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TAX REFORM BILL OF 1974

Tentative Decisions of the Ways and Means Committee Since September 11, 1974, Corresponding to Sections of Draft Bill

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PREPARED FOR THE USE OF

THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES

BY

THE STAFF

OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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THE COMMITTEE ON RULES AND NEWS

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TAX REFORM BILL OF 1974

Tentative Decisions of the Ways and Means Committee Since September 11, 1974

The press releases previously issued by the Ways and Means Committee covered its tentative decisions on the tax reform bill through August 2, 1974. When the draft bill was reviewed by the Committee in September, the press release descriptions of the tentative decisions were reprinted in five pamphlets arranged to correspond to the sections of the bill.

This pamphlet summarizes all of the Committee's subsequent decisions. It is arranged according to the sections in the draft bill and is intended to be used along with the earlier pamphlets. Thus, the only provisions that appear in this document are those in which some change was made by the Committee, either a deletion, addition, or other modification of a previous tentative decision. This pamphlet also contains new provisions added by the Committee, and they appear in this document as new sections that will be included in the next draft of the bill.

TITLE I—CHANGES PRIMARILY AFFECTING INDIVIDUALS

Sec. 101. Deductions for expenses attributable to business use of homes, rental of vacation homes, etc.

The committee tentatively decided to raise from seven to fourteen the number of days during a taxable year that a home may be used by an individual for personal purposes before the limitations on the deduction of expenses attributable to that home provided in the bill comes into effect. Thus, for example, if a vacation home is used by a taxpayer for personal purposes for more than 14 days or 5 percent of the actual time it is rented, whichever is greater, the limitation on the rental of a personal residence would apply. This means that the allowable business deductions allocable to the rental of the vacation home are not to exceed the rental income reduced by property taxes and interest.

If the vacation home is used for less than 14 days or less than 5 percent of the actual business use, then the new provision will not be applicable.

Sec. 102. Deductions for conventions, etc., outside the United States.

The committee decided to limit the denial of deductions for foreign conventions in the bill to those outside of North America and the Caribbean. Also, it agreed to a transitional rule for trips beginning before January 1, 1978, where the accommodations were booked before September 11, 1974, and the convention was announced before that date.

Sec. 104. Revision of retirement income credit.

The committee raised the maximum amount under present law on which the credit may be computed in the case of individuals under 65 who receive public retirement pensions to $2,500 for single persons and $3,750 for married couples, the same levels that will apply under the bill to people over 65. It did not change the other provisions of the existing retirement income credit for people under 65.

Sec. 105. Changes in exclusion for sick pay and certain military, etc., disability pensions.

The committee lowered the income level provided in the bill at which the disability income exclusion will phase out from $10,000 for married couples who file joint returns and $7,500 for single persons to $5,200 for all taxpayers. The maximum amount of income that may be excluded as disability income for the permanently disabled is limited to $100 a week ($5,200 a year) as under the present law sick pay exclusion, and the bill imposes a similar limitation on military service connected disability pensions other than payments by the Veteran's Administration. Thus, to the extent a disabled person's income exceeds $5,200, the amount of the exclusion ($5,200) is reduced on a dollar-for-dollar basis.

Sec. 106. Child care deduction.

In addition to the revisions in the bill to broaden the overall application of the child care deduction and to simplify it, the committee agreed to raise the income level at which under present law the child care deduction starts to phase out from $18,000 to $30,000.

Sec. 118. Cancellation of indebtedness with respect to certain student loan programs.

The committee added a new provision to the bill which excludes from income cancellations of indebtedness from government-sponsored student loan programs that occur before 1976 to permit a review of the policy in this area.

Sec. 124. Change in maximum rate provision.

The committee reversed its earlier decision to modify the maximum tax on earned income and deleted this provision from the bill.

Sec. 131. Minimum tax for individuals.

