

107TH CONGRESS
1ST SESSION

H. R. 86

To amend the Internal Revenue Code of 1986 to restructure and replace the income tax system of the United States to meet national priorities, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 3, 2001

Mr. ENGLISH introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to restructure and replace the income tax system of the United States to meet national priorities, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE;**

4 **TABLE OF CONTENTS.**

5 (a) **SHORT TITLE.**—This Act may be cited as the
6 “Simplified USA Tax Act of 2001”.

7 (b) **AMENDMENT OF 1986 CODE.**—Except as other-
8 wise expressly provided, whenever in this Act a reference
9 is made to the Code or to a section or provision of the

1 Code, the reference shall be considered to be made to the
2 Internal Revenue Code of 1986 or to a section or provision
3 thereof.

4 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; amendment of 1986 Code; table of contents.

TITLE I—FINDINGS; NEED TO REPLACE THE INCOME TAX

Sec. 101. Replacing the income tax of the United States.

TITLE II—SIMPLIFIED USA TAX FOR INDIVIDUALS

Sec. 201. Simplified USA Tax for individuals.

Sec. 202. Reorganization of the Code.

TITLE III—SIMPLIFIED USA TAX FOR BUSINESSES

Sec. 301. Repeal of present corporate income tax; new tax paid by corporations
and other businesses.

Sec. 302. Repeal of chapter 6.

TITLE IV—DEFERRED COMPENSATION PLANS

Sec. 401. Provisions saved.

Sec. 402. Clerical Amendments.

Sec. 403. Clerical Amendments.

TITLE V—REPEAL OF ESTATE AND GIFT TAXES

Sec. 501. Repeal of gratuitous transfer taxes.

Sec. 502. Effective Date.

TITLE VI—TECHNICAL AND ADMINISTRATIVE CHANGES;
EFFECTIVE DATES

Sec. 601. USA Tax Code.

Sec. 602. Revisions to the Code.

Sec. 603. Application of subtitle F.

Sec. 604. Clerical amendment.

5 **TITLE I—FINDINGS; NEED TO**
6 **REPLACE THE INCOME TAX**

7 **SEC. 101. REPLACING THE INCOME TAX OF THE UNITED**
8 **STATES.**

9 (a) FINDINGS.—The Congress finds that—

1 (1) the current Tax Code is irreparably flawed
2 and must be replaced;

3 (2) to enhance the liberty and protect the pri-
4 vacy of individuals, the Tax Code must be made sim-
5 pler and nonintrusive, and it must be applied
6 evenhandedly to all;

7 (3) to be fair and to provide for the prosperity
8 of current and future generation, the Tax Code must
9 give all individuals at all income levels an oppor-
10 tunity to save, invest and raise their standard of liv-
11 ing and that of their children; and

12 (4) future economic growth requires a tax sys-
13 tem that facilitates successful competition in the
14 global marketplace.

15 (b) MAIN FEATURES OF SIMPLIFIED USA TAX SYS-
16 TEM.—

17 (1) REPLACEMENT OF OLD TAX SYSTEM.—
18 Chapter 1 of subtitle A (related to income taxes) of
19 the Code is repealed and replaced for years begin-
20 ning after 2001.

21 (2) ESTATE AND GIFT TAX REPEALED.

22 (3) NEW TAX SYSTEM.—The Simplified USA
23 Tax consists of—

24 (A) a simplified tax collected from individ-
25 uals, that for years after 2001 replaces the in-

1 come tax imposed on individuals by section 1 of
2 the Code, and

3 (B) a simplified tax collected from corpora-
4 tions and other businesses, that for years after
5 2001 replaces the income tax imposed on cor-
6 porations by section 11 of the Code.

7 (3) SIMPLIFIED USA TAX ON GROSS PROFITS.—
8 Corporations and other businesses pay tax on their
9 annual gross profits from business conducted in the
10 United States, except that—

11 (A) export revenues are excluded, and

12 (B) imports are taxed.

13 (4) SIMPLIFIED USA TAX ON INCOME.—Individ-
14 uals pay tax on their annual income from wages,
15 dividends, interest, and other financial income (in-
16 cluding sales of property), except that—

17 (A) investment earnings on previously
18 taxed income that is placed in a Roth IRA is
19 exempt from further taxation,

20 (B) a portion of each family's income is ex-
21 empt from tax, and

22 (C) deductions are allowed for—

23 (i) education costs,

24 (ii) religious, charitable, and other
25 philanthropic donations,

1 (iii) home mortgage interest pay-
2 ments, and

3 (iv) contributions to qualified IRAs.

4 (5) CREDIT FOR FICA PAYROLL TAXES PAID.—

5 The amount of tax due is reduced by the payroll tax
6 that is—

7 (A) in the case of an employee, withheld
8 from wages, or

9 (B) in the case of a corporation or other
10 business, paid by the employer.

11 (c) CONCEPTS AND STRUCTURE OF NEW TAX SYS-
12 TEM.—

13 (1) GUIDING PRINCIPLES OF THE SIMPLIFIED
14 USA TAX SYSTEM.—The Simplified USA Tax is
15 based on the following principles:

16 (A) National wealth and well-being depend
17 on the work, skill, and savings and investment
18 of people.

19 (B) Businesses are people and their capital
20 working together.

21 (C) Capital makes people more productive.

22 (D) Everyone benefits from a growing
23 stock of national savings which in turn allows
24 for a growing stock of physical and human cap-
25 ital.

1 (E) Under the Simplified USA Tax, the
2 deferral of taxation on investments in human
3 capital represents an investment by the Federal
4 government in the nation's capital stock and
5 the Federal government shares in the return on
6 its investment in the form of higher economic
7 output and revenues in the future.

8 (2) SINGLE TAX IN 2 PARTS.—The Simplified
9 USA Tax is composed of a business tax and an indi-
10 vidual tax which are 2 parts of a single tax system
11 that subjects all income produced and received to
12 taxation once and only once. The 2 parts are as fol-
13 lows:

14 (A) BUSINESS TAX AT THE SOURCE OF IN-
15 COME.—Tax is paid by corporations and other
16 businesses which produce and sell goods and
17 services that are—

18 (i) the source of nearly all the gross
19 domestic product of the United States, and

20 (ii) the ultimate source of income re-
21 ceived by individuals.

22 (B) INDIVIDUAL TAX ON INCOME RE-
23 CEIVED.—Tax is paid by individuals when they
24 receive wages and salaries as compensation for
25 gross domestic product created by their work.

1 (3) SAVING AND INVESTMENT.—The Simplified
2 USA Tax allows people to save and businesses to in-
3 vest as follows:

4 (A) FAIR OPPORTUNITY FOR PEOPLE TO
5 SAVE.—

6 (i) OPTIONAL ELIMINATION OF DOU-
7 BLE TAXATION.—When an individual earns
8 income and is taxed on that income, the
9 individual can save that income in a Roth
10 IRA and not pay income taxes on the in-
11 vestment earnings.

12 (ii) DEDUCTIBLE AND EXCLUDABLE
13 SAVINGS.—The Simplified USA Tax con-
14 tinues provisions of present law that
15 allow—

16 (I) lower income individuals and
17 certain others to make deductible con-
18 tributions to individual retirement ac-
19 counts, and

20 (II) encourage employer spon-
21 sored savings and retirement plans
22 that defer taxation of income through
23 use of 401(k) plans and other quali-
24 fied retirement plans.

1 (B) FAIR OPPORTUNITY FOR BUSINESSES
2 TO INVEST.—

3 (i) NO PREPAYMENT OF TAX.—When
4 a business invests in plant and
5 equipment—

6 (I) a deduction is allowed for the
7 cost, and

8 (II) tax is deferred.

