

AMERICAN INNOVATION ACT OF 2018

SEPTEMBER 24, 2018.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. BRADY of Texas, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 6756]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 6756) to amend the Internal Revenue Code of 1986 to promote new business innovation, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “American Innovation Act of 2018”.

SEC. 2. SIMPLIFICATION AND EXPANSION OF DEDUCTION FOR START-UP AND ORGANIZATIONAL EXPENDITURES.

(a) IN GENERAL.—Section 195 of the Internal Revenue Code of 1986 is amended by redesignating subsections (c) and (d) as subsections (d) and (e), respectively, and by striking all that precedes subsection (d) (as so redesignated) and inserting the following:

“SEC. 195. START-UP AND ORGANIZATIONAL EXPENDITURES.

“(a) CAPITALIZATION OF EXPENDITURES.—Except as otherwise provided in this section, no deduction shall be allowed for start-up or organizational expenditures.

“(b) ELECTION TO DEDUCT.—

“(1) IN GENERAL.—If a taxpayer elects the application of this subsection with respect to any active trade or business—

“(A) the taxpayer shall be allowed a deduction for the taxable year in which such active trade or business begins in an amount equal to the lesser of—

“(i) the aggregate amount of start-up and organizational expenditures paid or incurred in connection with such active trade or business, or

“(ii) \$20,000, reduced (but not below zero) by the amount by which such aggregate amount exceeds \$120,000, and

“(B) the remainder of such start-up and organizational expenditures shall be charged to capital account and allowed as an amortization deduction determined by amortizing such expenditures ratably over the 180-month period beginning with the month in which the active trade or business begins.

“(2) APPLICATION TO ORGANIZATIONAL EXPENDITURES.—In the case of organizational expenditures with respect to any corporation or partnership, the active trade or business referred to in paragraph (1) means the first active trade or business carried on by such corporation or partnership.

“(3) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after December 31, 2019, the \$20,000 and \$120,000 amounts in paragraph (1)(A)(ii) shall each be increased by an amount equal to—

“(A) such dollar amount, multiplied by

“(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ‘calendar year 2018’ for ‘calendar year 2016’ in subparagraph (A)(ii) thereof.

If any amount as increased under the preceding sentence is not a multiple of \$1,000, such amount shall be rounded to the nearest multiple of \$1,000.

“(c) ALLOWANCE OF DEDUCTION UPON LIQUIDATION OR DISPOSITION.—

“(1) LIQUIDATION OF PARTNERSHIP OR CORPORATION.—If any partnership or corporation is completely liquidated by the taxpayer, any start-up or organizational expenditures paid or incurred in connection with such partnership or corporation which were not allowed as a deduction by reason of this section may be deducted to the extent allowable under section 165.

“(2) DISPOSITION OF TRADE OR BUSINESS.—If any trade or business is completely disposed of or discontinued by the taxpayer, any start-up expenditures paid or incurred in connection with such trade or business which were not allowed as a deduction by reason of this section (and not taken into account in connection with a liquidation to which paragraph (1) applies) may be deducted to the extent allowable under section 165. For purposes of this paragraph, in

the case of any deduction allowed under subsection (b)(1) with respect to both start-up and organizational expenditures, the amount treated as so allowed with respect to start-up expenditures shall bear the same ratio to such deduction as the start-up expenditures taken into account in determining such deduction bears to the aggregate of the start-up and organizational expenditures so taken into account.”.

(b) ORGANIZATIONAL EXPENDITURES.—Section 195(d) of such Code, as redesignated by subsection (a), is amended by adding at the end the following new paragraphs:

“(3) ORGANIZATIONAL EXPENDITURES.—The term ‘organizational expenditures’ means any expenditure which—

“(A) is incident to the creation of a corporation or a partnership,

“(B) is chargeable to capital account, and

“(C) is of a character which, if expended incident to the creation of a corporation or a partnership having an ascertainable life, would be amortizable over such life.

“(4) APPLICATION TO CERTAIN DISREGARDED ENTITIES.—In the case of any entity with a single owner that is disregarded as an entity separate from its owner, this section shall be applied in the same manner as if such entity were a corporation.”.

(c) ELECTION.—Section 195(e)(2) of such Code, as redesignated by subsection (a), is amended to read as follows:

“(2) PARTNERSHIPS AND S CORPORATIONS.—In the case of any partnership or S corporation, the election under subsection (b) shall be made (and this section shall be applied) at the entity level.”.

(d) CONFORMING AMENDMENTS.—

(1)(A) Part VIII of subchapter B of chapter 1 is amended by striking section 248 of such Code (and by striking the item relating to such section in the table of sections of such part).

(B) Section 170(b)(2)(D)(ii) of such Code is amended by striking “(except section 248)”.

(C) Section 312(n)(3) of such Code is amended by striking “Sections 173 and 248” and inserting “Sections 173 and 195”.

(D) Section 535(b)(3) of such Code is amended by striking “(except section 248)”.

(E) Section 545(b)(3) of such Code is amended by striking “(except section 248)”.

(F) Section 545(b)(4) of such Code is amended by striking “(except section 248)”.

(G) Section 834(c)(7) of such Code is amended by striking “(except section 248)”.

(H) Section 852(b)(2)(C) of such Code is amended by striking “(except section 248)”.

(I) Section 857(b)(2)(A) of such Code is amended by striking “(except section 248)”.

(J) Section 1363(b) of such Code is amended by adding “and” at the end of paragraph (2), by striking paragraph (3), and by redesignating paragraph (4) as paragraph (3).

(K) Section 1375(b)(1)(B)(i) of such Code is amended by striking “(other than the deduction allowed by section 248, relating to organization expenditures)”.

(2)(A) Section 709 of such Code is amended to read as follows:

“SEC. 709. TREATMENT OF SYNDICATION FEES.

“No deduction shall be allowed under this chapter to a partnership or to any partner of the partnership for any amounts paid or incurred to promote the sale of (or to sell) an interest in the partnership.”.

(B) The item relating to section 709 in the table of sections for part I of subchapter K of chapter 1 of such Code is amended to read as follows:

“Sec. 709. Treatment of syndication fees.”.

(3) Section 1202(e)(2)(A) of such Code is amended by striking “section 195(c)(1)(A)” and inserting “section 195(d)(1)(A)”.

(4) The item relating to section 195 in the table of contents of part VI of subchapter B of chapter 1 of such Code is amended to read as follows:

“Sec. 195. Start-up and organizational expenditures.”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to expenditures paid or incurred in connection with active trades or businesses which begin in taxable years beginning after December 31, 2018.

SEC. 3. PRESERVATION OF START-UP NET OPERATING LOSSES AND TAX CREDITS AFTER OWNERSHIP CHANGE.

(a) APPLICATION TO NET OPERATING LOSSES.—Section 382(d) of the Internal Revenue Code of 1986 is amended by adding at the end the following new paragraph:

“(4) EXCEPTION FOR START-UP LOSSES.—

“(A) IN GENERAL.—In the case of any net operating loss carryforward described in paragraph (1)(A) which arose in a start-up period taxable year, the amount of such net operating loss carryforward otherwise taken into account under such paragraph shall be reduced by the net start-up loss determined with respect to the trade or business referred to in subparagraph (B)(i) for such start-up period taxable year.

“(B) START-UP PERIOD TAXABLE YEAR.—The term ‘start-up period taxable year’ means any taxable year of the old loss corporation which—

“(i) begins before the close of the 3-year period beginning on the date on which any trade or business of such corporation begins as an active trade or business (as determined under section 195(d)(2) without regard to subparagraph (B) thereof), and

“(ii) ends after September 10, 2018.

“(C) NET START-UP LOSS.—

“(i) IN GENERAL.—The term ‘net start-up loss’ means, with respect to any trade or business referred to in subparagraph (B)(i) for any start-up period taxable year, the amount which bears the same ratio (but not greater than 1) to the net operating loss carryforward which arose in such start-up period taxable year as—

“(I) the net operating loss (if any) which would have been determined for such start-up period taxable year if only items of income, gain, deduction, and loss properly allocable to such trade or business were taken into account, bears to

“(II) the amount of the net operating loss determined for such start-up period taxable year.

“(ii) SPECIAL RULE FOR LAST TAXABLE YEAR IN START-UP PERIOD.—In the case of any start-up period taxable year which ends after the close of the 3-year period described in subparagraph (B)(i) with respect to any trade or business, the net start-up loss with respect to such trade or business for such start-up period taxable year shall be the same proportion of such loss (determined without regard to this clause) as the proportion of such start-up period taxable year which is on or before the last day of such period.

“(D) APPLICATION TO NET OPERATING LOSS ARISING IN YEAR OF OWNERSHIP CHANGE.—Subparagraph (A) shall apply to any net operating loss described in paragraph (1)(B) in the same manner as such subparagraph applies to net operating loss carryforwards described in paragraph (1)(A), but by only taking into account the amount of such net operating loss (and the amount of the net start-up loss) which is allocable under paragraph (1)(B) to the period described in such paragraph. Proper adjustment in the allocation of the net start-up loss under the preceding sentence shall be made in the case of a taxable year to which subparagraph (C)(ii) applies.

“(E) APPLICATION TO TAXABLE YEARS WHICH ARE START-UP PERIOD TAXABLE YEARS WITH RESPECT TO MORE THAN 1 TRADE OR BUSINESS.—In the case of any net operating loss carryforward which arose in a taxable year which is a start-up period taxable year with respect to more than 1 trade or business—

“(i) this paragraph shall be applied separately with respect to each such trade or business, and

“(ii) the aggregate reductions under subparagraph (A) shall not exceed such net operating loss carryforward.

“(F) CONTINUITY OF BUSINESS REQUIREMENT.—If the new loss corporation does not continue the trade or business referred to in subparagraph (B)(i) at all times during the 2-year period beginning on the change date, this paragraph shall not apply with respect to such trade or business.

“(G) CERTAIN TITLE 11 OR SIMILAR CASES.—

“(i) MULTIPLE OWNERSHIP CHANGES.—In the case of a 2nd ownership change to which subsection (1)(5)(D) applies, this paragraph shall not apply for purposes of determining the pre-change loss with respect to such 2nd ownership change.

“(ii) CERTAIN INSOLVENCY TRANSACTIONS.—If subsection (1)(6) applies for purposes of determining the value of the old loss corporation under subsection (e), this paragraph shall not apply.

“(H) NOT APPLICABLE TO DISALLOWED INTEREST.—This paragraph shall not apply for purposes of applying the rules of paragraph (1) to the carry-over of disallowed interest under paragraph (3).

“(I) TRANSITION RULE.—This paragraph shall not apply with respect to any trade or business if the date on which such trade or business begins as an active trade or business (as determined under section 195(d)(2) without regard to subparagraph (B) thereof) is on or before September 10, 2018.”.

(b) APPLICATION TO EXCESS CREDITS.—Section 383 of such Code is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

“(e) EXCEPTION FOR START-UP EXCESS CREDITS.—

“(1) IN GENERAL.—In the case of any unused general business credit of the corporation under section 39 which arose in a start-up period taxable year, the amount of such unused general business credit otherwise taken into account under subsection (a)(2)(A) shall be reduced by the start-up excess credit determined with respect to any trade or business referred to in section 382(d)(4)(B)(i) for such start-up period taxable year.

“(2) START-UP PERIOD TAXABLE YEAR.—For purposes of this subsection, the term ‘start-up period taxable year’ has the meaning given such term in section 382(d)(4)(B).

“(3) START-UP EXCESS CREDIT.—For purposes of this subsection, the term ‘start-up excess credit’ means, with respect to any trade or business referred to in section 382(d)(4)(B)(i) for any start-up period taxable year, the amount which bears the same ratio to the unused general business credit which arose in such start-up period taxable year as—

“(A) the amount of the general business credit which would have been determined for such start-up period taxable year if only credits properly allocable to such trade or business were taken into account, bears to

“(B) the amount of the general business credit determined for such start-up period taxable year.

“(4) APPLICATION OF CERTAIN RULES.—Rules similar to the rules of subparagraphs (C)(ii), (D), (E), and (F) of section 382(d)(4) shall apply for purposes of this subsection.

“(5) TRANSITION RULE.—This subsection shall not apply with respect to any trade or business if the date on which such trade or business begins as an active trade or business (as determined under section 195(d)(2) without regard to subparagraph (B) thereof) is on or before September 10, 2018.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after September 10, 2018.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

The bill, H.R. 6756, as reported by the Committee on Ways and Means, provides that the current law provisions for start-up expenditures and organizational expenditures in the Internal Revenue Code of 1986 are combined into a single provision applicable to all businesses. The bill allows a taxpayer to immediately deduct up to \$20,000 (indexed for inflation) in combined start-up and organizational expenditures. This deduction is phased out to the extent that a taxpayer’s start-up and organizational expenditures, in the aggregate, exceed \$120,000 (indexed for inflation). Expenditures above the new increased limit continue to be amortized over a 180-month period following the start of the new business.

Additionally, the bill generally provides that a corporation’s start-up losses and start-up credits are not limited in the event that the corporation undergoes an ownership change under sections 382 and 383. Start-up losses and start-up credits are losses and credits that are properly allocable to the corporation’s new business that arise in any taxable year that begins before the third anniversary of the date on which the business is considered to begin.

B. BACKGROUND AND NEED FOR LEGISLATION

The Committee believes it is important to continually improve the tax laws. This bill doubles the amount of start-up and organizational costs that can be expensed in the first year of operations. Additionally, the bill provides start-up businesses more flexibility in attracting capital to fund their operations during the start-up phase exempting net operating losses and general business credits generated in the early years of a start-up business from the limitations on use that otherwise could apply. This bill helps to foster a friendlier business climate for entrepreneurs and innovators by reducing tax barriers and allowing start-up businesses to focus on growing and innovating. The bill supports entrepreneurship and innovation, helping new businesses expand and create jobs.

C. LEGISLATIVE HISTORY

Background

H.R. 6756 was introduced on September 10, 2018, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up H.R. 6756, the “American Innovation Act of 2018,” on September 13, 2018, and ordered the bill, as amended, favorably reported (with a quorum being present).

Committee hearings

Reforms to the rules for expensing business costs were discussed at a Full Committee hearing on How Tax Reform Will Grow Our Economy and Create Jobs on May 18, 2017 and a Subcommittee on Tax Policy hearing on How Tax Reform Will Help America’s Small Businesses Grow and Create New Jobs on July 13, 2017.

II. EXPLANATION OF THE BILL

A. SIMPLIFICATION AND EXPANSION OF DEDUCTION FOR START-UP AND ORGANIZATIONAL EXPENDITURES (SEC. 2 OF THE BILL AND SECS. 195, 248, AND 709 OF THE CODE)

PRESENT LAW

In the taxable year in which a taxpayer begins an active trade or business, the taxpayer may elect to deduct up to \$5,000 of start-up expenditures.¹ In addition, a taxpayer that is a corporation or a partnership may separately elect to deduct up to \$5,000 of organizational expenditures.² In each case, however, the \$5,000 amount is reduced (but not below zero) by the amount by which the cumulative cost of start-up or organizational expenditures exceeds \$50,000.³ Any remaining start-up expenditures or organizational expenditures may be amortized ratably over a period of 180 months, beginning with the month in which the active trade or

¹Sec. 195(b)(1)(A). Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the “Code”).

²Secs. 248(a)(1) and 709(b)(1)(A).

³Secs. 195(b)(1)(A)(ii), 248(a)(1)(B), and 709(b)(1)(A)(ii).

business begins.⁴ A taxpayer is deemed to make an election to deduct and amortize start-up or organizational expenditures for the applicable taxable year, unless the taxpayer affirmatively elects to capitalize such amounts on a timely-filed (including extensions) Federal income tax return.⁵ Capitalized amounts are recovered when the business is sold, exchanged, or otherwise disposed of before the end of the 180-month amortization period.⁶

Start-up expenditures are amounts that would have been deductible as trade or business expenses had they not been paid or incurred before business began.⁷ Organizational expenditures are expenditures that are incident to the creation of a corporation or the organization of a partnership, are chargeable to capital, and would be eligible for amortization had they been paid or incurred in connection with the organization of a corporation or partnership with a limited or ascertainable life.⁸

REASONS FOR CHANGE

The Committee believes that increasing the amount of start-up and organizational expenditures that a taxpayer may elect to deduct, rather than requiring their amortization, will help facilitate the formation of new businesses. The Committee also believes that consolidating the rules regarding the treatment of start-up and organizational expenditures into a single provision applicable to all business entities (*e.g.*, corporations, partnerships, and sole proprietorships) will simplify tax administration and taxpayer compliance.

EXPLANATION OF PROVISION

Under the provision, the rules for start-up expenditures (section 195) and organizational expenditures (sections 248 and 709(b)) are consolidated into a single provision.⁹ A taxpayer may elect¹⁰ to deduct up to \$20,000 of the aggregate amount of start-up and organizational expenditures in the taxable year in which the active trade or business begins.¹¹ The \$20,000 amount is reduced (but not below zero) by the amount by which the aggregate amount of start-up and organizational expenditures exceeds \$120,000.¹² The \$20,000 and \$120,000 amounts are adjusted for inflation in taxable years beginning after 2019. Any remaining start-up and organizational

⁴ Secs. 195(b)(1)(B), 248(a)(2), and 709(b)(1)(B).

⁵ Treas. Reg. secs. 1.195-1(b), 1.248-1(c), and 1.709-1(b)(2).

⁶ Secs. 195(b)(2) and 709(b)(2). See also Treas. Reg. sec. 1.709-1(b)(3) and *Kingsford Co. v. Commissioner*, 41 T.C. 646 (1964).

⁷ Sec. 195(c)(1).

⁸ Secs. 248(b) and 709(b)(3).

⁹ The definitions of start-up and organizational expenditures are unchanged by the provision, as is the requirement to capitalize partnership syndication fees under section 709(a).

¹⁰ In the case of a partnership or S corporation, the election is made (and the provision is applied) at the entity level. In the case of a disregarded entity, the provision is applied in the same manner as if such disregarded entity were a corporation.

¹¹ In the case of organizational expenditures with respect to any corporation or partnership, the term "active trade or business" means the first active trade or business carried on by such corporation or partnership.

¹² For example, assume that Corporation X, a calendar year taxpayer, incurs \$100,000 of start-up expenditures and \$30,000 of organizational expenditures that relate to an active trade or business that begins on July 1, 2019. On its 2019 tax return, Corporation X may elect to deduct \$10,000 (\$20,000 - (\$130,000 - \$120,000)) plus the portion of the remaining \$120,000 that is allocable to July through December of 2019 (\$120,000/180 months x 6 months = \$4,000). Thus, Corporation X's total deduction under section 195 for 2019, the year in which its active trade or business begins, is \$14,000 (\$10,000 deduction + \$4,000 amortization deduction). Corporation X may amortize the remaining \$116,000 ratably over the remaining 174 months.

expenditures must be amortized ratably over the 180-month period beginning with the month in which the active trade or business begins.

In the case of any partnership, corporation, or disregarded entity that is completely liquidated by the taxpayer before the end of the 180-month period, any unamortized amounts may be deducted to the extent allowable under section 165. In the case of any active trade or business which is completely disposed of or discontinued by the taxpayer before the end of the 180-month period, any unamortized start-up expenditures may be deducted to the extent allowable under section 165.¹³

EFFECTIVE DATE

The provision applies to start-up and organizational expenditures paid or incurred in connection with active trades or businesses which begin in taxable years beginning after December 31, 2018.

B. PRESERVATION OF START-UP NET OPERATING LOSSES AND TAX CREDITS AFTER OWNERSHIP CHANGE (SEC. 3 OF THE BILL AND SECS. 382 AND 383 OF THE CODE)

PRESENT LAW

Net operating losses

Section 382(a) limits the extent to which a corporation that experiences an ownership change may offset taxable income after the ownership change with losses attributable to the period before the ownership change. Specifically, following an ownership change, a new loss corporation's taxable income may be offset by pre-change losses from an old loss corporation only to the extent of the section 382 limitation (discussed below).¹⁴ A pre-change loss is (1) any net operating loss carryforward of an old loss corporation to a taxable year ending with an ownership change or in which an ownership change occurs, and (2) any net operating loss of an old loss corporation for the taxable year in which the ownership change occurs to the extent such loss is allocable to the period in such year on or before such change date.¹⁵ Any loss that is not a pre-change loss is not limited by section 382(a).¹⁶

¹³For purposes of the disposition rule, the amount treated as unamortized start-up expenditures equals the aggregate amount of unamortized start-up and organizational expenditures multiplied by the ratio that (1) the amount of start-up expenditures taken into account in determining the deduction under section 195(b)(1) bears to (2) the aggregate amount of start-up and organizational expenditures so taken into account. For example, continuing the example in footnote 13, assume that on June 30, 2024, Corporation X completely discontinues its initial trade or business for purposes of section 165, but remains in existence. Corporation X has \$80,000 of unamortized start-up and organizational expenditures on such date. Corporation X may deduct \$61,538 of unamortized start-up expenditures in 2024 ($\$80,000 \times (\$100,000/\$130,000)$), but must continue to amortize the remaining \$18,462 of unamortized organizational expenditures over the remaining 120 months. Thus, Corporation X's total deduction under section 195 for 2024, the year in which its trade or business is discontinued, is \$66,461 (section 165 loss deduction of \$61,538 + amortization deduction of \$4,923 (*i.e.*, the \$4,000 amortization deduction for start-up and organizational expenditures from January 1, 2024, through June 30, 2024, plus the \$923 amortization deduction for organizational expenditures from July 1, 2024, through December 31, 2024)).

¹⁴Sec. 382(a). However, if the new loss corporation does not continue the business enterprise of the old loss corporation at all times during the two-year period beginning on the change date, the section 382 limitation for any post-change year is generally zero. See sec. 382(c).

¹⁵Sec. 382(d)(1).

¹⁶Special rules apply to built-in gains and losses and section 338 gains. See sec. 382(h); Notice 2003-65, 2003-2 C.B. 747; Notice 2018-30, 2018-21 I.R.B. 610. Special rules also apply to financially troubled corporations, discussed below.

The section 382 limitation is determined by multiplying the value of the old loss corporation immediately before the ownership change by the long-term tax-exempt interest rate.¹⁷ If the section 382 limitation for a post-change year exceeds the taxable income of the new loss corporation for such year which was offset by pre-change losses, the section 382 limitation for the next post-change year is increased by the amount of such excess.¹⁸

A loss corporation is a corporation entitled to use a net operating loss carryover or having a net operating loss for the taxable year in which an ownership change occurs.¹⁹ An old loss corporation is a corporation with respect to which there is an ownership change and which was a loss corporation before the ownership change.²⁰ A new loss corporation is a corporation which is a loss corporation after an ownership change.²¹

An ownership change generally is defined as an increase by more than 50 percentage points in the percentage of stock of a loss corporation that is owned by any one or more five-percent shareholders²² within a three-year period.²³ Treasury regulations generally provide that this measurement is to be made as of any testing date, which is any date on which the ownership by one or more persons who were or who become five-percent shareholders changes.²⁴

Section 382(1)(5) provides rules that limit section 382's application to ownership changes that occur in the context of a title 11 or similar case. These rules generally provide that the use of pre-change losses is not limited by section 382(a) where the old loss corporation is under the jurisdiction of a court in a title 11 or similar case immediately before the ownership change and the shareholders and creditors of the old loss corporation immediately before the ownership change own (after the ownership change) at least 50 percent of the total voting power of the stock of the new loss corporation and at least 50 percent of the total value of the stock of

¹⁷Sec. 382(b)(1). The long-term tax-exempt rate is the highest of the adjusted Federal long-term rates in effect for any month in the three-calendar-month period ending with the calendar month in which the change date occurs. Sec. 382(f)(1).

¹⁸Sec. 382(b)(2).

¹⁹Sec. 382(k)(1). A loss corporation also includes any corporation that entitled to use a carryforward of disallowed interest under section 381(c)(20), and generally includes any corporation with a net unrealized built-in loss. Treasury Regulation section 1.382-2(a)(1) contains additional description of when a corporation qualifies as a loss corporation.

²⁰Sec. 382(k)(2).

²¹Sec. 382(k)(3).

²²The term "5-percent shareholder" means any person holding five percent or more of the stock of the corporation at any time during the testing period. Sec. 382(k)(7). Determinations of the percentage of stock of a corporation held by any person are made on the basis of value. Sec. 382(k)(6)(C).

²³Sec. 382(g) and (i).

²⁴See Treas. Reg. sec. 1.382-2(a)(4)(i) (providing that, generally, a loss corporation is required to determine whether an ownership change has occurred immediately after any owner shift, or issuance or transfer of certain options with respect to stock of the loss corporation that are treated as exercised, and defining a "testing date" as "each date on which a loss corporation is required to make a determination of whether an ownership change has occurred"). All computations of increases in percentage ownership are to be made as of the close of the testing date. Treas. Reg. sec. 1.382-2(a)(4)(i). A loss corporation must include a statement on or with its Federal income tax return for each taxable year that it is a loss corporation in which an event described in Temporary Treasury Regulation section 1.382-2T(a)(2) occurs. Treas. Reg. sec. 1.382-11(a). The statement must include: (1) the date(s) of any owner shifts, equity structure shifts, or other transactions described in Temporary Treasury Regulation Section 1.382-2T(a)(2)(i), (2) the date(s) on which any ownership change(s) occurred, and (3) the amount of any attributes described in Treasury Regulation Section 1.382-2(a)(1)(i) that caused the corporation to be a loss corporation. *Ibid.*

the new loss corporation.²⁵ Among other things, these rules provide that if, during the two-year period immediately following an ownership change meeting the criteria described in the previous sentence, an ownership change of the new loss corporation occurs, the exception described in the previous sentence does not apply and the section 382 limitation with respect to the second ownership change for any post-change year after the second ownership change is zero.²⁶

Section 382(l)(6) provides that in an ownership change involving a transfer by a corporation of all or part of its assets to another corporation in a title 11 or similar case that fails to meet the criteria described in the previous paragraph, or in an ownership change involving an exchange of debt for stock in a title 11 or similar case, the value of the old loss corporation used for purposes of calculating the section 382 limitation must reflect any increase in value of the old loss corporation resulting from any surrender or cancellation of creditors' claims in the transaction.

Tax credits

Section 383 imposes similar limitations to those imposed by section 382(a) on the use of carryforwards of unused general business credits, alternative minimum tax credits, foreign tax credits, and net capital loss carryforwards. With regard to unused general business credits, section 383 and the regulations thereunder limit the amount of regular tax liability that can be offset by excess credits (referred to in the Treasury regulations as "pre-change credits") of the new loss corporation.²⁷ Use of pre-change credits absorbs the section 383 credit limitation.²⁸ Once the section 383 credit limitation has been fully absorbed, no more pre-change credits may be used.²⁹ Any unused general business credit that is not a pre-change credit is not limited by section 383 or the regulations thereunder.

REASONS FOR CHANGE

The tax law includes rules that limit the use of tax attributes of a corporation, such as net operating loss carryforwards and general business credits, following certain ownership change transactions in order to prevent abuse, such as trafficking in these attributes. The Committee believes that these limits can be unduly restrictive when applied to losses and credits attributable to the early years of a trade or business. At the start-up stage of a business, when income tends to be low or nonexistent, application of the limits can prevent the future use of all or almost all of the business's loss carryforwards and unused credits. The Committee believes that accepting such tax attributes from these limitations will better allow start-up businesses to raise capital and pursue opportunities to grow.

²⁵ Sec. 382(l)(5)(A).

²⁶ Sec. 382(l)(5)(D).

²⁷ Treas. Reg. sec. 1.383-1(b).

²⁸ The section 383 credit limitation is defined as the excess of (1) the new loss corporation's regular tax liability for the post-change year over (2) the new loss corporation's regular tax liability for the post-change year computed, for this purpose, by allowing as an additional deduction an amount equal to the section 382 limitation remaining after reduction for pre-change losses and pre-change capital losses under sections 382 and 383 (and the regulations thereunder). See Treas. Reg. sec. 1.383-1(c)(6); see generally sec. 383(a).

²⁹ Treas. Reg. sec. 1.383-1(d)(1).

EXPLANATION OF PROVISION

The provision amends sections 382 and 383 to permit the pre-change net operating loss carryforwards, net operating losses, general business credit carryforwards, and general business credits of a start-up business to be available for use in a post-change year without limitation by sections 382(a) and 383.

Start-up losses under section 382

With regard to section 382, the provision generally reduces a new loss corporation's pre-change losses by the portion of the old loss corporation's net operating loss carryforwards and net operating losses that are attributable to a start-up business of the old loss corporation.³⁰ Specifically, in the case of any pre-change net operating loss carryforward which arose in any start-up period taxable year (defined below), the amount of such net operating loss carryforward otherwise taken into account for purposes of calculating the new loss corporation's pre-change loss is reduced by the net start-up loss (defined below) determined with respect to the start-up trade or business. In a similar manner, pre-change losses are also reduced by any net operating loss incurred in the year of the ownership change to the extent such loss is attributable to a start-up business in the period on or before the change date. By reducing pre-change losses, the provision reduces the total amount of losses that are limited by section 382(a).

A start-up period taxable year is any taxable year of the old loss corporation which (1) begins before the close of the three-year period beginning on the date on which any trade or business of such corporation begins as an active trade or business³¹ and (2) ends

³⁰ However, the provision does not apply for purposes of including the carryover of disallowed business interest in the corporation's pre-change loss under section 382(d)(1) and (3).

³¹ The beginning of an active trade or business is the same under the provision as under present-law section 195(c)(2) without regard to subparagraph (B) thereof. (While section 195 is modified elsewhere in the bill, those changes do not affect the meaning of the beginning of active trade or business under section 195.) Thus, the three-year period described in the provision begins on the same date that triggers allowance of a deduction under section 195(b)(1)(A). The Senate Finance Committee Report describing what ultimately became section 195 defined that concept as follows:

Generally, it is anticipated that the definition of when a business begins is to be made in reference to the existing provisions for the amortization of organizational expenditures (Code secs. 248 and 709). Generally, if the activities of the corporation have advanced to the extent necessary to establish the nature of its business operations, it will be deemed to have begun business. For example, the acquisition of operating assets which are necessary to the type of business contemplated may constitute the beginning of business.

See Senate Finance Committee Report to accompany H.R. 7956, Miscellaneous Revenue Act of 1980, S. Rep. No. 96-1036 (96th Cong., 2d Sess.), November 25, 1980, p. 14. As the Senate Finance Committee Report states, this is similar to the concept referred to in section 248(a)(2) and defined in Treasury regulations as follows:

The determination of the date the corporation begins business presents a question of fact which must be determined in each case in light of all the circumstances of the particular case. The words "begins business," however, do not have the same meaning as "in existence." Ordinarily, a corporation begins business when it starts the business operations for which it was organized; a corporation comes into existence on the date of its incorporation. Mere organizational activities, such as the obtaining of the corporate charter, are not alone sufficient to show the beginning of business. If the activities of the corporation have advanced to the extent necessary to establish the nature of its business operations, however, it will be deemed to have begun business. For example, the acquisition of operating assets which are necessary to the type of business contemplated may constitute the beginning of business.