The committee made several changes in its previous tentative decision to replace the existing minimum tax with a new minimum tax for individuals. Accelerated depreciation (to the extent subject to LAL or attributable to certain low income housing) and construction period interest and taxes with respect to real estate and accelerated depreciation on personal property subject to a net lease were deleted from the list of tax preferences. Generally, these items will be subject to the limitation on artificial losses (sec. 132 of the bill). The deduction for charitable contributions under the new minimum tax will be the same as that under the regular tax; that is, a deduction will be allowed for the fair market value of contributions, subject to the regular tax limitations on contributions as a percentage of adjusted gross income. The minimum tax exemption under the bill was lowered from $25,000 to $20,000 and will be phased out as economic income

(less deductions) rises above $20,000. Also, the minimum tax rates were changed to one-half the rates of the regular income tax on an equivalent amount of taxable income.

Sec. 132. Limitation on artificial losses.

The provision dealing with the limitation on artificial losses provided under the bill was extended to personal property subject to a net lease and to real property. (Under the committee's original tentative decision, it applies to farm losses and the production of movies.) For personal property subject to a net lease, the excess of accelerated over straight-line depreciation will be allowed as a deduction only against income from that property. The application of LAL to accelerated depreciation on net lease property will be effective after December 31, 1974. For real estate, the excess of accelerated over straight-line depreciation and interest and taxes attributable to the construction period of a building will be allowed as a deduction only against income from real estate (with all properties treated on a consolidated basis). Excess deductions that are not permitted for a year will be suspended and offset against related income in future years. Generally, LAL will apply to commercial property constructed after December 31, 1975, and residential property constructed after December 31, 1977. The application of LAL to construction period interest and taxes on commercial real estate will be phased in between 1976 and 1978; and its application to construction period interest and taxes on residential property will be phased in between 1978 and 1980. Low income housing built under various Federal, State and local government subsidy programs will be permanently exempted from LAL. The effective date of LAL for movies was made for films or video tapes the production on which begins after June 30, 1975, and for farm losses it was changed from September 11, 1974, to January 1, 1975.

Sec. 133. Method of accounting for corporations engaged in farming.

The committee agreed to exempt family corporations from the provision in the bill that requires corporations, other than subchapter S corporations, to use the accrual method of accounting for their farming operations. A family corporation for these purposes is defined as a group where at least 75 percent of the voting stock and 75 percent of the total stock in a corporation are owned either by a family, which includes the taxpayer, brothers and sisters, spouses, ancestors, and lineal descendants, or by the estate of the taxpayer.

Sec. 136. Limitation on deduction of intangible drilling costs to amount for which the taxpayer is at risk.

The committee decided to add a provision that limits the deduction of intangible drilling and development costs on a property to the amount for which the taxpayer is at risk with respect to that property.

Sec. 142. Individuals may elect 3-year carryback of capital losses.

The committee modified the new 3-year capital loss carryback provided in the bill. The modification allows individuals to elect the carryback when capital losses incurred in a year plus capital loss carryforwards into that year exceed $30,000, instead of being able to elect it only when losses incurred in a year exceed that amount. Also, the committee's previous tentative decision provided for two limitations

on the carryforward of losses, which are incurred in a year in which a carryback election is made, in excess of those that may be carried back: these. losses could not be deducted against ordinary income if they exceeded the capital gains in the year and could be carried forward and deducted against capital gains only for a five-year period. The committee agreed to delete these limitations, so that these losses may be carried forward indefinitely as normal capital losses.

Sec. 145. Increase in amount of capital gain deduction for certain assets held for long periods.

The committee agreed to change the form of the additional capital gain deduction for certain assets held for long periods that is provided in the bill. Instead of the additional exclusion being equal to 1 percent of the adjusted basis of each asset multiplied by the number of years the asset was held, the additional deduction will equal 1 percent of the gain on each asset multiplied by the number of years held in excess of five years. The additional deduction will be limited to 20 percent of the gain on each asset (for holding periods exceeding 25 years) and to 25 percent of the taxpayer's overall net capital gain.

Sec. 150. Change in tax treatment of qualified stock options.

The committee added two new transition rules to its previous tentative decision to change the tax treatment of qualified stock options. These transitional rules continue present law first in the case of stock options granted under a qualified plan adopted by a Board of Directors on or before May 9, 1974, even if the plan was approved by the shareholders after that date, and second in the case of options granted under a plan adopted after May 9, 1974, where the options are granted as a result of a corporate reorganization or similar transaction.