9 (ii) TAX ON EARNINGS AND RECOVERY
10 OF COST.—When recovered out of business
11 revenues, both the cost of the investment
12 and the earnings on the investment are in-
13 cluded in gross profit subject to tax.

14 (iii) EXPENSING.—The deduction for
15 investment is the equivalent of allowing the
16 cost of plant and equipment to be expensed
17 instead of depreciated.

18 (4) FAIR OPPORTUNITY TO COMPETE IN THE
19 GLOBAL MARKETPLACE.—The Simplified USA Tax
20 serves the strategic interests of the United States in
21 international markets as follows:

22 (A) BORDER ADJUSTABLE TAX.—

23 (i) AMERICAN-MADE EXPORTS.—
24 Goods and services produced in the United

1 States can be sold into world markets free
2 of tax.

3 (ii) FOREIGN-MADE IMPORTS.—Goods
4 and services imported into the United
5 States bear a fair and proportionate share
6 of the tax burden in the United States.

7 (iii) LEVELING THE INTERNATIONAL
8 PLAYING FIELD.—Border adjustments for
9 exports and imports are consistent with
10 international standards and practice.

11 (5) A SIMPLE AND UNDERSTANDABLE TAX.—
12 The Simplified USA Tax for individuals—

13 (A) is written in a simple, understandable
14 form,

15 (B) contains only a few exemptions, deduc-
16 tions, and credits, and can be reported on a tax
17 return only a small fraction the size of Form
18 1040.

19 (6) A NONINTRUSIVE, EVENHANDED TAX.—

20 (A) TAXPAYERS ARE IN CONTROL.—When
21 the rules are few and clear, taxpayers can cal-
22 culate their own tax correctly and file their own
23 returns without fear of mistake or of getting
24 caught up in an argument with the IRS.

1 (B) LIMITED ROLE FOR IRS.—When the
2 rules are few and clear, the IRS does not have
3 the broad interpretive power that puts tax-
4 payers at risk of being treated unfairly and un-
5 evenly.

6 (C) RESTORING VOLUNTARY COMPLI-
7 ANCE.—When the rules are few and clear, the
8 IRS can concentrate on helping taxpayers vol-
9 untarily pay their correct share of tax revenues
10 for public use and benefit under a tax system
11 that is understood and respected.

12 (7) MAINTAINING TAX PROGRESSIVITY FOR IN-
13 DIVIDUALS.—

14 (A) GRADUATED TAX.—Like the tax im-
15 posed by section 1 of the current Code, the
16 Simplified USA Tax for individuals is a grad-
17 uated tax.

18 (B) FAMILY LIVING ALLOWANCE.—The
19 Simplified USA Tax recognizes that every fam-
20 ily’s budget includes necessities. The Simplified
21 USA Tax provides a family living allowance
22 that exempts from taxation the first dollars
23 earned and spent to maintain a basic standard
24 of living.

1 (8) BUSINESSES AND INDIVIDUAL SHARE THE
2 TAX BURDEN.—

3 (A) BUSINESS PORTION OF TAX BUR-
4 DEN.—Corporations and other businesses pay
5 about the same portion of the total tax as
6 under the current Code.

7 (B) INDIVIDUAL PORTION OF TAX BUR-
8 DEN.—Individuals pay about the same portion
9 of the total tax as under the current Code.

10 (9) EMPHASIZING PERSONAL INDEPENDENCE
11 AND RESPONSIBILITY.—

12 (A) REINFORCING A CULTURE OF WORK
13 AND THRIFT.—Instead of being solely a calcula-
14 tion of how much they must pay to the govern-
15 ment, the Simplified USA Tax converts the in-
16 come tax into an annual calculation of how
17 much people produce and contribute to the
18 economy.

19 (B) GREATER CONTROL AND RESPONSI-
20 BILITY.—Because people are not double taxed
21 on their saving, they have—

22 (i) more control over their own income
23 and taxes,

24 (ii) a greater ability to plan and pro-
25 vide for their own future, and

1 (iii) a fair opportunity to do so.

2 (10) MORE OPPORTUNITY FOR WAGE EARNERS
3 AT LOWER INCOME LEVELS.—

4 (A) REFUNDABLE CREDIT FOR EMPLOYEE
5 PAYROLL TAX.—The amount of the payroll tax
6 paid or withheld under the Code from an em-
7 ployee’s wages (and paid into the Social Secu-
8 rity and Hospital Insurance Trust Funds) is—

9 (i) credited against the employee’s in-
10 come tax, and

11 (ii) refunded to the employee to the
12 extent in excess of the employee’s income
13 tax.

14 (B) NO EFFECT ON TRUST FUND OR BEN-
15 EFITS.—The income tax credit allowed for pay-
16 roll taxes deposited in the Social Security Trust
17 Fund does not—

18 (i) reduce the amount in such fund, or

19 (ii) reduce the payment of any per-
20 son’s benefits from the fund.

21 **TITLE II—SIMPLIFIED USA TAX**
22 **FOR INDIVIDUALS**

23 **SEC. 201. SIMPLIFIED USA TAX FOR INDIVIDUALS.**

24 (a) IN GENERAL.—Chapter 1 of the Code is amended
25 to read as follows:

1 **“CHAPTER 1—SIMPLIFIED USA TAX FOR**
 2 **INDIVIDUALS**

- “Subchapter A. Basic rules.
- “Subchapter B. Roth IRA and other savings provisions.
- “Subchapter C. Basis, business transactions, and nonrecognition transactions.
- “Subchapter D. Rules for exclusions from gross income.
- “Subchapter E. Rules relating to deductions.
- “Subchapter F. Special business activities.
- “Subchapter G. Accounting methods.
- “Subchapter H. Nonresident aliens.
- “Subchapter I. Trusts and estates.
- “Subchapter J. Definitions and rules of application.

3 **“Subchapter A—Basic Rules**

- “Sec. 1. Simplified USA tax for individuals.
- “Sec. 2. Persons liable for the Simplified USA for individuals.
- “Sec. 3. Gross income.
- “Sec. 4. Exclusions from gross income.
- “Sec. 5. Alimony and child support deductions.
- “Sec. 6. Personal and dependency deduction.
- “Sec. 7. Family Living Allowance.
- “Sec. 8. USA deductions.
- “Sec. 9. Homeowner deduction.
- “Sec. 10. Education deduction.
- “Sec. 11. Philanthropic transfer deduction.
- “Sec. 13. Limitation on deductions.
- “Sec. 15. Tax rates.
- “Sec. 16. Kiddie tax.
- “Sec. 17. Rules for filing status and rate tables.
- “Sec. 20. USA tax credits.
- “Sec. 21. Payroll tax credit.
- “Sec. 22. Taxes-paid tax credit.
- “Sec. 23. Indexing for inflation.

4 **“SEC. 1. SIMPLIFIED USA TAX FOR INDIVIDUALS.**

5 “(a) IMPOSITION OF TAX.—An income tax is imposed
 6 on each individual described in section 2. The income tax
 7 shall equal the amount determined by applying the tax
 8 schedules in section 15 to the taxable income of the tax-
 9 payer for the taxable year and reducing the tax so deter-
 10 mined by the USA tax credits for the taxable year.

1 “(b) TAXABLE INCOME.—‘Taxable income’ means
2 adjusted gross income, reduced by—

3 “(1) the personal and dependency deduction,

4 “(2) the Family Living Allowance, and

5 “(3) the USA deductions, including—

6 “(A) the homeowner deduction,

7 “(B) the education deduction, and

8 “(C) the philanthropic transfer deduction.

9 “(c) ADJUSTED GROSS INCOME.—‘Adjusted gross in-
10 come’ means gross income, reduced by—

11 “(1) the alimony and child support deductions,

12 and

13 “(2) the qualified IRA deduction.