See Treas. Reg. sec. 1.248-1(d); see also Treas. Reg. sec. 1.709-2(c) (echoing the distinctions above and explaining that "[t]he term 'operating assets', as used herein, means assets that are in a state of readiness to be placed in service within a reasonable period following their acquisition"); *Richmond Television Corp. v. United States*, 345 F.2d 901 (4th Cir. 1965) (holding that

Continued

after September 10, 2018.³² Start-up period taxable years may predate the beginning of active trade or business, meaning deductible expenditures paid or incurred in connection with a trade or business prior to the beginning of active trade or business may be treated as paid or incurred in a start-up period taxable year with respect to such trade or business.³³

Generally, a net start-up loss is the portion of the old loss corporation's net operating loss carryforward from a particular year that is attributable to activities of a start-up business in that year. Specifically, the net start-up loss with respect to a start-up business for any start-up period taxable year is the amount that bears the same ratio to the net operating loss carryforward which arose in such year as (1) the net operating loss (if any) which would have been determined for such taxable year if only items of income, gain, deduction, and loss properly allocable to the start-up trade or business were taken into account, bears to (2) the amount of the net operating loss determined for such taxable year. If the ratio described in the previous sentence is greater than one, the ratio shall be deemed to equal one.

Any net operating loss incurred prior to the ownership change date in the year of change is treated similarly to net operating loss carryforwards to the taxable year ending with the ownership change or in which the change date occurs, after proper allocation of such net operating loss and any net start-up loss to the period in such year on or before the change date.³⁴ For example, consider Corporation X, which undergoes an ownership change. In the year of change (which is also a start-up period taxable year), Corporation X has a net start-up loss of \$100, \$50 of which is allocable to the period on or before the change date. In this example, Corporation X's pre-change losses subject to limitation under section 382(a) would be reduced by \$50.

In the case of any start-up period taxable year which ends after the close of the three-year period beginning on the date an active trade or business begins, the net start-up loss with respect to such trade or business for such year is the same proportion of such loss as the proportion of such taxable year on or before the close of such period. For example, consider Corporation Y, a calendar year taxpayer that begins an active trade or business on June 30, 2019. If Corporation Y has a net start-up loss for tax year 2022 and later undergoes an ownership change, Corporation Y's pre-change losses would be reduced by half of the net start-up loss for 2022.

In the event that the old loss corporation starts more than one trade or business in a timeframe that causes a single taxable year of the old loss corporation to be a start-up period taxable year with respect to more than one trade or business, the provision applies separately to each trade or business, and the provision's aggregate

trade or business has begun when the taxpayer has "begun to function as a going concern and performed those activities for which it was organized"). The Internal Revenue Service has cited *Richmond Television* in interpreting the active trade or business requirement under section 195. See, e.g., Tech. Adv. Mem. 9310001, November 4, 1992; Tech. Adv. Mem. 9414004, December 17, 1993.

³² By requiring that the start-up taxable year end after September 10, 2018, the provision does not apply to expenses incurred in taxable years ending on or prior to September 10, 2018.

³³ For example, a taxpayer could have expenses in connection with a trade or business under section 174 prior to beginning active trade or business.

³⁴ Section 382(d)(1)(B) requires allocation of the net operating loss to the period on or before the change date.

reduction of pre-change losses for any taxable year of the old loss corporation cannot exceed the old loss corporation's net operating loss carryforward with respect to that year.

If the new loss corporation does not continue the start-up trade or business at all times during the two-year period beginning on the change date, the provision does not apply with respect to such trade or business.

The provision also provides that it does not apply in the event of an ownership change described in section 382(1)(5)(D) (*i.e.*, an ownership change that occurs during the two-year period following an ownership change in a title 11 or similar case that meets the criteria of section 382(1)(5)(A)), nor does it apply to an ownership change to which section 382(1)(6) applies (*i.e.*, certain insolvency transactions).

Start-up excess credits under section 383

The provision generally permits unused general business credits earned by a start-up business prior to an ownership change to be used in a post-change year without limitation by section 383. Using the same definition of a start-up period taxable year as above, the provision reduces the amount of excess credits subject to limitation under section 383 by the amount of any start-up excess credit earned in any start-up period taxable year.³⁵ A start-up excess credit with respect to a start-up business for any start-up period taxable year is the amount which bears the same ratio to the unused general business credit which arose in such taxable year as (1) the amount of the general business credit which would have been determined for such taxable year if only credits properly allocable to the start-up trade or business were taken into account, bears to (2) the amount of the general business credit determined for such taxable year. By reducing excess credits, the provision reduces the total amount of credits that are limited by section 383.

Rules similar to those provided by the provision under section 382 apply to (1) the last taxable year in the start-up period, (2) credits arising in the year of ownership change, (3) taxable years which are start-up period taxable years with respect to more than one trade or business, and (4) the two-year continuity of business requirement.

EFFECTIVE DATE

The provision is effective for taxable years ending after September 10, 2018.

Transition rules provide that the provision does not apply to any active trade or business that begins on or before September 10, 2018.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consider-

³⁵ As described above, the regulations under section 383 use the concept of "pre-change credits" rather than excess credits. The provision alters the Code, and so uses the Code's approach; the intent is that the rule for reducing excess credits should apply to the calculation of pre-change credits under Treasury regulation section 1.383-1.

ation of H.R. 6756, the “American Innovation Act of 2018,” on September 13, 2018.

H.R. 6756 was ordered favorably reported to the House of Representatives as amended by an amendment in the nature of a substitute offered by Chairman Brady by a voice vote (with a quorum being present).

IV. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATE OF BUDGETARY EFFECTS

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 6756, as reported.

The bill, as reported, is estimated to have the following effect on Federal fiscal year budget receipts for the period 2019–2028:

FISCAL YEARS
[Millions of dollars]

Provision	Effective	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019-23	2019-28
1. Simplification and expansion of deduction for start-up and organizational expenditures	[1]	-44	-109	-153	-198	-246	-295	-346	-399	-456	-518	-750	-2,764
2. Preservation of start-up net operating losses and tax credits after ownership changes	Year 9/10/18	-17	-32	-55	-90	-144	-225	-329	-459	-592	-709	-338	-2,652
NET TOTAL		-61	-141	-208	-288	-390	-520	-675	-858	-1,048	-1,227	-1,088	-5,416

Joint Committee on Taxation

Note: Details may not add to totals due to rounding. The date of enactment is generally assumed to be October 1, 2018.

Legend for "Effective" column: Year = taxable years ending after

[1] Proposal applies to expenditures paid or incurred in connection with active trades or businesses which begin in taxable years beginning after December 31, 2018.

Pursuant to clause 8 of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: The gross budgetary effect (before incorporating macroeconomic effects) in any fiscal year is less than 0.25 percent of the current projected gross domestic product of the United States for that fiscal year; therefore, the bill is not “major legislation” for purposes of requiring that the estimate include the budgetary effects of changes in economic output, employment, capital stock and other macroeconomic variables.

B. STATEMENT REGARDING NEW BUDGET AUTHORITY AND TAX
EXPENDITURES BUDGET AUTHORITY

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue provisions involve no new tax expenditures.

C. COST ESTIMATE PREPARED BY THE CONGRESSIONAL BUDGET
OFFICE

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, September 21, 2018.

Hon. KEVIN BRADY,
*Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 6756, the American Innovation Act of 2018. It contains estimates of tax provisions prepared by the staff of the Joint Committee on Taxation.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Cecilia Pastrone.

Sincerely,

KEITH HALL,
Director.

Enclosure.

H.R. 6756—American Innovation Act of 2018

Summary: H.R. 6756, the American Innovation Act of 2018, would amend the Internal Revenue Code by modifying the deduction for start-up and organizational expenditures and the treatment of losses, carryforwards and unused pre-change tax credits for companies after an ownership change. The bill raises the amount which may be deducted for start-up and organizational expenditures. In addition, it removes some limitations on the use of losses, carryforwards, and unused pre-change tax credits for new loss corporations that have experienced an ownership change.

The staff of the Joint Committee on Taxation (JCT) estimates that enacting the bill would reduce revenues by \$5,416 million over

the 2019–2028 period. Pay-as-you-go procedures apply because enacting the legislation would affect revenues.

JCT estimates that enacting the legislation would increase on-budget deficits by more than \$5 billion in at least one of the four consecutive 10-year periods beginning in 2029. CBO and JCT estimate that enacting the bill would not increase net direct spending in any of the four consecutive 10-year periods beginning in 2029.

JCT has determined that the tax provisions of the bill contain no intergovernmental or private sector mandates as defined in the Unfunded Mandates Reform Act (UMRA).

Estimated cost to the Federal Government: The estimated budgetary effect of H.R. 6756 is shown in the following table.

	By fiscal year, in millions of dollars—												
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019–2023	2019–2028
CHANGES IN REVENUES													
Simplification and expansion of deduction for start-up and organizational expenditures	0	-44	-109	-153	-198	-246	-295	-346	-399	-456	-518	-750	-2,764
Preservation of start-up net operating losses and tax credits after ownership changes	0	-17	-32	-55	-90	-144	-225	-329	-459	-592	-709	-338	-2,652
Total Estimated Changes in Revenues	0	-61	-141	-208	-288	-390	-520	-675	-858	-1,048	-1,227	-1,088	-5,416
NET INCREASE IN THE DEFICIT FROM DECREASES IN REVENUES													
Effect on Deficit	0	61	141	208	288	390	520	675	858	1,048	1,227	1,088	5,416

Source: Staff of the Joint Committee on Taxation.
Components may not add to totals due to rounding.

Basis of estimate: The Congressional Budget Act of 1974, as amended, stipulates that revenue estimates provided by the staff of the Joint Committee on Taxation will be the official estimates for all tax legislation considered by the Congress. As such, CBO incorporates those estimates into its cost estimates of the effects of legislation. All of the estimates for the provisions of H.R. 6756 were provided by JCT.¹ The date of enactment is generally assumed to be October 1, 2018.

Simplification and Expansion of Deduction for Start-up and Organizational Expenditures. Under current law, business start-up expenditures may be deducted in the amount of \$5,000 in the taxable year in which a business or trade was started. Up to \$5,000 of organizational expenditures may also be deducted. The amount deducted in both cases is reduced by the amount by which the cumulative cost of start-up and organizational expenditures exceeds \$50,000.

H.R. 6756 would raise the amount that could be deducted for start-up and organizational expenditures to \$20,000 for the combined total of start-up and organizational expenses. This is reduced by the amount by which the sum of start-up and organizational expenditures exceeds \$120,000. The dollar amounts are adjusted for inflation beginning in 2020. H.R. 6756 also allows partnerships or corporations liquidated within a 180-month period and disposed or discontinued businesses to deduct any unamortized start-up expenses. JCT estimates that the changes in this provision would reduce revenues by \$2,764 million from 2019 to 2028.

Preservation of Start-Up Net Operating Losses and Tax Credits after Ownership Changes. Under current law, companies that experience an ownership change may offset taxable income by the pre-change net operating losses (NOLs), unused pre-change tax credits, and net capital losses of the original corporation subject to certain limitations. Pre-change credits from the old loss corporation may include unused general business credits, alternative minimum tax credits, and foreign tax credits. The pre-change NOL amount that can be used to offset taxable income is limited to the value of the old loss corporation before the ownership change multiplied by the long-term tax-exempt interest rate. Use of pre-change credits and net capital losses to offset the tax liability of the new loss corporation are likewise limited. Similarly limited carryforwards of both losses and pre-change credits may also be used provided the new loss corporation continues the business of the old corporation for a two-year period.

H.R. 6756 generally provides for an exception to the limitations for pre-change net operating and capital losses, unused credits, and carryforwards in the case of a start-up. The bill would allow the new loss firm to fully utilize pre-change losses, unused credits and carryforwards identified as accruing to the old loss firm as a result of start-up activity. Use of any remaining pre-change losses, unused credits or carryforwards of the old loss firm would then be subject to the limitations. Business continuity conditions still apply

¹ For JCT's description of the bill and estimates of the provisions, which include detail beyond the summary presented below, see Joint Committee on Taxation, Description of H.R. 6756, the "American Innovation Act of 2018," JCX-76-18, <https://www.jct.gov/publications.html?func=startdown&id=5142>, and Estimated Revenue Effects of H.R. 6756, the "American Innovation Act of 2018," JCX-78-18, <https://www.jct.gov/publications.html?func=startdown&id=5144>.

for the use of carryforwards. JCT estimates that this provision would reduce revenues by \$2,652 million from 2019 to 2028.

Pay-As-You-Go Considerations: The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table. Only on-budget changes to outlays or revenues are subject to pay-as-you-go procedures.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 6756, AS ORDERED REPORTED BY THE
HOUSE COMMITTEE ON WAYS AND MEANS ON SEPTEMBER 13, 2018

	By fiscal year, in millions of dollars—													2019– 2023	2019– 2028
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028				
NET INCREASE IN THE ON-BUDGET DEFICIT															
Statutory Pay-As-You-Go Effects	0	61	141	208	288	390	520	675	858	1,048	1,227	1,088	5,416		

Source: Staff of the Joint Committee on Taxation.
Components may not add to totals due to rounding.

Increase in long-term direct spending and deficits: JCT estimates that enacting H.R. 6756 would increase on-budget deficits by more than \$5 billion in at least one of the four 10-year periods beginning in 2029. CBO and JCT estimate that enacting the bill would not increase net direct spending in any of the four consecutive 10-year periods beginning in 2029.

Mandates: JCT has determined that H.R. 6756 contains no private-sector or intergovernmental mandates as defined by UMRA.

Estimate prepared by: Staff of the Joint Committee on Taxation and Cecilia Pastrone.

Estimate reviewed by: Joshua Shakin, Chief, Revenue Estimating Unit; John McClelland, Assistant Director for Tax Analysis.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. COMMITTEE OVERSIGHT FINDINGS AND RECOMMENDATIONS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee advises that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated into the description portions of this report.

B. STATEMENT OF GENERAL PERFORMANCE GOALS AND OBJECTIVES

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. INFORMATION RELATING TO UNFUNDED MANDATES

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104-4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. APPLICABILITY OF HOUSE RULE XXI 5(b)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that “A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present.” The Committee has carefully reviewed the bill and states that the bill does not involve any Federal income tax rate increases within the meaning of the rule.

E. TAX COMPLEXITY ANALYSIS

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (“IRS Reform Act”) requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code of 1986 and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Internal Revenue Code of 1986 and that have “widespread applicability” to individuals or small businesses, within the meaning of the rule.

F. CONGRESSIONAL EARMARKS, LIMITED TAX BENEFITS, AND LIMITED TARIFF BENEFITS

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

G. DUPLICATION OF FEDERAL PROGRAMS

In compliance with Sec. 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program, (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111-139, or (3) a program related to a program identified in

the most recent Catalog of Federal Domestic Assistance, published pursuant to section 6104 of title 31, United States Code.

H. DISCLOSURE OF DIRECTED RULE MAKINGS

In compliance with Sec. 3(i) of H. Res. 5 (115th Congress), the following statement is made concerning directed rule makings: The Committee advises that the bill requires no directed rule makings within the meaning of such section.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

A. CHANGES IN EXISTING LAW PROPOSED BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law proposed by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

* * * * *

Subtitle A—Income Taxes

* * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * *

Subchapter B—Computation of Taxable Income

* * * * *

PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

* * * * *

[Sec. 195. Start-up expenditures.]
Sec. 195. Start-up and organizational expenditures.

* * * * *

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) ALLOWANCE OF DEDUCTION.—

(1) GENERAL RULE.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

(2) CORPORATIONS ON ACCRUAL BASIS.—In the case of a corporation reporting its taxable income on the accrual basis, if—

(A) the board of directors authorizes a charitable contribution during any taxable year, and

(B) payment of such contribution is made after the close of such taxable year and on or before the 15th day of the fourth month following the close of such taxable year, then the taxpayer may elect to treat such contribution as paid during such taxable year. The election may be made only at the time of the filing of the return for such taxable year, and shall be signified in such manner as the Secretary shall by regulations prescribe.

(3) FUTURE INTERESTS IN TANGIBLE PERSONAL PROPERTY.—For purposes of this section, payment of a charitable contribution which consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in section 267(b) or 707(b). For purposes of the preceding sentence, a fixture which is intended to be severed from the real property shall be treated as tangible personal property.

(b) PERCENTAGE LIMITATIONS.—

(1) INDIVIDUALS.—In the case of an individual, the deduction provided in subsection (a) shall be limited as provided in the succeeding subparagraphs.

(A) GENERAL RULE.—Any charitable contribution to—

(i) a church or a convention or association of churches,

(ii) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on,

(iii) an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research, if the organization is a hospital, or if the organization is a medical research organization directly engaged in the continuous active conduct of medical research in conjunction with a hospital, and during the calendar year in which the contribution is made such organization is committed to spend such contributions for such research before January 1 of the fifth calendar year which begins after the date such contribution is made,

(iv) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose

or function constituting the basis for its exemption under section 501(a) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public, and which is organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university which is an organization referred to in clause (ii) of this subparagraph and which is an agency or instrumentality of a State or political subdivision thereof, or which is owned or operated by a State or political subdivision thereof or by an agency or instrumentality of one or more States or political subdivisions,

(v) a governmental unit referred to in subsection (c)(1),

(vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public,

(vii) a private foundation described in subparagraph (F),

(viii) an organization described in section 509(a)(2) or (3), or

(ix) an agricultural research organization directly engaged in the continuous active conduct of agricultural research (as defined in section 1404 of the National Agricultural Research, Extension, and Teaching Policy Act of 1977) in conjunction with a land-grant college or university (as defined in such section) or a non-land grant college of agriculture (as defined in such section), and during the calendar year in which the contribution is made such organization is committed to spend such contribution for such research before January 1 of the fifth calendar year which begins after the date such contribution is made,

shall be allowed to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year.

(B) OTHER CONTRIBUTIONS.—Any charitable contribution other than a charitable contribution to which subparagraph (A) applies shall be allowed to the extent that the aggregate of such contributions does not exceed the lesser of—

(i) 30 percent of the taxpayer's contribution base for the taxable year, or

(ii) the excess of 50 percent of the taxpayer's contribution base for the taxable year over the amount of charitable contributions allowable under subparagraph (A) (determined without regard to subparagraph (C)).

If the aggregate of such contributions exceeds the limitation of the preceding sentence, such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution (to which subparagraph (A) does not apply) in each of the 5 succeeding taxable years in order of time.

(C) Special limitation with respect to contributions described in subparagraph (A) of certain capital gain property (i) In the case of charitable contributions described in subparagraph (A) of capital gain property to which subsection (e)(1)(B) does not apply, the total amount of contributions of such property which may be taken into account under subsection (a) for any taxable year shall not exceed 30 percent of the taxpayer's contribution base for such year. For purposes of this subsection, contributions of capital gain property to which this subparagraph applies shall be taken into account after all other charitable contributions (other than charitable contributions to which subparagraph (D) applies).

(ii) If charitable contributions described in subparagraph (A) of capital gain property to which clause (i) applies exceeds 30 percent of the taxpayer's contribution base for any taxable year, such excess shall be treated, in a manner consistent with the rules of subsection (d)(1), as a charitable contribution of capital gain property to which clause (i) applies in each of the 5 succeeding taxable years in order of time.

(iii) At the election of the taxpayer (made at such time and in such manner as the Secretary prescribes by regulations), subsection (e)(1) shall apply to all contributions of capital gain property (to which subsection (e)(1)(B) does not otherwise apply) made by the taxpayer during the taxable year. If such an election is made, clauses (i) and (ii) shall not apply to contributions of capital gain property made during the taxable year, and, in applying subsection (d)(1) for such taxable year with respect to contributions of capital gain property made in any prior contribution year for which an election was not made under this clause, such contributions shall be reduced as if subsection (e)(1) had applied to such contributions in the year in which made.

(iv) For purposes of this paragraph, the term "capital gain property" means, with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long-term capital gain. For purposes of the preceding sentence, any property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset.

(D) Special limitation with respect to contributions of capital gain property to organizations not described in subparagraph (A)

(i) IN GENERAL.—In the case of charitable contributions (other than charitable contributions to which subparagraph (A) applies) of capital gain property, the total amount of such contributions of such property taken into account under subsection (a) for any taxable year shall not exceed the lesser of—

(I) 20 percent of the taxpayer's contribution base for the taxable year, or

(II) the excess of 30 percent of the taxpayer's contribution base for the taxable year over the amount of the contributions of capital gain property to which subparagraph (C) applies.

For purposes of this subsection, contributions of capital gain property to which this subparagraph applies shall be taken into account after all other charitable contributions.

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution of capital gain property to which clause (i) applies in each of the 5 succeeding taxable years in order of time.

(E) CONTRIBUTIONS OF QUALIFIED CONSERVATION CONTRIBUTIONS.—

(i) IN GENERAL.—Any qualified conservation contribution (as defined in subsection (h)(1)) shall be allowed to the extent the aggregate of such contributions does not exceed the excess of 50 percent of the taxpayer's contribution base over the amount of all other charitable contributions allowable under this paragraph.

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution to which clause (i) applies in each of the 15 succeeding years in order of time.

(iii) COORDINATION WITH OTHER SUBPARAGRAPHS.—For purposes of applying this subsection and subsection (d)(1), contributions described in clause (i) shall not be treated as described in subparagraph (A), (B), (C), or (D) and such subparagraphs shall apply without regard to such contributions.

(iv) SPECIAL RULE FOR CONTRIBUTION OF PROPERTY USED IN AGRICULTURE OR LIVESTOCK PRODUCTION.—

(I) IN GENERAL.—If the individual is a qualified farmer or rancher for the taxable year for which the contribution is made, clause (i) shall be applied by substituting "100 percent" for "50 percent".

(II) EXCEPTION.—Subclause (I) shall not apply to any contribution of property made after the date of the enactment of this subparagraph which is used in agriculture or livestock production (or

available for such production) unless such contribution is subject to a restriction that such property remain available for such production. This subparagraph shall be applied separately with respect to property to which subclause (I) does not apply by reason of the preceding sentence prior to its application to property to which subclause (I) does apply.

(v) DEFINITION.—For purposes of clause (iv), the term “qualified farmer or rancher” means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer’s gross income for the taxable year.

(F) CERTAIN PRIVATE FOUNDATIONS.—The private foundations referred to in subparagraph (A)(vii) and subsection (e)(1)(B) are—

(i) a private operating foundation (as defined in section 4942(j)(3)),

(ii) any other private foundation (as defined in section 509(a)) which, not later than the 15th day of the third month after the close of the foundation’s taxable year in which contributions are received, makes qualifying distributions (as defined in section 4942(g), without regard to paragraph (3) thereof), which are treated, after the application of section 4942(g)(3), as distributions out of corpus (in accordance with section 4942(h)) in an amount equal to 100 percent of such contributions, and with respect to which the taxpayer obtains adequate records or other sufficient evidence from the foundation showing that the foundation made such qualifying distributions, and

(iii) a private foundation all of the contributions to which are pooled in a common fund and which would be described in section 509(a)(3) but for the right of any substantial contributor (hereafter in this clause called “donor”) or his spouse to designate annually the recipients, from among organizations described in paragraph (1) of section 509(a), of the income attributable to the donor’s contribution to the fund and to direct (by deed or by will) the payment, to an organization described in such paragraph (1), of the corpus in the common fund attributable to the donor’s contribution; but this clause shall apply only if all of the income of the common fund is required to be (and is) distributed to one or more organizations described in such paragraph (1) not later than the 15th day of the third month after the close of the taxable year in which the income is realized by the fund and only if all of the corpus attributable to any donor’s contribution to the fund is required to be (and is) distributed to one or more of such organizations not later than one year after his death or after the death of his surviving spouse if she has the right to designate the recipients of such corpus.

(G) INCREASED LIMITATION FOR CASH CONTRIBUTIONS.—

(i) IN GENERAL.—In the case of any contribution of cash to an organization described in subparagraph (A), the total amount of such contributions which may be taken into account under subsection (a) for any taxable year beginning after December 31, 2017, and before January 1, 2026, shall not exceed 60 percent of the taxpayer's contribution base for such year.

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the applicable limitation under clause (i) for any taxable year described in such clause, such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution to which clause (i) applies in each of the 5 succeeding years in order of time.

(iii) Coordination with subparagraphs (A) and (B)

(I) IN GENERAL.—Contributions taken into account under this subparagraph shall not be taken into account under subparagraph (A).

(II) LIMITATION REDUCTION.—For each taxable year described in clause (i), and each taxable year to which any contribution under this subparagraph is carried over under clause (ii), subparagraph (A) shall be applied by reducing (but not below zero) the contribution limitation allowed for the taxable year under such subparagraph by the aggregate contributions allowed under this subparagraph for such taxable year, and subparagraph (B) shall be applied by treating any reference to subparagraph (A) as a reference to both subparagraph (A) and this subparagraph.

(H) CONTRIBUTION BASE DEFINED.—For purposes of this section, the term “contribution base” means adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172).

(2) CORPORATIONS.—In the case of a corporation—

(A) IN GENERAL.—The total deductions under subsection (a) for any taxable year (other than for contributions to which subparagraph (B) or (C) applies) shall not exceed 10 percent of the taxpayer's taxable income.

(B) QUALIFIED CONSERVATION CONTRIBUTIONS BY CERTAIN CORPORATE FARMERS AND RANCHERS.—

(i) IN GENERAL.—Any qualified conservation contribution (as defined in subsection (h)(1))—

(I) which is made by a corporation which, for the taxable year during which the contribution is made, is a qualified farmer or rancher (as defined in paragraph (1)(E)(v)) and the stock of which is not readily tradable on an established securities market at any time during such year, and

(II) which, in the case of contributions made after the date of the enactment of this subparagraph, is a contribution of property which is used in agriculture or livestock production (or available

for such production) and which is subject to a restriction that such property remain available for such production,

shall be allowed to the extent the aggregate of such contributions does not exceed the excess of the taxpayer's taxable income over the amount of charitable contributions allowable under subparagraph (A).

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(2)) as a charitable contribution to which clause (i) applies in each of the 15 succeeding taxable years in order of time.

(C) QUALIFIED CONSERVATION CONTRIBUTIONS BY CERTAIN NATIVE CORPORATIONS.—

(i) IN GENERAL.—Any qualified conservation contribution (as defined in subsection (h)(1)) which—

(I) is made by a Native Corporation, and

(II) is a contribution of property which was land conveyed under the Alaska Native Claims Settlement Act,

shall be allowed to the extent that the aggregate amount of such contributions does not exceed the excess of the taxpayer's taxable income over the amount of charitable contributions allowable under subparagraph (A).

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(2)) as a charitable contribution to which clause (i) applies in each of the 15 succeeding taxable years in order of time.

(iii) NATIVE CORPORATION.—For purposes of this subparagraph, the term "Native Corporation" has the meaning given such term by section 3(m) of the Alaska Native Claims Settlement Act.

(D) TAXABLE INCOME.—For purposes of this paragraph, taxable income shall be computed without regard to—

(i) this section,

(ii) part VIII [(except section 248)],

(iii) any net operating loss carryback to the taxable year under section 172,

(iv) any capital loss carryback to the taxable year under section 1212(a)(1)

(v) section 199A(g).

(c) CHARITABLE CONTRIBUTION DEFINED.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B). Rules similar to the rules of section 501(j) shall apply for purposes of this paragraph.

(3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions, and

(B) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(5) A cemetery company owned and operated exclusively for the benefit of its members, or any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if such company or corporation is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

For purposes of this section, the term “charitable contribution” also means an amount treated under subsection (g) as paid for the use of an organization described in paragraph (2), (3), or (4).

(d) CARRYOVERS OF EXCESS CONTRIBUTIONS.—

(1) INDIVIDUALS.—

(A) IN GENERAL.—In the case of an individual, if the amount of charitable contributions described in subsection (b)(1)(A) payment of which is made within a taxable year

(hereinafter in this paragraph referred to as the “contribution year”) exceeds 50 percent of the taxpayer’s contribution base for such year, such excess shall be treated as a charitable contribution described in subsection (b)(1)(A) paid in each of the 5 succeeding taxable years in order of time, but, with respect to any such succeeding taxable year, only to the extent of the lesser of the two following amounts:

(i) the amount by which 50 percent of the taxpayer’s contribution base for such succeeding taxable year exceeds the sum of the charitable contributions described in subsection (b)(1)(A) payment of which is made by the taxpayer within such succeeding taxable year (determined without regard to this subparagraph) and the charitable contributions described in subsection (b)(1)(A) payment of which was made in taxable years before the contribution year which are treated under this subparagraph as having been paid in such succeeding taxable year; or

(ii) in the case of the first succeeding taxable year, the amount of such excess, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess not treated under this subparagraph as a charitable contribution described in subsection (b)(1)(A) paid in any taxable year intervening between the contribution year and such succeeding taxable year.

(B) SPECIAL RULE FOR NET OPERATING LOSS CARRYOVERS.—In applying subparagraph (A), the excess determined under subparagraph (A) for the contribution year shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases the net operating loss deduction for a taxable year succeeding the contribution year.

(2) CORPORATIONS.—

(A) IN GENERAL.—Any contribution made by a corporation in a taxable year (hereinafter in this paragraph referred to as the “contribution year”) in excess of the amount deductible for such year under subsection (b)(2)(A) shall be deductible for each of the 5 succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under subsection (b)(2)(A) over the sum of the contributions made in such year plus the aggregate of the excess contributions which were made in taxable years before the contribution year and which are deductible under this subparagraph for such succeeding taxable year; or (ii) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess contribution not deductible under this subparagraph for any taxable year intervening between the contribution year and such succeeding taxable year.

(B) SPECIAL RULE FOR NET OPERATING LOSS CARRYOVERS.—For purposes of subparagraph (A), the excess of—

(i) the contributions made by a corporation in a taxable year to which this section applies, over

(ii) the amount deductible in such year under the limitation in subsection (b)(2)(A),

shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases a net operating loss carryover under section 172 to a succeeding taxable year.

(e) CERTAIN CONTRIBUTIONS OF ORDINARY INCOME AND CAPITAL GAIN PROPERTY.—

(1) GENERAL RULE.—The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of—

(A) the amount of gain which would not have been long-term capital gain (determined without regard to section 1221(b)(3)) if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution), and

(B) in the case of a charitable contribution—

(i) of tangible personal property—

(I) if the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under section 501 (or, in the case of a governmental unit, to any purpose or function described in subsection (c)), or

(II) which is applicable property (as defined in paragraph (7)(C), but without regard to clause (ii) thereof) which is sold, exchanged, or otherwise disposed of by the donee before the last day of the taxable year in which the contribution was made and with respect to which the donee has not made a certification in accordance with paragraph (7)(D),

(ii) to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in subsection (b)(1)(F),

(iii) of any patent, copyright (other than a copyright described in section 1221(a)(3) or 1231(b)(1)(C)), trademark, trade name, trade secret, know-how, software (other than software described in section 197(e)(3)(A)(i)), or similar property, or applications or registrations of such property, or

(iv) of any taxidermy property which is contributed by the person who prepared, stuffed, or mounted the property or by any person who paid or incurred the cost of such preparation, stuffing, or mounting,

the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

For purposes of applying this paragraph (other than in the case of gain to which section 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a) applies), property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset. For purposes of applying this paragraph in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply in determining whether gain on such stock would have been long-term capital gain if such stock were sold by the taxpayer.

(2) ALLOCATION OF BASIS.—For purposes of paragraph (1), in the case of a charitable contribution of less than the taxpayer's entire interest in the property contributed, the taxpayer's adjusted basis in such property shall be allocated between the interest contributed and any interest not contributed in accordance with regulations prescribed by the Secretary.