TITLE II—CHANGES PRIMARILY AFFECTING CORPORATIONS

Sec. 224. Tax treatment of face amount certificates.

The committee agreed to delete the provision in the bill that prevented corporations issuing face-amount certificates from deducting the amount of the discount until it is actually paid to the holder of the certificate.

Sec. 231. Extension of period during which pollution control facilities, railroad rolling stock, rehabilitation of housing and coal mine safety equipment may qualify for 5-year amortization.

The committee agreed to extend the rapid amortization of coal mine safety equipment until January 1, 1977, instead of until January 1, 1976, as previously decided. The other rapid amortization provisions that expire at the end of 1974 are extended for three more years through 1977, as previously decided.

Sec. 234. Amortization of certain railroad equipment.

The committee agreed to allow improvements or betterments in railroads' track accounts to qualify for 5-year amortization.

Sec. 235. Amortization of expenditures in connection with literary, historical, etc., projects.

The committee agreed to add a new 5-year amortization provision for certain expenses in connection with a literary, historical or similar project. These are expenses which are paid or incurred in connection with a trade or business and are chargeable to capital account but not chargeable to property which is depreciable. The amortization deductions, however, will be limited to the taxpayer's net income from the project.

Sec. 241. Increase in investment credit for certain public utilities.

The committee agreed to raise the investment credit from 4 percent to 7 percent for telephone companies. (The committee previously decided to increase the credit from 4 to 7 percent for property used for furnishing or sale of electrical energy or gas through a local distribution system.) For a controlled group of telephone companies, the additional 3 percentage points is limited to $25 million of investment credit each year.

Present law limits the amount of the investment credit in a year to the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. In the case of all public utilities, the committee decided to raise the limitation on the amount of the investment credit that may be taken in a year from 50 percent of tax liability in excess of $25,000 to 75 percent in 1974 and 1975, and then to decrease the limit to 70 percent in 1976, 65 percent in 1977, 60 percent in 1978, and 55 percent in 1979. The existing 50-percent limitation will apply thereafter.

Also, the committee decided to delete the requirement in the bill that utilities use the method of depreciation for tax purposes that they must use for rate-making purposes.

Sec. 244. Investment credit for postconsumer solid waste materials.

To stimulate the recycling of postconsumer solid waste into productive uses, the committee decided to add a new provision to the bill to provide an investment credit equal to 7 percent of the purchase price of certain solid wastes by the firm that uses the materials in a recycling process. The credit will be available for such solid wastes as paper, glass, textiles and nonferrous metals. The credit will phase out if the current price for postconsumer solid wastes exceeds twice a base price adjusted for increases in the consumer price index. This provision will expire on December 31, 1979.

Sec. 245. Investment credit for certain leased commuter cars.

The committee agreed to add a new provision to allow a governmental unit to treat the lessee as having acquired property for purposes of the investment credit to the extent the lessee has actually paid an amount toward the purchase of the property. This is intended to cover cases where a railroad paid an amount to a local unit toward the purchase of urban mass transit cars which under the Urban Mass Transportation Act of 1964 were required to be owned by the governmental unit so that the railroad company was not eligible for the investment credit for the amount they paid toward the purchase of the cars.

Sec. 251. $10,000,000 exemption from industrial development bond provision.

The committee deleted the provision in the bill limiting a corporation to $10 million of industrial development bonds over its lifetime. The increase in the ceiling on the small issue exemption from industrial development bond treatment to $10 million is continued, as previously decided, if the proceeds of the issue are used to construct a facility that will be a separate, self-contained, operational unit and will not require capital expenditures from other sources.

Sec. 252. Limitation on amount of expenditures which can be treated as pollution control facilities for purposes of the exemption to the industrial development bond provision.

The committee deleted the provision in the bill that limited pollution control facilities that qualify for the exemption from the industrial development bond provision to 10 percent of the total cost of a new facility.

Sec. 261. Distributions pursuant to Bank Holding Company Act Amendments of 1970.