14 “(d) NAME.—The tax imposed by this chapter shall
15 be known as the ‘Simplified USA Tax for Individuals’.

16 **“SEC. 2. PERSONS LIABLE FOR THE SIMPLIFIED USA TAX**
17 **FOR INDIVIDUALS.**

18 “(a) INDIVIDUALS ONLY.—The Simplified USA Tax
19 for Individuals shall apply only to individuals.

20 “(b) CITIZENS AND RESIDENT ALIENS.—The Sim-
21 plified USA Tax for Individuals shall apply to all citizens
22 of the United States and to all resident aliens of the
23 United States. Except as specifically provided in this chap-
24 ter, the Simplified USA Tax for Individuals shall not
25 apply to nonresident aliens.

1 “(c) NONRESIDENT ALIENS.—For rules applicable to
2 the compensation income of nonresident aliens, see sub-
3 chapter H (sections 131 and 132). For rules on the with-
4 holding of tax on nonresident aliens, see chapter 5 (sec-
5 tions 1441–1464).

6 “(d) TAXPAYER.—For purposes of this chapter, ‘tax-
7 payer’ means an individual, or, in the case of a joint re-
8 turn, the husband and the wife.

9 **“SEC. 3. GROSS INCOME.**

10 “(a) GENERAL DEFINITION.—Except as otherwise
11 provided in this chapter, ‘gross income for the taxable
12 year’ means all income from whatever source derived by
13 a taxpayer during the taxable year, including (but not lim-
14 ited to) the following items:

15 “(1) Compensation for services, including (but
16 not limited to)—

17 “(A) salaries,

18 “(B) wages,

19 “(C) commissions,

20 “(D) tips, and

21 “(E) distributions from business entities

22 (as defined in section 171).

23 “(2) Fringe benefits (except as specifically ex-
24 cluded by section 4(a)), including (but not limited
25 to)—

1 “(A) the cost of health, disability, life or
2 other similar insurance paid by an employer if
3 the taxpayer is indirectly or directly the bene-
4 ficiary of the policy or has the right to name
5 the beneficiary of the policy,

6 “(B) employer-paid parking (unless the
7 employee uses the automobile parked in the
8 space regularly on employer business),

9 “(C) employer-paid educational benefits,

10 “(D) employer-paid housing (other than
11 housing provided for the convenience of the em-
12 ployer),

13 “(E) employer-paid meals (other than
14 meals provided for the convenience of the em-
15 ployer or reimbursement for the reasonable cost
16 of meals incurred on overnight travel),

17 “(F) amounts contributed by an employer
18 on behalf of an employee to a group legal serv-
19 ices plan, and

20 “(G) dependent care assistance received
21 from an employer.

22 “(3) Distributions from business entities (as de-
23 fined in section 171) constituting—

24 “(A) compensation for use of capital, in-
25 cluding interest, or

1 “(B) shares of profits (including divi-
2 dends).

3 “(4) Interest not described in paragraph (3)(A).

4 “(5) Rents.

5 “(6) Royalties.

6 “(7) Alimony, child support, and separate
7 maintenance payments.

8 “(8) Includible social security benefits.

9 “(9) Income from the discharge of indebted-
10 ness.

11 “(10) Gains on the sale or disposition of assets.

12 “(11) Amounts stolen or embezzled.

13 “(12) Distributions from retirement plans and
14 annuities (other than USA Roth IRAs) to the extent
15 not previously included as income, as determined in
16 accordance with section 33.

17 “(13) Amounts received through health, acci-
18 dent or disability insurance to the extent that—

19 “(A) the cost of such insurance was paid
20 by an employer and not included in the employ-
21 ee’s taxable income and

22 “(B) such amounts exceed the actual med-
23 ical expenses incurred and not paid or treated
24 as paid with amounts otherwise excluded from
25 income.

1 “(b) DEFINITIONS.—For purposes of subsection (a)
2 and section 4—

3 “(1) EMPLOYER.—‘Employer’ includes—

4 “(A) in the case of a partner who provides
5 services for a partnership, the partnership,

6 “(B) in the case of a proprietor, the pro-
7 prietorship, and

8 “(C) in the case of an independent con-
9 tractor, any business or individual that hires
10 the independent contractor.

11 “(2) SOCIAL SECURITY BENEFITS.—

12 “(A) IN GENERAL.—‘Social Security bene-
13 fits’ means any amount received by the tax-
14 payer by reason of entitlement to—

15 “(i) a monthly benefit under title II of
16 the Social Security Act, or

17 “(ii) a tier 1 railroad retirement ben-
18 efit. The amount received by a taxpayer
19 shall be determined as if the Social Secu-
20 rity Act did not contain section 203(i)
21 thereof.

22 “(B) TIER 1 RAILROAD RETIREMENT BEN-
23 EFIT.—‘Tier 1 railroad retirement benefit’
24 means—

1 “(i) the amount of the annuity under
2 the Railroad Retirement Act of 1974 equal
3 to the amount of the benefit to which the
4 taxpayer would have been entitled under
5 the Social Security Act if all of the service
6 after December 31, 1936, of the employee
7 (on whose record the annuity is being
8 paid) has been included in the term ‘em-
9 ployment’ as defined in the Social Security
10 Act, and

11 “(ii) a monthly annuity amount under
12 section 3(f)(3) of the Railroad Retirement
13 Act of 1974.

14 “(C) WORKERS’ COMPENSATION SUB-
15 STITUTES.—If by reason of section 224 of the
16 Social Security Act or section 3(a)(1) of the
17 Railroad Retirement Act of 1974, any social se-
18 curity benefit is reduced because of the receipt
19 of a benefit under a workers’ compensation act,
20 the term ‘social security benefit’ includes that
21 portion of such benefit which equals such reduc-
22 tion.

23 “(D) EFFECT OF EARLY PAYMENT.—If so-
24 cial security benefits checks are delivered before
25 the end of the calendar month for which they

1 are issued and are not deposited until the
2 month for which they are issued, they will be
3 treated as received in the month for which they
4 are issued.

5 “(3) INCLUDIBLE SOCIAL SECURITY BENE-
6 FITS.—‘Includible social security benefits’ means the
7 portion of social security benefits that would be in-
8 cluded in gross income under section 86(a) of the
9 Internal Revenue Code of 1986, except that for pur-
10 poses of applying such section, the term ‘modified
11 adjusted gross income’ means adjusted gross income
12 (as defined in section 1(c)), determined without re-
13 gard to the inclusion of any social security benefits.

14 “(c) PROPERTY RECEIVED FOR SERVICES.—

15 “(1) IN GENERAL.—If, in connection with the
16 performance of services, property is transferred to
17 any person other than the person for whom such
18 services are performed, the excess of—

19 “(A) the fair market value of such prop-
20 erty (determined without regard to any restric-
21 tion other than a restriction which by its terms
22 will never lapse) at the first time the rights of
23 the person having the beneficial interest in such
24 property are transferable or are not subject to

1 a substantial risk of forfeiture, whichever oc-
2 curs earlier, over

3 “(B) the amount (if any) paid for such
4 property, shall be included in the gross income
5 of the person who performed such services in
6 the first taxable year in which the rights of the
7 person having the beneficial interest in such
8 property are transferable or are not subject to
9 a substantial risk of forfeiture, whichever is ap-
10 plicable. The preceding sentence shall not apply
11 if such person sells or otherwise disposes of
12 such property in an arm’s length transaction
13 before his rights in such property become trans-
14 ferable or not subject to a substantial risk of
15 forfeiture.

16 “(2) RULES AND REGULATIONS.—The Sec-
17 retary shall prescribe rules and regulations similar
18 to those applicable under section 83 of the Internal
19 Revenue Code of 1986 for purposes of implementing
20 this subsection.