(3) SPECIAL RULE FOR CERTAIN CONTRIBUTIONS OF INVENTORY AND OTHER PROPERTY.—

(A) QUALIFIED CONTRIBUTIONS.—For purposes of this paragraph, a qualified contribution shall mean a charitable contribution of property described in paragraph (1) or (2) of section 1221(a), by a corporation (other than a corporation which is an S corporation) to an organization which is described in section 501(c)(3) and is exempt under section 501(a) (other than a private foundation, as defined in section 509(a), which is not an operating foundation, as defined in section 4942(j)(3)), but only if—

(i) the use of the property by the donee is related to the purpose or function constituting the basis for its exemption under section 501 and the property is to be used by the donee solely for the care of the ill, the needy, or infants;

(ii) the property is not transferred by the donee in exchange for money, other property, or services;

(iii) the taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with the provisions of clauses (i) and (ii); and

(iv) in the case where the property is subject to regulation under the Federal Food, Drug, and Cosmetic Act, as amended, such property must fully satisfy the applicable requirements of such Act and regulations promulgated thereunder on the date of transfer and for one hundred and eighty days prior thereto.

(B) AMOUNT OF REDUCTION.—The reduction under paragraph (1)(A) for any qualified contribution (as defined in subparagraph (A)) shall be no greater than the sum of—

(i) one-half of the amount computed under paragraph (1)(A) (computed without regard to this paragraph), and

(ii) the amount (if any) by which the charitable contribution deduction under this section for any qualified contribution (computed by taking into account the amount determined in clause (i), but without regard to this clause) exceeds twice the basis of such property.

(C) SPECIAL RULE FOR CONTRIBUTIONS OF FOOD INVENTORY.—

(i) GENERAL RULE.—In the case of a charitable contribution of food from any trade or business of the taxpayer, this paragraph shall be applied—

(I) without regard to whether the contribution is made by a C corporation, and

(II) only to food that is apparently wholesome food.

(ii) LIMITATION.—The aggregate amount of such contributions for any taxable year which may be taken into account under this section shall not exceed—

(I) in the case of any taxpayer other than a C corporation, 15 percent of the taxpayer's aggregate net income for such taxable year from all trades or businesses from which such contributions were made for such year, computed without regard to this section, and

(II) in the case of a C corporation, 15 percent of taxable income (as defined in subsection (b)(2)(D)).

(iii) RULES RELATED TO LIMITATION.—

(I) CARRYOVER.—If such aggregate amount exceeds the limitation imposed under clause (ii), such excess shall be treated (in a manner consistent with the rules of subsection (d)) as a charitable contribution described in clause (i) in each of the 5 succeeding taxable years in order of time.

(II) COORDINATION WITH OVERALL CORPORATE LIMITATION.—In the case of any charitable contribution which is allowable after the application of clause (ii)(II), subsection (b)(2)(A) shall not apply to such contribution, but the limitation imposed by such subsection shall be reduced (but not below zero) by the aggregate amount of such contributions. For purposes of subsection (b)(2)(B), such contributions shall be treated as allowable under subsection (b)(2)(A).

(iv) DETERMINATION OF BASIS FOR CERTAIN TAXPAYERS.—If a taxpayer—

(I) does not account for inventories under section 471, and

(II) is not required to capitalize indirect costs under section 263A,

the taxpayer may elect, solely for purposes of subparagraph (B), to treat the basis of any apparently wholesome food as being equal to 25 percent of the fair market value of such food.

(v) DETERMINATION OF FAIR MARKET VALUE.—In the case of any such contribution of apparently wholesome food which cannot or will not be sold solely by reason of internal standards of the taxpayer, lack of market, or similar circumstances, or by reason of being produced by the taxpayer exclusively for the purposes of transferring the food to an organization described in

subparagraph (A), the fair market value of such contribution shall be determined—

(I) without regard to such internal standards, such lack of market, such circumstances, or such exclusive purpose, and

(II) by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer at the time of the contribution (or, if not so sold at such time, in the recent past).

(vi) APPARENTLY WHOLESOME FOOD.—For purposes of this subparagraph, the term “apparently wholesome food” has the meaning given to such term by section 22(b)(2) of the Bill Emerson Good Samaritan Food Donation Act (42 U.S.C. 1791(b)(2)), as in effect on the date of the enactment of this subparagraph.

(D) This paragraph shall not apply to so much of the amount of the gain described in paragraph (1)(A) which would be long-term capital gain but for the application of sections 617, 1245, 1250, or 1252.

(4) SPECIAL RULE FOR CONTRIBUTIONS OF SCIENTIFIC PROPERTY USED FOR RESEARCH.—

(A) LIMIT ON REDUCTION.—In the case of a qualified research contribution, the reduction under paragraph (1)(A) shall be no greater than the amount determined under paragraph (3)(B).

(B) QUALIFIED RESEARCH CONTRIBUTIONS.—For purposes of this paragraph, the term “qualified research contribution” means a charitable contribution by a corporation of tangible personal property described in paragraph (1) of section 1221(a), but only if—

(i) the contribution is to an organization described in subparagraph (A) or subparagraph (B) of section 41(e)(6),

(ii) the property is constructed or assembled by the taxpayer,

(iii) the contribution is made not later than 2 years after the date the construction or assembly of the property is substantially completed,

(iv) the original use of the property is by the donee,

(v) the property is scientific equipment or apparatus substantially all of the use of which by the donee is for research or experimentation (within the meaning of section 174), or for research training, in the United States in physical or biological sciences,

(vi) the property is not transferred by the donee in exchange for money, other property, or services, and

(vii) the taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with the provisions of clauses (v) and (vi).

(C) CONSTRUCTION OF PROPERTY BY TAXPAYER.—For purposes of this paragraph, property shall be treated as constructed by the taxpayer only if the cost of the parts used in the construction of such property (other than parts man-

ufactured by the taxpayer or a related person) do not exceed 50 percent of the taxpayer's basis in such property.

(D) CORPORATION.—For purposes of this paragraph, the term “corporation” shall not include—

- (i) an S corporation,
- (ii) a personal holding company (as defined in section 542), and
- (iii) a service organization (as defined in section 414(m)(3)).

(5) SPECIAL RULE FOR CONTRIBUTIONS OF STOCK FOR WHICH MARKET QUOTATIONS ARE READILY AVAILABLE.—

(A) IN GENERAL.—Subparagraph (B)(ii) of paragraph (1) shall not apply to any contribution of qualified appreciated stock.

(B) QUALIFIED APPRECIATED STOCK.—Except as provided in subparagraph (C), for purposes of this paragraph, the term “qualified appreciated stock” means any stock of a corporation—

- (i) for which (as of the date of the contribution) market quotations are readily available on an established securities market, and
- (ii) which is capital gain property (as defined in subsection (b)(1)(C)(iv)).

(C) DONOR MAY NOT CONTRIBUTE MORE THAN 10 PERCENT OF STOCK OF CORPORATION.—

(i) IN GENERAL.—In the case of any donor, the term “qualified appreciated stock” shall not include any stock of a corporation contributed by the donor in a contribution to which paragraph (1)(B)(ii) applies (determined without regard to this paragraph) to the extent that the amount of the stock so contributed (when increased by the aggregate amount of all prior contributions by the donor of stock in such corporation) exceeds 10 percent (in value) of all of the outstanding stock of such corporation.

(ii) SPECIAL RULE.—For purposes of clause (i), an individual shall be treated as making all contributions made by any member of his family (as defined in section 267(c)(4)).

(7) RECAPTURE OF DEDUCTION ON CERTAIN DISPOSITIONS OF EXEMPT USE PROPERTY.—

(A) IN GENERAL.—In the case of an applicable disposition of applicable property, there shall be included in the income of the donor of such property for the taxable year of such donor in which the applicable disposition occurs an amount equal to the excess (if any) of—

- (i) the amount of the deduction allowed to the donor under this section with respect to such property, over
- (ii) the donor's basis in such property at the time such property was contributed.

(B) APPLICABLE DISPOSITION.—For purposes of this paragraph, the term “applicable disposition” means any sale, exchange, or other disposition by the donee of applicable property—

(i) after the last day of the taxable year of the donor in which such property was contributed, and
(ii) before the last day of the 3-year period beginning on the date of the contribution of such property, unless the donee makes a certification in accordance with subparagraph (D).

(C) APPLICABLE PROPERTY.—For purposes of this paragraph, the term “applicable property” means charitable deduction property (as defined in section 6050L(a)(2)(A))—

(i) which is tangible personal property the use of which is identified by the donee as related to the purpose or function constituting the basis of the donee’s exemption under section 501, and

(ii) for which a deduction in excess of the donor’s basis is allowed.

(D) CERTIFICATION.—A certification meets the requirements of this subparagraph if it is a written statement which is signed under penalty of perjury by an officer of the donee organization and—

(i) which—

(I) certifies that the use of the property by the donee was substantial and related to the purpose or function constituting the basis for the donee’s exemption under section 501, and

(II) describes how the property was used and how such use furthered such purpose or function, or

(ii) which—

(I) states the intended use of the property by the donee at the time of the contribution, and

(II) certifies that such intended use has become impossible or infeasible to implement.

(f) DISALLOWANCE OF DEDUCTION IN CERTAIN CASES AND SPECIAL RULES.—

(1) IN GENERAL.—No deduction shall be allowed under this section for a contribution to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.

(2) CONTRIBUTIONS OF PROPERTY PLACED IN TRUST.—

(A) REMAINDER INTEREST.—In the case of property transferred in trust, no deduction shall be allowed under this section for the value of a contribution of a remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664), or a pooled income fund (described in section 642(c)(5)).

(B) INCOME INTERESTS, ETC.—No deduction shall be allowed under this section for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest for purposes of applying section 671. If the donor ceases to be

treated as the owner of such an interest for purposes of applying section 671, at the time the donor ceases to be so treated, the donor shall for purposes of this chapter be considered as having received an amount of income equal to the amount of any deduction he received under this section for the contribution reduced by the discounted value of all amounts of income earned by the trust and taxable to him before the time at which he ceases to be treated as the owner of the interest. Such amounts of income shall be discounted to the date of the contribution. The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph.

(C) DENIAL OF DEDUCTION IN CASE OF PAYMENTS BY CERTAIN TRUSTS.—In any case in which a deduction is allowed under this section for the value of an interest in property described in subparagraph (B), transferred in trust, no deduction shall be allowed under this section to the grantor or any other person for the amount of any contribution made by the trust with respect to such interest.

(D) EXCEPTION.—This paragraph shall not apply in a case in which the value of all interests in property transferred in trust are deductible under subsection (a).

(3) DENIAL OF DEDUCTION IN CASE OF CERTAIN CONTRIBUTIONS OF PARTIAL INTERESTS IN PROPERTY.—

(A) IN GENERAL.—In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply to—

- (i) a contribution of a remainder interest in a personal residence or farm,
- (ii) a contribution of an undivided portion of the taxpayer's entire interest in property, and
- (iii) a qualified conservation contribution.

(4) VALUATION OF REMAINDER INTEREST IN REAL PROPERTY.—For purposes of this section, in determining the value of a remainder interest in real property, depreciation (computed on the straight line method) and depletion of such property shall be taken into account, and such value shall be discounted at a rate of 6 percent per annum, except that the Secretary may prescribe a different rate.

(5) REDUCTION FOR CERTAIN INTEREST.—If, in connection with any charitable contribution, a liability is assumed by the recipient or by any other person, or if a charitable contribution is of property which is subject to a liability, then, to the extent necessary to avoid the duplication of amounts, the amount taken into account for purposes of this section as the amount of the charitable contribution—

(A) shall be reduced for interest (i) which has been paid (or is to be paid) by the taxpayer, (ii) which is attributable to the liability, and (iii) which is attributable to any period after the making of the contribution, and

(B) in the case of a bond, shall be further reduced for interest (i) which has been paid (or is to be paid) by the taxpayer on indebtedness incurred or continued to purchase or carry such bond, and (ii) which is attributable to any period before the making of the contribution.

The reduction pursuant to subparagraph (B) shall not exceed the interest (including interest equivalent) on the bond which is attributable to any period before the making of the contribution and which is not (under the taxpayer's method of accounting) includible in the gross income of the taxpayer for any taxable year. For purposes of this paragraph, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness.

(6) DEDUCTIONS FOR OUT-OF-POCKET EXPENDITURES.—No deduction shall be allowed under this section for an out-of-pocket expenditure made by any person on behalf of an organization described in subsection (c) (other than an organization described in section 501(h)(5) (relating to churches, etc.)) if the expenditure is made for the purpose of influencing legislation (within the meaning of section 501(c)(3)).

(7) Reformatations to comply with paragraph (2)

(A) IN GENERAL.—A deduction shall be allowed under subsection (a) in respect of any qualified reformation (within the meaning of section 2055(e)(3)(B)).

(B) RULES SIMILAR TO SECTION 2055(E)(3) TO APPLY.—For purposes of this paragraph, rules similar to the rules of section 2055(e)(3) shall apply.

(8) SUBSTANTIATION REQUIREMENT FOR CERTAIN CONTRIBUTIONS.—

(A) GENERAL RULE.—No deduction shall be allowed under subsection (a) for any contribution of \$250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements of subparagraph (B).

(B) CONTENT OF ACKNOWLEDGEMENT.—An acknowledgment meets the requirements of this subparagraph if it includes the following information:

(i) The amount of cash and a description (but not value) of any property other than cash contributed.

(ii) Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i).

(iii) A description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

For purposes of this subparagraph, the term "intangible religious benefit" means any intangible religious benefit which is provided by an organization organized exclusively

for religious purposes and which generally is not sold in a commercial transaction outside the donative context.

(C) CONTEMPORANEOUS.—For purposes of subparagraph (A), an acknowledgment shall be considered to be contemporaneous if the taxpayer obtains the acknowledgment on or before the earlier of—

(i) the date on which the taxpayer files a return for the taxable year in which the contribution was made, or

(ii) the due date (including extensions) for filing such return.

(D) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations that may provide that some or all of the requirements of this paragraph do not apply in appropriate cases.

(9) DENIAL OF DEDUCTION WHERE CONTRIBUTION FOR LOBBYING ACTIVITIES.—No deduction shall be allowed under this section for a contribution to an organization which conducts activities to which section 162(e)(1) applies on matters of direct financial interest to the donor's trade or business, if a principal purpose of the contribution was to avoid Federal income tax by securing a deduction for such activities under this section which would be disallowed by reason of section 162(e) if the donor had conducted such activities directly. No deduction shall be allowed under section 162(a) for any amount for which a deduction is disallowed under the preceding sentence.

(10) SPLIT-DOLLAR LIFE INSURANCE, ANNUITY, AND ENDOWMENT CONTRACTS.—

(A) IN GENERAL.—Nothing in this section or in section 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522 shall be construed to allow a deduction, and no deduction shall be allowed, for any transfer to or for the use of an organization described in subsection (c) if in connection with such transfer—

(i) the organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or

(ii) there is an understanding or expectation that any person will directly or indirectly pay any premium on any personal benefit contract with respect to the transferor.

(B) PERSONAL BENEFIT CONTRACT.—For purposes of subparagraph (A), the term “personal benefit contract” means, with respect to the transferor, any life insurance, annuity, or endowment contract if any direct or indirect beneficiary under such contract is the transferor, any member of the transferor's family, or any other person (other than an organization described in subsection (c)) designated by the transferor.

(C) APPLICATION TO CHARITABLE REMAINDER TRUSTS.—In the case of a transfer to a trust referred to in subparagraph (E), references in subparagraphs (A) and (F) to an organization described in subsection (c) shall be treated as a reference to such trust.

(D) EXCEPTION FOR CERTAIN ANNUITY CONTRACTS.—If, in connection with a transfer to or for the use of an organization described in subsection (c), such organization incurs an obligation to pay a charitable gift annuity (as defined in section 501(m)) and such organization purchases any annuity contract to fund such obligation, persons receiving payments under the charitable gift annuity shall not be treated for purposes of subparagraph (B) as indirect beneficiaries under such contract if—

- (i) such organization possesses all of the incidents of ownership under such contract,
- (ii) such organization is entitled to all the payments under such contract, and
- (iii) the timing and amount of payments under such contract are substantially the same as the timing and amount of payments to each such person under such obligation (as such obligation is in effect at the time of such transfer).

(E) EXCEPTION FOR CERTAIN CONTRACTS HELD BY CHARITABLE REMAINDER TRUSTS.—A person shall not be treated for purposes of subparagraph (B) as an indirect beneficiary under any life insurance, annuity, or endowment contract held by a charitable remainder annuity trust or a charitable remainder unitrust (as defined in section 664(d)) solely by reason of being entitled to any payment referred to in paragraph (1)(A) or (2)(A) of section 664(d) if—

- (i) such trust possesses all of the incidents of ownership under such contract, and
- (ii) such trust is entitled to all the payments under such contract.

(F) EXCISE TAX ON PREMIUMS PAID.—

(i) IN GENERAL.—There is hereby imposed on any organization described in subsection (c) an excise tax equal to the premiums paid by such organization on any life insurance, annuity, or endowment contract if the payment of premiums on such contract is in connection with a transfer for which a deduction is not allowable under subparagraph (A), determined without regard to when such transfer is made.

(ii) PAYMENTS BY OTHER PERSONS.—For purposes of clause (i), payments made by any other person pursuant to an understanding or expectation referred to in subparagraph (A) shall be treated as made by the organization.

(iii) REPORTING.—Any organization on which tax is imposed by clause (i) with respect to any premium shall file an annual return which includes—

(I) the amount of such premiums paid during the year and the name and TIN of each beneficiary under the contract to which the premium relates, and

(II) such other information as the Secretary may require.

The penalties applicable to returns required under section 6033 shall apply to returns required under this

clause. Returns required under this clause shall be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

(iv) CERTAIN RULES TO APPLY.—The tax imposed by this subparagraph shall be treated as imposed by chapter 42 for purposes of this title other than subchapter B of chapter 42.

(G) SPECIAL RULE WHERE STATE REQUIRES SPECIFICATION OF CHARITABLE GIFT ANNUITANT IN CONTRACT.—In the case of an obligation to pay a charitable gift annuity referred to in subparagraph (D) which is entered into under the laws of a State which requires, in order for the charitable gift annuity to be exempt from insurance regulation by such State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in such State, the requirements of clauses (i) and (ii) of subparagraph (D) shall be treated as met if—

(i) such State law requirement was in effect on February 8, 1999,

(ii) each such beneficiary under the charitable gift annuity is a bona fide resident of such State at the time the obligation to pay a charitable gift annuity is entered into, and

(iii) the only persons entitled to payments under such contract are persons entitled to payments as beneficiaries under such obligation on the date such obligation is entered into.

(H) MEMBER OF FAMILY.—For purposes of this paragraph, an individual's family consists of the individual's grandparents, the grandparents of such individual's spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.

(I) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations to prevent the avoidance of such purposes.

(11) QUALIFIED APPRAISAL AND OTHER DOCUMENTATION FOR CERTAIN CONTRIBUTIONS.—

(A) IN GENERAL.—

(i) DENIAL OF DEDUCTION.—In the case of an individual, partnership, or corporation, no deduction shall be allowed under subsection (a) for any contribution of property for which a deduction of more than \$500 is claimed unless such person meets the requirements of subparagraphs (B), (C), and (D), as the case may be, with respect to such contribution.

(ii) EXCEPTIONS.—

(I) READILY VALUED PROPERTY.—Subparagraphs (C) and (D) shall not apply to cash, property described in subsection (e)(1)(B)(iii) or section 1221(a)(1), publicly traded securities (as defined in section 6050L(a)(2)(B)), and any qualified vehicle described in paragraph (12)(A)(ii) for which an ac-

knowledge under paragraph (12)(B)(iii) is provided.

(II) REASONABLE CAUSE.—Clause (i) shall not apply if it is shown that the failure to meet such requirements is due to reasonable cause and not to willful neglect.

(B) PROPERTY DESCRIPTION FOR CONTRIBUTIONS OF MORE THAN \$500.—In the case of contributions of property for which a deduction of more than \$500 is claimed, the requirements of this subparagraph are met if the individual, partnership or corporation includes with the return for the taxable year in which the contribution is made a description of such property and such other information as the Secretary may require. The requirements of this subparagraph shall not apply to a C corporation which is not a personal service corporation or a closely held C corporation.

(C) QUALIFIED APPRAISAL FOR CONTRIBUTIONS OF MORE THAN \$5,000.—In the case of contributions of property for which a deduction of more than \$5,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require.

(D) SUBSTANTIATION FOR CONTRIBUTIONS OF MORE THAN \$500,000.—In the case of contributions of property for which a deduction of more than \$500,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation attaches to the return for the taxable year a qualified appraisal of such property.

(E) QUALIFIED APPRAISAL AND APPRAISER.—For purposes of this paragraph—

(i) QUALIFIED APPRAISAL.—The term “qualified appraisal” means, with respect to any property, an appraisal of such property which—

(I) is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and

(II) is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed under subclause (I).

(ii) QUALIFIED APPRAISER.—Except as provided in clause (iii), the term “qualified appraiser” means an individual who—

(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary,

(II) regularly performs appraisals for which the individual receives compensation, and

(III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.

(iii) SPECIFIC APPRAISALS.—An individual shall not be treated as a qualified appraiser with respect to any specific appraisal unless—

(I) the individual demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and

(II) the individual has not been prohibited from practicing before the Internal Revenue Service by the Secretary under section 330(c) of title 31, United States Code, at any time during the 3-year period ending on the date of the appraisal.

(F) AGGREGATION OF SIMILAR ITEMS OF PROPERTY.—For purposes of determining thresholds under this paragraph, property and all similar items of property donated to 1 or more donees shall be treated as 1 property.

(G) SPECIAL RULE FOR PASS-THRU ENTITIES.—In the case of a partnership or S corporation, this paragraph shall be applied at the entity level, except that the deduction shall be denied at the partner or shareholder level.

(H) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations that may provide that some or all of the requirements of this paragraph do not apply in appropriate cases.

(12) CONTRIBUTIONS OF USED MOTOR VEHICLES, BOATS, AND AIRPLANES.—

(A) IN GENERAL.—In the case of a contribution of a qualified vehicle the claimed value of which exceeds \$500—

(i) paragraph (8) shall not apply and no deduction shall be allowed under subsection (a) for such contribution unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgement of the contribution by the donee organization that meets the requirements of subparagraph (B) and includes the acknowledgement with the taxpayer's return of tax which includes the deduction, and

(ii) if the organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction allowed under subsection (a) shall not exceed the gross proceeds received from such sale.

(B) CONTENT OF ACKNOWLEDGEMENT.—An acknowledgement meets the requirements of this subparagraph if it includes the following information:

(i) The name and taxpayer identification number of the donor.

(ii) The vehicle identification number or similar number.

(iii) In the case of a qualified vehicle to which subparagraph (A)(ii) applies—

(I) a certification that the vehicle was sold in an arm's length transaction between unrelated parties,

(II) the gross proceeds from the sale, and

(III) a statement that the deductible amount may not exceed the amount of such gross proceeds.

(iv) In the case of a qualified vehicle to which subparagraph (A)(ii) does not apply—

(I) a certification of the intended use or material improvement of the vehicle and the intended duration of such use, and

(II) a certification that the vehicle would not be transferred in exchange for money, other property, or services before completion of such use or improvement.

(v) Whether the donee organization provided any goods or services in consideration, in whole or in part, for the qualified vehicle.

(vi) A description and good faith estimate of the value of any goods or services referred to in clause (v) or, if such goods or services consist solely of intangible religious benefits (as defined in paragraph (8)(B)), a statement to that effect.

(C) CONTEMPORANEOUS.—For purposes of subparagraph (A), an acknowledgement shall be considered to be contemporaneous if the donee organization provides it within 30 days of—

(i) the sale of the qualified vehicle, or

(ii) in the case of an acknowledgement including a certification described in subparagraph (B)(iv), the contribution of the qualified vehicle.

(D) INFORMATION TO SECRETARY.—A donee organization required to provide an acknowledgement under this paragraph shall provide to the Secretary the information contained in the acknowledgement. Such information shall be provided at such time and in such manner as the Secretary may prescribe.

(E) QUALIFIED VEHICLE.—For purposes of this paragraph, the term “qualified vehicle” means any—

(i) motor vehicle manufactured primarily for use on public streets, roads, and highways,

(ii) boat, or

(iii) airplane.

Such term shall not include any property which is described in section 1221(a)(1).

(F) REGULATIONS OR OTHER GUIDANCE.—The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this paragraph. The Secretary may prescribe regulations or other guidance which exempts sales by the donee organization which are in direct furtherance of such organization's charitable purpose from the requirements of subparagraphs (A)(ii) and (B)(iv)(II).

(13) CONTRIBUTIONS OF CERTAIN INTERESTS IN BUILDINGS LOCATED IN REGISTERED HISTORIC DISTRICTS.—

(A) IN GENERAL.—No deduction shall be allowed with respect to any contribution described in subparagraph (B) unless the taxpayer includes with the return for the taxable year of the contribution a \$500 filing fee.

(B) CONTRIBUTION DESCRIBED.—A contribution is described in this subparagraph if such contribution is a qualified conservation contribution (as defined in subsection (h)) which is a restriction with respect to the exterior of a building described in subsection (h)(4)(C)(ii) and for which a deduction is claimed in excess of \$10,000.

(C) DEDICATION OF FEE.—Any fee collected under this paragraph shall be used for the enforcement of the provisions of subsection (h).

(14) REDUCTION FOR AMOUNTS ATTRIBUTABLE TO REHABILITATION CREDIT.—In the case of any qualified conservation contribution (as defined in subsection (h)), the amount of the deduction allowed under this section shall be reduced by an amount which bears the same ratio to the fair market value of the contribution as—

(A) the sum of the credits allowed to the taxpayer under section 47 for the 5 preceding taxable years with respect to any building which is a part of such contribution, bears to

(B) the fair market value of the building on the date of the contribution.

(15) SPECIAL RULE FOR TAXIDERMY PROPERTY.—

(A) BASIS.—For purposes of this section and notwithstanding section 1012, in the case of a charitable contribution of taxidermy property which is made by the person who prepared, stuffed, or mounted the property or by any person who paid or incurred the cost of such preparation, stuffing, or mounting, only the cost of the preparing, stuffing, or mounting shall be included in the basis of such property.

(B) TAXIDERMY PROPERTY.—For purposes of this section, the term “taxidermy property” means any work of art which—

(i) is the reproduction or preservation of an animal, in whole or in part,

(ii) is prepared, stuffed, or mounted for purposes of recreating one or more characteristics of such animal, and

(iii) contains a part of the body of the dead animal.

(16) CONTRIBUTIONS OF CLOTHING AND HOUSEHOLD ITEMS.—

(A) IN GENERAL.—In the case of an individual, partnership, or corporation, no deduction shall be allowed under subsection (a) for any contribution of clothing or a household item unless such clothing or household item is in good used condition or better.

(B) ITEMS OF MINIMAL VALUE.—Notwithstanding subparagraph (A), the Secretary may by regulation deny a deduction under subsection (a) for any contribution of cloth-

ing or a household item which has minimal monetary value.

(C) EXCEPTION FOR CERTAIN PROPERTY.—Subparagraphs (A) and (B) shall not apply to any contribution of a single item of clothing or a household item for which a deduction of more than \$500 is claimed if the taxpayer includes with the taxpayer's return a qualified appraisal with respect to the property.

(D) HOUSEHOLD ITEMS.—For purposes of this paragraph—

(i) IN GENERAL.—The term “household items” includes furniture, furnishings, electronics, appliances, linens, and other similar items.

(ii) EXCLUDED ITEMS.—Such term does not include—

(I) food,

(II) paintings, antiques, and other objects of art,

(III) jewelry and gems, and

(IV) collections.

(E) SPECIAL RULE FOR PASS-THRU ENTITIES.—In the case of a partnership or S corporation, this paragraph shall be applied at the entity level, except that the deduction shall be denied at the partner or shareholder level.

(17) RECORDKEEPING.—No deduction shall be allowed under subsection (a) for any contribution of a cash, check, or other monetary gift unless the donor maintains as a record of such contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

(18) CONTRIBUTIONS TO DONOR ADVISED FUNDS.—A deduction otherwise allowed under subsection (a) for any contribution to a donor advised fund (as defined in section 4966(d)(2)) shall only be allowed if—

(A) the sponsoring organization (as defined in section 4966(d)(1)) with respect to such donor advised fund is not—

(i) described in paragraph (3), (4), or (5) of subsection (c), or

(ii) a type III supporting organization (as defined in section 4943(f)(5)(A)) which is not a functionally integrated type III supporting organization (as defined in section 4943(f)(5)(B)), and

(B) the taxpayer obtains a contemporaneous written acknowledgment (determined under rules similar to the rules of paragraph (8)(C)) from the sponsoring organization (as so defined) of such donor advised fund that such organization has exclusive legal control over the assets contributed.

(g) AMOUNTS PAID TO MAINTAIN CERTAIN STUDENTS AS MEMBERS OF TAXPAYER'S HOUSEHOLD.—

(1) IN GENERAL.—Subject to the limitations provided by paragraph (2), amounts paid by the taxpayer to maintain an individual (other than a dependent, as defined in section 152 (determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), or a relative of the taxpayer) as a member of his household during the period that such individual is—

(A) a member of the taxpayer's household under a written agreement between the taxpayer and an organization described in paragraph (2), (3), or (4) of subsection (c) to implement a program of the organization to provide educational opportunities for pupils or students in private homes, and

(B) a full-time pupil or student in the twelfth or any lower grade at an educational organization described in section 170(b)(1)(A)(ii) located in the United States, shall be treated as amounts paid for the use of the organization.

(2) LIMITATIONS.—

(A) AMOUNT.—Paragraph (1) shall apply to amounts paid within the taxable year only to the extent that such amounts do not exceed \$50 multiplied by the number of full calendar months during the taxable year which fall within the period described in paragraph (1). For purposes of the preceding sentence, if 15 or more days of a calendar month fall within such period such month shall be considered as a full calendar month.

(B) COMPENSATION OR REIMBURSEMENT.—Paragraph (1) shall not apply to any amount paid by the taxpayer within the taxable year if the taxpayer receives any money or other property as compensation or reimbursement for maintaining the individual in his household during the period described in paragraph (1).

(3) RELATIVE DEFINED.—For purposes of paragraph (1), the term “relative of the taxpayer” means an individual who, with respect to the taxpayer, bears any of the relationships described in subparagraphs (A) through (G) of section 152(d)(2).

(4) NO OTHER AMOUNT ALLOWED AS DEDUCTION.—No deduction shall be allowed under subsection (a) for any amount paid by a taxpayer to maintain an individual as a member of his household under a program described in paragraph (1)(A) except as provided in this subsection.

(h) QUALIFIED CONSERVATION CONTRIBUTION.—

(1) IN GENERAL.—For purposes of subsection (f)(3)(B)(iii), the term “qualified conservation contribution” means a contribution—

(A) of a qualified real property interest,

(B) to a qualified organization,

(C) exclusively for conservation purposes.

(2) QUALIFIED REAL PROPERTY INTEREST.—For purposes of this subsection, the term “qualified real property interest” means any of the following interests in real property:

(A) the entire interest of the donor other than a qualified mineral interest,

(B) a remainder interest, and

(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

(3) QUALIFIED ORGANIZATION.—For purposes of paragraph (1), the term “qualified organization” means an organization which—

(A) is described in clause (v) or (vi) of subsection

(b)(1)(A), or

(B) is described in section 501(c)(3) and—

- (i) meets the requirements of section 509(a)(2), or
- (ii) meets the requirements of section 509(a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

(4) CONSERVATION PURPOSE DEFINED.—

(A) IN GENERAL.—For purposes of this subsection, the term “conservation purpose” means—

- (i) the preservation of land areas for outdoor recreation by, or the education of, the general public,
- (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,
- (iii) the preservation of open space (including farmland and forest land) where such preservation is—
 - (I) for the scenic enjoyment of the general public, or
 - (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit, or
- (iv) the preservation of an historically important land area or a certified historic structure.