The committee modified its previous decision with respect to tax treatment of distributions pursuant to the Bank Holding Company Act Amendments of 1970. The committee agreed to permit corporations required to divest certain assets pursuant to the Bank Holding Company Act Amendments of 1970 to elect the so-called "rollover" treatment which would allow the tax on any gain from a sale pursuant to the divestiture to be deferred if the proceeds of the sale are reinvested in qualified replacement property (including inventory, accounts re-

ceivable, and depreciable property), if the basis of qualifying replacement property is reduced, and if in the case of a reinvestment in stock the basis of both the stock and of property of the corporation which is qualified replacement property is reduced. In addition, the committee agreed to include type A reorganizations (i.e., mergers) among the types of reorganizations under which assets required to be divested may be distributed tax free to stockholders of a bank holding company.

Sec. 262. Installment payment of tax with respect to bank holding company divestitures.

The committee agreed to eliminate any requirement for reinvestment of the proceeds from the sale of assets pursuant to the Bank Holding Company Act Amendments of 1970 if installment payment of tax is being made.

Sec. 294. Common trust funds of affiliated banks.

The committee agreed to permit banks that are members of the same affiliated group to have a combined trust fund for tax purposes during the period of the affiliation.

Sec. 295. Interest on certain corporate indebtedness.

The committee added a new provision to the bill to eliminate the limitation on the deduction of interest where debt is issued to acquire stock of any corporation in which the issuing corporation owned at least 50 percent of the stock on October 29, 1969, the effective date of the provision in the Tax Reform Act of 1969 limiting the deduction of interest on indebtedness incurred by a corporation to acquire the stock or assets of another corporation.

Sec. 296. Gain from dispositions of interests in oil and gas wells.

The committee added a new provision to the bill to treat as ordinary income any gain on the disposition of interests in oil and gas wells to the extent of the excess of the intangible drilling deductions taken with respect to those wells over the deductions that would have been allowed had the expenses been capitalized.

Sec. 297. Disallowance of deductions for entertainment of public officials.

The committee added a new provision to the bill that denies deductions for entertainment (including meals) or gifts to Government officials or employees.

Sec. 298. Pooled mortgage funds.

The committee added a new provision to the bill which includes certain pooled mortgage funds as qualifying real property loans for purposes of the special bad debt reserve treatment for savings and loan associations and mutual savings banks. This covers an instrument, which is essentially a bond backed by a pool of mortgages, that is issued by the Federal Home Loan Mortgage Corporation.

Sec. 299. Redemption of stock with appreciated property.

The committee added a new provision to the bill to permit the application of constructive ownership rules for purposes of the 10-percent ownership of stock test which must be met before a corporation may distribute appreciated property to the shareholder in redemption of his stock without recognizing any gain.

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TITLE III—CHANGES IN TREATMENT OF FOREIGN INCOME

Sec. 311. Income earned abroad by United States citizens living or residing abroad.

The committee agreed to modify its earlier decision to repeal the earned income exclusion as of 1975 by providing for a 4-year phaseout of the provision. The committee agreed to a similar 4-year phaseout of the exclusion for certain allowances of government employees based abroad. In lieu of these exclusions, the committee agreed to a $1,200 deduction for certain tuition expenses of dependents of taxpayers employed outside the United States. Further, the committee agreed to an exclusion from gross income for municipal-type services furnished in a foreign country by an employer on a nondiscriminatory basis.

Sec. 322. Exclusion of sales income from foreign manufacturing from foreign base company sales income.

The committee agreed to modify the definition of foreign-base company sales income under subpart F to exclude from that definition sales income arising from the sale of goods manufactured abroad.

Sec. 352. Changes in ruling requirements under section 367; certain changes in section 1248.

The committee modified the effective dates of the provisions in the bill relating to advance rulings under section 367 to permit after-the-fact rulings on corporate reorganizations solely involving foreign corporations to be obtained until 183 days after the date of enactment if the exchange was in a taxable year beginning after December 31, 1962, and before December 31, 1974.

Sec. 361. Tax treatment of corporations conducting a trade or business in possessions of the United States.

The committee agreed to modify its earlier tentative decisions regarding the treatment of possessions corporations. The requirements for qualifying as a possessions corporation will remain the same as under present law except that such corporations will qualify only if they elect for a period of 10 years to become a possessions corporation. In lieu of the exclusion under present law, a new tax credit is provided for possessions corporations equal to the U.S. tax attributable to the corporation's income from a possession trade or business and from qualified possession investments. Other income of a possession's corporation is subject to the normal U.S. tax without any offset by this new credit. Finally, the committee agreed to permit corporations receiving dividends from possessions corporations to be eligible for the dividends received deduction.