21 **“SEC. 4. EXCLUSIONS FROM GROSS INCOME.**

22 “(a) GENERAL RULE.—Gross income does not in-
23 clude:

24 “(1) RETURNS OR BENEFITS FROM PRE-
25 VIOUSLY TAXED INCOME.—

1 “(A) Social security benefits (as defined in
2 section 3(b)(2)), other than includible social se-
3 curity benefits (as defined in section 3(b)(3)).

4 “(B) Amounts received under accident or
5 health benefit plans (except as provided in sec-
6 tion 3(a)(13)).

7 “(C) Value of services provided pursuant
8 to a group legal service plan (but only if the
9 cost of such services was paid by the employee
10 or paid by the employer and included in the
11 gross income of the employee).

12 “(D) Amounts received under an insurance
13 contract for certain living expenses in the case
14 of an individual whose principal residence is
15 damaged or destroyed or who is denied access
16 because of the threat of such occurrence.

17 “(E) Amounts treated as recovery of basis
18 under any other provision of chapter 1.

19 “(2) COMPENSATION FOR SPECIAL KINDS OF
20 SERVICE.—

21 “(A) In the case of a minister of the
22 gospel—

23 “(i) the rental value of a home fur-
24 nished to him, or

1 “(ii) the rental allowance paid to him
2 as part of his compensation, to the extent
3 used by him to rent or provide a home.

4 “(B) Certain combat pay of members of
5 the Armed Forces of the United States (as pro-
6 vided in section 92).

7 “(C) Certain reduced uniform services re-
8 tirement pay (as defined in section 122 of the
9 Internal Revenue Code of 1986).

10 “(D) Qualified military benefits (as defined
11 in section 93).

12 “(E) Moving allowances for active military
13 personnel (as defined in section 217(g) of the
14 Internal Revenue Code of 1986).

15 “(F) Certain foster care payments (as de-
16 fined in section 94).

17 “(3) GRATUITOUS, CHARITABLE, AND GOVERN-
18 MENTAL TRANSFERS.—

19 “(A) Gifts.

20 “(B) Inheritances.

21 “(C) Supplemental security income, aid to
22 families with dependent children, food stamps,
23 section 8 low-income rental assistance, benefits
24 under the low-income home energy assistance
25 program, and benefits under other similar Fed-

1 eral and State assistance programs for low-in-
2 come individuals and families.

3 “(D) Benefits or assistance received from
4 a charitable organization as the result of a dis-
5 aster or by reason of financial need.

6 “(4) TAX-EXEMPT BOND INTEREST.—Interest
7 on State and local bonds (as provided in section 91);

8 “(5) COMPENSATION FOR INJURY AND SICK-
9 NESS.—

10 “(A) Amounts received as compensation
11 for personal injury or sickness (as provided in
12 section 95).

13 “(B) Reimbursement and direct payments
14 under Medicare and Medicaid.

15 “(6) BENEFITS PRIMARILY FOR THE CONVEN-
16 IENCE OF THE EMPLOYER AND CERTAIN FRINGE
17 BENEFITS.—

18 “(A) Meals or lodging furnished for the
19 convenience of the employer (as provided in sec-
20 tion 96).

21 “(B) Value of a parking space if employee
22 uses the car parked in the space regularly on
23 company business.

24 “(C) A fringe benefit that is a no-addi-
25 tional-cost service (as defined in section 97(b)),

1 subject to rules prohibiting discrimination in
2 favor of the highly compensated.

3 “(D) A qualified employee discount (as de-
4 fined in section 97(c)), subject to rules prohib-
5 iting discrimination in favor of the highly com-
6 pensated.

7 “(E) Any property or services provided to
8 an employee to the extent that if the employee
9 were treated as a business and the business
10 paid for those services, the employee could de-
11 duct the cost of such property or services under
12 the business tax.

13 “(F) A de minimis fringe benefit (as de-
14 fined in section 97(d)).

15 “(G) Transportation in a commuter high-
16 way vehicle if such transportation is in connec-
17 tion with travel between the employee’s resi-
18 dence and place of employment.

19 “(H) Any amount received directly or indi-
20 rectly by an individual from an employer for
21 moving expenses if—

22 “(i) the move is associated with a
23 change in job locations for the same em-
24 ployer, and

1 “(ii) the expenses of such move would
2 have been deductible under the rules under
3 section 217 of the Internal Revenue Code
4 of 1986 if paid directly by the employee.

5 “(I) Employer provided coverage under an
6 accident or health plan.

7 “(7) REPAYABLE RECEIPTS.—The proceeds of
8 borrowing or any other amounts legally received that
9 the taxpayer is legally obligated to return (except
10 that the imputed interest rules of section 7872 may
11 apply if there is inadequate stated interest).

12 “(8) CERTAIN INCOME EARNED ABROAD.—Cer-
13 tain income and housing costs of citizens and resi-
14 dents of the United States living outside the United
15 States in accordance with the rules under section
16 911 of the Internal Revenue Code of 1986.

17 “(9) DISCHARGE OF INDEBTEDNESS.—The
18 amount of indebtedness discharged unless the dis-
19 charge is for services, property, or other valuable
20 right.

21 “(10) NONRECOGNITION TRANSACTIONS.—
22 Amounts to which the nonrecognition transaction
23 rules of section 77 apply.

24 “(11) PROCEEDS FROM SALE OF PRINCIPAL
25 RESIDENCE.—Amounts excludable under section 76

1 (relating to certain proceeds from the sale of the
2 taxpayer's principal residence).

3 “(12) TAXABLE RECEIPTS OF A BUSINESS EN-
4 TITY.—Amounts that are treated as taxable receipts
5 of a business entity under the Simplified USA Tax
6 for businesses and are not distributed to the indi-
7 vidual taxpayer.

8 “(13) QUALIFIED RETIREMENT CONTRIBU-
9 TIONS.—Employer contributions to retirement plans
10 that are exempt from taxation under chapter 3, in-
11 cluding contributions pursuant to a cash or deferred
12 payment plan described in section 401(k).

13 “(b) CROSS REFERENCES.—

14 “(1) ROTH IRAS.—For rules excluding from in-
15 come earnings on, and distributions from, Roth
16 IRAs, see sections 30 and 408A.

17 “(2) OTHER RETIREMENT PLANS.—For rules
18 excluding or deferring from income earnings on
19 other retirement plans, see chapter 3.

20 **“SEC. 5. ALIMONY AND CHILD SUPPORT DEDUCTIONS.**

21 “(a) GENERAL RULE.—A taxpayer shall be allowed
22 an alimony and child support deductions for an amount
23 equal to the alimony, child support, or separate mainte-
24 nance payments paid during the taxpayer's taxable year.

1 “(b) DEFINITION OF ALIMONY, CHILD SUPPORT,
2 AND SEPARATE MAINTENANCE PAYMENTS.—‘Alimony,
3 child support, and separate maintenance payments’ means
4 any alimony, child support, or separate maintenance pay-
5 ment which is includible in gross income of the recipient
6 under section 3.

7 **“SEC. 6. PERSONAL AND DEPENDENCY DEDUCTION.**

8 “(a) AMOUNT OF EXEMPTION.—The personal and
9 dependency deduction for an individual shall equal the
10 number of exemptions multiplied by \$2,700.

11 “(b) NUMBER OF EXEMPTIONS.—

12 “(1) TAXPAYER.—One exemption shall be al-
13 lowed for the taxpayer unless the taxpayer files a
14 joint return with a spouse, in which case 1 exemp-
15 tion shall be allowed for the husband and 1 for the
16 wife.

17 “(2) ELIGIBLE DEPENDENT.—An exemption
18 shall be allowed for each eligible dependent.