(B) SPECIAL RULES WITH RESPECT TO BUILDINGS IN REGISTERED HISTORIC DISTRICTS.—In the case of any contribution of a qualified real property interest which is a restriction with respect to the exterior of a building described in subparagraph (C)(ii), such contribution shall not be considered to be exclusively for conservation purposes unless—

- (i) such interest—
 - (I) includes a restriction which preserves the entire exterior of the building (including the front, sides, rear, and height of the building), and
 - (II) prohibits any change in the exterior of the building which is inconsistent with the historical character of such exterior,
- (ii) the donor and donee enter into a written agreement certifying, under penalty of perjury, that the donee—
 - (I) is a qualified organization (as defined in paragraph (3)) with a purpose of environmental protection, land conservation, open space preservation, or historic preservation, and
 - (II) has the resources to manage and enforce the restriction and a commitment to do so, and
 - (iii) in the case of any contribution made in a taxable year beginning after the date of the enactment of this subparagraph, the taxpayer includes with the taxpayer’s return for the taxable year of the contribution—
 - (I) a qualified appraisal (within the meaning of subsection (f)(11)(E)) of the qualified property interest,
 - (II) photographs of the entire exterior of the building, and
 - (III) a description of all restrictions on the development of the building.

(C) CERTIFIED HISTORIC STRUCTURE.—For purposes of subparagraph (A)(iv), the term “certified historic structure” means—

(i) any building, structure, or land area which is listed in the National Register, or

(ii) any building which is located in a registered historic district (as defined in section 47(c)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor’s return under this chapter for the taxable year in which the transfer is made.

(5) EXCLUSIVELY FOR CONSERVATION PURPOSES.—For purposes of this subsection—

(A) CONSERVATION PURPOSE MUST BE PROTECTED.—A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

(B) NO SURFACE MINING PERMITTED.—

(i) IN GENERAL.—Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph (A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

(ii) SPECIAL RULE.—With respect to any contribution of property in which the ownership of the surface estate and mineral interests has been and remains separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

(6) QUALIFIED MINERAL INTEREST.—For purposes of this subsection, the term “qualified mineral interest” means—

(A) subsurface oil, gas, or other minerals, and

(B) the right to access to such minerals.

(i) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—For purposes of computing the deduction under this section for use of a passenger automobile, the standard mileage rate shall be 14 cents per mile.

(j) DENIAL OF DEDUCTION FOR CERTAIN TRAVEL EXPENSES.—No deduction shall be allowed under this section for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

(1) TREATMENT OF CERTAIN AMOUNTS PAID TO OR FOR THE BENEFIT OF INSTITUTIONS OF HIGHER EDUCATION.—

(1) IN GENERAL.—No deduction shall be allowed under this section for any amount described in paragraph (2).

(2) AMOUNT DESCRIBED.—For purposes of paragraph (1), an amount is described in this paragraph if—

(A) the amount is paid by the taxpayer to or for the benefit of an educational organization—

(i) which is described in subsection (b)(1)(A)(ii), and
(ii) which is an institution of higher education (as defined in section 3304(f)), and

(B) the taxpayer receives (directly or indirectly) as a result of paying such amount the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.

If any portion of a payment is for the purchase of such tickets, such portion and the remaining portion (if any) of such payment shall be treated as separate amounts for purposes of this subsection.

(m) CERTAIN DONEE INCOME FROM INTELLECTUAL PROPERTY TREATED AS AN ADDITIONAL CHARITABLE CONTRIBUTION.—

(1) TREATMENT AS ADDITIONAL CONTRIBUTION.—In the case of a taxpayer who makes a qualified intellectual property contribution, the deduction allowed under subsection (a) for each taxable year of the taxpayer ending on or after the date of such contribution shall be increased (subject to the limitations under subsection (b)) by the applicable percentage of qualified donee income with respect to such contribution which is properly allocable to such year under this subsection.

(2) REDUCTION IN ADDITIONAL DEDUCTIONS TO EXTENT OF INITIAL DEDUCTION.—With respect to any qualified intellectual property contribution, the deduction allowed under subsection (a) shall be increased under paragraph (1) only to the extent that the aggregate amount of such increases with respect to such contribution exceed the amount allowed as a deduction under subsection (a) with respect to such contribution determined without regard to this subsection.

(3) QUALIFIED DONEE INCOME.—For purposes of this subsection, the term “qualified donee income” means any net income received by or accrued to the donee which is properly allocable to the qualified intellectual property.

(4) ALLOCATION OF QUALIFIED DONEE INCOME TO TAXABLE YEARS OF DONOR.—For purposes of this subsection, qualified donee income shall be treated as properly allocable to a taxable year of the donor if such income is received by or accrued to the donee for the taxable year of the donee which ends within or with such taxable year of the donor.

(5) 10-YEAR LIMITATION.—Income shall not be treated as properly allocable to qualified intellectual property for purposes of this subsection if such income is received by or accrued to the donee after the 10-year period beginning on the date of the contribution of such property.

(6) BENEFIT LIMITED TO LIFE OF INTELLECTUAL PROPERTY.—Income shall not be treated as properly allocable to qualified intellectual property for purposes of this subsection if such income is received by or accrued to the donee after the expiration of the legal life of such property.

(7) APPLICABLE PERCENTAGE.—For purposes of this subsection, the term “applicable percentage” means the percentage determined under the following table which corresponds to a taxable year of the donor ending on or after the date of the qualified intellectual property contribution:

Taxable Year of Donor Ending on or After Date of Contribution:	Applicable Percentage:
1st.....	100
2nd.....	100
3rd.....	90
4th.....	80
5th.....	70
6th.....	60
7th.....	50
8th.....	40
9th.....	30
10th.....	20
11th.....	10
12th.....	10

(8) **QUALIFIED INTELLECTUAL PROPERTY CONTRIBUTION.**—For purposes of this subsection, the term “qualified intellectual property contribution” means any charitable contribution of qualified intellectual property—

(A) the amount of which taken into account under this section is reduced by reason of subsection (e)(1), and

(B) with respect to which the donor informs the donee at the time of such contribution that the donor intends to treat such contribution as a qualified intellectual property contribution for purposes of this subsection and section 6050L.

(9) **QUALIFIED INTELLECTUAL PROPERTY.**—For purposes of this subsection, the term “qualified intellectual property” means property described in subsection (e)(1)(B)(iii) (other than property contributed to or for the use of an organization described in subsection (e)(1)(B)(ii)).

(10) **OTHER SPECIAL RULES.**—

(A) **APPLICATION OF LIMITATIONS ON CHARITABLE CONTRIBUTIONS.**—Any increase under this subsection of the deduction provided under subsection (a) shall be treated for purposes of subsection (b) as a deduction which is attributable to a charitable contribution to the donee to which such increase relates.

(B) **NET INCOME DETERMINED BY DONEE.**—The net income taken into account under paragraph (3) shall not exceed the amount of such income reported under section 6050L(b)(1).

(C) **DEDUCTION LIMITED TO 12 TAXABLE YEARS.**—Except as may be provided under subparagraph (D)(i), this subsection shall not apply with respect to any qualified intellectual property contribution for any taxable year of the donor after the 12th taxable year of the donor which ends on or after the date of such contribution.

(D) **REGULATIONS.**—The Secretary may issue regulations or other guidance to carry out the purposes of this subsection, including regulations or guidance—

(i) modifying the application of this subsection in the case of a donor or donee with a short taxable year, and

(ii) providing for the determination of an amount to be treated as net income of the donee which is properly allocable to qualified intellectual property in the case of a donee who uses such property to further a

purpose or function constituting the basis of the donee's exemption under section 501 (or, in the case of a governmental unit, any purpose described in section 170(c)) and does not possess a right to receive any payment from a third party with respect to such property.

(n) EXPENSES PAID BY CERTAIN WHALING CAPTAINS IN SUPPORT OF NATIVE ALASKAN SUBSISTENCE WHALING.—

(1) IN GENERAL.—In the case of an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities and who engages in such activities during the taxable year, the amount described in paragraph (2) (to the extent such amount does not exceed \$10,000 for the taxable year) shall be treated for purposes of this section as a charitable contribution.

(2) AMOUNT DESCRIBED.—

(A) IN GENERAL.—The amount described in this paragraph is the aggregate of the reasonable and necessary whaling expenses paid by the taxpayer during the taxable year in carrying out sanctioned whaling activities.

(B) WHALING EXPENSES.—For purposes of subparagraph

(A), the term "whaling expenses" includes expenses for—

- (i) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities,
- (ii) the supplying of food for the crew and other provisions for carrying out such activities, and
- (iii) storage and distribution of the catch from such activities.

(3) SANCTIONED WHALING ACTIVITIES.—For purposes of this subsection, the term "sanctioned whaling activities" means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission.

(4) SUBSTANTIATION OF EXPENSES.—The Secretary shall issue guidance requiring that the taxpayer substantiate the whaling expenses for which a deduction is claimed under this subsection, including by maintaining appropriate written records with respect to the time, place, date, amount, and nature of the expense, as well as the taxpayer's eligibility for such deduction, and that (to the extent provided by the Secretary) such substantiation be provided as part of the taxpayer's return of tax.

(o) SPECIAL RULES FOR FRACTIONAL GIFTS.—

(1) DENIAL OF DEDUCTION IN CERTAIN CASES.—

(A) IN GENERAL.—No deduction shall be allowed for a contribution of an undivided portion of a taxpayer's entire interest in tangible personal property unless all interests in the property are held immediately before such contribution by—

- (i) the taxpayer, or
- (ii) the taxpayer and the donee.

(B) EXCEPTIONS.—The Secretary may, by regulation, provide for exceptions to subparagraph (A) in cases where all persons who hold an interest in the property make propor-

tional contributions of an undivided portion of the entire interest held by such persons.

(2) VALUATION OF SUBSEQUENT GIFTS.—In the case of any additional contribution, the fair market value of such contribution shall be determined by using the lesser of—

(A) the fair market value of the property at the time of the initial fractional contribution, or

(B) the fair market value of the property at the time of the additional contribution.

(3) RECAPTURE OF DEDUCTION IN CERTAIN CASES; ADDITION TO TAX.—

(A) RECAPTURE.—The Secretary shall provide for the recapture of the amount of any deduction allowed under this section (plus interest) with respect to any contribution of an undivided portion of a taxpayer's entire interest in tangible personal property—

(i) in any case in which the donor does not contribute all of the remaining interests in such property to the donee (or, if such donee is no longer in existence, to any person described in section 170(c)) on or before the earlier of—

(I) the date that is 10 years after the date of the initial fractional contribution, or

(II) the date of the death of the donor, and (ii) in any case in which the donee has not, during the period beginning on the date of the initial fractional contribution and ending on the date described in clause (i)—

(I) had substantial physical possession of the property, and

(II) used the property in a use which is related to a purpose or function constituting the basis for the organizations' exemption under section 501.

(B) ADDITION TO TAX.—The tax imposed under this chapter for any taxable year for which there is a recapture under subparagraph (A) shall be increased by 10 percent of the amount so recaptured.

(4) DEFINITIONS.—For purposes of this subsection—

(A) ADDITIONAL CONTRIBUTION.—The term "additional contribution" means any charitable contribution by the taxpayer of any interest in property with respect to which the taxpayer has previously made an initial fractional contribution.

(B) INITIAL FRACTIONAL CONTRIBUTION.—The term "initial fractional contribution" means, with respect to any taxpayer, the first charitable contribution of an undivided portion of the taxpayer's entire interest in any tangible personal property.

(p) OTHER CROSS REFERENCES.—

(1) For treatment of certain organizations providing child care, see section 501(k).

(2) For charitable contributions of estates and trusts, see section 642(c).

(3) For nondeductibility of contributions by common trust funds, see section 584.

(4) For charitable contributions of partners, see section 702.

(5) For charitable contributions of nonresident aliens, see section 873.

(6) For treatment of gifts for benefit of or use in connection with the Naval Academy as gifts to or for use of the United States, see section 6973 of title 10, United States Code.

(7) For treatment of gifts accepted by the Secretary of State, the Director of the International Communication Agency, or the Director of the United States International Development Cooperation Agency, as gifts to or for the use of the United States, see section 25 of the State Department Basic Authorities Act of 1956.

(8) For treatment of gifts of money accepted by the Attorney General for credit to the "Commissary Funds Federal Prisons" as gifts to or for the use of the United States, see section 4043 of title 18, United States Code.

(9) For charitable contributions to or for the use of Indian tribal governments (or their subdivisions), see section 7871.

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SEC. 195. START-UP [EXPENDITURES] AND ORGANIZATIONAL EXPENDITURES.

[(a) CAPITALIZATION OF EXPENDITURES.—Except as otherwise provided in this section, no deduction shall be allowed for start-up expenditures.

[(b) ELECTION TO DEDUCT.—

[(1) ALLOWANCE OF DEDUCTION.—If a taxpayer elects the application of this subsection with respect to any start-up expenditures—

[(A) the taxpayer shall be allowed a deduction for the taxable year in which the active trade or business begins in an amount equal to the lesser of—

[(i) the amount of start-up expenditures with respect to the active trade or business, or

[(ii) \$5,000, reduced (but not below zero) by the amount by which such start-up expenditures exceed \$50,000, and

[(B) the remainder of such start-up expenditures shall be allowed as a deduction ratably over the 180-month period beginning with the month in which the active trade or business begins.

[(2) DISPOSITIONS BEFORE CLOSE OF AMORTIZATION PERIOD.—In any case in which a trade or business is completely disposed of by the taxpayer before the end of the period to which paragraph (1) applies, any deferred expenses attributable to such trade or business which were not allowed as a deduction by reason of this section may be deducted to the extent allowable under section 165.

[(3) SPECIAL RULE FOR TAXABLE YEARS BEGINNING IN 2010.—In the case of a taxable year beginning in 2010, paragraph (1)(A)(ii) shall be applied—

[(A) by substituting "\$10,000" for "\$5,000", and

[(B) by substituting "\$60,000" for "\$50,000".]

(a) *CAPITALIZATION OF EXPENDITURES.*—Except as otherwise provided in this section, no deduction shall be allowed for start-up or organizational expenditures.

(b) *ELECTION TO DEDUCT.*—

(1) *IN GENERAL.*—If a taxpayer elects the application of this subsection with respect to any active trade or business—

(A) the taxpayer shall be allowed a deduction for the taxable year in which such active trade or business begins in an amount equal to the lesser of—

(i) the aggregate amount of start-up and organizational expenditures paid or incurred in connection with such active trade or business, or

(ii) \$20,000, reduced (but not below zero) by the amount by which such aggregate amount exceeds \$120,000, and

(B) the remainder of such start-up and organizational expenditures shall be charged to capital account and allowed as an amortization deduction determined by amortizing such expenditures ratably over the 180-month period beginning with the month in which the active trade or business begins.

(2) *APPLICATION TO ORGANIZATIONAL EXPENDITURES.*—In the case of organizational expenditures with respect to any corporation or partnership, the active trade or business referred to in paragraph (1) means the first active trade or business carried on by such corporation or partnership.

(3) *INFLATION ADJUSTMENT.*—In the case of any taxable year beginning after December 31, 2019, the \$20,000 and \$120,000 amounts in paragraph (1)(A)(ii) shall each be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting “calendar year 2018” for “calendar year 2016” in subparagraph (A)(ii) thereof.

If any amount as increased under the preceding sentence is not a multiple of \$1,000, such amount shall be rounded to the nearest multiple of \$1,000.

(c) *ALLOWANCE OF DEDUCTION UPON LIQUIDATION OR DISPOSITION.*—

(1) *LIQUIDATION OF PARTNERSHIP OR CORPORATION.*—If any partnership or corporation is completely liquidated by the taxpayer, any start-up or organizational expenditures paid or incurred in connection with such partnership or corporation which were not allowed as a deduction by reason of this section may be deducted to the extent allowable under section 165.

(2) *DISPOSITION OF TRADE OR BUSINESS.*—If any trade or business is completely disposed of or discontinued by the taxpayer, any start-up expenditures paid or incurred in connection with such trade or business which were not allowed as a deduction by reason of this section (and not taken into account in connection with a liquidation to which paragraph (1) applies) may be deducted to the extent allowable under section 165. For purposes of this paragraph, in the case of any deduction allowed under subsection (b)(1) with respect to both start-up and

organizational expenditures, the amount treated as so allowed with respect to start-up expenditures shall bear the same ratio to such deduction as the start-up expenditures taken into account in determining such deduction bears to the aggregate of the start-up and organizational expenditures so taken into account.

[(c)] (d) DEFINITIONS.—For purposes of this section—

(1) **START-UP EXPENDITURES.**—The term “start-up expenditure” means any amount—

(A) paid or incurred in connection with—

(i) investigating the creation or acquisition of an active trade or business, or

(ii) creating an active trade or business, or

(iii) any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business, and

(B) which, if paid or incurred in connection with the operation of an existing active trade or business (in the same field as the trade or business referred to in subparagraph (A)), would be allowable as a deduction for the taxable year in which paid or incurred.

The term “start-up expenditure” does not include any amount with respect to which a deduction is allowable under section 163(a), 164, or 174.

(2) **BEGINNING OF TRADE OR BUSINESS.**—

(A) **IN GENERAL.**—Except as provided in subparagraph (B), the determination of when an active trade or business begins shall be made in accordance with such regulations as the Secretary may prescribe.

(B) **ACQUIRED TRADE OR BUSINESS.**—An acquired active trade or business shall be treated as beginning when the taxpayer acquires it.

(3) **ORGANIZATIONAL EXPENDITURES.**—*The term “organizational expenditures” means any expenditure which—*

(A) *is incident to the creation of a corporation or a partnership,*

(B) *is chargeable to capital account, and*

(C) *is of a character which, if expended incident to the creation of a corporation or a partnership having an ascertainable life, would be amortizable over such life.*

(4) **APPLICATION TO CERTAIN DISREGARDED ENTITIES.**—*In the case of any entity with a single owner that is disregarded as an entity separate from its owner, this section shall be applied in the same manner as if such entity were a corporation.*

[(d)] (e) ELECTION.—

(1) **TIME FOR MAKING ELECTION.**—An election under subsection (b) shall be made not later than the time prescribed by law for filing the return for the taxable year in which the trade or business begins (including extensions thereof).

(2) **SCOPE OF ELECTION.**—The period selected under subsection (b) shall be adhered to in computing taxable income for the taxable year for which the election is made and all subsequent taxable years.】

(2) *PARTNERSHIPS AND S CORPORATIONS.*—*In the case of any partnership or S corporation, the election under subsection (b) shall be made (and this section shall be applied) at the entity level.*

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PART VIII—SPECIAL DEDUCTIONS FOR CORPORATIONS

[Sec. 248. Organizational expenditures.]

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[SEC. 248. ORGANIZATIONAL EXPENDITURES.]

[(a) ELECTION TO DEDUCT.]—If a corporation elects the application of this subsection (in accordance with regulations prescribed by the Secretary) with respect to any organizational expenditures—

[(1) the corporation shall be allowed a deduction for the taxable year in which the corporation begins business in an amount equal to the lesser of—

[(A) the amount of organizational expenditures with respect to the taxpayer, or

[(B) \$5,000, reduced (but not below zero) by the amount by which such organizational expenditures exceed \$50,000, and

[(2) the remainder of such organizational expenditures shall be allowed as a deduction ratably over the 180-month period beginning with the month in which the corporation begins business.

[(b) ORGANIZATIONAL EXPENDITURES DEFINED.]—The term “organizational expenditures” means any expenditure which—

[(1) is incident to the creation of the corporation;

[(2) is chargeable to capital account; and

[(3) is of a character which, if expended incident to the creation of a corporation having a limited life, would be amortizable over such life.

[(c) TIME FOR AND SCOPE OF ELECTION.]—The election provided by subsection (a) may be made for any taxable year but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The period so elected shall be adhered to in computing the taxable income of the corporation for the taxable year for which the election is made and all subsequent taxable years.]

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Subchapter C—Corporate Distributions and Adjustments

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PART I—DISTRIBUTIONS BY CORPORATIONS

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Subpart B—Effects on Corporation

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SEC. 312. EFFECT ON EARNINGS AND PROFITS.

(a) **GENERAL RULE.**—Except as otherwise provided in this section, on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation (to the extent thereof) shall be decreased by the sum of—

- (1) the amount of money,
- (2) the principal amount of the obligations of such corporation (or, in the case of obligations having original issue discount, the aggregate issue price of such obligations), and
- (3) the adjusted basis of the other property, so distributed.

(b) **DISTRIBUTIONS OF APPRECIATED PROPERTY.**—On the distribution by a corporation, with respect to its stock, of any property (other than an obligation of such corporation) the fair market value of which exceeds the adjusted basis thereof—

- (1) the earnings and profits of the corporation shall be increased by the amount of such excess, and
- (2) subsection (a)(3) shall be applied by substituting “fair market value” for “adjusted basis”.

For purposes of this subsection and subsection (a), the adjusted basis of any property is its adjusted basis as determined for purposes of computing earnings and profits.

(c) **ADJUSTMENTS FOR LIABILITIES.**—In making the adjustments to the earnings and profits of a corporation under subsection (a) or (b), proper adjustment shall be made for—

- (1) the amount of any liability to which the property distributed is subject, and
- (2) the amount of any liability of the corporation assumed by a shareholder in connection with the distribution.

(d) **CERTAIN DISTRIBUTIONS OF STOCK AND SECURITIES.**—

(1) **IN GENERAL.**—The distribution to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property, in a distribution to which this title applies, shall not be considered a distribution of the earnings and profits of any corporation—

(A) if no gain to such distributee from the receipt of such stock or securities, or property, was recognized under this title, or

(B) if the distribution was not subject to tax in the hands of such distributee by reason of section 305(a).

(2) **STOCK OR SECURITIES.**—For purposes of this subsection, the term “stock or securities” includes rights to acquire stock or securities.

(f) **EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS AND OF RECEIPT OF TAX-FREE DISTRIBUTIONS.**—

(1) **EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS.**—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

(A) for the purpose of the computation of the earnings and profits of the corporation, shall (except as provided in subparagraph (B)) be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(B) for purposes of the computation of the earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing taxable income under the law applicable to the year in which such sale or disposition was made. Where, in determining the adjusted basis used in computing such realized gain or loss, the adjustment to the basis differs from the adjustment proper for the purpose of determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided. For purposes of this subsection, a loss with respect to which a deduction is disallowed under section 1091 (relating to wash sales of stock or securities), or the corresponding provision of prior law, shall not be deemed to be recognized.

(2) EFFECT ON EARNINGS AND PROFITS OF RECEIPT OF TAX-FREE DISTRIBUTIONS.—Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

(A) no such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made; and

(B) no such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received (or such basis would, but for section 307(b), be so allocated).

(g) EARNINGS AND PROFITS - INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—

(1) If any increase or decrease in the earnings and profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2), an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(2) If the application of subsection (f) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (f) and in lieu of the rule provided in paragraph (1) of this subsection, the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss exceeds the adjusted basis computed without regard to the value of the prop-

erty on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(h) ALLOCATION IN CERTAIN CORPORATE SEPARATIONS AND REORGANIZATIONS.—

(1) SECTION 355.—In the case of a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation (or corporations) shall be made under regulations prescribed by the Secretary.

(2) SECTION 368(A)(1)(C) OR (D).—In the case of a reorganization described in subparagraph (C) or (D) of section 368(a)(1), proper allocation with respect to the earnings and profits of the acquired corporation shall, under regulations prescribed by the Secretary, be made between the acquiring corporation and the acquired corporation (or any corporation which had control of the acquired corporation before the reorganization).

(i) DISTRIBUTION OF PROCEEDS OF LOAN INSURED BY THE UNITED STATES.—If a corporation distributes property with respect to its stock and if, at the time of distribution—

(1) there is outstanding a loan to such corporation which was made, guaranteed, or insured by the United States (or by any agency or instrumentality thereof), and

(2) the amount of such loan so outstanding exceeds the adjusted basis of the property constituting security for such loan, then the earnings and profits of the corporation shall be increased by the amount of such excess, and (immediately after the distribution) shall be decreased by the amount of such excess. For purposes of paragraph (2), the adjusted basis of the property at the time of distribution shall be determined without regard to any adjustment under section 1016(a)(2) (relating to adjustment for depreciation, etc.). For purposes of this subsection, a commitment to make, guarantee, or insure a loan shall be treated as the making, guaranteeing, or insuring of a loan.

(k) EFFECT OF DEPRECIATION ON EARNINGS AND PROFITS.—

(1) GENERAL RULE.—For purposes of computing the earnings and profits of a corporation for any taxable year beginning after June 30, 1972, the allowance for depreciation (and amortization, if any) shall be deemed to be the amount which would be allowable for such year if the straight line method of depreciation had been used for each taxable year beginning after June 30, 1972.

(2) EXCEPTION.—If for any taxable year a method of depreciation was used by the taxpayer which the Secretary has determined results in a reasonable allowance under section 167(a) and which is the unit-of-production method or other method not expressed in a term of years, then the adjustment to earnings and profits for depreciation for such year shall be determined under the method so used (in lieu of the straight line method).

(3) EXCEPTION FOR TANGIBLE PROPERTY.—

(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of tangible property to which section 168

applies, the adjustment to earnings and profits for depreciation for any taxable year shall be determined under the alternative depreciation system (within the meaning of section 168(g)(2)).

(B) TREATMENT OF AMOUNTS DEDUCTIBLE UNDER SECTION 179, 179B, 179C, 179D, OR 179E.—For purposes of computing the earnings and profits of a corporation, any amount deductible under section 179, 179B, 179C, 179D, or 179E shall be allowed as a deduction ratably over the period of 5 taxable years (beginning with the taxable year for which such amount is deductible under section 179, 179B, 179C, 179D, or 179E, as the case may be).

(4) CERTAIN FOREIGN CORPORATIONS.—The provisions of paragraph (1) shall not apply in computing the earnings and profits of a foreign corporation for any taxable year for which less than 20 percent of the gross income from all sources of such corporation is derived from sources within the United States.

(5) BASIS ADJUSTMENT NOT TAKEN INTO ACCOUNT.—In computing the earnings and profits of a corporation for any taxable year, the allowance for depreciation (and amortization, if any) shall be computed without regard to any basis adjustment under section 50(c).

(1) DISCHARGE OF INDEBTEDNESS INCOME.—

(1) DOES NOT INCREASE EARNINGS AND PROFITS IF APPLIED TO REDUCE BASIS.—The earnings and profits of a corporation shall not include income from the discharge of indebtedness to the extent of the amount applied to reduce basis under section 1017.

(2) REDUCTION OF DEFICIT IN EARNINGS AND PROFITS IN CERTAIN CASES.—If—

(A) the interest of any shareholder of a corporation is terminated or extinguished in a title 11 or similar case (within the meaning of section 368(a)(3)(A)), and

(B) there is a deficit in the earnings and profits of the corporation,

then such deficit shall be reduced by an amount equal to the paid-in capital which is allocable to the interest of the shareholder which is so terminated or extinguished.

(m) NO ADJUSTMENT FOR INTEREST PAID ON CERTAIN REGISTRATION-REQUIRED OBLIGATIONS NOT IN REGISTERED FORM.—The earnings and profits of any corporation shall not be decreased by any interest with respect to which a deduction is not or would not be allowable by reason of section 163(f), unless at the time of issuance the issuer is a foreign corporation that is not a controlled foreign corporation (within the meaning of section 957) and the issuance did not have as a purpose the avoidance of section 163(f) of this subsection

(n) ADJUSTMENTS TO EARNINGS AND PROFITS TO MORE ACCURATELY REFLECT ECONOMIC GAIN AND LOSS.—For purposes of computing the earnings and profits of a corporation, the following adjustments shall be made:

(1) CONSTRUCTION PERIOD CARRYING CHARGES.—

(A) IN GENERAL.—In the case of any amount paid or incurred for construction period carrying charges—

(i) no deduction shall be allowed with respect to such amount, and

(ii) the basis of the property with respect to which such charges are allocable shall be increased by such amount.

(B) CONSTRUCTION PERIOD CARRYING CHARGES DEFINED.—For purposes of this paragraph, the term “construction period carrying charges” means all—

(i) interest paid or accrued on indebtedness incurred or continued to acquire, construct, or carry property,

(ii) property taxes, and

(iii) similar carrying charges, to the extent such interest, taxes, or charges are attributable to the construction period for such property and would be allowable as a deduction in determining taxable income under this chapter for the taxable year in which paid or incurred.

(C) CONSTRUCTION PERIOD.—The term “construction period” has the meaning given the term production period under section 263A(f)(4)(B).

(2) INTANGIBLE DRILLING COSTS AND MINERAL EXPLORATION AND DEVELOPMENT COSTS.—

(A) INTANGIBLE DRILLING COSTS.—Any amount allowable as a deduction under section 263(c) in determining taxable income (other than costs incurred in connection with a nonproductive well)—

(i) shall be capitalized, and

(ii) shall be allowed as a deduction ratably over the 60-month period beginning with the month in which such amount was paid or incurred.

(B) MINERAL EXPLORATION AND DEVELOPMENT COSTS.—Any amount allowable as a deduction under section 616(a) or 617 in determining taxable income—

(i) shall be capitalized, and

(ii) shall be allowed as a deduction ratably over the 120-month period beginning with the later of—

(I) the month in which production from the deposit begins, or

(II) the month in which such amount was paid or incurred.

(3) CERTAIN AMORTIZATION PROVISIONS NOT TO APPLY.—[Sections 173 and 248] *Sections 173 and 195* shall not apply.

(4) LIFO INVENTORY ADJUSTMENTS.—

(A) IN GENERAL.—Earnings and profits shall be increased or decreased by the amount of any increase or decrease in the LIFO recapture amount as of the close of each taxable year; except that any decrease below the LIFO recapture amount as of the close of the taxable year preceding the 1st taxable year to which this paragraph applies to the taxpayer shall be taken into account only to the extent provided in regulations prescribed by the Secretary.

(B) LIFO RECAPTURE AMOUNT.—For purposes of this paragraph, the term “LIFO recapture amount” means the amount (if any) by which—

(i) the inventory amount of the inventory assets under the first-in, first-out method authorized by section 471, exceeds

(ii) the inventory amount of such assets under the LIFO method.

(C) DEFINITIONS.—For purposes of this paragraph—

(i) LIFO METHOD.—The term “LIFO method” means the method authorized by section 472 (relating to last-in, first-out inventories).

(ii) INVENTORY ASSETS.—The term “inventory assets” means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

(iii) INVENTORY AMOUNT.—The inventory amount of assets under the first-in, first-out method authorized by section 471 shall be determined—

(I) if the corporation uses the retail method of valuing inventories under section 472, by using such method, or

(II) if subclause (I) does not apply, by using cost or market, whichever is lower.

(5) INSTALLMENT SALES.—In the case of any installment sale, earnings and profits shall be computed as if the corporation did not use the installment method.

(6) COMPLETED CONTRACT METHOD OF ACCOUNTING.—In the case of a taxpayer who uses the completed contract method of accounting, earnings and profits shall be computed as if such taxpayer used the percentage of completion method of accounting.

(7) REDEMPTIONS.—If a corporation distributes amounts in a redemption to which section 302(a) or 303 applies, the part of such distribution which is properly chargeable to earnings and profits shall be an amount which is not in excess of the ratable share of the earnings and profits of such corporation accumulated after February 28, 1913, attributable to the stock so redeemed.