Sec. 362. Western Hemisphere Trade Corporations.

The committee agreed to permit corporations not presently qualifying for WHTC treatment to receive the benefits of that treatment during the period when the WHTC provision is being phased out, as provided in the bill, if they qualify for WHTC treatment during that period.

Sec. 371. Repeal of percentage depletion for foreign minerals.

The committee reversed its earlier decision and agreed to maintain foreign percentage depletion for foreign minerals other than oil and gas.

TITLE IV—OIL AND GAS ENERGY PROVISIONS

Sec. 411. Windfall profits tax; plowback credit.

The committee agreed to several modifications of the windfall profits tax. First, taxpayers will be able to deduct the increase in their State and local severance taxes over those payable on December 1, 1973, in computing their windfall profits subject to tax. Second, windfall profits on a barrel of oil will be limited to 75 percent of the net income from that barrel, computed without regard to an allowance for depletion and intangible drilling deductions. (There will be a similar limitation on the taxpayer's plowback threshold.) Finally, taxpayers will be given two dollars of plowback credit for one dollar of qualified investment in cases where the expenditures cannot be deducted under the regular corporate income tax in the year they are incurred (other than lease acquisitions).

TITLE V—ADMINISTRATIVE AND MISCELLANEOUS CHANGES

Sec. 514. Voluntary withholding of State income tax in the case of certain legislative officers and employees.[1]

The committee agreed to permit the paying officers of the House of Representatives to enter into agreements with requesting States to withhold State income tax from any members or employees of the House who request it.

Sec. 515. Withholding tax on excludable contributions for section 403(b) annuities.

The committee decided to exclude from the definition of wages subject to withholding tax any remuneration paid under a plan described in section 403(b) to the extent that the payment does not exceed the exclusion allowance defined in that section. These plans are annuity contracts purchased by public schools and tax-exempt organizations.

Sec. 516. Withholding State and city income taxes from the compensation of members of the National Guard or the Ready Reserve.[2]

The committee decided to extend the provision under present law requiring the Treasury to enter into agreements with States and cities to withhold income taxes from Federal employees to members of the National Guard and Ready Reserve when they are paid for performing regular training.

Sec. 517. Withholding tax on certain gambling winnings.

The committee revised its previous decision imposing a withholding tax on certain gambling winnings to require a 20-percent withholding tax on gambling winnings of more than $600 when odds are greater than 300 to 1. For lottery winnings, however, a 20-percent withholding tax will be levied regardless of the odds whenever the proceeds exceed $100. (The previous committee decisions were contained in what had previously been sections 546 and 547 of the draft bill.)

Sec. 523. Transfer of appreciated property to political organizations.

The committee changed the effective date of this section from May 7, 1974, to August 1, 1973. Thus, gain or loss will not be recognized on sales of contributed property by a political organization before August 2, 1973.

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[1] What had previously been section 514, the provision requiring audits of the income tax returns of elected Federal officials, was deleted from the bill.

[2] What had previously been section 516, the provision for forfeiture of cash or other personal property found in the possession of a narcotics traffickers, was deleted from the bill.

Sec. 532. Expenditures by public charities to influence legislation.

This provision dealing with lobbying by tax exempt organizations was deleted from the bill. (The new sec. 532 relating to electioneering by civic leagues, etc. (sec. 501(c)(4) organizations) is the same as the previous committee decision in sec. 533 of the old draft bill.)

Sec. 533. Social clubs.

The committee agreed to change the definition of social clubs for purposes of determining tax-exempt status from clubs *exclusively* engaged in nonprofit activities to clubs *substantially all* of whose activities are nonprofit. Also, the dividends received deduction are denied for the investment income of social clubs, employee beneficiary associations, and taxable membership organizations.

Sec. 535. Credit union insurance organizations.[3]

The committee agreed to exempt from tax those mutual nonprofit organizations that provide reserve funds for, or insure shares in, credit unions.