19 “(c) DEPENDENT.—

20 “(1) DEFINITION.—‘Dependent’ means any of
21 the following individuals over half of whose support,
22 for the calendar year was received from the taxpayer
23 or is treated as received from the taxpayer:

24 “(A) A son or daughter of the taxpayer, or
25 a descendant of either.

1 “(B) A stepson, stepdaughter, stepfather,
2 or stepmother of the taxpayer.

3 “(C) A brother, sister, stepbrother, or
4 stepsister of the taxpayer.

5 “(D) The father or mother of the taxpayer,
6 or an ancestor of either.

7 “(E) A son or daughter of a brother or sis-
8 ter of the taxpayer.

9 “(F) A brother or sister of the mother or
10 father of the taxpayer.

11 “(G) A son-in-law, daughter-in-law, father-
12 in-law, mother-in-law, brother-in-law, or sister-
13 in-law of the taxpayer.

14 “(H) An individual (other than an indi-
15 vidual who at any time during the taxable year
16 was the spouse, determined without regard to
17 section 7703, of a taxpayer) who, for the tax-
18 able year of the taxpayer, has as his principal
19 place of abode the home of the taxpayer and
20 is a member of the taxpayer’s household.

21 “(2) RULES RELATING TO THE GENERAL DEFINI-
22 TION.—The Secretary shall prescribe rules similar
23 to the rules under section 152 of the Internal Rev-
24 enue Code of 1986 that shall apply to the general
25 definition of ‘dependent’, including definitional rules,

1 rules relating to multiple support agreements, and
2 support tests in cases of children of divorced par-
3 ents.

4 “(d) ELIGIBLE DEPENDENT.—

5 “(1) IN GENERAL.—‘Eligible dependent’ means
6 a dependent—

7 “(A) whose gross income for the calendar
8 year in which the taxable year of the taxpayer
9 begins is less than the exemption amount, or

10 “(B) who is a child of the taxpayer and
11 who—

12 “(i) has not attained the age of 19 at
13 the close of the calendar year in which the
14 taxable year of the taxpayer begins, or

15 “(ii) is a student who has not attained
16 the age of 24 at the close of such calendar
17 year.

18 “(2) EXCLUSIONS.—A dependent who files a
19 joint return with a spouse for the calendar year is
20 not an eligible dependent.

21 “(3) RULES RELATING TO DEFINITIONS.—The
22 Secretary shall prescribe rules similar to those in-
23 cluded in or applicable under the Internal Revenue
24 Code of 1986 relating to this subsection, including

1 rules defining ‘child’ and ‘student’ and rules relating
2 to the income of handicapped dependents.

3 “(e) INFLATION ADJUSTMENT.—The dollar amount
4 contained in subsection (a) shall be adjusted for inflation
5 beginning with calendar year 2002 in accordance with the
6 procedures of section 23.

7 **“SEC. 7. FAMILY LIVING ALLOWANCE.**

8 “(a) AMOUNT OF ALLOWANCE.—The Family Living
9 Allowance for a taxpayer shall be determined in accord-
10 ance with the following schedule:

“Form of Return:	Family Living Allowance:
Taxpayers filing joint return	\$8,140.
Surviving spouse	\$8,140.
Head of household	\$5,940.
Individual who is not married or a head of household.	\$4,840.
Married filing separate return	\$4,070.

11 “(b) LIMITATION IN THE CASE OF CERTAIN DE-
12 PENDENTS.—In the case of an individual for whom an-
13 other taxpayer can claim an exemption under section 6,
14 the Family Living Allowance for such individual shall not
15 exceed the greater of \$700 or such individual’s earned in-
16 come (as defined in section 171(a)(6)).

17 “(c) ADJUSTMENTS FOR INFLATION.—The dollar
18 amounts contained in subsections (a) and (b) shall be ad-
19 justed for inflation beginning with calendar year 2002 in
20 accordance with the procedures of section 23.

1 **“SEC. 8. USA DEDUCTIONS.**

2 “In computing taxable income, an individual shall be
3 entitled to the following deductions:

4 “(1) The homeowner deduction described in
5 section 9.

6 “(2) The education deduction described in sec-
7 tion 10.

8 “(3) The philanthropic transfer deduction de-
9 scribed in section 11.

10 **“SEC. 9. HOMEOWNER DEDUCTION.**

11 “(a) IN GENERAL.—The homeowner deduction shall
12 equal the amount of interest paid by the taxpayer during
13 the taxable year on acquisition indebtedness with respect
14 to any qualified residence of the taxpayer.

15 “(b) DEFINITIONS.—

16 “(1) ACQUISITION INDEBTEDNESS.—‘Acquisi-
17 tion indebtedness’ means any indebtedness that is
18 secured by a qualified residence and that—

19 “(A) was incurred in acquiring, con-
20 structing, or substantially improving the quali-
21 fied residence, or

22 “(B) was incurred to refinance any indebt-
23 edness that is described in subparagraph (A) or
24 this subparagraph (B) but only to the extent
25 that the refinancing does not exceed the
26 amount refinanced.

1 The aggregate amount treated as acquisition indebt-
2 edness shall not exceed \$1,000,000 (\$500,000 in the
3 case of a married individual filing separately).

4 “(2) QUALIFIED RESIDENCE.—‘Qualified resi-
5 dence’ means the principal residence of the taxpayer
6 and 1 other residence of the taxpayer that is des-
7 ignated by the taxpayer and which—

8 “(A) is used by the taxpayer as a residence
9 for more than 14 days during such year for
10 which such unit is rented, and

11 “(B) is not rented for more than 14 days
12 during such year.

13 “(c) COOPERATIVE HOUSING CORPORATION TEN-
14 ANT.—Any indebtedness secured by stock held by a tax-
15 payer as a tenant-stockholder in a cooperative housing cor-
16 poration shall be treated as secured by the house or apart-
17 ment which the taxpayer is entitled to occupy as a tenant-
18 stockholder. If such stock cannot be used to secure indebt-
19 edness, the indebtedness will be treated as so secured if
20 the taxpayer establishes that such indebtedness was in-
21 curred to acquire stock.

22 **“SEC. 10. EDUCATION DEDUCTION.**

23 “(a) IN GENERAL.—The education deduction shall
24 equal the sum of the qualified educational expenses for
25 each eligible student.

1 “(b) QUALIFIED EDUCATION EXPENSES.—

2 “(1) IN GENERAL.—‘Qualified education ex-
3 penses’ means with respect to an eligible student the
4 lesser of—

5 “(A) \$4,000, or

6 “(B) the qualified higher education ex-
7 penses of the eligible student paid by the tax-
8 payer during the taxable year.

9 “(2) QUALIFIED HIGHER EDUCATION EX-
10 PENSES.—

11 “(A) IN GENERAL.—‘Qualified higher edu-
12 cation expenses’ means tuition and fees re-
13 quired for the enrollment of an eligible student
14 at an eligible education institution. Such term
15 shall not include expenses with respect to any
16 course or other education involving sports,
17 games, or hobbies other than as part of a de-
18 gree program.

19 “(B) ELIGIBLE EDUCATIONAL INSTITU-
20 TION.—‘Eligible educational institution’
21 means—

22 “(i) an institution which is described
23 in section 481 of the Higher Education
24 Act of 1965 (as in effect on May 15,
25 1998), and which is eligible to participate

1 in a program under title IV of such Act,
2 and

3 “(ii) in the case of a student who has
4 attained the age of 18 before the beginning
5 of the taxable year, and not graduated
6 from high school before the beginning of
7 the taxable year, an accredited school pro-
8 viding remedial education.