(8) SPECIAL RULE FOR CERTAIN FOREIGN CORPORATIONS.—In the case of a foreign corporation described in subsection (k)(4)—

(A) paragraphs (4) and (6) shall apply only in the case of taxable years beginning after December 31, 1985, and

(B) paragraph (5) shall apply only in the case of taxable years beginning after December 31, 1987.

(o) DEFINITION OF ORIGINAL ISSUE DISCOUNT AND ISSUE PRICE FOR PURPOSES OF SUBSECTION (A)(2).—For purposes of subsection (a)(2), the terms “original issue discount” and “issue price” have the same respective meanings as when used in subpart A of part V of subchapter P of this chapter.

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PART V—CARRYOVERS

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SEC. 382. LIMITATION ON NET OPERATING LOSS CARRYFORWARDS AND CERTAIN BUILT-IN LOSSES FOLLOWING OWNERSHIP CHANGE.

(a) **GENERAL RULE.**—The amount of the taxable income of any new loss corporation for any post-change year which may be offset by pre-change losses shall not exceed the section 382 limitation for such year.

(b) **SECTION 382 LIMITATION.**—For purposes of this section—

(1) **IN GENERAL.**—Except as otherwise provided in this section, the section 382 limitation for any post-change year is an amount equal to—

- (A) the value of the old loss corporation, multiplied by
- (B) the long-term tax-exempt rate.

(2) **CARRYFORWARD OF UNUSED LIMITATION.**—If the section 382 limitation for any post-change year exceeds the taxable income of the new loss corporation for such year which was offset by pre-change losses, the section 382 limitation for the next post-change year shall be increased by the amount of such excess.

(3) **SPECIAL RULE FOR POST-CHANGE YEAR WHICH INCLUDES CHANGE DATE.**—In the case of any post-change year which includes the change date—

(A) **LIMITATION DOES NOT APPLY TO TAXABLE INCOME BEFORE CHANGE.**—Subsection (a) shall not apply to the portion of the taxable income for such year which is allocable to the period in such year on or before the change date. Except as provided in subsection (h)(5) and in regulations, taxable income shall be allocated ratably to each day in the year.

(B) **LIMITATION FOR PERIOD AFTER CHANGE.**—For purposes of applying the limitation of subsection (a) to the remainder of the taxable income for such year, the section 382 limitation shall be an amount which bears the same ratio to such limitation (determined without regard to this paragraph) as—

- (i) the number of days in such year after the change date, bears to
- (ii) the total number of days in such year.

(c) **CARRYFORWARDS DISALLOWED IF CONTINUITY OF BUSINESS REQUIREMENTS NOT MET.**—

(1) **IN GENERAL.**—Except as provided in paragraph (2), if the new loss corporation does not continue the business enterprise of the old loss corporation at all times during the 2-year period beginning on the change date, the section 382 limitation for any post-change year shall be zero.

(2) **EXCEPTION FOR CERTAIN GAINS.**—The section 382 limitation for any post-change year shall not be less than the sum of—

- (A) any increase in such limitation under—
 - (i) subsection (h)(1)(A) for recognized built-in gains for such year, and
 - (ii) subsection (h)(1)(C) for gain recognized by reason of an election under section 338, plus (B) any increase in such limitation under subsection (b)(2) for amounts described in subparagraph (A) which are carried forward to such year.

(d) PRE-CHANGE LOSS AND POST-CHANGE YEAR.—For purposes of this section—

(1) PRE-CHANGE LOSS.—The term “pre-change loss” means—

(A) any net operating loss carryforward of the old loss corporation to the taxable year ending with the ownership change or in which the change date occurs, and

(B) the net operating loss of the old loss corporation for the taxable year in which the ownership change occurs to the extent such loss is allocable to the period in such year on or before the change date.

Except as provided in subsection (h)(5) and in regulations, the net operating loss shall, for purposes of subparagraph (B), be allocated ratably to each day in the year.

(2) POST-CHANGE YEAR.—The term “post-change year” means any taxable year ending after the change date.

(3) APPLICATION TO CARRYFORWARD OF DISALLOWED INTEREST.—The term “pre-change loss” shall include any carryover of disallowed interest described in section 163(j)(2) under rules similar to the rules of paragraph (1).

(4) EXCEPTION FOR START-UP LOSSES.—

(A) *IN GENERAL.*—*In the case of any net operating loss carryforward described in paragraph (1)(A) which arose in a start-up period taxable year, the amount of such net operating loss carryforward otherwise taken into account under such paragraph shall be reduced by the net start-up loss determined with respect to the trade or business referred to in subparagraph (B)(i) for such start-up period taxable year.*

(B) *START-UP PERIOD TAXABLE YEAR.*—*The term “start-up period taxable year” means any taxable year of the old loss corporation which—*

(i) begins before the close of the 3-year period beginning on the date on which any trade or business of such corporation begins as an active trade or business (as determined under section 195(d)(2) without regard to subparagraph (B) thereof), and

(ii) ends after September 10, 2018.

(C) *NET START-UP LOSS.*—

(i) IN GENERAL.—*The term “net start-up loss” means, with respect to any trade or business referred to in subparagraph (B)(i) for any start-up period taxable year, the amount which bears the same ratio (but not greater than 1) to the net operating loss carryforward which arose in such start-up period taxable year as—*

(I) the net operating loss (if any) which would have been determined for such start-up period taxable year if only items of income, gain, deduction, and loss properly allocable to such trade or business were taken into account, bears to

(II) the amount of the net operating loss determined for such start-up period taxable year.

(ii) SPECIAL RULE FOR LAST TAXABLE YEAR IN START-UP PERIOD.—*In the case of any start-up period taxable year which ends after the close of the 3-year period described in subparagraph (B)(i) with respect to any*

trade or business, the net start-up loss with respect to such trade or business for such start-up period taxable year shall be the same proportion of such loss (determined without regard to this clause) as the proportion of such start-up period taxable year which is on or before the last day of such period.

(D) APPLICATION TO NET OPERATING LOSS ARISING IN YEAR OF OWNERSHIP CHANGE.—Subparagraph (A) shall apply to any net operating loss described in paragraph (1)(B) in the same manner as such subparagraph applies to net operating loss carryforwards described in paragraph (1)(A), but by only taking into account the amount of such net operating loss (and the amount of the net start-up loss) which is allocable under paragraph (1)(B) to the period described in such paragraph. Proper adjustment in the allocation of the net start-up loss under the preceding sentence shall be made in the case of a taxable year to which subparagraph (C)(ii) applies.

(E) APPLICATION TO TAXABLE YEARS WHICH ARE START-UP PERIOD TAXABLE YEARS WITH RESPECT TO MORE THAN 1 TRADE OR BUSINESS.—In the case of any net operating loss carryforward which arose in a taxable year which is a start-up period taxable year with respect to more than 1 trade or business—

(i) *this paragraph shall be applied separately with respect to each such trade or business, and*

(ii) *the aggregate reductions under subparagraph (A) shall not exceed such net operating loss carryforward.*

(F) CONTINUITY OF BUSINESS REQUIREMENT.—If the new loss corporation does not continue the trade or business referred to in subparagraph (B)(i) at all times during the 2-year period beginning on the change date, this paragraph shall not apply with respect to such trade or business.

(G) CERTAIN TITLE 11 OR SIMILAR CASES.—

(i) **MULTIPLE OWNERSHIP CHANGES.**—In the case of a 2nd ownership change to which subsection (l)(5)(D) applies, this paragraph shall not apply for purposes of determining the pre-change loss with respect to such 2nd ownership change.

(ii) **CERTAIN INSOLVENCY TRANSACTIONS.**—If subsection (l)(6) applies for purposes of determining the value of the old loss corporation under subsection (e), this paragraph shall not apply.

(H) NOT APPLICABLE TO DISALLOWED INTEREST.—This paragraph shall not apply for purposes of applying the rules of paragraph (1) to the carryover of disallowed interest under paragraph (3).

(I) TRANSITION RULE.—This paragraph shall not apply with respect to any trade or business if the date on which such trade or business begins as an active trade or business (as determined under section 195(d)(2) without regard to subparagraph (B) thereof) is on or before September 10, 2018.

(e) VALUE OF OLD LOSS CORPORATION.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the value of the old loss corporation is the value of the stock of such corporation (including any stock described in section 1504(a)(4)) immediately before the ownership change.

(2) SPECIAL RULE IN THE CASE OF REDEMPTION OR OTHER CORPORATE CONTRACTION.—If a redemption or other corporate contraction occurs in connection with an ownership change, the value under paragraph (1) shall be determined after taking such redemption or other corporate contraction into account.

(3) TREATMENT OF FOREIGN CORPORATIONS.—Except as otherwise provided in regulations, in determining the value of any old loss corporation which is a foreign corporation, there shall be taken into account only items treated as connected with the conduct of a trade or business in the United States.

(f) LONG-TERM TAX-EXEMPT RATE.—For purposes of this section—

(1) IN GENERAL.—The long-term tax-exempt rate shall be the highest of the adjusted Federal long-term rates in effect for any month in the 3-calendar-month period ending with the calendar month in which the change date occurs.

(2) ADJUSTED FEDERAL LONG-TERM RATE.—For purposes of paragraph (1), the term “adjusted Federal long-term rate” means the Federal long-term rate determined under section 1274(d), except that—

(A) paragraphs (2) and (3) thereof shall not apply, and

(B) such rate shall be properly adjusted for differences between rates on long-term taxable and tax-exempt obligations.

(g) OWNERSHIP CHANGE.—For purposes of this section—

(1) IN GENERAL.—There is an ownership change if, immediately after any owner shift involving a 5-percent shareholder or any equity structure shift—

(A) the percentage of the stock of the loss corporation owned by 1 or more 5-percent shareholders has increased by more than 50 percentage points, over

(B) the lowest percentage of stock of the loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period.

(2) OWNER SHIFT INVOLVING 5-PERCENT SHAREHOLDER.—There is an owner shift involving a 5-percent shareholder if—

(A) there is any change in the respective ownership of stock of a corporation, and

(B) such change affects the percentage of stock of such corporation owned by any person who is a 5-percent shareholder before or after such change.

(3) EQUITY STRUCTURE SHIFT DEFINED.—

(A) IN GENERAL.—The term “equity structure shift” means any reorganization (within the meaning of section 368). Such term shall not include—

(i) any reorganization described in subparagraph (D) or (G) of section 368(a)(1) unless the requirements of section 354(b)(1) are met, and

(ii) any reorganization described in subparagraph (F) of section 368(a)(1).

(B) TAXABLE REORGANIZATION-TYPE TRANSACTIONS, ETC.—To the extent provided in regulations, the term “eq-

uity structure shift” includes taxable reorganization-type transactions, public offerings, and similar transactions.

(4) SPECIAL RULES FOR APPLICATION OF SUBSECTION.—

(A) TREATMENT OF LESS THAN 5-PERCENT SHAREHOLDERS.—Except as provided in subparagraphs (B)(i) and (C), in determining whether an ownership change has occurred, all stock owned by shareholders of a corporation who are not 5-percent shareholders of such corporation shall be treated as stock owned by 1 5-percent shareholder of such corporation.

(B) COORDINATION WITH EQUITY STRUCTURE SHIFTS.—For purposes of determining whether an equity structure shift (or subsequent transaction) is an ownership change—

(i) LESS THAN 5-PERCENT SHAREHOLDERS.—Subparagraph (A) shall be applied separately with respect to each group of shareholders (immediately before such equity structure shift) of each corporation which was a party to the reorganization involved in such equity structure shift.

(ii) ACQUISITIONS OF STOCK.—Unless a different proportion is established, acquisitions of stock after such equity structure shift shall be treated as being made proportionately from all shareholders immediately before such acquisition.

(C) COORDINATION WITH OTHER OWNER SHIFTS.—Except as provided in regulations, rules similar to the rules of subparagraph (B) shall apply in determining whether there has been an owner shift involving a 5-percent shareholder and whether such shift (or subsequent transaction) results in an ownership change.

(D) TREATMENT OF WORTHLESS STOCK.—If any stock held by a 50-percent shareholder is treated by such shareholder as becoming worthless during any taxable year of such shareholder and such stock is held by such shareholder as of the close of such taxable year, for purposes of determining whether an ownership change occurs after the close of such taxable year, such shareholder—

(i) shall be treated as having acquired such stock on the 1st day of his 1st succeeding taxable year, and

(ii) shall not be treated as having owned such stock during any prior period.

For purposes of the preceding sentence, the term “50-percent shareholder” means any person owning 50 percent or more of the stock of the corporation at any time during the 3-year period ending on the last day of the taxable year with respect to which the stock was so treated.

(h) SPECIAL RULES FOR BUILT-IN GAINS AND LOSSES AND SECTION 338 GAINS.—For purposes of this section—

(1) IN GENERAL.—

(A) NET UNREALIZED BUILT-IN GAIN.—

(i) IN GENERAL.—If the old loss corporation has a net unrealized built-in gain, the section 382 limitation for any recognition period taxable year shall be increased by the recognized built-in gains for such taxable year.

(ii) LIMITATION.—The increase under clause (i) for any recognition period taxable year shall not exceed—
 (I) the net unrealized built-in gain, reduced by
 (II) recognized built-in gains for prior years ending in the recognition period.

(B) NET UNREALIZED BUILT-IN LOSS.—

(i) IN GENERAL.—If the old loss corporation has a net unrealized built-in loss, the recognized built-in loss for any recognition period taxable year shall be subject to limitation under this section in the same manner as if such loss were a pre-change loss.

(ii) LIMITATION.—Clause (i) shall apply to recognized built-in losses for any recognition period taxable year only to the extent such losses do not exceed—

- (I) the net unrealized built-in loss, reduced by
- (II) recognized built-in losses for prior taxable years ending in the recognition period.

(C) SPECIAL RULES FOR CERTAIN SECTION 338 GAINS.—If an election under section 338 is made in connection with an ownership change and the net unrealized built-in gain is zero by reason of paragraph (3)(B), then, with respect to such change, the section 382 limitation for the post-change year in which gain is recognized by reason of such election shall be increased by the lesser of—

- (i) the recognized built-in gains by reason of such election, or
- (ii) the net unrealized built-in gain (determined without regard to paragraph (3)(B)).

(2) RECOGNIZED BUILT-IN GAIN AND LOSS.—

(A) RECOGNIZED BUILT-IN GAIN.—The term “recognized built-in gain” means any gain recognized during the recognition period on the disposition of any asset to the extent the new loss corporation establishes that—

- (i) such asset was held by the old loss corporation immediately before the change date, and
- (ii) such gain does not exceed the excess of—
 - (I) the fair market value of such asset on the change date, over
 - (II) the adjusted basis of such asset on such date.

(B) RECOGNIZED BUILT-IN LOSS.—The term “recognized built-in loss” means any loss recognized during the recognition period on the disposition of any asset except to the extent the new loss corporation establishes that—

- (i) such asset was not held by the old loss corporation immediately before the change date, or
- (ii) such loss exceeds the excess of—
 - (I) the adjusted basis of such asset on the change date, over
 - (II) the fair market value of such asset on such date.

Such term includes any amount allowable as depreciation, amortization, or depletion for any period within the recognition period except to the extent the new loss corpora-

- tion establishes that the amount so allowable is not attributable to the excess described in clause (ii).
- (3) NET UNREALIZED BUILT-IN GAIN AND LOSS DEFINED.—
- (A) NET UNREALIZED BUILT-IN GAIN AND LOSS.—
- (i) IN GENERAL.—The terms “net unrealized built-in gain” and “net unrealized built-in loss” mean, with respect to any old loss corporation, the amount by which—
- (I) the fair market value of the assets of such corporation immediately before an ownership change is more or less, respectively, than
- (II) the aggregate adjusted basis of such assets at such time.
- (ii) SPECIAL RULE FOR REDEMPTIONS OR OTHER CORPORATE CONTRACTIONS.—If a redemption or other corporate contraction occurs in connection with an ownership change, to the extent provided in regulations, determinations under clause (i) shall be made after taking such redemption or other corporate contraction into account.
- (B) THRESHOLD REQUIREMENT.—
- (i) IN GENERAL.—If the amount of the net unrealized built-in gain or net unrealized built-in loss (determined without regard to this subparagraph) of any old loss corporation is not greater than the lesser of—
- (I) 15 percent of the amount determined for purposes of subparagraph (A)(i)(I), or
- (II) \$10,000,000,
- the net unrealized built-in gain or net unrealized built-in loss shall be zero.
- (ii) CASH AND CASH ITEMS NOT TAKEN INTO ACCOUNT.—In computing any net unrealized built-in gain or net unrealized built-in loss under clause (i), except as provided in regulations, there shall not be taken into account—
- (I) any cash or cash item, or
- (II) any marketable security which has a value which does not substantially differ from adjusted basis.
- (4) DISALLOWED LOSS ALLOWED AS A CARRYFORWARD.—If a deduction for any portion of a recognized built-in loss is disallowed for any post-change year, such portion—
- (A) shall be carried forward to subsequent taxable years under rules similar to the rules for the carrying forward of net operating losses (or to the extent the amount so disallowed is attributable to capital losses, under rules similar to the rules for the carrying forward of net capital losses), but
- (B) shall be subject to limitation under this section in the same manner as a pre-change loss.
- (5) SPECIAL RULES FOR POST-CHANGE YEAR WHICH INCLUDES CHANGE DATE.—For purposes of subsection (b)(3)—
- (A) in applying subparagraph (A) thereof, taxable income shall be computed without regard to recognized built-in gains to the extent such gains increased the section 382

limitation for the year (or recognized built-in losses to the extent such losses are treated as pre-change losses), and gain described in paragraph (1)(C), for the year, and

(B) in applying subparagraph (B) thereof, the section 382 limitation shall be computed without regard to recognized built-in gains, and gain described in paragraph (1)(C), for the year.

(6) TREATMENT OF CERTAIN BUILT-IN ITEMS.—

(A) INCOME ITEMS.—Any item of income which is properly taken into account during the recognition period but which is attributable to periods before the change date shall be treated as a recognized built-in gain for the taxable year in which it is properly taken into account.

(B) DEDUCTION ITEMS.—Any amount which is allowable as a deduction during the recognition period (determined without regard to any carryover) but which is attributable to periods before the change date shall be treated as a recognized built-in loss for the taxable year for which it is allowable as a deduction.

(C) ADJUSTMENTS.—The amount of the net unrealized built-in gain or loss shall be properly adjusted for amounts which would be treated as recognized built-in gains or losses under this paragraph if such amounts were properly taken into account (or allowable as a deduction) during the recognition period.

(7) Recognition period, etc.

(A) RECOGNITION PERIOD.—The term “recognition period” means, with respect to any ownership change, the 5-year period beginning on the change date.

(B) RECOGNITION PERIOD TAXABLE YEAR.—The term “recognition period taxable year” means any taxable year any portion of which is in the recognition period.

(8) DETERMINATION OF FAIR MARKET VALUE IN CERTAIN CASES.—If 80 percent or more in value of the stock of a corporation is acquired in 1 transaction (or in a series of related transactions during any 12-month period), for purposes of determining the net unrealized built-in loss, the fair market value of the assets of such corporation shall not exceed the grossed up amount paid for such stock properly adjusted for indebtedness of the corporation and other relevant items.

(9) TAX-FREE EXCHANGES OR TRANSFERS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection where property held on the change date was acquired (or is subsequently transferred) in a transaction where gain or loss is not recognized (in whole or in part).

(i) TESTING PERIOD.—For purposes of this section—

(1) 3-YEAR PERIOD.—Except as otherwise provided in this section, the testing period is the 3-year period ending on the day of any owner shift involving a 5-percent shareholder or equity structure shift.

(2) SHORTER PERIOD WHERE THERE HAS BEEN RECENT OWNERSHIP CHANGE.—If there has been an ownership change under this section, the testing period for determining whether a 2nd ownership change has occurred shall not begin before the 1st

day following the change date for such earlier ownership change.

(3) SHORTER PERIOD WHERE ALL LOSSES ARISE AFTER 3-YEAR PERIOD BEGINS.—The testing period shall not begin before the earlier of the 1st day of the 1st taxable year from which there is a carryforward of a loss or of an excess credit to the 1st post-change year or the taxable year in which the transaction being tested occurs. Except as provided in regulations, this paragraph shall not apply to any loss corporation which has a net unrealized built-in loss (determined after application of subsection (h)(3)(B)).

(j) CHANGE DATE.—For purposes of this section, the change date is—

(1) in the case where the last component of an ownership change is an owner shift involving a 5-percent shareholder, the date on which such shift occurs, and

(2) in the case where the last component of an ownership change is an equity structure shift, the date of the reorganization.

(k) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) LOSS CORPORATION.—The term “loss corporation” means a corporation entitled to use a net operating loss carryover or having a net operating loss for the taxable year in which the ownership change occurs. Such term shall include any corporation entitled to use a carryforward of disallowed interest described in section 381(c)(20). Except to the extent provided in regulations, such term includes any corporation with a net unrealized built-in loss.

(2) OLD LOSS CORPORATION.—The term “old loss corporation” means any corporation—

(A) with respect to which there is an ownership change, and

(B) which (before the ownership change) was a loss corporation.

(3) NEW LOSS CORPORATION.—The term “new loss corporation” means a corporation which (after an ownership change) is a loss corporation. Nothing in this section shall be treated as implying that the same corporation may not be both the old loss corporation and the new loss corporation.

(4) TAXABLE INCOME.—Taxable income shall be computed with the modifications set forth in section 172(d).

(5) VALUE.—The term “value” means fair market value.

(6) RULES RELATING TO STOCK.—

(A) PREFERRED STOCK.—Except as provided in regulations and subsection (e), the term “stock” means stock other than stock described in section 1504(a)(4).

(B) TREATMENT OF CERTAIN RIGHTS, ETC.—The Secretary shall prescribe such regulations as may be necessary—

(i) to treat warrants, options, contracts to acquire stock, convertible debt interests, and other similar interests as stock, and

(ii) to treat stock as not stock.

- (C) DETERMINATIONS ON BASIS OF VALUE.—Determinations of the percentage of stock of any corporation held by any person shall be made on the basis of value.
- (7) 5-PERCENT SHAREHOLDER.—The term “5-percent shareholder” means any person holding 5 percent or more of the stock of the corporation at any time during the testing period.
- (1) CERTAIN ADDITIONAL OPERATING RULES.—For purposes of this section—
- (1) CERTAIN CAPITAL CONTRIBUTIONS NOT TAKEN INTO ACCOUNT.—
- (A) IN GENERAL.—Any capital contribution received by an old loss corporation as part of a plan a principal purpose of which is to avoid or increase any limitation under this section shall not be taken into account for purposes of this section.
- (B) CERTAIN CONTRIBUTIONS TREATED AS PART OF PLAN.—For purposes of subparagraph (A), any capital contribution made during the 2-year period ending on the change date shall, except as provided in regulations, be treated as part of a plan described in subparagraph (A).
- (2) ORDERING RULES FOR APPLICATION OF SECTION.—
- (A) COORDINATION WITH SECTION 172(B) CARRYOVER RULES.—In the case of any pre-change loss for any taxable year (hereinafter in this subparagraph referred to as the “loss year”) subject to limitation under this section, for purposes of determining under the 2nd sentence of section 172(b)(2) the amount of such loss which may be carried to any taxable year, taxable income for any taxable year shall be treated as not greater than—
- (i) the section 382 limitation for such taxable year, reduced by
- (ii) the unused pre-change losses for taxable years preceding the loss year.
- Similar rules shall apply in the case of any credit or loss subject to limitation under section 383.
- (B) ORDERING RULE FOR LOSSES CARRIED FROM SAME TAXABLE YEAR.—In any case in which—
- (i) a pre-change loss of a loss corporation for any taxable year is subject to a section 382 limitation, and
- (ii) a net operating loss of such corporation from such taxable year is not subject to such limitation,
- taxable income shall be treated as having been offset first by the loss subject to such limitation.
- (3) OPERATING RULES RELATING TO OWNERSHIP OF STOCK.—
- (A) CONSTRUCTIVE OWNERSHIP.—Section 318 (relating to constructive ownership of stock) shall apply in determining ownership of stock, except that—
- (i) paragraphs (1) and (5)(B) of section 318(a) shall not apply and an individual and all members of his family described in paragraph (1) of section 318(a) shall be treated as 1 individual for purposes of applying this section,
- (ii) paragraph (2) of section 318(a) shall be applied—
- (I) without regard to the 50-percent limitation contained in subparagraph (C) thereof, and

(II) except as provided in regulations, by treating stock attributed thereunder as no longer being held by the entity from which attributed,
 (iii) paragraph (3) of section 318(a) shall be applied only to the extent provided in regulations,
 (iv) except to the extent provided in regulations, an option to acquire stock shall be treated as exercised if such exercise results in an ownership change, and
 (v) in attributing stock from an entity under paragraph (2) of section 318(a), there shall not be taken into account—

(I) in the case of attribution from a corporation, stock which is not treated as stock for purposes of this section, or

(II) in the case of attribution from another entity, an interest in such entity similar to stock described in subclause (I).

A rule similar to the rule of clause (iv) shall apply in the case of any contingent purchase, warrant, convertible debt, put, stock subject to a risk of forfeiture, contract to acquire stock, or similar interests.

(B) STOCK ACQUIRED BY REASON OF DEATH, GIFT, DIVORCE, SEPARATION, ETC.—If—

(i) the basis of any stock in the hands of any person is determined—

(I) under section 1014 (relating to property acquired from a decedent),

(II) section 1015 (relating to property acquired by a gift or transfer in trust), or

(III) section 1041(b)(2) (relating to transfers of property between spouses or incident to divorce),
 (ii) stock is received by any person in satisfaction of a right to receive a pecuniary bequest, or

(iii) stock is acquired by a person pursuant to any divorce or separation instrument (within the meaning of section 121(d)(3)(C)),

such person shall be treated as owning such stock during the period such stock was owned by the person from whom it was acquired.

(C) CERTAIN CHANGES IN PERCENTAGE OWNERSHIP WHICH ARE ATTRIBUTABLE TO FLUCTUATIONS IN VALUE NOT TAKEN INTO ACCOUNT.—Except as provided in regulations, any change in proportionate ownership which is attributable solely to fluctuations in the relative fair market values of different classes of stock shall not be taken into account.

(4) REDUCTION IN VALUE WHERE SUBSTANTIAL NONBUSINESS ASSETS.—

(A) IN GENERAL.—If, immediately after an ownership change, the new loss corporation has substantial nonbusiness assets, the value of the old loss corporation shall be reduced by the excess (if any) of—

(i) the fair market value of the nonbusiness assets of the old loss corporation, over

(ii) the nonbusiness asset share of indebtedness for which such corporation is liable.

(B) CORPORATION HAVING SUBSTANTIAL NONBUSINESS ASSETS.—For purposes of subparagraph (A)—

(i) IN GENERAL.—The old loss corporation shall be treated as having substantial nonbusiness assets if at least 1/3 of the value of the total assets of such corporation consists of nonbusiness assets.

(ii) EXCEPTION FOR CERTAIN INVESTMENT ENTITIES.—A regulated investment company to which part I of subchapter M applies, a real estate investment trust to which part II of subchapter M applies, or a REMIC to which part IV of subchapter M applies, shall not be treated as a new loss corporation having substantial nonbusiness assets.

(C) NONBUSINESS ASSETS.—For purposes of this paragraph, the term “nonbusiness assets” means assets held for investment.

(D) NONBUSINESS ASSET SHARE.—For purposes of this paragraph, the nonbusiness asset share of the indebtedness of the corporation is an amount which bears the same ratio to such indebtedness as—

(i) the fair market value of the nonbusiness assets of the corporation, bears to

(ii) the fair market value of all assets of such corporation.

(E) TREATMENT OF SUBSIDIARIES.—For purposes of this paragraph, stock and securities in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary’s assets. For purposes of the preceding sentence, a corporation shall be treated as a subsidiary if the parent owns 50 percent or more of the combined voting power of all classes of stock entitled to vote, and 50 percent or more of the total value of shares of all classes of stock.

(5) TITLE 11 OR SIMILAR CASE.—

(A) IN GENERAL.—Subsection (a) shall not apply to any ownership change if—

(i) the old loss corporation is (immediately before such ownership change) under the jurisdiction of the court in a title 11 or similar case, and

(ii) the shareholders and creditors of the old loss corporation (determined immediately before such ownership change) own (after such ownership change and as a result of being shareholders or creditors immediately before such change) stock of the new loss corporation (or stock of a controlling corporation if also in bankruptcy) which meets the requirements of section 1504(a)(2) (determined by substituting “50 percent” for “80 percent” each place it appears).

(B) REDUCTION FOR INTEREST PAYMENTS TO CREDITORS BECOMING SHAREHOLDERS.—In any case to which subparagraph (A) applies, the pre-change losses and excess credits (within the meaning of section 383(a)(2)) which may be carried to a post-change year shall be computed as if no deduction was allowable under this chapter for the interest paid or accrued by the old loss corporation on indebtedness

which was converted into stock pursuant to title 11 or similar case during—

(i) any taxable year ending during the 3-year period preceding the taxable year in which the ownership change occurs, and

(ii) the period of the taxable year in which the ownership change occurs on or before the change date.

(C) COORDINATION WITH SECTION 108.—In applying section 108(e)(8) to any case to which subparagraph (A) applies, there shall not be taken into account any indebtedness for interest described in subparagraph (B).

(D) SECTION 382 LIMITATION ZERO IF ANOTHER CHANGE WITHIN 2 YEARS.—If, during the 2-year period immediately following an ownership change to which this paragraph applies, an ownership change of the new loss corporation occurs, this paragraph shall not apply and the section 382 limitation with respect to the 2nd ownership change for any post-change year ending after the change date of the 2nd ownership change shall be zero.

(E) ONLY CERTAIN STOCK TAKEN INTO ACCOUNT.—For purposes of subparagraph (A)(ii), stock transferred to a creditor shall be taken into account only to the extent such stock is transferred in satisfaction of indebtedness and only if such indebtedness—

(i) was held by the creditor at least 18 months before the date of the filing of the title 11 or similar case, or

(ii) arose in the ordinary course of the trade or business of the old loss corporation and is held by the person who at all times held the beneficial interest in such indebtedness.

(F) TITLE 11 OR SIMILAR CASE.—For purposes of this paragraph, the term “title 11 or similar case” has the meaning given such term by section 368(a)(3)(A).

(G) ELECTION NOT TO HAVE PARAGRAPH APPLY.—A new loss corporation may elect, subject to such terms and conditions as the Secretary may prescribe, not to have the provisions of this paragraph apply.

(6) SPECIAL RULE FOR INSOLVENCY TRANSACTIONS.—If paragraph (5) does not apply to any reorganization described in subparagraph (G) of section 368(a)(1) or any exchange of debt for stock in a title 11 or similar case (as defined in section 368(a)(3)(A)), the value under subsection (e) shall reflect the increase (if any) in value of the old loss corporation resulting from any surrender or cancellation of creditors’ claims in the transaction.

(7) COORDINATION WITH ALTERNATIVE MINIMUM TAX.—The Secretary shall by regulation provide for the application of this section to the alternative tax net operating loss deduction under section 56(d).

(8) PREDECESSOR AND SUCCESSOR ENTITIES.—Except as provided in regulations, any entity and any predecessor or successor entities of such entity shall be treated as 1 entity.

(m) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes

of this section and section 383, including (but not limited to) regulations—

(1) providing for the application of this section and section 383 where an ownership change with respect to the old loss corporation is followed by an ownership change with respect to the new loss corporation, and

(2) providing for the application of this section and section 383 in the case of a short taxable year,

(3) providing for such adjustments to the application of this section and section 383 as is necessary to prevent the avoidance of the purposes of this section and section 383, including the avoidance of such purposes through the use of related persons, pass-thru entities, or other intermediaries,

(4) providing for the application of subsection (g)(4) where there is only 1 corporation involved, and

(5) providing, in the case of any group of corporations described in section 1563(a) (determined by substituting “50 percent” for “80 percent” each place it appears and determined without regard to paragraph (4) thereof), appropriate adjustments to value, built-in gain or loss, and other items so that items are not omitted or taken into account more than once.