Sec. 536. Exclusion from unrelated business income of gain from lapse of certain options.

The committee agreed to exclude from unrelated business income all gains on the lapse of options to buy or sell securities that are written by an exempt organization in connection with its investment activities.

Sec. 537. Exemption from unrelated business income tax of public entertainment activities at certain State and local fairs.

The committee decided to exclude from unrelated business income the income from public entertainment activities conducted at State, local or regional fairs conducted by agricultural or horticultural organizations.

Sec. 538. Five-year transitional rule for private foundation payout.

The committee decided that for a 5-year period beginning December 31, 1973, the private foundation charitable expenditure rules would be modified so that a foundation would not be required to reduce the value of its endowment below the value on December 31, 1970; however, this rule would not reduce the charitable expenditure requirement below the greater of (1) 4 percent of the value of the endowment or (2) the foundation's income for the year.

Sec. 539. Certain dispositions of property before 1976 not subject to taxes on self-dealing.

The committee decided to add a temporary exception to the rules prohibiting self-dealing transactions (i.e., transactions between a private foundation and a disqualified person) to permit a private founda-

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[3] What had previously been sec. 535, the provision allowing an additional period for qualifying charitable remainder trusts, was deleted from the bill since the provision was contained in H.R. 12035 which was recently agreed to in conference, and sent to the President.

tion to sell to a disqualified person property which is at present leased to a disqualified person. The sale must be for not less than the fair market value of the property and must be made before January 1, 1976.

Sec. 543. Distilled spirits.

The committee agreed to a series of modifications with respect to the tax treatment of distilled spirits. These are to: (1) eliminate the requirement that the name of the distiller or producer be on gin or vodka bottled in bond for export; (2) allow drawback of tax on distilled spirits and wines that are imported, bottled or packaged here, and subsequently exported; (3) allow producers to store distilled spirits on their bonded premises pending specified nontaxable dispositions of the spirits (such as export) without having their capital tied up in a tax payment during the storage period; (4) allow spirits bottled in bond or certain spirits returned to bonded premises for storage, under (3) above, to be transferred without payment of tax to a customs bonded warehouse for storage pending export; (5) allow spirits to be withdrawn from bond without payment of tax for specified scientific purposes additional to those now provided; (6) relax the conditions under which spirits may be mingled on bonded premises; (7) allow gin to be made with the extracted oils of juniper berries and other aromatics, as well as with the berries or other aromatics themselves, without payment of the rectification tax; and (8) extend the tax treatment presently given domestic distilled spirits in certain cases of loss or voluntary destruction to distilled spirits brought into this country from Puerto Rico or the Virgin Islands.

Sec. 544. Use of strip stamps for payment of distilled spirits tax.

The committee agreed to allow use of devices other than stamps to be used as evidence of payment of the excise tax on distilled spirits.

Sec. 552. Gasoline tax refund procedure for aerial applicators.

The committee agreed to permit crop-dusters to get a full refund of the gasoline excise tax for the nonhighway use of gasoline, if the farm owner or operator waives his right to the refund.

Sec. 553. Lubricating oil.

The committee agreed to remove the exemption from the excise tax on lubricating oil for oil used off highways, except for oil used on farms. The revenue from this change will not be placed in the Highway Trust Fund.

Sec. 554. Tread rubber.

The committee agreed to provide credits or refunds of the manufacturers excise tax on tread rubber where tax-paid tread rubber is wasted in the recapping or retreading process, is used in the recapping or retreading of tires the sale of which is later adjusted, or is used in the recapping or retreading of tires which are exported, are sold to nonprofit educational institutions, or are sold as supplies for vessels or aircraft.

Sec. 555. Constructive sales price for application of excise tax on automotive parts.

The committee agreed that when automotive parts are sold in a non-arm's length transaction and the manufacturer makes bona-fide purchases or sales of similar articles to or from others, the constructive sales price (in applying the excise tax on automotive parts) is to be no higher than the lowest price determined with reference to the bona-fide sales. This provision will be retroactive for all open tax years.

Sec. 581. Tax treatment for retirement purposes of commissions received by certain State and local tax collectors.

The committee agreed to treat State or local tax collectors who work on a commission basis as self-employed for retirement purposes.

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