9 “(3) ELIGIBLE STUDENT.—‘Eligible student’
10 means—

11 “(A) the taxpayer, but only if no other tax-
12 payer treats the taxpayer as a dependent for
13 which an exemption is allowed in computing the
14 dependency deduction under section 6,

15 “(B) the taxpayer’s spouse if a joint return
16 is filed, and

17 “(C) any dependent of the taxpayer for
18 whom the taxpayer is allowed an exemption in
19 computing the dependency deduction under sec-
20 tion 6.

21 “(c) LIMITATION.—The maximum education deduc-
22 tion in a taxable year is \$12,000 (\$6,000 in the case of
23 married individuals filing separate returns).

24 “(d) INFLATION ADJUSTMENTS.—The dollar
25 amounts contained in subsections (b)(1)(A) and (c) shall

1 be adjusted for inflation beginning with calendar year
2 2002 in accordance with section 23.

3 **“SEC. 11. PHILANTHROPIC TRANSFER DEDUCTION.**

4 “(a) IN GENERAL.—The philanthropic transfer de-
5 duction shall equal the amount of charitable contributions
6 made by the taxpayer in the taxable year, subject to the
7 limitations in subsection (b). A deduction shall be allow-
8 able as a deduction only if verified under regulations pre-
9 scribed by the Secretary.

10 “(b) LIMITATION ON AMOUNT.—

11 “(1) GENERAL RULE.—A deduction for con-
12 tributions to regular charities in any taxable year
13 shall be allowed only to the extent that such con-
14 tributions do not exceed 50 percent of the taxpayer’s
15 adjusted gross income. Other charitable contribu-
16 tions shall be allowed only to the extent that such
17 contributions do not exceed the lesser of—

18 “(A) 30 percent of the taxpayer’s adjusted
19 gross income, or

20 “(B) the excess, if any, of 50 percent of
21 the taxpayer’s adjusted gross income over the
22 amount of charitable contributions to regular
23 charities.

24 “(2) CARRYOVER.—If the amount of charitable
25 contributions made in a taxable year exceeds the

1 amount which can be deducted in such year, the ex-
2 cess shall be carried over for a period of up to 5
3 years in accordance with rules to be prescribed by
4 the Secretary.

5 “(3) REGULAR CHARITY.—For purposes of this
6 subsection, ‘regular charity’ means an organization
7 described in section 101, that is not a private foun-
8 dation (other than a private operating foundation)
9 (as such terms are defined in section 102).

10 “(c) CHARITABLE CONTRIBUTION.—‘Charitable con-
11 tribution’ means a contribution or gift to or for the use
12 of a governmental or charitable recipient (as defined in
13 section 101).

14 “(d) CONTRIBUTIONS OF PROPERTY.—

15 “(1) GENERAL RULE.—In the case of a chari-
16 table contribution of property, the amount of the
17 contribution shall equal the lesser of the fair market
18 value of the property or the taxpayer’s basis in the
19 property.

20 “(2) FAIR MARKET VALUE DEDUCTIONS IN
21 CERTAIN CASES.—Notwithstanding paragraph (1),
22 in the case of a charitable contribution (other than
23 a contribution to a private foundation that is not a
24 private operating foundation) of—

25 “(A) real property,

1 “(B) tangible property if the use by the
2 donee is related to its purpose or function con-
3 stituting the basis for its exemption from the
4 business tax or in the case of a governmental
5 unit, to any governmental unit, and

6 “(C) stocks, bonds, or other securities held
7 for more than one year,
8 the amount of the charitable contribution shall equal
9 the fair market value of the property.

10 “(3) CONTRIBUTIONS OF STOCK FOR WHICH
11 MARKET QUOTATIONS ARE READILY AVAILABLE.—

12 “(A) IN GENERAL.—In the case of con-
13 tributions of qualified appreciated stock, para-
14 graph (2) shall apply without regard to whether
15 the stock is contributed to a private foundation.

16 “(B) QUALIFIED APPRECIATED STOCK.—
17 ‘Qualified appreciated stock’ means any stock
18 of a corporation for which (as of the date of the
19 contribution) market quotations are readily
20 available on an established securities market,
21 except that in the case of a donor to a private
22 foundation, the term does not include stock to
23 the extent that the amount so contributed,
24 when increased by prior contributions by the
25 donor of stock in the same corporation, exceeds

1 10 percent in value of the outstanding stock of
2 such corporation.

3 “(e) OTHER RULES.—The Secretary shall prescribe
4 rules limiting the availability of the philanthropic transfer
5 deduction in certain cases, including rules for—

6 “(1) contributions of property placed in trust,

7 “(2) contributions of partial interests in prop-
8 erty,

9 “(3) contributions subject to liabilities that are
10 assumed,

11 “(4) out-of-pocket expenditures on behalf of a
12 charity to influence legislation,

13 “(5) substantiation of contributions in excess of
14 \$250,

15 “(6) contributions designated for lobbying activ-
16 ity,

17 “(7) amounts paid to maintain certain students
18 as members of taxpayer’s household,

19 “(8) qualified conservation contributions, and

20 “(9) deductions for travel expenses on behalf of
21 a charity where there is a significant element of per-
22 sonal pleasure.

23 **“SEC. 13. LIMITATION ON DEDUCTIONS.**

24 “(a) IN GENERAL.—A taxpayer’s deductions shall
25 not reduce the taxpayer’s taxable income below zero. Ex-

1 cept as provided in section 11(b) (relating to the limitation
 2 on the philanthropic transfer deduction), a taxpayer shall
 3 not be entitled to carry over any unused deductions.

4 “(b) DEDUCTIONS.—For purposes of this section,
 5 ‘deductions’ means—

6 “(1) the alimony and child support deductions,

7 “(2) the personal and dependency deduction,

8 “(3) the Family Living Allowance,

9 “(4) the USA deductions, and

10 “(5) the qualified IRA deduction.

11 **“SEC. 15. TAX RATES.**

12 “(a) MARRIED INDIVIDUALS FILING JOINT RETURNS
 13 AND SURVIVING SPOUSES.—The tax schedule for every
 14 married individual who files a joint return with a spouse
 15 and for every surviving spouse (as defined in section
 16 17(a)) is—

“If taxable income is:	The tax is:
Not over \$40,000	15% of taxable income.
Over \$40,000, but not over \$80,000.	\$6,000, plus 25% of the excess over \$40,000.
Over \$80,000	\$16,000, plus 30% of the excess over \$80,000.

17 “(b) HEADS OF HOUSEHOLDS.—The tax schedule for
 18 every head of household (as defined in section 17(b)) is—

“If taxable income is:	The tax is:
Not over \$35,000	15% of taxable income.
Over \$35,000, but not over \$70,000.	\$5,250, plus 25% of the excess over \$35,000.
Over \$70,000	\$14,000, plus 30% of the excess over \$70,000.

1 “(c) UNMARRIED INDIVIDUALS.—The tax schedule
2 for an unmarried individual who is not a head of a house-
3 hold or a surviving spouse is—

“If taxable income is:	The tax is:
Not over \$24,000	15% of taxable income.
Over \$24,000, but not over \$48,000.	\$3,600, plus 25% of the excess over \$24,000.
Over \$48,000	\$9,600, plus 30% of the excess over \$48,000.

4 “(d) MARRIED INDIVIDUALS FILING SEPARATE RE-
5 TURNS.—The tax schedule for a married individual filing
6 a separate return is—

“If taxable income is:	The tax is:
Not over \$20,000	15% of taxable income.
Over \$20,000, but not over \$40,000.	\$3,000, plus 25% of the excess over \$20,000.
Over \$40,000	\$8,000, plus 30% of the excess over \$40,000.

7 “(e) ADJUSTMENTS FOR INFLATION.—Beginning
8 with calendar year 2002, the tax schedules in subsections
9 (a) through (d) shall be adjusted so that inflation will not
10 result in tax increases in accordance with the procedures
11 under section 23.