(n) SPECIAL RULE FOR CERTAIN OWNERSHIP CHANGES.—

(1) IN GENERAL.—The limitation contained in subsection (a) shall not apply in the case of an ownership change which is pursuant to a restructuring plan of a taxpayer which—

(A) is required under a loan agreement or a commitment for a line of credit entered into with the Department of the Treasury under the Emergency Economic Stabilization Act of 2008, and

(B) is intended to result in a rationalization of the costs, capitalization, and capacity with respect to the manufacturing workforce of, and suppliers to, the taxpayer and its subsidiaries.

(2) SUBSEQUENT ACQUISITIONS.—Paragraph (1) shall not apply in the case of any subsequent ownership change unless such ownership change is described in such paragraph.

(3) LIMITATION BASED ON CONTROL IN CORPORATION.—

(A) IN GENERAL.—Paragraph (1) shall not apply in the case of any ownership change if, immediately after such ownership change, any person (other than a voluntary employees’ beneficiary association under section 501(c)(9)) owns stock of the new loss corporation possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or of the total value of the stock of such corporation.

(B) TREATMENT OF RELATED PERSONS.—

(i) IN GENERAL.—Related persons shall be treated as a single person for purposes of this paragraph.

(ii) RELATED PERSONS.—For purposes of clause (i), a person shall be treated as related to another person if—

(I) such person bears a relationship to such other person described in section 267(b) or 707(b), or

(II) such persons are members of a group of persons acting in concert.

SEC. 383. SPECIAL LIMITATIONS ON CERTAIN EXCESS CREDITS, ETC.

(a) **EXCESS CREDITS.**—

(1) **IN GENERAL.**—Under regulations, if an ownership change occurs with respect to a corporation, the amount of any excess credit for any taxable year which may be used in any post-change year shall be limited to an amount determined on the basis of the tax liability which is attributable to so much of the taxable income as does not exceed the section 382 limitation for such post-change year to the extent available after the application of section 382 and subsections (b) and (c) of this section.

(2) **EXCESS CREDIT.**—For purposes of paragraph (1), the term “excess credit” means—

(A) any unused general business credit of the corporation under section 39, and

(B) any unused minimum tax credit of the corporation under section 53.

(b) **LIMITATION ON NET CAPITAL LOSS.**—If an ownership change occurs with respect to a corporation, the amount of any net capital loss under section 1212 for any taxable year before the 1st post-change year which may be used in any post-change year shall be limited under regulations which shall be based on the principles applicable under section 382. Such regulations shall provide that any such net capital loss used in a post-change year shall reduce the section 382 limitation which is applied to pre-change losses under section 382 for such year.

(c) **FOREIGN TAX CREDITS.**—If an ownership change occurs with respect to a corporation, the amount of any excess foreign taxes under section 904(c) for any taxable year before the 1st post-change taxable year shall be limited under regulations which shall be consistent with purposes of this section and section 382.

(d) **PRO RATION RULES FOR YEAR WHICH INCLUDES CHANGE.**—For purposes of this section, rules similar to the rules of subsections (b)(3) and (d)(1)(B) of section 382 shall apply.

(e) **EXCEPTION FOR START-UP EXCESS CREDITS.**—

(1) **IN GENERAL.**—*In the case of any unused general business credit of the corporation under section 39 which arose in a start-up period taxable year, the amount of such unused general business credit otherwise taken into account under subsection (a)(2)(A) shall be reduced by the start-up excess credit determined with respect to any trade or business referred to in section 382(d)(4)(B)(i) for such start-up period taxable year.*

(2) **START-UP PERIOD TAXABLE YEAR.**—*For purposes of this subsection, the term “start-up period taxable year” has the meaning given such term in section 382(d)(4)(B).*

(3) **START-UP EXCESS CREDIT.**—*For purposes of this subsection, the term “start-up excess credit” means, with respect to any trade or business referred to in section 382(d)(4)(B)(i) for any start-up period taxable year, the amount which bears the same ratio to the unused general business credit which arose in such start-up period taxable year as—*

(A) *the amount of the general business credit which would have been determined for such start-up period tax-*

able year if only credits properly allocable to such trade or business were taken into account, bears to

(B) the amount of the general business credit determined for such start-up period taxable year.

(4) APPLICATION OF CERTAIN RULES.—Rules similar to the rules of subparagraphs (C)(ii), (D), (E), and (F) of section 382(d)(4) shall apply for purposes of this subsection.

(5) TRANSITION RULE.—This subsection shall not apply with respect to any trade or business if the date on which such trade or business begins as an active trade or business (as determined under section 195(d)(2) without regard to subparagraph (B) thereof) is on or before September 10, 2018.

[(e)] (f) DEFINITIONS.—Terms used in this section shall have the same respective meanings as when used in section 382, except that appropriate adjustments shall be made to take into account that the limitations of this section apply to credits and net capital losses.

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**Subchapter G—Corporations Used to Avoid
Income Tax on Shareholders**

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**PART I—CORPORATIONS IMPROPERLY ACCUMULATING
SURPLUS**

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SEC. 535. ACCUMULATED TAXABLE INCOME.

(a) DEFINITION.—For purposes of this subtitle, the term “accumulated taxable income” means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

(b) ADJUSTMENTS TO TAXABLE INCOME.—For purposes of subsection (a), taxable income shall be adjusted as follows:

(1) TAXES.—There shall be allowed as a deduction Federal income and excess profits taxes and income, war profits, and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4)), accrued during the taxable year or deemed to be paid by a domestic corporation under section 960 for the taxable year, but not including the accumulated earnings tax imposed by section 531 or the personal holding company tax imposed by section 541.

(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions provided under section 170 shall be allowed without regard to section 170(b)(2).

(3) SPECIAL DEDUCTIONS DISALLOWED.—The special deductions for corporations provided in part VIII [(except section 248)] of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) NET OPERATING LOSS.—The net operating loss deduction provided in section 172 shall not be allowed.

(5) CAPITAL LOSSES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), there shall be allowed as a deduction an amount equal to the net capital loss for the taxable year (determined without regard to paragraph (7)(A)).

(B) RECAPTURE OF PREVIOUS DEDUCTIONS FOR CAPITAL GAINS.—The aggregate amount allowable as a deduction under subparagraph (A) for any taxable year shall be reduced by the lesser of—

- (i) the nonrecaptured capital gains deductions, or
- (ii) the amount of the accumulated earnings and profits of the corporation as of the close of the preceding taxable year.

(C) NONRECAPTURED CAPITAL GAINS DEDUCTIONS.—For purposes of subparagraph (B), the term “nonrecaptured capital gains deductions” means the excess of—

- (i) the aggregate amount allowable as a deduction under paragraph (6) for preceding taxable years beginning after July 18, 1984, over
- (ii) the aggregate of the reductions under subparagraph (B) for preceding taxable years.

(6) NET CAPITAL GAINS.—

(A) IN GENERAL.—There shall be allowed as a deduction—

- (i) the net capital gain for the taxable year (determined with the application of paragraph (7)), reduced by
- (ii) the taxes attributable to such net capital gain.

(B) ATTRIBUTABLE TAXES.—For purposes of subparagraph (A), the taxes attributable to the net capital gain shall be an amount equal to the difference between—

- (i) the taxes imposed by this subtitle (except the tax imposed by this part) for the taxable year, and
- (ii) such taxes computed for such year without including in taxable income the net capital gain for the taxable year (determined without the application of paragraph (7)).

(7) CAPITAL LOSS CARRYOVERS.—

(A) UNLIMITED CARRYFORWARD.—The net capital loss for any taxable year shall be treated as a short-term capital loss in the next taxable year.

(B) SECTION 1212 INAPPLICABLE.—No allowance shall be made for the capital loss carryback or carryforward provided in section 1212.

(8) SPECIAL RULES FOR MERE HOLDING OR INVESTMENT COMPANIES.—In the case of a mere holding or investment company—

(A) CAPITAL LOSS DEDUCTION, ETC., NOT ALLOWED.—Paragraphs (5) and (7)(A) shall not apply.

(B) DEDUCTION FOR CERTAIN OFFSETS.—There shall be allowed as a deduction the net short-term capital gain for the taxable year to the extent such gain does not exceed the amount of any capital loss carryover to such taxable

year under section 1212 (determined without regard to paragraph (7)(B)).

(C) EARNINGS AND PROFITS.—For purposes of subchapter C, the accumulated earnings and profits at any time shall not be less than they would be if this subsection had applied to the computation of earnings and profits for all taxable years beginning after July 18, 1984.

(9) SPECIAL RULE FOR CAPITAL GAINS AND LOSSES OF FOREIGN CORPORATIONS.—In the case of a foreign corporation, paragraph (6) shall be applied by taking into account only gains and losses which are effectively connected with the conduct of a trade or business within the United States and are not exempt from tax under treaty.

(10) CONTROLLED FOREIGN CORPORATIONS.—There shall be allowed as a deduction the amount of the corporation's income for the taxable year which is included in the gross income of a United States shareholder under section 951(a). In the case of any corporation the accumulated taxable income of which would (but for this sentence) be determined without allowance of any deductions, the deduction under this paragraph shall be allowed and shall be appropriately adjusted to take into account any deductions which reduced such inclusion.

(c) ACCUMULATED EARNINGS CREDIT.—

(1) GENERAL RULE.—For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b)(6). For purposes of this paragraph, the amount of the earnings and profits for the taxable year which are retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction (as defined in section 561) for such year.

(2) MINIMUM CREDIT.—

(A) IN GENERAL.—The credit allowable under paragraph (1) shall in no case be less than the amount by which \$250,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

(B) CERTAIN SERVICE CORPORATIONS.—In the case of a corporation the principal function of which is the performance of services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, subparagraph (A) shall be applied by substituting “\$150,000” for “\$250,000”.

(3) HOLDING AND INVESTMENT COMPANIES.—In the case of a corporation which is a mere holding or investment company, the accumulated earnings credit is the amount (if any) by which \$250,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

(4) ACCUMULATED EARNINGS AND PROFITS.—For purposes of paragraphs (2) and (3), the accumulated earnings and profits at the close of the preceding taxable year shall be reduced by the dividends which under section 563(a) (relating to dividends paid after the close of the taxable year) are considered as paid during such taxable year.

(5) **CROSS REFERENCE.**—For limitation on credit provided in paragraph (2) or (3) in the case of certain controlled corporations, see section 1561.

(d) **INCOME DISTRIBUTED TO UNITED STATES-OWNED FOREIGN CORPORATION RETAINS UNITED STATES CONNECTION.**—

(1) **IN GENERAL.**—For purposes of this part, if 10 percent or more of the earnings and profits of any foreign corporation for any taxable year—

(A) is derived from sources within the United States, or
 (B) is effectively connected with the conduct of a trade or business within the United States,
 any distribution out of such earnings and profits (and any interest payment) received (directly or through 1 or more other entities) by a United States-owned foreign corporation shall be treated as derived by such corporation from sources within the United States.

(2) **UNITED STATES-OWNED FOREIGN CORPORATION.**—The term “United States-owned foreign corporation” has the meaning given to such term by section 904(h)(6).

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PART II—PERSONAL HOLDING COMPANIES

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SEC. 545. UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME.

(a) **DEFINITION.**—For purposes of this part, the term “undistributed personal holding company income” means the taxable income of a personal holding company adjusted in the manner provided in subsections (b), (c), and (d), minus the dividends paid deduction as defined in section 561. In the case of a personal holding company which is a foreign corporation, not more than 10 percent in value of the outstanding stock of which is owned (within the meaning of section 958(a)) during the last half of the taxable year by United States persons, the term “undistributed personal holding company income” means the amount determined by multiplying the undistributed personal holding company income (determined without regard to this sentence) by the percentage in value of its outstanding stock which is the greatest percentage in value of its outstanding stock so owned by United States persons on any one day during such period.

(b) **ADJUSTMENTS TO TAXABLE INCOME.**—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

(1) **TAXES.**—There shall be allowed as a deduction Federal income and excess profits taxes and income, war profits and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4)), accrued during the taxable year or deemed to be paid by a domestic corporation under section 960 for the taxable year, but not including the accumulated earnings tax imposed by section 531 or the personal holding company tax imposed by section 541.

(2) **CHARITABLE CONTRIBUTIONS.**—The deduction for charitable contributions provided under section 170 shall be allowed, but in computing such deduction the limitations in section 170(b)(1)(A), (B), (D), and (E) shall apply, and section

170(b)(2) and (d)(1) shall not apply. For purposes of this paragraph, the term “contribution base” when used in section 170(b)(1) means the taxable income computed with the adjustments (other than the 10-percent limitation) provided in section 170(b)(2) and (d)(1) and without deduction of the amount disallowed under paragraph (6) of this subsection.

(3) SPECIAL DEDUCTIONS DISALLOWED.—The special deductions for corporations provided in part VIII [(except section 248)] of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) NET OPERATING LOSS.—The net operating loss deduction provided in section 172 shall not be allowed, but there shall be allowed as a deduction the amount of the net operating loss (as defined in section 172(c)) for the preceding taxable year computed without the deductions provided in part VIII [(except section 248)] of subchapter B.

(5) NET CAPITAL GAINS.—There shall be allowed as a deduction the net capital gain for the taxable year, minus the taxes imposed by this subtitle attributable to such net capital gain. The taxes attributable to such net capital gain shall be an amount equal to the difference between—

(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

(B) such taxes computed for such year without including such excess in taxable income.

(6) EXPENSES AND DEPRECIATION APPLICABLE TO PROPERTY OF THE TAXPAYER.—The aggregate of the deductions allowed under section 162 (relating to trade or business expenses) and section 167 (relating to depreciation), which are allocable to the operation and maintenance of property owned or operated by the corporation, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Secretary) to the satisfaction of the Secretary—

(A) that the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(B) that the property was held in the course of a business carried on bona fide for profit; and

(C) either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(7) SPECIAL RULE FOR CAPITAL GAINS AND LOSSES OF FOREIGN CORPORATIONS.—In the case of a foreign corporation, paragraph (5) shall be applied by taking into account only gains and losses which are effectively connected with the conduct of a trade or business within the United States and are not exempt from tax under treaty.

(c) CERTAIN FOREIGN CORPORATIONS.—In the case of a foreign corporation all of the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), the tax-

able income for purposes of subsection (a) shall be the income which constitutes personal holding company income under section 543(a)(7), reduced by the deductions attributable to such income, and adjusted, with respect to such income, in the manner provided in subsection (b).

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Subchapter K—Partners and Partnerships

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PART I—DETERMINATION OF TAX LIABILITY

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[Sec. 709. Treatment of organization and syndication fees.]
Sec. 709. Treatment of syndication fees.

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[SEC. 709. TREATMENT OF ORGANIZATION AND SYNDICATION FEES.]

[(a) GENERAL RULE.—Except as provided in subsection (b), no deduction shall be allowed under this chapter to the partnership or to any partner for any amounts paid or incurred to organize a partnership or to promote the sale of (or to sell) an interest in such partnership.

[(b) DEDUCTION OF ORGANIZATION FEES.—

[(1) ALLOWANCE OF DEDUCTION.—If a partnership elects the application of this subsection (in accordance with regulations prescribed by the Secretary) with respect to any organizational expenses—

[(A) the partnership shall be allowed a deduction for the taxable year in which the partnership begins business in an amount equal to the lesser of—

[(i) the amount of organizational expenses with respect to the partnership, or

[(ii) \$5,000, reduced (but not below zero) by the amount by which such organizational expenses exceed \$50,000, and

[(B) the remainder of such organizational expenses shall be allowed as a deduction ratably over the 180-month period beginning with the month in which the partnership begins business.

[(2) DISPOSITIONS BEFORE CLOSE OF AMORTIZATION PERIOD.—In any case in which a partnership is liquidated before the end of the period to which paragraph (1)(B) applies, any deferred expenses attributable to the partnership which were not allowed as a deduction by reason of this section may be deducted to the extent allowable under section 165.

[(3) ORGANIZATIONAL EXPENSES DEFINED.—The organizational expenses to which paragraph (1) applies, are expenditures which—

[(A) are incident to the creation of the partnership;

[(B) are chargeable to capital account; and

[(C) are of a character which, if expended incident to the creation of a partnership having an ascertainable life, would be amortized over such life.]

SEC. 709. TREATMENT OF SYNDICATION FEES.

No deduction shall be allowed under this chapter to a partnership or to any partner of the partnership for any amounts paid or incurred to promote the sale of (or to sell) an interest in the partnership.

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Subchapter L—Insurance Companies

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PART II—OTHER INSURANCE COMPANIES

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SEC. 834. DETERMINATION OF TAXABLE INVESTMENT INCOME.

(a) **GENERAL RULE.**—For purposes of section 831(b), the term “taxable investment income” means the gross investment income, minus the deductions provided in subsection (c).

(b) **GROSS INVESTMENT INCOME.**—For purposes of subsection (a), the term “gross investment income” means the sum of the following:

- (1) The gross amount of income during the taxable year from—
 - (A) interest, dividends, rents, and royalties,
 - (B) the entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derives interest, rents, or royalties,
 - (C) the alteration or termination of any instrument or agreement described in subparagraph (B), and
 - (D) gains from sales or exchanges of capital assets to the extent provided in subchapter P (relating to capital gains and losses).

(2) The gross income during the taxable year from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

(c) **DEDUCTIONS.**—In computing taxable investment income, the following deductions shall be allowed:

(1) **TAX-FREE INTEREST.**—The amount of interest which under section 103 is excluded for the taxable year from gross income.

(2) **INVESTMENT EXPENSES.**—Investment expenses paid or accrued during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which taxable investment income (computed without any deduction for investment expenses allowed by this paragraph, for tax-free interest allowed by paragraph (1), or for dividends received allowed by paragraph (7)), exceeds 3 3/4 percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

(3) REAL ESTATE EXPENSES.—Taxes (as provided in section 164), and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

(4) DEPRECIATION.—The depreciation deduction allowed by section 167.

(5) INTEREST PAID OR ACCRUED.—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from taxation under this subtitle.

(6) CAPITAL LOSSES.—Capital losses to the extent provided in subchapter P (sec. 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid over the sum of the items described in subsection (b) (other than paragraph (1)(D) thereof) and net premiums received. In the application of section 1212 for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) the taxable investment income (computed without regard to gains or losses from sales or exchanges of capital assets); or

(B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

(7) SPECIAL DEDUCTIONS.—The special deductions allowed by part VIII [(except section 248)] of subchapter B (sec. 241 and following, relating to dividends received). In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of this paragraph, the reference in such section to “taxable income” shall be treated as a reference to “taxable investment income”.

(8) TRADE OR BUSINESS DEDUCTIONS.—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner; except that for purposes of this paragraph—

(A) any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account, and

(B) the deduction for net operating losses provided in section 172 shall not be allowed.

(9) DEPLETION.—The deduction allowed by section 611 (relating to depletion).

(d) OTHER APPLICABLE RULES.—

(1) RENTAL VALUE OF REAL ESTATE.—The deduction under subsection (c)(3) or (4) on account of any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 831 shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this paragraph) as the rental value of the space not so occupied bears to the rental value of the entire property.

(2) AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.—The gross amount of income during the taxable year from interest and the deduction provided in subsection (c)(1) shall each be decreased to reflect the appropriate amortization of premium and increased to reflect the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 831. Such amortization and accrual shall be determined—

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary.

No accrual of discount shall be required under this paragraph on any bond (as defined in section 171(d)) except in the case of discount which is original issue discount (as defined in section 1273).

(3) DOUBLE DEDUCTIONS.—Nothing in this part shall permit the same item to be deducted more than once.

(e) DEFINITIONS.—For purposes of this part—

(1) NET PREMIUMS.—The term “net premiums” means gross premiums (including deposits and assessments) written or received on insurance contracts during the taxable year less return premiums and premiums paid or incurred for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends on the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (2).

(2) DIVIDENDS TO POLICYHOLDERS.—The term “dividends to policyholders” means dividends and similar distributions paid or declared to policyholders. For purposes of the preceding sentence, the term “paid or declared” shall be construed according to the method regularly employed in keeping the books of the insurance company.

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Subchapter M—Regulated Investment Companies and Real Estate Investment Trusts

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PART I—REGULATED INVESTMENT COMPANIES

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SEC. 852. TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS.

(a) REQUIREMENTS APPLICABLE TO REGULATED INVESTMENT COMPANIES.—The provisions of this part (other than subsection (c) of this section) shall not be applicable to a regulated investment company for a taxable year unless—

(1) the deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gain dividends) equals or exceeds the sum of—

(A) 90 percent of its investment company taxable income for the taxable year determined without regard to subsection (b)(2)(D); and

(B) 90 percent of the excess of (i) its interest income excludable from gross income under section 103(a) over (ii) its deductions disallowed under sections 265 and 171(a)(2), and

(2) either—

(A) the provisions of this part applied to the investment company for all taxable years ending on or after November 8, 1983, or

(B) as of the close of the taxable year, the investment company has no earnings and profits accumulated in any taxable year to which the provisions of this part (or the corresponding provisions of prior law) did not apply to it.

The Secretary may waive the requirements of paragraph (1) for any taxable year if the regulated investment company establishes to the satisfaction of the Secretary that it was unable to meet such requirements by reason of distributions previously made to meet the requirements of section 4982.

(b) METHOD OF TAXATION OF COMPANIES AND SHAREHOLDERS.—

(1) IMPOSITION OF TAX ON REGULATED INVESTMENT COMPANIES.—There is hereby imposed for each taxable year upon the investment company taxable income of every regulated investment company a tax computed as provided in section 11, as though the investment company taxable income were the taxable income referred to in section 11.

(2) INVESTMENT COMPANY TAXABLE INCOME.—The investment company taxable income shall be the taxable income of the regulated investment company adjusted as follows:

(A) There shall be excluded the amount of the net capital gain, if any.

(B) The net operating loss deduction provided in section 172 shall not be allowed.

(C) The deductions for corporations provided in part VIII [(except section 248)] in subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(D) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gain dividends and exempt-interest dividends.

(E) The taxable income shall be computed without regard to section 443(b) (relating to computation of tax on change of annual accounting period).

(F) The taxable income shall be computed without regard to section 454(b) (relating to short-term obligations issued on a discount basis) if the company so elects in a manner prescribed by the Secretary.

(G) There shall be deducted an amount equal to the tax imposed by subsections (d)(2) and (i) of section 851 for the taxable year.

(3) CAPITAL GAINS.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year in the case of every regulated investment company a tax, determined as provided in section 11(b), on the excess, if any, of the net capital gain over the deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only.

(B) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by the shareholders as a gain from the sale or exchange of a capital asset held for more than 1 year.

(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part—

(i) IN GENERAL.—Except as provided in clause (ii), a capital gain dividend is any dividend, or part thereof, which is reported by the company as a capital gain dividend in written statements furnished to its shareholders.

(ii) EXCESS REPORTED AMOUNTS.—If the aggregate reported amount with respect to the company for any taxable year exceeds the net capital gain of the company for such taxable year, a capital gain dividend is the excess of—

(I) the reported capital gain dividend amount, over

(II) the excess reported amount which is allocable to such reported capital gain dividend amount.

(iii) ALLOCATION OF EXCESS REPORTED AMOUNT.—

(I) IN GENERAL.—Except as provided in subclause (II), the excess reported amount (if any) which is allocable to the reported capital gain dividend amount is that portion of the excess reported amount which bears the same ratio to the excess reported amount as the reported capital gain dividend amount bears to the aggregate reported amount.

(II) SPECIAL RULE FOR NONCALENDAR YEAR TAXPAYERS.—In the case of any taxable year which does not begin and end in the same calendar year, if the post-December reported amount equals or

exceeds the excess reported amount for such taxable year, subclause (I) shall be applied by substituting "post-December reported amount" for "aggregate reported amount" and no excess reported amount shall be allocated to any dividend paid on or before December 31 of such taxable year.

(iv) DEFINITIONS.—For purposes of this subparagraph—

(I) REPORTED CAPITAL GAIN DIVIDEND AMOUNT.—The term "reported capital gain dividend amount" means the amount reported to its shareholders under clause (i) as a capital gain dividend.

(II) EXCESS REPORTED AMOUNT.—The term "excess reported amount" means the excess of the aggregate reported amount over the net capital gain of the company for the taxable year.

(III) AGGREGATE REPORTED AMOUNT.—The term "aggregate reported amount" means the aggregate amount of dividends reported by the company under clause (i) as capital gain dividends for the taxable year (including capital gain dividends paid after the close of the taxable year described in section 855).

(IV) POST-DECEMBER REPORTED AMOUNT.—The term "post-December reported amount" means the aggregate reported amount determined by taking into account only dividends paid after December 31 of the taxable year.

(v) ADJUSTMENT FOR DETERMINATIONS.—If there is an increase in the excess described in subparagraph (A) for the taxable year which results from a determination (as defined in section 860(e)), the company may, subject to the limitations of this subparagraph, increase the amount of capital gain dividends reported under clause (i).

(vi) SPECIAL RULE FOR LOSSES LATE IN THE CALENDAR YEAR.—For special rule for certain losses after October 31, see paragraph (8).

(D) TREATMENT BY SHAREHOLDERS OF UNDISTRIBUTED CAPITAL GAINS.—

(i) Every shareholder of a regulated investment company at the close of the company's taxable year shall include, in computing his long-term capital gains in his return for his taxable year in which the last day of the company's taxable year falls, such amount as the company shall designate in respect of such shares in a written notice mailed to its shareholders at any time prior to the expiration of 60 days after close of its taxable year, but the amount so includible by any shareholder shall not exceed that part of the amount subjected to tax in subparagraph (A) which he would have received if all of such amount had been distributed as capital gain dividends by the company to the holders of such shares at the close of its taxable year.

(ii) For purposes of this title, every such shareholder shall be deemed to have paid, for his taxable year under clause (i), the tax imposed by subparagraph (A) on the amounts required by this subparagraph to be included in respect of such shares in computing his long-term capital gains for that year; and such shareholder shall be allowed credit or refund, as the case may be, for the tax so deemed to have been paid by him.

(iii) The adjusted basis of such shares in the hands of the shareholder shall be increased, with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, by the difference between the amount of such includible gains and the tax deemed paid by such shareholder in respect of such shares under clause (ii).

(iv) In the event of such designation the tax imposed by subparagraph (A) shall be paid by the regulated investment company within 30 days after close of its taxable year.

(v) The earnings and profits of such regulated investment company, and the earnings and profits of any such shareholder which is a corporation, shall be appropriately adjusted in accordance with regulations prescribed by the Secretary.

(E) CERTAIN DISTRIBUTIONS.—In the case of a distribution to which section 897 does not apply by reason of the second sentence of section 897(h)(1), the amount of such distribution which would be included in computing long-term capital gains for the shareholder under subparagraph (B) or (D) (without regard to this subparagraph)—

(i) shall not be included in computing such shareholder's long-term capital gains, and

(ii) shall be included in such shareholder's gross income as a dividend from the regulated investment company.

(4) LOSS ON SALE OR EXCHANGE OF STOCK HELD 6 MONTHS OR LESS.—

(A) LOSS ATTRIBUTABLE TO CAPITAL GAIN DIVIDEND.—If—

(i) subparagraph (B) or (D) of paragraph (3) provides that any amount with respect to any share is to be treated as long-term capital gain, and

(ii) such share is held by the taxpayer for 6 months or less,

then any loss (to the extent not disallowed under subparagraph (B)) on the sale or exchange of such share shall, to the extent of the amount described in clause (i), be treated as a long-term capital loss.

(B) LOSS ATTRIBUTABLE TO EXEMPT-INTEREST DIVIDEND.—If—

(i) a shareholder of a regulated investment company receives an exempt-interest dividend with respect to any share, and

(ii) such share is held by the taxpayer for 6 months or less,

then any loss on the sale or exchange of such share shall, to the extent of the amount of such exempt-interest dividend, be disallowed.

(C) DETERMINATION OF HOLDING PERIODS.—For purposes of this paragraph, in determining the period for which the taxpayer has held any share of stock—

(i) the rules of paragraphs (3) and (4) of section 246(c) shall apply, and

(ii) there shall not be taken into account any day which is more than 6 months after the date on which such share becomes ex-dividend.

(D) LOSSES INCURRED UNDER A PERIODIC LIQUIDATION PLAN.—To the extent provided in regulations, subparagraphs (A) and (B) shall not apply to losses incurred on the sale or exchange of shares of stock in a regulated investment company pursuant to a plan which provides for the periodic liquidation of such shares.

(E) EXCEPTION TO HOLDING PERIOD REQUIREMENT FOR CERTAIN REGULARLY DECLARED EXEMPT-INTEREST DIVIDENDS.—

(i) DAILY DIVIDEND COMPANIES.—Except as otherwise provided by regulations, subparagraph (B) shall not apply with respect to a regular dividend paid by a regulated investment company which declares exempt-interest dividends on a daily basis in an amount equal to at least 90 percent of its net tax-exempt interest and distributes such dividends on a monthly or more frequent basis.

(ii) AUTHORITY TO SHORTEN REQUIRED HOLDING PERIOD WITH RESPECT TO OTHER COMPANIES.—In the case of a regulated investment company (other than a company described in clause (i)) which regularly distributes at least 90 percent of its net tax-exempt interest, the Secretary may by regulations prescribe that subparagraph (B) (and subparagraph (C) to the extent it relates to subparagraph (B)) shall be applied on the basis of a holding period requirement shorter than 6 months; except that such shorter holding period requirement shall not be shorter than the greater of 31 days or the period between regular distributions of exempt-interest dividends.

(5) EXEMPT-INTEREST DIVIDENDS.—If, at the close of each quarter of its taxable year, at least 50 percent of the value (as defined in section 851(c)(4)) of the total assets of the regulated investment company consists of obligations described in section 103(a), such company shall be qualified to pay exempt-interest dividends, as defined herein, to its shareholders.

(A) DEFINITION OF EXEMPT-INTEREST DIVIDEND.—

(i) IN GENERAL.—Except as provided in clause (ii), an exempt-interest dividend is any dividend or part thereof (other than a capital gain dividend) paid by a regulated investment company and reported by the company as an exempt-interest dividend in written statements furnished to its shareholders.

(ii) EXCESS REPORTED AMOUNTS.—If the aggregate reported amount with respect to the company for any taxable year exceeds the exempt interest of the company for such taxable year, an exempt-interest dividend is the excess of—

(I) the reported exempt-interest dividend amount, over

(II) the excess reported amount which is allocable to such reported exempt-interest dividend amount.

(iii) ALLOCATION OF EXCESS REPORTED AMOUNT.—

(I) IN GENERAL.—Except as provided in subclause (II), the excess reported amount (if any) which is allocable to the reported exempt-interest dividend amount is that portion of the excess reported amount which bears the same ratio to the excess reported amount as the reported exempt-interest dividend amount bears to the aggregate reported amount.

(II) SPECIAL RULE FOR NONCALENDAR YEAR TAXPAYERS.—In the case of any taxable year which does not begin and end in the same calendar year, if the post-December reported amount equals or exceeds the excess reported amount for such taxable year, subclause (I) shall be applied by substituting “post-December reported amount” for “aggregate reported amount” and no excess reported amount shall be allocated to any dividend paid on or before December 31 of such taxable year.

