified straddle must be increased in a manner that (1) is reasonable, is consistent with the purposes of the identified straddle rules, and is consistently applied by the taxpayer, and (2) allocates to offsetting positions the full amount of the loss (but no more than the full amount of the loss). At the time a taxpayer adopts an allocation method under this rule, the taxpayer is expected to describe that method in its books and records.

Under the provision, unless the Secretary of the Treasury provides otherwise, similar rules apply for purposes of the identified straddle rules when there is a loss on a position in an identified straddle and an offsetting position in the identified straddle is or has been a liability or an obligation (including, for instance, a debt obligation issued by the taxpayer, a written option, or a notional principal contract entered into by the taxpayer). Under this rule, if a taxpayer, for example, receives \$1 to enter into a five-year short forward contract and the next day \$100 of loss is allocated to that position, the resulting basis of the contract is \$99.

Under present law, a straddle is treated as an identified straddle only if, among other requirements, it is clearly identified on the taxpayer's records as an identified straddle before the earlier of (1) the close of the day on which the straddle is acquired, or (2) a time that the Secretary of the Treasury may prescribe by regulations. The provision clarifies that for purposes of this identification requirement, a straddle is clearly identified only if the identification includes an identification of the positions in the straddle that are offsetting with respect to other positions in the straddle. Consequently, taxpayers are required to identify not only the positions that make up an identified straddle but also which positions in that identified straddle are offsetting with respect to one another. The offsetting positions identification requirement added by the provision is effective for straddles acquired after the date of enactment.

The provision provides that regulations or other guidance prescribed by the Secretary for carrying out the purposes of the identified straddle rules may include the rules for the application of section 1092 to a position that is or has been a liability or an obligation. Regulations or other guidance also may include safe harbor basis allocation methods that satisfy the requirements that an allocation other than under section 1092(a)(2)(A)(ii) must be reasonable, consistent with the purposes of the identified straddle rules, and consistently applied by the taxpayer.

### **Amendments related to the Economic Growth Tax Relief Reconciliation Act of 2001**

**Application of special elective deferral limit to designated Roth contributions (Act sec. 617).**—Code section 402(g)(7) provides a special rule allowing certain employees to make additional elective deferrals to a tax-sheltered annuity, subject to (1) an annual limit of \$3,000, and (2) a cumulative limit of \$15,000 minus the amount of additional elective deferrals made in previous years under the special rule. Present law provides a rule to coordinate the cumulative limit with the ability to make designated Roth contributions, but inadvertently reduces the \$15,000 amount by all designated Roth contributions made in previous years. The provision clarifies that the \$15,000 amount is reduced only by additional designated Roth contributions made under the special rule.

**Application of FICA taxes to designated Roth contributions (Act sec. 617).**—Under Code section 3121(v)(1)(A), elective deferrals are included in wages for purposes of social security and Medicare taxes. The provision clarifies that wage treatment applies also to elective deferrals that are designated as Roth contributions.

#### **Amendments related to the Tax Relief Extension Act of 1999**

**Renewable electricity sold to utilities under certain contracts (Act sec. 507).**—Code section 45(e)(7) provides that a wind energy facility placed in service by the taxpayer after June 30, 1999, does not qualify for the section 45 production tax credit if the electricity generated at the facility is sold to a utility pursuant to certain pre-1987 contracts. The provision clarifies that facilities placed in service prior to June 30, 1999, that sell electricity under applicable pre-1987 contracts are not denied the section 45 production tax credit solely by reason of a change in ownership after June 30, 1999.

**Treatment of income and services provided by taxable REIT subsidiaries (Act sec. 542).**—The provision clarifies that the transient basis language in the definition of a lodging facility applies only in determining whether an establishment other than a hotel or motel qualifies as a lodging facility.

#### **Amendment related to the Internal Revenue Service Restructuring and Reform Act of 1998**

**Redactions for background documents related to Chief Counsel Advice documents (Act sec. 3509).**—The Internal Revenue Service Restructuring and Reform Act of 1998 established a structured process by which the IRS makes certain work products, designated Chief Counsel advice (“CCA”), open to public inspection. To afford additional protection for certain governmental interests implicated by CCAs, section 6110(i)(3) governs redactions that may be made to CCAs, including the exemptions or exclusions available under the Freedom of Information Act, 5 U.S.C. § 552(b) and (c) (except that the provision for redaction under a Federal statute excludes Title 26), as well as the exemptions pertaining to taxpayer identity information described in section 6110(c)(1). Section 6110(i)(3) does not expressly address redactions to the “background file documents” related to a CCA. The provision clarifies that the CCA background file documents are governed by the same redactions as CCAs.

#### **Clerical corrections**

The bill includes a number of clerical and conforming amendments, including amendments correcting typographical errors.