12 “(f) DEFINITIONS.—See section 17 for rules on filing
13 status.

14 **“SEC. 16. KIDDIE TAX.**

15 “(a) GENERAL RULE.—If a child has a living parent
16 and net unearned income and the child has not attained
17 the age of 14 before the close of the taxable year—

18 “(1) the net unearned income of the child shall
19 be included in the taxable income of the eligible par-

1 ent for purposes of determining the parent’s tax li-
2 ability, or

3 “(2) the tax calculated under the tax rate
4 schedules for the child as a separate taxpayer shall
5 not be less than the sum of—

6 “(A) the tax which would have been deter-
7 mined under the rate schedule if the taxable in-
8 come of the child were reduced by the net un-
9 earned income of the child, plus

10 “(B) such child’s share of the allocable pa-
11 rental tax.

12 “(b) CHILD’S SHARE OF ALLOCABLE PARENTAL
13 TAX.—

14 “(1) ALLOCABLE PARENTAL TAX.—‘Allocable
15 parental tax’ means the excess of—

16 “(A) the tax that would have been deter-
17 mined under the rate schedules on the eligible
18 parent’s taxable income if such income included
19 the net unearned income of all of the eligible
20 parent’s children to which this section applies,
21 over

22 “(B) the tax actually determined under the
23 rate schedules without regard to this section.

24 “(2) CHILD’S SHARE.—A child’s share of the
25 allocable parental tax is equal to the amount that

1 bears the same ratio to the total allocable parental
2 tax as the child's net unearned income bears to the
3 aggregate net unearned income of all children to
4 whom this section applies for whom the eligible par-
5 ent is the eligible parent.

6 “(c) ELIGIBLE PARENT.—‘Eligible parent’ means—

7 “(1) both parents of the child if the parents file
8 a joint return,

9 “(2) the surviving parent of a child if the child
10 has only 1 surviving parent,

11 “(3) the custodial parent if the child's parents
12 are not married, or

13 “(4) the parent with the greater taxable income
14 if the parents are married and filing separate re-
15 turns.

16 “(d) NET UNEARNED INCOME.—‘Net unearned in-
17 come’ means the excess, if any, of—

18 “(1) the adjusted gross income of the child,
19 over

20 “(2) the sum of—

21 “(A) the earned income (as defined in sec-
22 tion 171(a)(6)) of the child, and

23 “(B) an amount equal to the Family Liv-
24 ing Allowance for a dependent child.

1 **“SEC. 17. RULES FOR FILING STATUS AND RATE TABLES.**

2 “(a) DEFINITION OF SURVIVING SPOUSE.—

3 “(1) IN GENERAL.—‘Surviving spouse’ means
4 an individual—

5 “(A) whose spouse died during either of
6 his 2 calendar years immediately preceding the
7 calendar year, and

8 “(B) who maintains as his home a house-
9 hold which constitutes for the taxable year the
10 principal place of abode (as a member of such
11 household) of a dependent—

12 “(i) who (within the meaning of sec-
13 tion 6) is a son, stepson, daughter, or step-
14 daughter of the taxpayer, and

15 “(ii) who the taxpayer is entitled to
16 treat as an exemption for purposes of com-
17 puting the personal dependency deduction
18 for the taxable year under section 6.

19 For purposes of this paragraph, an individual shall
20 be considered as maintaining a household only if
21 over half of the cost of maintaining the household
22 during the taxable year is furnished by such indi-
23 vidual.

24 “(2) LIMITATIONS.—Notwithstanding para-
25 graph (1), for purposes of section 15, an individual
26 shall not be considered to be a surviving spouse—

1 “(A) if the individual has remarried at any
2 time before the close of the taxable year, or

3 “(B) unless, for the individual’s taxable
4 year during which his spouse died, a joint re-
5 turn could have been made under the provisions
6 of section 6013 (without regard to subsection
7 (a)(3) thereof).

8 “(3) SPECIAL RULE WHERE DECEASED SPOUSE
9 WAS IN MISSING STATUS.—If an individual was in a
10 missing status (within the meaning of section
11 6013(f)(3)) as a result of service in a combat zone
12 and if such individual remains in such status until
13 the date referred to in subparagraph (A) or (B),
14 then, for purposes of paragraph (1)(A), the date on
15 which such individual died shall be treated as the
16 earlier of the date determined under subparagraph
17 (A) or the date determined under subparagraph (B):

18 “(A) the date on which the determination
19 is made under section 556 of title 37 of the
20 United States Code or under section 5566 of
21 title 5 of such Code (whichever is applicable)
22 that such individual died while in such missing
23 status, or

24 “(B) the date which is 2 years after the
25 date designated under section 92 (relating to

1 exemption for combat zones) as the date of ter-
2 mination of combatant activities in that zone.

3 “(b) DEFINITION OF HEAD OF HOUSEHOLD.—

4 “(1) IN GENERAL.—An individual shall be con-
5 sidered a head of a household if, and only if, such
6 individual is not married at the close of his taxable
7 year, is not a surviving spouse (as defined in sub-
8 section (a)), and either—

9 “(A) maintains as his home a household
10 which constitutes for more than one-half of
11 such taxable year the principal place of abode,
12 as a member of such household, of—

13 “(i) a son, stepson, daughter, or step-
14 daughter of the taxpayer, or a descendant
15 of a son or daughter of the taxpayer, but
16 if such son, stepson, daughter, step-
17 daughter, or descendant is married at the
18 close of the taxpayer’s taxable year, only if
19 the taxpayer is entitled to claim such per-
20 son as an exemption for the taxable year
21 for purposes of computing the dependency
22 deduction under section 6 (or would be so
23 entitled but for the release of a claim to
24 such exemption by the custodial parent),

1 “(ii) any other person who is a de-
2 pendent of the taxpayer, if the taxpayer is
3 entitled to claim such person as an exemp-
4 tion in determining the personal depend-
5 ency deduction for the taxable year, or

6 “(B) maintains a household which con-
7 stitutes for such taxable year the principal place
8 of abode of the father or mother of the tax-
9 payer, if the taxpayer is entitled to a personal
10 dependency deduction for the taxable year for
11 such father or mother.

12 For purposes of this paragraph, an individual shall
13 be considered as maintaining a household only if
14 over half of the cost of maintaining the household
15 during the taxable year is furnished by such indi-
16 vidual.

17 “(2) DETERMINATION OF STATUS.—For pur-
18 poses of this subsection—

19 “(A) a legally adopted child of a person
20 shall be considered a child of such person by
21 blood;

22 “(B) an individual who is legally separated
23 from his spouse under a decree of divorce or of
24 separate maintenance shall not be considered as
25 married;

1 “(C) a taxpayer shall be considered as not
2 married at the close of his taxable year if at
3 any time during the taxable year his spouse is
4 a nonresident alien; and

5 “(D) a taxpayer shall be considered as
6 married at the close of his taxable year if his
7 spouse (other than a spouse described in sub-
8 paragraph (C)) died during the taxable year.

9 “(3) LIMITATIONS.—Notwithstanding para-
10 graph (1), for purposes of this chapter, a taxpayer
11 shall not be considered to be a head of a
12 household—

13 “(A) if at any time during the taxable year
14 he is a nonresident alien; or

15 “(B) by reason of an individual who would
16 not be a dependent for the taxable year but
17 for—

18 “(i) subparagraph (H) of section
19 6(c)(1), or

20 “(ii) multiple support rules prescribed
21 by the Secretary.

22 “(c) CERTAIN MARRIED INDIVIDUALS LIVING
23 APART.—For purposes of this part, an individual shall be
24 treated as not married at the close of the taxable year

1 if such individual is so treated under the provisions of sec-
2 tion 7703(b).