(iv) DEFINITIONS.—For purposes of this subparagraph—

(I) REPORTED EXEMPT-INTEREST DIVIDEND AMOUNT.—The term “reported exempt-interest dividend amount” means the amount reported to its shareholders under clause (i) as an exempt-interest dividend.

(II) EXCESS REPORTED AMOUNT.—The term “excess reported amount” means the excess of the aggregate reported amount over the exempt interest of the company for the taxable year.

(III) AGGREGATE REPORTED AMOUNT.—The term “aggregate reported amount” means the aggregate amount of dividends reported by the company under clause (i) as exempt-interest dividends for the taxable year (including exempt-interest dividends paid after the close of the taxable year described in section 855).

(IV) POST-DECEMBER REPORTED AMOUNT.—The term “post-December reported amount” means the aggregate reported amount determined by taking into account only dividends paid after December 31 of the taxable year.

(V) EXEMPT INTEREST.—The term “exempt interest” means, with respect to any regulated invest-

ment company, the excess of the amount of interest excludable from gross income under section 103(a) over the amounts disallowed as deductions under sections 265 and 171(a)(2).

(B) TREATMENT OF EXEMPT-INTEREST DIVIDENDS BY SHAREHOLDERS.—An exempt-interest dividend shall be treated by the shareholders for all purposes of this subtitle as an item of interest excludable from gross income under section 103(a). Such purposes include but are not limited to—

- (i) the determination of gross income and taxable income,
- (ii) the determination of distributable net income under subchapter J,
- (iii) the allowance of, or calculation of the amount of, any credit or deduction, and
- (iv) the determination of the basis in the hands of any shareholder of any share of stock of the company.

(6) SECTION 311(B) NOT TO APPLY TO CERTAIN DISTRIBUTIONS.—Section 311(b) shall not apply to any distribution by a regulated investment company to which this part applies, if such distribution is in redemption of its stock upon the demand of the shareholder.

(7) TIME CERTAIN DIVIDENDS TAKEN INTO ACCOUNT.—For purposes of this title, any dividend declared by a regulated investment company in October, November, or December of any calendar year and payable to shareholders of record on a specified date in such a month shall be deemed—

- (A) to have been received by each shareholder on December 31 of such calendar year, and
- (B) to have been paid by such company on December 31 of such calendar year (or, if earlier, as provided in section 855).

The preceding sentence shall apply only if such dividend is actually paid by the company during January of the following calendar year.

(8) ELECTIVE DEFERRAL OF CERTAIN LATE-YEAR LOSSES.—

(A) IN GENERAL.—Except as otherwise provided by the Secretary, a regulated investment company may elect for any taxable year to treat any portion of any qualified late-year loss for such taxable year as arising on the first day of the following taxable year for purposes of this title.

(B) QUALIFIED LATE-YEAR LOSS.—For purposes of this paragraph, the term “qualified late-year loss” means—

- (i) any post-October capital loss, and
- (ii) any late-year ordinary loss.

(C) POST-OCTOBER CAPITAL LOSS.—For purposes of this paragraph, the term “post-October capital loss” means—

- (i) any net capital loss attributable to the portion of the taxable year after October 31, or
- (ii) if there is no such loss—
 - (I) any net long-term capital loss attributable to such portion of the taxable year, or
 - (II) any net short-term capital loss attributable to such portion of the taxable year.

(D) LATE-YEAR ORDINARY LOSS.—For purposes of this paragraph, the term “late-year ordinary loss” means the sum of any post-October specified loss and any post-December ordinary loss.

(E) POST-OCTOBER SPECIFIED LOSS.—For purposes of this paragraph, the term “post-October specified loss” means the excess (if any) of—

(i) the specified losses (as defined in section 4982(e)(5)(B)(ii)) attributable to the portion of the taxable year after October 31, over

(ii) the specified gains (as defined in section 4982(e)(5)(B)(i)) attributable to such portion of the taxable year.

(F) POST-DECEMBER ORDINARY LOSS.—For purposes of this paragraph, the term “post-December ordinary loss” means the excess (if any) of—

(i) the ordinary losses not described in subparagraph (E)(i) and attributable to the portion of the taxable year after December 31, over

(ii) the ordinary income not described in subparagraph (E)(ii) and attributable to such portion of the taxable year.

(G) SPECIAL RULE FOR COMPANIES DETERMINING REQUIRED CAPITAL GAIN DISTRIBUTIONS ON TAXABLE YEAR BASIS.—In the case of a company to which an election under section 4982(e)(4) applies—

(i) if such company’s taxable year ends with the month of November, the amount of qualified late-year losses (if any) shall be computed without regard to any income, gain, or loss described in subparagraphs (C) and (E), and

(ii) if such company’s taxable year ends with the month of December, subparagraph (A) shall not apply.

(9) DIVIDENDS TREATED AS RECEIVED BY COMPANY ON EX-DIVIDEND DATE.—For purposes of this title, if a regulated investment company is the holder of record of any share of stock on the record date for any dividend payable with respect to such stock, such dividend shall be included in gross income by such company as of the later of—

(A) the date such share became ex-dividend with respect to such dividend, or

(B) the date such company acquired such share.

(c) EARNINGS AND PROFITS.—

(1) TREATMENT OF NONDEDUCTIBLE ITEMS.—

(A) NET CAPITAL LOSS.—If a regulated investment company has a net capital loss for any taxable year—

(i) such net capital loss shall not be taken into account for purposes of determining the company’s earnings and profits, and

(ii) any capital loss arising on the first day of the next taxable year by reason of clause (ii) or (iii) of section 1212(a)(3)(A) shall be treated as so arising for purposes of determining earnings and profits.

(B) OTHER NONDEDUCTIBLE ITEMS.—

(i) IN GENERAL.—The earnings and profits of a regulated investment company for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction (other than by reason of section 265 or 171(a)(2)) in computing its taxable income for such taxable year.

(ii) COORDINATION WITH TREATMENT OF NET CAPITAL LOSSES.—Clause (i) shall not apply to a net capital loss to which subparagraph (A) applies.

(2) COORDINATION WITH TAX ON UNDISTRIBUTED INCOME.—For purposes of applying this chapter to distributions made by a regulated investment company with respect to any calendar year, the earnings and profits of such company shall be determined without regard to any net capital loss attributable to the portion of the taxable year after October 31, without regard to any late-year ordinary loss (as defined in subsection (b)(8)(D)), without regard to any capital loss arising on the first day of the taxable year by reason of clauses (ii) and (iii) of section 1212(a)(3)(A), and with such other adjustments as the Secretary may prescribe. The preceding sentence shall apply—

(A) only to the extent that the amount distributed by the company with respect to the calendar year does not exceed the required distribution for such calendar year (as determined under section 4982 by substituting “100 percent” for each percentage set forth in section 4982(b)(1)), and

(B) except as provided in regulations, only if an election under section 4982(e)(4) is not in effect with respect to such company.

(3) DISTRIBUTIONS TO MEET REQUIREMENTS OF SUBSECTION (A)(2)(B).—Any distribution which is made in order to comply with the requirements of subsection (a)(2)(B)—

(A) shall be treated for purposes of this subsection and subsection (a)(2)(B) as made from earnings and profits which, but for the distribution, would result in a failure to meet such requirements (and allocated to such earnings on a first-in, first-out basis), and

(B) to the extent treated under subparagraph (A) as made from accumulated earnings and profits, shall not be treated as a distribution for purposes of subsection (b)(2)(D) and section 855.

(4) REGULATED INVESTMENT COMPANY.—For purposes of this subsection, the term “regulated investment company” includes a domestic corporation which is a regulated investment company determined without regard to the requirements of subsection (a).

(d) DISTRIBUTIONS IN REDEMPTION OF INTERESTS IN UNIT INVESTMENT TRUSTS.—In the case of a unit investment trust—

(1) which is registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 and following) and issues periodic payment plan certificates (as defined in such Act), and

(2) substantially all of the assets of which consist of securities issued by a management company (as defined in such Act), section 562(c) (relating to preferential dividends) shall not apply to a distribution by such trust to a holder of an interest

in such trust in redemption of part or all of such interest, with respect to the capital gain net income of such trust attributable to such redemption.

(e) PROCEDURES SIMILAR TO DEFICIENCY DIVIDEND PROCEDURES MADE APPLICABLE.—

(1) IN GENERAL.—If—

(A) there is a determination that the provisions of this part do not apply to an investment company for any taxable year (hereinafter in this subsection referred to as the “non-RIC year”), and

(B) such investment company meets the distribution requirements of paragraph (2) with respect to the non-RIC year,

for purposes of applying subsection (a)(2) to subsequent taxable years, the provisions of this part shall be treated as applying to such investment company for the non-RIC year. If the determination under subparagraph (A) is solely as a result of the failure to meet the requirements of subsection (a)(2), the preceding sentence shall also apply for purposes of applying subsection (a)(2) to the non-RIC year and the amount referred to in paragraph (2)(A)(i) shall be the portion of the accumulated earnings and profits which resulted in such failure.

(2) DISTRIBUTION REQUIREMENTS.—

(A) IN GENERAL.—The distribution requirements of this paragraph are met with respect to any non-RIC year if, within the 90-day period beginning on the date of the determination (or within such longer period as the Secretary may permit), the investment company makes 1 or more qualified designated distributions and the amount of such distributions is not less than the excess of—

(i) the portion of the accumulated earnings and profits of the investment company (as of the date of the determination) which are attributable to the non-RIC year, over

(ii) any interest payable under paragraph (3).

(B) QUALIFIED DESIGNATED DISTRIBUTION.—For purposes of this paragraph, the term “qualified designated distribution” means any distribution made by the investment company if—

(i) section 301 applies to such distribution, and

(ii) such distribution is designated (at such time and in such manner as the Secretary shall by regulations prescribe) as being taken into account under this paragraph with respect to the non-RIC year.

(C) EFFECT ON DIVIDENDS PAID DEDUCTION.—Any qualified designated distribution shall not be included in the amount of dividends paid for purposes of computing the dividends paid deduction for any taxable year.

(3) INTEREST CHARGE.—

(A) IN GENERAL.—If paragraph (1) applies to any non-RIC year of an investment company, such investment company shall pay interest at the underpayment rate established under section 6621—

(i) on an amount equal to 50 percent of the amount referred to in paragraph (2)(A)(i),

(ii) for the period—

(I) which begins on the last day prescribed for payment of the tax imposed for the non-RIC year (determined without regard to extensions), and

(II) which ends on the date the determination is made.

(B) COORDINATION WITH SUBTITLE F.—Any interest payable under subparagraph (A) may be assessed and collected at any time during the period during which any tax imposed for the taxable year in which the determination is made may be assessed and collected.

(4) PROVISION NOT TO APPLY IN THE CASE OF FRAUD.—The provisions of this subsection shall not apply if the determination contains a finding that the failure to meet any requirement of this part was due to fraud with intent to evade tax.

(5) DETERMINATION.—For purposes of this subsection, the term “determination” has the meaning given to such term by section 860(e). Such term also includes a determination by the investment company filed with the Secretary that the provisions of this part do not apply to the investment company for a taxable year.

(f) TREATMENT OF CERTAIN LOAD CHARGES.—

(1) IN GENERAL.—If—

(A) the taxpayer incurs a load charge in acquiring stock in a regulated investment company and, by reason of incurring such charge or making such acquisition, the taxpayer acquires a reinvestment right,

(B) such stock is disposed of before the 91st day after the date on which such stock was acquired, and

(C) the taxpayer acquires, during the period beginning on the date of the disposition referred to in subparagraph (B) and ending on January 31 of the calendar year following the calendar year that includes the date of such disposition, stock in such regulated investment company or in another regulated investment company and the otherwise applicable load charge is reduced by reason of the reinvestment right,

the load charge referred to in subparagraph (A) (to the extent it does not exceed the reduction referred to in subparagraph (C)) shall not be taken into account for purposes of determining the amount of gain or loss on the disposition referred to in subparagraph (B). To the extent such charge is not taken into account in determining the amount of such gain or loss, such charge shall be treated as incurred in connection with the acquisition referred to in subparagraph (C) (including for purposes of reapplying this paragraph).

(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) LOAD CHARGE.—The term “load charge” means any sales or similar charge incurred by a person in acquiring stock of a regulated investment company. Such term does not include any charge incurred by reason of the reinvestment of a dividend.

(B) REINVESTMENT RIGHT.—The term “reinvestment right” means any right to acquire stock of 1 or more regu-

lated investment companies without the payment of a load charge or with the payment of a reduced charge.

(C) **NONRECOGNITION TRANSACTIONS.**—If the taxpayer acquires stock in a regulated investment company from another person in a transaction in which gain or loss is not recognized, the taxpayer shall succeed to the treatment of such other person under this subsection.

(g) **SPECIAL RULES FOR FUND OF FUNDS.**—

(1) **IN GENERAL.**—In the case of a qualified fund of funds—

(A) such fund shall be qualified to pay exempt-interest dividends to its shareholders without regard to whether such fund satisfies the requirements of the first sentence of subsection (b)(5), and

(B) such fund may elect the application of section 853 (relating to foreign tax credit allowed to shareholders) without regard to the requirement of subsection (a)(1) thereof.

(2) **QUALIFIED FUND OF FUNDS.**—For purposes of this subsection, the term “qualified fund of funds” means a regulated investment company if (at the close of each quarter of the taxable year) at least 50 percent of the value of its total assets is represented by interests in other regulated investment companies.

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PART II—REAL ESTATE INVESTMENT TRUSTS

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SEC. 857. TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

(a) **REQUIREMENTS APPLICABLE TO REAL ESTATE INVESTMENT TRUSTS.**—The provisions of this part (other than subsection (d) of this section and subsection (g) of section 856) shall not apply to a real estate investment trust for a taxable year unless—

(1) the deduction for dividends paid during the taxable year (as defined in section 561, but determined without regard to capital gains dividends) equals or exceeds—

(A) the sum of—

(i) 90 percent of the real estate investment trust taxable income for the taxable year (determined without regard to the deduction for dividends paid (as defined in section 561) and by excluding any net capital gain); and

(ii) 90 percent of the excess of the net income from foreclosure property over the tax imposed on such income by subsection (b)(4)(A); minus

(B) any excess noncash income (as determined under subsection (e)); and

(2) either—

(A) the provisions of this part apply to the real estate investment trust for all taxable years beginning after February 28, 1986, or

(B) as of the close of the taxable year, the real estate investment trust has no earnings and profits accumulated in any non-REIT year.

For purposes of the preceding sentence, the term “non-REIT year” means any taxable year to which the provisions of this part did not apply with respect to the entity. The Secretary may waive the requirements of paragraph (1) for any taxable year if the real estate investment trust establishes to the satisfaction of the Secretary that it was unable to meet such requirements by reason of distributions previously made to meet the requirements of section 4981.

(b) METHOD OF TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND HOLDERS OF SHARES OR CERTIFICATES OF BENEFICIAL INTEREST.—

(1) IMPOSITION OF TAX ON REAL ESTATE INVESTMENT TRUSTS.—There is hereby imposed for each taxable year on the real estate investment trust taxable income of every real estate investment trust a tax computed as provided in section 11, as though the real estate investment trust taxable income were the taxable income referred to in section 11.

(2) REAL ESTATE INVESTMENT TRUST TAXABLE INCOME.—For purposes of this part, the term “real estate investment trust taxable income” means the taxable income of the real estate investment trust, adjusted as follows:

(A) The deductions for corporations provided in part VIII [(except section 248)] of subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(B) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to that portion of such deduction which is attributable to the amount excluded under subparagraph (D).

(C) The taxable income shall be computed without regard to section 443(b) (relating to computation of tax on change of annual accounting period).

(D) There shall be excluded an amount equal to the net income from foreclosure property.

(E) There shall be deducted an amount equal to the tax imposed by paragraphs (5) and (7) of this subsection, section 856(c)(7)(C), and section 856(g)(5) for the taxable year.

(F) There shall be excluded an amount equal to any net income derived from prohibited transactions.

(3) CAPITAL GAINS.—

(A) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by the shareholders or holders of beneficial interests as a gain from the sale or exchange of a capital asset held for more than 1 year.

(B) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders or holders of beneficial interests at any time before the expiration of 30 days after the close of its taxable year (or mailed to its shareholders or holders of beneficial interests with its annual report for the taxable year); except that, if there is an increase in the excess described in subparagraph (A)(ii) of this paragraph for such year which results from a determination (as de-

fined in section 860(e)), such designation may be made with respect to such increase at any time before the expiration of 120 days after the date of such determination. If the aggregate amount so designated with respect to a taxable year of the trust (including capital gain dividends paid after the close of the taxable year described in section 858) is greater than the net capital gain of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such net capital gain bears to the aggregate amount so designated. For purposes of this subparagraph, the amount of the net capital gain for any taxable year which is not a calendar year shall be determined without regard to any net capital loss attributable to transactions after December 31 of such year, and any such net capital loss shall be treated as arising on the 1st day of the next taxable year. To the extent provided in regulations, the preceding sentence shall apply also for purposes of computing the taxable income of the real estate investment trust.

(C) TREATMENT BY SHAREHOLDERS OF UNDISTRIBUTED CAPITAL GAINS.—

(i) Every shareholder of a real estate investment trust at the close of the trust's taxable year shall include, in computing his long-term capital gains in his return for his taxable year in which the last day of the trust's taxable year falls, such amount as the trust shall designate in respect of such shares in a written notice mailed to its shareholders at any time prior to the expiration of 60 days after the close of its taxable year (or mailed to its shareholders or holders of beneficial interests with its annual report for the taxable year), but the amount so includible by any shareholder shall not exceed that part of the amount subjected to tax in paragraph (1) which he would have received if all of such amount had been distributed as capital gain dividends by the trust to the holders of such shares at the close of its taxable year.

(ii) For purposes of this title, every such shareholder shall be deemed to have paid, for his taxable year under clause (i), the tax imposed by paragraph (1) on undistributed capital gain on the amounts required by this subparagraph to be included in respect of such shares in computing his long-term capital gains for that year; and such shareholders shall be allowed credit or refund as the case may be, for the tax so deemed to have been paid by him.

(iii) The adjusted basis of such shares in the hands of the holder shall be increased with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, by the difference between the amount of such includible gains and the tax deemed paid by such shareholder in respect of such shares under clause (ii).

(iv) In the event of such designation, the tax imposed by paragraph (1) on undistributed capital gain shall be paid by the real estate investment trust within 30 days after the close of its taxable year.

(v) The earnings and profits of such real estate investment trust, and the earnings and profits of any such shareholder which is a corporation, shall be appropriately adjusted in accordance with regulations prescribed by the Secretary.

(vi) As used in this subparagraph, the terms “shares” and “shareholders” shall include beneficial interests and holders of beneficial interests, respectively.

(D) COORDINATION WITH NET OPERATING LOSS PROVISIONS.—For purposes of section 172, if a real estate investment trust pays capital gain dividends during any taxable year, the amount of the net capital gain for such taxable year (to the extent such gain does not exceed the amount of such capital gain dividends) shall be excluded in determining—

- (i) the net operating loss for the taxable year, and
- (ii) the amount of the net operating loss of any prior taxable year which may be carried through such taxable year under section 172(b)(2) to a succeeding taxable year.

(E) CERTAIN DISTRIBUTIONS.—In the case of a shareholder of a real estate investment trust to whom section 897 does not apply by reason of the second sentence of section 897(h)(1) or subparagraph (A)(ii) or (C) of section 897(k)(2), the amount which would be included in computing long-term capital gains for such shareholder under subparagraph (A) or (C) (without regard to this subparagraph)—

- (i) shall not be included in computing such shareholder’s long-term capital gains, and
- (ii) shall be included in such shareholder’s gross income as a dividend from the real estate investment trust.

(F) UNDISTRIBUTED CAPITAL GAIN.—For purposes of this paragraph, the term “undistributed capital gain” means the excess of the net capital gain over the deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only.

(4) INCOME FROM FORECLOSURE PROPERTY.—

(A) IMPOSITION OF TAX.—A tax is hereby imposed for each taxable year on the net income from foreclosure property of every real estate investment trust. Such tax shall be computed by multiplying the net income from foreclosure property by the highest rate of tax specified in section 11(b).

(B) NET INCOME FROM FORECLOSURE PROPERTY.—For purposes of this part, the term “net income from foreclosure property” means the excess of—

- (i) gain (including any foreign currency gain, as defined in section 988(b)(1)) from the sale or other disposition of foreclosure property described in section

1221(a)(1) and the gross income for the taxable year derived from foreclosure property (as defined in section 856(e)), but only to the extent such gross income is not described in (or, in the case of foreign currency gain, not attributable to gross income described in) section 856(c)(3) other than subparagraph (F) thereof, over

(ii) the deductions allowed by this chapter which are directly connected with the production of the income referred to in clause (i).

(5) IMPOSITION OF TAX IN CASE OF FAILURE TO MEET CERTAIN REQUIREMENTS.—If section 856(c)(6) applies to a real estate investment trust for any taxable year, there is hereby imposed on such trust a tax in an amount equal to the greater of—

(A) the excess of—

(i) 95 percent of the gross income (excluding gross income from prohibited transactions) of the real estate investment trust, over

(ii) the amount of such gross income which is derived from sources referred to in section 856(c)(2); or

(B) the excess of—

(i) 75 percent of the gross income (excluding gross income from prohibited transactions) of the real estate investment trust, over

(ii) the amount of such gross income which is derived from sources referred to in section 856(c)(3),

multiplied by a fraction the numerator of which is the real estate investment trust taxable income for the taxable year (determined without regard to the deductions provided in paragraphs (2)(B) and (2)(E), without regard to any net operating loss deduction, and by excluding any net capital gain) and the denominator of which is the gross income for the taxable year (excluding gross income from prohibited transactions; gross income and gain from foreclosure property (as defined in section 856(e), but only to the extent such gross income and gain is not described in subparagraph (A), (B), (C), (D), (E), or (G) of section 856(c)(3)); long-term capital gain; and short-term capital gain to the extent of any short-term capital loss).

(6) INCOME FROM PROHIBITED TRANSACTIONS.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year of every real estate investment trust a tax equal to 100 percent of the net income derived from prohibited transactions.

(B) DEFINITIONS.—For purposes of this part—

(i) the term “net income derived from prohibited transactions” means the excess of the gain (including any foreign currency gain, as defined in section 988(b)(1)) from prohibited transactions over the deductions (including any foreign currency loss, as defined in section 988(b)(2)) allowed by this chapter which are directly connected with prohibited transactions;

(ii) in determining the amount of the net income derived from prohibited transactions, there shall not be

taken into account any item attributable to any prohibited transaction for which there was a loss; and

(iii) the term “prohibited transaction” means a sale or other disposition of property described in section 1221(a)(1) which is not foreclosure property.

(C) CERTAIN SALES NOT TO CONSTITUTE PROHIBITED TRANSACTIONS.—For purposes of this part, the term “prohibited transaction” does not include a sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) if—

(i) the trust has held the property for not less than 2 years;

(ii) aggregate expenditures made by the trust, or any partner of the trust, during the 2-year period preceding the date of sale which are includible in the basis of the property do not exceed 30 percent of the net selling price of the property;

(iii)(I) during the taxable year the trust does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the trust as of the beginning of the taxable year, or (III) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the fair market value of all of the assets of the trust as of the beginning of the taxable year, or (IV) the trust satisfies the requirements of subclause (II) applied by substituting “20 percent” for “10 percent” and the 3-year average adjusted bases percentage for the taxable year (as defined in subparagraph (G)) does not exceed 10 percent, or (V) the trust satisfies the requirements of subclause (III) applied by substituting “20 percent” for “10 percent” and the 3-year average fair market value percentage for the taxable year (as defined in subparagraph (H)) does not exceed 10 percent;

(iv) in the case of property, which consists of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the trust has held the property for not less than 2 years for production of rental income; and

(v) if the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the trust itself does not derive or receive any income or a taxable REIT subsidiary.

(D) CERTAIN SALES NOT TO CONSTITUTE PROHIBITED TRANSACTIONS.—For purposes of this part, the term “prohibited transaction” does not include a sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) if—

(i) the trust held the property for not less than 2 years in connection with the trade or business of producing timber,

(ii) the aggregate expenditures made by the trust, or a partner of the trust, during the 2-year period preceding the date of sale which—

(I) are includible in the basis of the property (other than timberland acquisition expenditures), and

(II) are directly related to operation of the property for the production of timber or for the preservation of the property for use as timberland, do not exceed 30 percent of the net selling price of the property,

(iii) the aggregate expenditures made by the trust, or a partner of the trust, during the 2-year period preceding the date of sale which—

(I) are includible in the basis of the property (other than timberland acquisition expenditures), and

(II) are not directly related to operation of the property for the production of timber, or for the preservation of the property for use as timberland, do not exceed 5 percent of the net selling price of the property,

(iv)(I) during the taxable year the trust does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or

(II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the trust as of the beginning of the taxable year, or

(III) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the fair market value of all of the assets of the trust as of the beginning of the taxable year, or

(IV) the trust satisfies the requirements of subclause (II) applied by substituting “20 percent” for “10 percent” and the 3-year average adjusted bases percentage for the taxable year (as defined in subparagraph (G)) does not exceed 10 percent, or

(V) the trust satisfies the requirements of subclause (III) applied by substituting “20 percent” for “10 percent” and the 3-year average fair market value percentage for the taxable year (as defined in subparagraph (H)) does not exceed 10 percent,

(v) in the case that the requirement of clause (iv)(I) is not satisfied, substantially all of the marketing expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the trust itself does not derive or receive any income, or a taxable REIT subsidiary, and

(vi) the sales price of the property sold by the trust is not based in whole or in part on income or profits, including income or profits derived from the sale or operation of such property.

(E) SPECIAL RULES.—In applying subparagraphs (C) and (D) the following special rules apply:

(i) The holding period of property acquired through foreclosure (or deed in lieu of foreclosure), or termination of the lease, includes the period for which the trust held the loan which such property secured, or the lease of such property.

(ii) In the case of a property acquired through foreclosure (or deed in lieu of foreclosure), or termination of a lease, expenditures made by, or for the account of, the mortgagor or lessee after default became imminent will be regarded as made by the trust.

(iii) Expenditures (including expenditures regarded as made directly by the trust, or indirectly by any partner of the trust, under clause (ii)) will not be taken into account if they relate to foreclosure property and did not cause the property to lose its status as foreclosure property.

(iv) Expenditures will not be taken into account if they are made solely to comply with standards or requirements of any government or governmental authority having relevant jurisdiction, or if they are made to restore the property as a result of losses arising from fire, storm or other casualty.

(v) The term “expenditures” does not include advances on a loan made by the trust.

(vi) The sale of more than one property to one buyer as part of one transaction constitutes one sale.

(vii) The term “sale” does not include any transaction in which the net selling price is less than \$10,000.

(F) NO INFERENCE WITH RESPECT TO TREATMENT AS INVENTORY PROPERTY.—The determination of whether property is described in section 1221(a)(1) shall be made without regard to this paragraph.

(G) 3-YEAR AVERAGE ADJUSTED BASES PERCENTAGE.—The term “3-year average adjusted bases percentage” means,

with respect to any taxable year, the ratio (expressed as a percentage) of—

(i) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the 3 taxable year period ending with such taxable year, divided by

(ii) the sum of the aggregate adjusted bases (as so determined) of all of the assets of the trust as of the beginning of each of the 3 taxable years which are part of the period referred to in clause (i).

(H) 3-YEAR AVERAGE FAIR MARKET VALUE PERCENTAGE.—The term “3-year average fair market value percentage” means, with respect to any taxable year, the ratio (expressed as a percentage) of—

(i) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the 3 taxable year period ending with such taxable year, divided by

(ii) the sum of the fair market value of all of the assets of the trust as of the beginning of each of the 3 taxable years which are part of the period referred to in clause (i).

(I) SALES OF PROPERTY THAT ARE NOT A PROHIBITED TRANSACTION.—In the case of a sale on or before the termination date, the sale of property which is not a prohibited transaction through the application of subparagraph (D) shall be considered property held for investment or for use in a trade or business and not property described in section 1221(a)(1) for all purposes of this subtitle. For purposes of the preceding sentence, the reference to subparagraph (D) shall be a reference to such subparagraph as in effect on the day before the enactment of the Housing Assistance Tax Act of 2008, as modified by subparagraph (G) as so in effect.

(J) TERMINATION DATE.—For purposes of this paragraph, the term “termination date” has the meaning given such term by section 856(c)(10).

(7) INCOME FROM REDETERMINED RENTS, REDETERMINED DEDUCTIONS, AND EXCESS INTEREST.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year of the real estate investment trust a tax equal to 100 percent of redetermined rents, redetermined deductions, excess interest, and redetermined TRS service income.

(B) REDETERMINED RENTS.—

(i) IN GENERAL.—The term “redetermined rents” means rents from real property (as defined in section 856(d)) to the extent the amount of the rents would (but for subparagraph (F)) be reduced on distribution, apportionment, or allocation under section 482 to clearly reflect income as a result of services furnished or rendered by a taxable REIT subsidiary of the real estate investment trust to a tenant of such trust.

(ii) EXCEPTION FOR DE MINIMIS AMOUNTS.—Clause (i) shall not apply to amounts described in section 856(d)(7)(A) with respect to a property to the extent such amounts do not exceed the one percent threshold described in section 856(d)(7)(B) with respect to such property.

(iii) EXCEPTION FOR COMPARABLY PRICED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

(I) such subsidiary renders a significant amount of similar services to persons other than such trust and tenants of such trust who are unrelated (within the meaning of section 856(d)(8)(F)) to such subsidiary, trust, and tenants, but

(II) only to the extent the charge for such service so rendered is substantially comparable to the charge for the similar services rendered to persons referred to in subclause (I).

(iv) EXCEPTION FOR CERTAIN SEPARATELY CHARGED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

(I) the rents paid to the trust by tenants (leasing at least 25 percent of the net leasable space in the trust's property) who are not receiving such service from such subsidiary are substantially comparable to the rents paid by tenants leasing comparable space who are receiving such service from such subsidiary, and

(II) the charge for such service from such subsidiary is separately stated.

(v) EXCEPTION FOR CERTAIN SERVICES BASED ON SUBSIDIARY'S INCOME FROM THE SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if the gross income of such subsidiary from such service is not less than 150 percent of such subsidiary's direct cost in furnishing or rendering the service.

(vi) EXCEPTIONS GRANTED BY SECRETARY.—The Secretary may waive the tax otherwise imposed by subparagraph (A) if the trust establishes to the satisfaction of the Secretary that rents charged to tenants were established on an arms' length basis even though a taxable REIT subsidiary of the trust provided services to such tenants.

(C) REDETERMINED DEDUCTIONS.—The term "redetermined deductions" means deductions (other than redetermined rents) of a taxable REIT subsidiary of a real estate investment trust to the extent the amount of such deductions would (but for subparagraph (F)) be decreased on distribution, apportionment, or allocation under section 482 to clearly reflect income as between such subsidiary and such trust.

(D) EXCESS INTEREST.—The term “excess interest” means any deductions for interest payments by a taxable REIT subsidiary of a real estate investment trust to such trust to the extent that the interest payments are in excess of a rate that is commercially reasonable.

(E) REDETERMINED TRS SERVICE INCOME.—

(i) IN GENERAL.—The term “redetermined TRS service income” means gross income of a taxable REIT subsidiary of a real estate investment trust attributable to services provided to, or on behalf of, such trust (less deductions properly allocable thereto) to the extent the amount of such income (less such deductions) would (but for subparagraph (F)) be increased on distribution, apportionment, or allocation under section 482.

(ii) COORDINATION WITH REDETERMINED RENTS.—Clause (i) shall not apply with respect to gross income attributable to services furnished or rendered to a tenant of the real estate investment trust (or to deductions properly allocable thereto).

(F) COORDINATION WITH SECTION 482.—The imposition of tax under subparagraph (A) shall be in lieu of any distribution, apportionment, or allocation under section 482.

(G) REGULATORY AUTHORITY.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph. Until the Secretary prescribes such regulations, real estate investment trusts and their taxable REIT subsidiaries may base their allocations on any reasonable method.

(8) LOSS ON SALE OR EXCHANGE OF STOCK HELD 6 MONTHS OR LESS.—

(A) IN GENERAL.—If—

(i) subparagraph (B) or (D) of paragraph (3) provides that any amount with respect to any share or beneficial interest is to be treated as a long-term capital gain, and

(ii) the taxpayer has held such share or interest for 6 months or less,

then any loss on the sale or exchange of such share or interest shall, to the extent of the amount described in clause (i), be treated as a long-term capital loss.

(B) DETERMINATION OF HOLDING PERIODS.—For purposes of this paragraph, in determining the period for which the taxpayer has held any share of stock or beneficial interest—

(i) the rules of paragraphs (3) and (4) of section 246(c) shall apply, and

(ii) there shall not be taken into account any day which is more than 6 months after the date on which such share or interest becomes ex-dividend.

(C) EXCEPTION FOR LOSSES INCURRED UNDER PERIODIC LIQUIDATION PLANS.—To the extent provided in regulations, subparagraph (A) shall not apply to any loss incurred on the sale or exchange of shares of stock of, or beneficial interest in, a real estate investment trust pursuant

to a plan which provides for the periodic liquidation of such shares or interests.

(9) TIME CERTAIN DIVIDENDS TAKEN INTO ACCOUNT.—For purposes of this title, any dividend declared by a real estate investment trust in October, November, or December of any calendar year and payable to shareholders of record on a specified date in such a month shall be deemed—

(A) to have been received by each shareholder on December 31 of such calendar year, and

(B) to have been paid by such trust on December 31 of such calendar year (or, if earlier, as provided in section 858).

The preceding sentence shall apply only if such dividend is actually paid by the company during January of the following calendar year.

(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—

(1) SECTION 243.—For purposes of section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered a dividend.

(2) Section (1)(h)(11)

(A) IN GENERAL.—In any case in which—

(i) a dividend is received from a real estate investment trust (other than a capital gain dividend), and

(ii) such trust meets the requirements of section 856(a) for the taxable year during which it paid such dividend,

then, in computing qualified dividend income, there shall be taken into account only that portion of such dividend designated by the real estate investment trust.

(B) LIMITATION.—The aggregate amount which may be designated as qualified dividend income under subparagraph (A) shall not exceed the sum of—

(i) the qualified dividend income of the trust for the taxable year,

(ii) the excess of—

(I) the sum of the real estate investment trust taxable income computed under section 857(b)(2) for the preceding taxable year and the income subject to tax by reason of the application of the regulations under section 337(d) for such preceding taxable year, over

(II) the sum of the taxes imposed on the trust for such preceding taxable year under section 857(b)(1) and by reason of the application of such regulations, and

(iii) the amount of any earnings and profits which were distributed by the trust for such taxable year and accumulated in a taxable year with respect to which this part did not apply.

(C) NOTICE TO SHAREHOLDERS.—The amount of any distribution by a real estate investment trust which may be taken into account as qualified dividend income shall not exceed the amount so designated by the trust in a written

notice to its shareholders mailed not later than 60 days after the close of its taxable year.

(D) QUALIFIED DIVIDEND INCOME.—For purposes of this paragraph, the term “qualified dividend income” has the meaning given such term by section 1(h)(11)(B).

(d) EARNINGS AND PROFITS.—

(1) IN GENERAL.—The earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings) shall not be reduced by any amount which—

(A) is not allowable in computing its taxable income for such taxable year, and

(B) was not allowable in computing its taxable income for any prior taxable year.

(2) COORDINATION WITH TAX ON UNDISTRIBUTED INCOME.—A real estate investment trust shall be treated as having sufficient earnings and profits to treat as a dividend any distribution (other than in a redemption to which section 302(a) applies) which is treated as a dividend by such trust. The preceding sentence shall not apply to the extent that the amount distributed during any calendar year by the trust exceeds the required distribution for such calendar year (as determined under section 4981).

(3) DISTRIBUTIONS TO MEET REQUIREMENTS OF SUBSECTION (A)(2)(B).—Any distribution which is made in order to comply with the requirements of subsection (a)(2)(B)—

(A) shall be treated for purposes of this subsection and subsection (a)(2)(B) as made from earnings and profits which, but for the distribution, would result in a failure to meet such requirements (and allocated to such earnings on a first-in, first-out basis), and

(B) to the extent treated under subparagraph (A) as made from accumulated earnings and profits, shall not be treated as a distribution for purposes of subsection (b)(2)(B) and section 858.

(4) REAL ESTATE INVESTMENT TRUST.—For purposes of this subsection, the term “real estate investment trust” includes a domestic corporation, trust, or association which is a real estate investment trust determined without regard to the requirements of subsection (a).

(5) SPECIAL RULES FOR DETERMINING EARNINGS AND PROFITS FOR PURPOSES OF THE DEDUCTION FOR DIVIDENDS PAID.—For special rules for determining the earnings and profits of a real estate investment trust for purposes of the deduction for dividends paid, see section 562(e)(1).

(e) EXCESS NONCASH INCOME.—

(1) IN GENERAL.—For purposes of subsection (a)(1)(B), the term “excess noncash income” means the excess (if any) of—

(A) the amount determined under paragraph (2) for the taxable year, over

(B) 5 percent of the real estate investment trust taxable income for the taxable year determined without regard to the deduction for dividends paid (as defined in section 561) and by excluding any net capital gain.

(2) DETERMINATION OF AMOUNT.—The amount determined under this paragraph for the taxable year is the sum of—

- (A) the amount (if any) by which—
 - (i) the amounts includible in gross income under section 467 (relating to certain payments for the use of property or services), exceed
 - (ii) the amounts which would have been includible in gross income without regard to such section,
 - (B) any income on the disposition of a real estate asset if—
 - (i) there is a determination (as defined in section 860(e)) that such income is not eligible for nonrecognition under section 1031, and
 - (ii) failure to meet the requirements of section 1031 was due to reasonable cause and not to willful neglect,
 - (C) the amount (if any) by which—
 - (i) the amounts includible in gross income with respect to instruments to which section 860E(a) or 1272 applies, exceed
 - (ii) the amount of money and the fair market value of other property received during the taxable year under such instruments, and
 - (D) amounts includible in income by reason of cancellation of indebtedness.
- (f) REAL ESTATE INVESTMENT TRUSTS TO ASCERTAIN OWNERSHIP.—
- (1) IN GENERAL.—Each real estate investment trust shall each taxable year comply with regulations prescribed by the Secretary for the purposes of ascertaining the actual ownership of the outstanding shares, or certificates of beneficial interest, of such trust.
 - (2) FAILURE TO COMPLY.—
 - (A) IN GENERAL.—If a real estate investment trust fails to comply with the requirements of paragraph (1) for a taxable year, such trust shall pay (on notice and demand by the Secretary and in the same manner as tax) a penalty of \$25,000.
 - (B) INTENTIONAL DISREGARD.—If any failure under paragraph (1) is due to intentional disregard of the requirement under paragraph (1), the penalty under subparagraph (A) shall be \$50,000.
 - (C) FAILURE TO COMPLY AFTER NOTICE.—The Secretary may require a real estate investment trust to take such actions as the Secretary determines appropriate to ascertain actual ownership if the trust fails to meet the requirements of paragraph (1). If the trust fails to take such actions, the trust shall pay (on notice and demand by the Secretary and in the same manner as tax) an additional penalty equal to the penalty determined under subparagraph (A) or (B), whichever is applicable.
 - (D) REASONABLE CAUSE.—No penalty shall be imposed under this paragraph with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect.
- (g) LIMITATIONS ON DESIGNATION OF DIVIDENDS.—
- (1) OVERALL LIMITATION.—The aggregate amount of dividends designated by a real estate investment trust under subsections (b)(3)(C) and (c)(2)(A) with respect to any taxable year

may not exceed the dividends paid by such trust with respect to such year. For purposes of the preceding sentence, dividends paid after the close of the taxable year described in section 858 shall be treated as paid with respect to such year.

(2) **PROPORTIONALITY.**—The Secretary may prescribe regulations or other guidance requiring the proportionality of the designation of particular types of dividends among shares or beneficial interests of a real estate investment trust.

(h) **CROSS REFERENCE.**—For provisions relating to excise tax based on certain real estate investment trust taxable income not distributed during the taxable year, see section 4981.

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Subchapter P—Capital Gains and Losses

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PART I—TREATMENT OF CAPITAL GAINS

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SEC. 1202. PARTIAL EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK.

(a) **EXCLUSION.**—

(1) **IN GENERAL.**—In the case of a taxpayer other than a corporation, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

(2) **EMPOWERMENT ZONE BUSINESSES.**—

(A) **IN GENERAL.**—In the case of qualified small business stock acquired after the date of the enactment of this paragraph in a corporation which is a qualified business entity (as defined in section 1397C(b)) during substantially all of the taxpayer’s holding period for such stock, paragraph (1) shall be applied by substituting “60 percent” for “50 percent”.

(B) **CERTAIN RULES TO APPLY.**—Rules similar to the rules of paragraphs (5) and (7) of section 1400B(b) (as in effect before its repeal) shall apply for purposes of this paragraph.

(C) **GAIN AFTER 2018 NOT QUALIFIED.**—Subparagraph (A) shall not apply to gain attributable to periods after December 31, 2018.

(D) **TREATMENT OF DC ZONE.**—The District of Columbia Enterprise Zone shall not be treated as an empowerment zone for purposes of this paragraph.

(3) **SPECIAL RULES FOR 2009 AND CERTAIN PERIODS IN 2010.**—In the case of qualified small business stock acquired after the date of the enactment of this paragraph and on or before the date of the enactment of the Creating Small Business Jobs Act of 2010—

(A) paragraph (1) shall be applied by substituting “75 percent” for “50 percent”, and

(B) paragraph (2) shall not apply.

In the case of any stock which would be described in the preceding sentence (but for this sentence), the acquisition date for

purposes of this subsection shall be the first day on which such stock was held by the taxpayer determined after the application of section 1223.

(4) 100 PERCENT EXCLUSION FOR STOCK ACQUIRED DURING CERTAIN PERIODS IN 2010 AND THEREAFTER.—In the case of qualified small business stock acquired after the date of the enactment of the Creating Small Business Jobs Act of 2010—

(A) paragraph (1) shall be applied by substituting “100 percent” for “50 percent”,

(B) paragraph (2) shall not apply, and

(C) paragraph (7) of section 57(a) shall not apply.

In the case of any stock which would be described in the preceding sentence (but for this sentence), the acquisition date for purposes of this subsection shall be the first day on which such stock was held by the taxpayer determined after the application of section 1223.

(b) PER-ISSUER LIMITATION ON TAXPAYER’S ELIGIBLE GAIN.—

(1) IN GENERAL.—If the taxpayer has eligible gain for the taxable year from 1 or more dispositions of stock issued by any corporation, the aggregate amount of such gain from dispositions of stock issued by such corporation which may be taken into account under subsection (a) for the taxable year shall not exceed the greater of—

(A) \$10,000,000 reduced by the aggregate amount of eligible gain taken into account by the taxpayer under subsection (a) for prior taxable years and attributable to dispositions of stock issued by such corporation, or

(B) 10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year.

For purposes of subparagraph (B), the adjusted basis of any stock shall be determined without regard to any addition to basis after the date on which such stock was originally issued.

(2) ELIGIBLE GAIN.—For purposes of this subsection, the term “eligible gain” means any gain from the sale or exchange of qualified small business stock held for more than 5 years.

(3) TREATMENT OF MARRIED INDIVIDUALS.—

(A) SEPARATE RETURNS.—In the case of a separate return by a married individual, paragraph (1)(A) shall be applied by substituting “\$5,000,000” for “\$10,000,000”.

(B) ALLOCATION OF EXCLUSION.—In the case of any joint return, the amount of gain taken into account under subsection (a) shall be allocated equally between the spouses for purposes of applying this subsection to subsequent taxable years.

(C) MARITAL STATUS.—For purposes of this subsection, marital status shall be determined under section 7703.

(c) QUALIFIED SMALL BUSINESS STOCK.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this section, the term “qualified small business stock” means any stock in a C corporation which is originally issued after the date of the enactment of the Revenue Reconciliation Act of 1993, if—

(A) as of the date of issuance, such corporation is a qualified small business, and

(B) except as provided in subsections (f) and (h), such stock is acquired by the taxpayer at its original issue (directly or through an underwriter)—

(i) in exchange for money or other property (not including stock), or

(ii) as compensation for services provided to such corporation (other than services performed as an underwriter of such stock).

(2) Active business requirement; etc.

(A) IN GENERAL.—Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for such stock, such corporation meets the active business requirements of subsection (e) and such corporation is a C corporation.

(B) SPECIAL RULE FOR CERTAIN SMALL BUSINESS INVESTMENT COMPANIES.—

(i) WAIVER OF ACTIVE BUSINESS REQUIREMENT.—Notwithstanding any provision of subsection (e), a corporation shall be treated as meeting the active business requirements of such subsection for any period during which such corporation qualifies as a specialized small business investment company.

(ii) SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY.—For purposes of clause (i), the term “specialized small business investment company” means any eligible corporation (as defined in subsection (e)(4)) which is licensed to operate under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993).

(3) CERTAIN PURCHASES BY CORPORATION OF ITS OWN STOCK.—

(A) REDEMPTIONS FROM TAXPAYER OR RELATED PERSON.—Stock acquired by the taxpayer shall not be treated as qualified small business stock if, at any time during the 4-year period beginning on the date 2 years before the issuance of such stock, the corporation issuing such stock purchased (directly or indirectly) any of its stock from the taxpayer or from a person related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

(B) SIGNIFICANT REDEMPTIONS.—Stock issued by a corporation shall not be treated as qualified business stock if, during the 2-year period beginning on the date 1 year before the issuance of such stock, such corporation made 1 or more purchases of its stock with an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of its stock as of the beginning of such 2-year period.

(C) TREATMENT OF CERTAIN TRANSACTIONS.—If any transaction is treated under section 304(a) as a distribution in redemption of the stock of any corporation, for purposes of subparagraphs (A) and (B), such corporation shall be treated as purchasing an amount of its stock equal to the amount treated as such a distribution under section 304(a).

- (d) QUALIFIED SMALL BUSINESS.—For purposes of this section—
- (1) IN GENERAL.—The term “qualified small business” means any domestic corporation which is a C corporation if—
- (A) the aggregate gross assets of such corporation (or any predecessor thereof) at all times on or after the date of the enactment of the Revenue Reconciliation Act of 1993 and before the issuance did not exceed \$50,000,000,
- (B) the aggregate gross assets of such corporation immediately after the issuance (determined by taking into account amounts received in the issuance) do not exceed \$50,000,000, and
- (C) such corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.
- (2) AGGREGATE GROSS ASSETS.—
- (A) IN GENERAL.—For purposes of paragraph (1), the term “aggregate gross assets” means the amount of cash and the aggregate adjusted bases of other property held by the corporation.
- (B) TREATMENT OF CONTRIBUTED PROPERTY.—For purposes of subparagraph (A), the adjusted basis of any property contributed to the corporation (or other property with a basis determined in whole or in part by reference to the adjusted basis of property so contributed) shall be determined as if the basis of the property contributed to the corporation (immediately after such contribution) were equal to its fair market value as of the time of such contribution.
- (3) AGGREGATION RULES.—
- (A) IN GENERAL.—All corporations which are members of the same parent-subsidiary controlled group shall be treated as 1 corporation for purposes of this subsection.
- (B) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of subparagraph (A), the term “parent-subsidiary controlled group” means any controlled group of corporations as defined in section 1563(a)(1), except that—
- (i) “more than 50 percent” shall be substituted for “at least 80 percent” each place it appears in section 1563(a)(1), and
- (ii) section 1563(a)(4) shall not apply.
- (e) ACTIVE BUSINESS REQUIREMENT.—
- (1) IN GENERAL.—For purposes of subsection (c)(2), the requirements of this subsection are met by a corporation for any period if during such period—
- (A) at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses, and
- (B) such corporation is an eligible corporation.
- (2) SPECIAL RULE FOR CERTAIN ACTIVITIES.—For purposes of paragraph (1), if, in connection with any future qualified trade or business, a corporation is engaged in—
- (A) start-up activities described in [section 195(c)(1)(A)] *section 195(d)(1)(A)*,
- (B) activities resulting in the payment or incurring of expenditures which may be treated as research and experimental expenditures under section 174, or

(C) activities with respect to in-house research expenses described in section 41(b)(4), assets used in such activities shall be treated as used in the active conduct of a qualified trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from such activities at the time of the determination.

(3) QUALIFIED TRADE OR BUSINESS.—For purposes of this subsection, the term “qualified trade or business” means any trade or business other than—

(A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,

(B) any banking, insurance, financing, leasing, investing, or similar business,

(C) any farming business (including the business of raising or harvesting trees),

(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

(E) any business of operating a hotel, motel, restaurant, or similar business.

(4) ELIGIBLE CORPORATION.—For purposes of this subsection, the term “eligible corporation” means any domestic corporation; except that such term shall not include—

(A) a DISC or former DISC,

(B) a regulated investment company, real estate investment trust, or REMIC, and

(C) a cooperative.

(5) STOCK IN OTHER CORPORATIONS.—

(A) LOOK-THRU IN CASE OF SUBSIDIARIES.—For purposes of this subsection, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary’s assets, and to conduct its ratable share of the subsidiary’s activities.

(B) PORTFOLIO STOCK OR SECURITIES.—A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consists of stock or securities in other corporations which are not subsidiaries of such corporation (other than assets described in paragraph (6)).

(C) SUBSIDIARY.—For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of such corporation.

(6) WORKING CAPITAL.—For purposes of paragraph (1)(A), any assets which—

(A) are held as a part of the reasonably required working capital needs of a qualified trade or business of the corporation, or

(B) are held for investment and are reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business, shall be treated as used in the active conduct of a qualified trade or business. For periods after the corporation has been in existence for at least 2 years, in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business by reason of this paragraph.

(7) **MAXIMUM REAL ESTATE HOLDINGS.**—A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets consists of real property which is not used in the active conduct of a qualified trade or business. For purposes of the preceding sentence, the ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a qualified trade or business.

(8) **COMPUTER SOFTWARE ROYALTIES.**—For purposes of paragraph (1), rights to computer software which produces active business computer software royalties (within the meaning of section 543(d)(1)) shall be treated as an asset used in the active conduct of a trade or business.

(f) **STOCK ACQUIRED ON CONVERSION OF OTHER STOCK.**—If any stock in a corporation is acquired solely through the conversion of other stock in such corporation which is qualified small business stock in the hands of the taxpayer—

(1) the stock so acquired shall be treated as qualified small business stock in the hands of the taxpayer, and

(2) the stock so acquired shall be treated as having been held during the period during which the converted stock was held.

(g) **TREATMENT OF PASS-THRU ENTITIES.**—

(1) **IN GENERAL.**—If any amount included in gross income by reason of holding an interest in a pass-thru entity meets the requirements of paragraph (2)—

(A) such amount shall be treated as gain described in subsection (a), and

(B) for purposes of applying subsection (b), such amount shall be treated as gain from a disposition of stock in the corporation issuing the stock disposed of by the pass-thru entity and the taxpayer's proportionate share of the adjusted basis of the pass-thru entity in such stock shall be taken into account.

(2) **REQUIREMENTS.**—An amount meets the requirements of this paragraph if—

(A) such amount is attributable to gain on the sale or exchange by the pass-thru entity of stock which is qualified small business stock in the hands of such entity (determined by treating such entity as an individual) and which was held by such entity for more than 5 years, and

(B) such amount is includible in the gross income of the taxpayer by reason of the holding of an interest in such en-

tity which was held by the taxpayer on the date on which such pass-thru entity acquired such stock and at all times thereafter before the disposition of such stock by such pass-thru entity.

(3) LIMITATION BASED ON INTEREST ORIGINALLY HELD BY TAXPAYER.—Paragraph (1) shall not apply to any amount to the extent such amount exceeds the amount to which paragraph (1) would have applied if such amount were determined by reference to the interest the taxpayer held in the pass-thru entity on the date the qualified small business stock was acquired.

(4) PASS-THRU ENTITY.—For purposes of this subsection, the term “pass-thru entity” means—

- (A) any partnership,
- (B) any S corporation,
- (C) any regulated investment company, and
- (D) any common trust fund.

(h) CERTAIN TAX-FREE AND OTHER TRANSFERS.—For purposes of this section—

(1) IN GENERAL.—In the case of a transfer described in paragraph (2), the transferee shall be treated as—

- (A) having acquired such stock in the same manner as the transferor, and
- (B) having held such stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subsection) by the transferor.

(2) DESCRIPTION OF TRANSFERS.—A transfer is described in this subsection if such transfer is—

- (A) by gift,
- (B) at death, or
- (C) from a partnership to a partner of stock with respect to which requirements similar to the requirements of subsection (g) are met at the time of the transfer (without regard to the 5-year holding period requirement).

(3) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of section 1244(d)(2) shall apply for purposes of this section.

(4) INCORPORATIONS AND REORGANIZATIONS INVOLVING NON-QUALIFIED STOCK.—

(A) IN GENERAL.—In the case of a transaction described in section 351 or a reorganization described in section 368, if qualified small business stock is exchanged for other stock which would not qualify as qualified small business stock but for this subparagraph, such other stock shall be treated as qualified small business stock acquired on the date on which the exchanged stock was acquired.

(B) LIMITATION.—This section shall apply to gain from the sale or exchange of stock treated as qualified small business stock by reason of subparagraph (A) only to the extent of the gain which would have been recognized at the time of the transfer described in subparagraph (A) if section 351 or 368 had not applied at such time. The preceding sentence shall not apply if the stock which is treated as qualified small business stock by reason of subparagraph (A) is issued by a corporation which (as of the time

of the transfer described in subparagraph (A)) is a qualified small business.

(C) SUCCESSIVE APPLICATION.—For purposes of this paragraph, stock treated as qualified small business stock under subparagraph (A) shall be so treated for subsequent transactions or reorganizations, except that the limitation of subparagraph (B) shall be applied as of the time of the first transfer to which such limitation applied (determined after the application of the second sentence of subparagraph (B)).

(D) CONTROL TEST.—In the case of a transaction described in section 351, this paragraph shall apply only if, immediately after the transaction, the corporation issuing the stock owns directly or indirectly stock representing control (within the meaning of section 368(c)) of the corporation whose stock was exchanged.

(i) BASIS RULES.—For purposes of this section—

(1) STOCK EXCHANGED FOR PROPERTY.—In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation—

(A) such stock shall be treated as having been acquired by the taxpayer on the date of such exchange, and

(B) the basis of such stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

(2) TREATMENT OF CONTRIBUTIONS TO CAPITAL.—If the adjusted basis of any qualified small business stock is adjusted by reason of any contribution to capital after the date on which such stock was originally issued, in determining the amount of the adjustment by reason of such contribution, the basis of the contributed property shall in no event be treated as less than its fair market value on the date of the contribution.

(j) TREATMENT OF CERTAIN SHORT POSITIONS.—

(1) IN GENERAL.—If the taxpayer has an offsetting short position with respect to any qualified small business stock, subsection (a) shall not apply to any gain from the sale or exchange of such stock unless—

(A) such stock was held by the taxpayer for more than 5 years as of the first day on which there was such a short position, and

(B) the taxpayer elects to recognize gain as if such stock were sold on such first day for its fair market value.

(2) OFFSETTING SHORT POSITION.—For purposes of paragraph (1), the taxpayer shall be treated as having an offsetting short position with respect to any qualified small business stock if—

(A) the taxpayer has made a short sale of substantially identical property,

(B) the taxpayer has acquired an option to sell substantially identical property at a fixed price, or

(C) to the extent provided in regulations, the taxpayer has entered into any other transaction which substantially reduces the risk of loss from holding such qualified small business stock.

For purposes of the preceding sentence, any reference to the taxpayer shall be treated as including a reference to any per-

son who is related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

(k) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise.

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Subchapter S—Tax Treatment of S Corporations and Their Shareholders

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PART I—IN GENERAL

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SEC. 1363. EFFECT OF ELECTION ON CORPORATION.

(a) GENERAL RULE.—Except as otherwise provided in this subchapter, an S corporation shall not be subject to the taxes imposed by this chapter.

(b) COMPUTATION OF CORPORATION'S TAXABLE INCOME.—The taxable income of an S corporation shall be computed in the same manner as in the case of an individual, except that—

(1) the items described in section 1366(a)(1)(A) shall be separately stated,

(2) the deductions referred to in section 703(a)(2) shall not be allowed to the corporation, *and*

[(3) section 248 shall apply, and]

[(4)] (3) section 291 shall apply if the S corporation (or any predecessor) was a C corporation for any of the 3 immediately preceding taxable years.

(c) ELECTIONS OF THE S CORPORATION.—

(1) IN GENERAL.—Except as provided in paragraph (2), any election affecting the computation of items derived from an S corporation shall be made by the corporation.

(2) EXCEPTIONS.—In the case of an S corporation, elections under the following provisions shall be made by each shareholder separately—

(A) section 617 (relating to deduction and recapture of certain mining exploration expenditures), and

(B) section 901 (relating to taxes of foreign countries and possessions of the United States).

(d) RECAPTURE OF LIFO BENEFITS.—

(1) IN GENERAL.—If—

(A) an S corporation was a C corporation for the last taxable year before the first taxable year for which the election under section 1362(a) was effective, and

(B) the corporation inventoried goods under the LIFO method for such last taxable year, the LIFO recapture amount shall be included in the gross income of the corporation for such last taxable year (and appropriate adjustments to the basis of inventory shall be made to

take into account the amount included in gross income under this paragraph).

(2) ADDITIONAL TAX PAYABLE IN INSTALLMENTS.—

(A) IN GENERAL.—Any increase in the tax imposed by this chapter by reason of this subsection shall be payable in 4 equal installments.

(B) DATE FOR PAYMENT OF INSTALLMENTS.—The first installment under subparagraph (A) shall be paid on or before the due date (determined without regard to extensions) for the return of the tax imposed by this chapter for the last taxable year for which the corporation was a C corporation and the 3 succeeding installments shall be paid on or before the due date (as so determined) for the corporation's return for the 3 succeeding taxable years.

(C) NO INTEREST FOR PERIOD OF EXTENSION.—Notwithstanding section 6601(b), for purposes of section 6601, the date prescribed for the payment of each installment under this paragraph shall be determined under this paragraph.

(3) LIFO RECAPTURE AMOUNT.—For purposes of this subsection, the term “LIFO recapture amount” means the amount (if any) by which—

(A) the inventory amount of the inventory asset under the first-in, first-out method authorized by section 471, exceeds

(B) the inventory amount of such assets under the LIFO method.

For purposes of the preceding sentence, inventory amounts shall be determined as of the close of the last taxable year referred to in paragraph (1).

(4) OTHER DEFINITIONS.—For purposes of this subsection—

(A) LIFO METHOD.—The term “LIFO method” means the method authorized by section 472.

(B) INVENTORY ASSETS.—The term “inventory assets” means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

(C) METHOD OF DETERMINING INVENTORY AMOUNT.—The inventory amount of assets under a method authorized by section 471 shall be determined—

(i) if the corporation uses the retail method of valuing inventories under section 472, by using such method, or

(ii) if clause (i) does not apply, by using cost or market, whichever is lower.

(D) NOT TREATED AS MEMBER OF AFFILIATED GROUP.—Except as provided in regulations, the corporation referred to in paragraph (1) shall not be treated as a member of an affiliated group with respect to the amount included in gross income under paragraph (1).

(5) SPECIAL RULE.—Sections 1367(a)(2)(D) and 1371(c)(1) shall not apply with respect to any increase in the tax imposed by reason of this subsection.

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PART III—SPECIAL RULES

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SEC. 1375. TAX IMPOSED WHEN PASSIVE INVESTMENT INCOME OF CORPORATION HAVING ACCUMULATED EARNINGS AND PROFITS EXCEEDS 25 PERCENT OF GROSS RECEIPTS.

(a) **GENERAL RULE.**—If for the taxable year an S corporation has—

- (1) accumulated earnings and profits at the close of such taxable year, and
- (2) gross receipts more than 25 percent of which are passive investment income,

then there is hereby imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in section 11(b).

(b) **DEFINITIONS.**—For purposes of this section—

(1) **EXCESS NET PASSIVE INCOME.**—

(A) **IN GENERAL.**—Except as provided in subparagraph (B), the term “excess net passive income” means an amount which bears the same ratio to the net passive income for the taxable year as—

- (i) the amount by which the passive investment income for the taxable year exceeds 25 percent of the gross receipts for the taxable year, bears to
- (ii) the passive investment income for the taxable year.

(B) **LIMITATION.**—The amount of the excess net passive income for any taxable year shall not exceed the amount of the corporation’s taxable income for such taxable year as determined under section 63(a)—

- (i) without regard to the deductions allowed by part VIII of subchapter B [(other than the deduction allowed by section 248, relating to organization expenditures)], and
- (ii) without regard to the deduction under section 172.

(2) **NET PASSIVE INCOME.**—The term “net passive income” means—

- (A) passive investment income, reduced by
- (B) the deductions allowable under this chapter which are directly connected with the production of such income (other than deductions allowable under section 172 and part VIII of subchapter B).

(3) **PASSIVE INVESTMENT INCOME, ETC.**—The terms “passive investment income” and “gross receipts” have the same respective meanings as when used in paragraph (3) of section 1362(d).

(4) **COORDINATION WITH SECTION 1374.**—Notwithstanding paragraph (3), the amount of passive investment income shall be determined by not taking into account any recognized built-in gain or loss of the S corporation for any taxable year in the recognition period. Terms used in the preceding sentence shall have the same respective meanings as when used in section 1374.

(c) CREDITS NOT ALLOWABLE.—No credit shall be allowed under part IV of subchapter A of this chapter (other than section 34) against the tax imposed by subsection (a).

(d) WAIVER OF TAX IN CERTAIN CASES.—If the S corporation establishes to the satisfaction of the Secretary that—

(1) it determined in good faith that it had no accumulated earnings and profits at the close of a taxable year, and

(2) during a reasonable period of time after it was determined that it did have accumulated earnings and profits at the close of such taxable year such earnings and profits were distributed,

the Secretary may waive the tax imposed by subsection (a) for such taxable year.

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VII. DISSENTING VIEWS

Democrats believe in American innovation and entrepreneurship. Democrats support small businesses who are the backbone of our economy. My Democratic colleagues and I would have enthusiastically and actively participated in the construction of bipartisan legislation to help small businesses deduct more of their startup costs. We are interested in helping idea incubators attract capital in an efficient way.

But that is not the process that the majority adopted. This exercise, capped off by what appears to be a dead-on-arrival reception in the Senate, told us how serious the majority is about making law. The Republicans are driving these bills down a road to nowhere. If they were serious about helping small business and innovative startups, they surely would not have treated these provisions like an afterthought to their 2017 tax bill. We can and should work together to ensure that small businesses and innovative startups have the tools to not just survive but actually thrive in this economy. We can and should do so in a fiscally responsible manner that does not further add to the deficit. We can and should be better.

RICHARD E. NEAL,
Ranking Member.

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