3 “(d) NONRESIDENT ALIENS.—In the case of a non-
4 resident alien individual, the taxes imposed by section 1
5 shall not apply.

6 **“SEC. 20. USA TAX CREDITS.**

7 “(a) IN GENERAL.—The USA tax credits are and
8 shall be applied in the following order:

9 “(1) The foreign tax credit as prescribed by the
10 Secretary under rules similar to the rules of subpart
11 A of part III of subchapter N of chapter 1 of the
12 Internal Revenue Code of 1986, but only with re-
13 spect to foreign taxes on amounts that are included
14 in the gross income of the taxpayer.

15 “(2) The payroll tax credit under section 21.

16 “(3) The taxes-paid tax credit under section 22.

17 “(b) REFUNDABLE CREDITS.—If a taxpayer’s USA
18 tax credits (other than the foreign tax credit) for a taxable
19 year exceed the taxpayer’s tax liability for the taxable year
20 (after application of the foreign tax credit but before appli-
21 cation of the other USA tax credits), the taxpayer shall
22 be entitled to a refund for such excess. The taxpayer may
23 elect in lieu of a refund to apply such excess as a tax paid
24 for the following taxable year.

1 **“SEC. 21. PAYROLL TAX CREDIT.**

2 “(a) IN GENERAL.—A taxpayer shall be allowed a
3 payroll tax credit in an amount equal to the sum of—

4 “(1) the employee’s share of the basic FICA
5 tax,

6 “(2) the employee’s share of the basic Tier 1
7 railroad retirement tax, and

8 “(3) one-half of the basic SECA tax payable
9 with respect to the taxpayer’s compensation or earn-
10 ings during the taxable year.

11 “(b) DEFINITIONS.—

12 “(1) EMPLOYEE’S SHARE OF THE BASIC FICA
13 TAX.—‘Employee’s share of the basic FICA tax’
14 means the old-age, survivors and disability insurance
15 tax imposed by section 3101(a) and the portion of
16 the hospital insurance tax imposed by section
17 3101(b) that is attributable to the wage base on
18 which the section 3101(a) tax is imposed.

19 “(2) EMPLOYEE’S SHARE OF THE BASIC TIER 1
20 RAILROAD RETIREMENT TAX.—Employee’s share of
21 the basic Tier 1 railroad retirement tax’ means—

22 “(A) the portion of the tax imposed by sec-
23 tion 3201 with respect to compensation below
24 the applicable base (as defined in section
25 3231(e)(2)); and

1 “(B) the portion of the tax imposed by sec-
2 tion 3211(a)(1) on railroad employee represent-
3 atives attributable to the tax imposed by section
4 3101(a) and the portion of the hospital insur-
5 ance tax imposed by section 3101(b) that is at-
6 tributable to the wage base on which the section
7 3101(a) tax is imposed.

8 “(3) BASIC SECA TAX.—‘Basic SECA tax’
9 means the old-age, survivors and disability insurance
10 tax imposed by section 1401(a) on self-employment
11 income and the portion of the hospital insurance tax
12 imposed by section 1401(b) on self-employment in-
13 come that is attributable to the amount of self-em-
14 ployment income (as determined under section
15 1402(b)) on which the section 1401(a) tax is im-
16 posed.

17 “(c) NO CREDIT FOR REFUNDABLE TAX.—No credit
18 shall be allowed with respect to any FICA tax or railroad
19 retirement tax for which a taxpayer is entitled to a refund
20 because of overpayment of tax on the applicable wage
21 base.

22 **“SEC. 22. TAXES-PAID TAX CREDIT.**

23 “The taxes-paid tax credit shall equal the sum of:

24 “(1) WAGE WITHHOLDING.—The amount with-
25 held as tax under chapter 24.

1 “(2) SPECIAL REFUNDS OF SOCIAL SECURITY
2 TAX WHEN WAGES EARNED FROM MORE THAN 1 EM-
3 PLOYER.—The amount allowable under section
4 6413(e) as a special refund of taxes imposed on
5 wages.

6 “(3) OVERPAYMENTS OF PRIOR-YEAR TAX.—
7 Any overpayment of a prior tax obligation that the
8 taxpayer or the Secretary applies to the tax for the
9 taxable year.

10 “(4) ESTIMATED TAXES.—Any estimated taxes
11 paid by the taxpayer with respect to the taxpayer’s
12 tax liability for the taxable year which are treated as
13 payment on account of income tax for purposes of
14 section 6315 (relating to estimated taxes).

15 **“SEC. 23. INDEXING FOR INFLATION.**

16 “(a) PUBLICATION OF TABLES AND NUMBERS.—Not
17 later than December 15 of 2001, and each subsequent cal-
18 endar year, the Secretary shall prescribe tables and dollar
19 amounts which shall apply in the immediately following
20 calendar year in lieu of the tables and dollar amounts that
21 are required to be adjusted for inflation in accordance with
22 this section.

23 “(b) METHOD OF ADJUSTMENT.—

24 “(1) IN GENERAL.—The dollar amounts which
25 are required to be adjusted pursuant to this section

1 for a calendar year shall be the dollar amounts as
2 stated in this chapter multiplied by the cost of living
3 adjustment for such calendar year, rounded as pro-
4 vided in subsection (d).

5 “(2) TAX RATE TABLES.—In the case of a tax
6 rate table, the dollar amounts to be adjusted in ac-
7 cordance with paragraph (1) are the minimum and
8 maximum dollar amounts for each rate bracket for
9 which a tax is imposed. The amounts setting forth
10 the bottom tax for each bracket shall be adjusted to
11 the extent necessary to reflect the adjustments in
12 the rate brackets.

13 “(c) COST-OF-LIVING ADJUSTMENT.—

14 “(1) IN GENERAL.—The cost-of-living adjust-
15 ment for any calendar year is the percentage (if any)
16 by which—

17 “(A) the CPI for the preceding calendar
18 year, exceeds

19 “(B) the CPI for the calendar year 2000.

20 “(2) CPI FOR ANY CALENDAR YEAR.—For pur-
21 poses of paragraph (1), the CPI for any calendar
22 year is the average of the Consumer Price Index as
23 of the close of the 12-month period ending on Au-
24 gust 31 of such calendar year.

1 **“SEC. 30. ROTH IRAS.**

2 “(a) GENERAL RULE.—Except as provided in this
3 section, a Roth IRA shall be treated for purposes of this
4 title in the same manner as an individual retirement plan.

5 “(b) ROTH IRA.—‘Roth IRA’ means an individual
6 retirement plan (as defined in section 7701(a)(37)) which
7 is designated (in such manner as the Secretary may pre-
8 scribe) at the time of establishment of the plan as a Roth
9 IRA. Such designation shall be made in such manner as
10 the Secretary may prescribe.

11 “(c) TREATMENT OF CONTRIBUTIONS.—

12 “(1) NO DEDUCTION ALLOWED.—No deduction
13 shall be allowed for a contribution to a Roth IRA.

14 “(2) CONTRIBUTION LIMIT.—The aggregate
15 amount of contributions for any taxable year to all
16 Roth IRAs maintained for the benefit of an indi-
17 vidual (or, in the case of individuals filing a joint re-
18 turn, either spouse) shall not exceed the taxpayer’s
19 adjusted gross income for the taxable year.

20 “(3) ROLLOVER FROM IRA.—

21 “(A) ROLLOVER CONTRIBUTIONS.—No
22 rollover contribution may be made to a Roth
23 IRA unless it is a qualified rollover contribu-
24 tion.

25 “(B) LIMITS.—A taxpayer shall not be al-
26 lowed to make a qualified rollover contribution

1 to a Roth IRA from an individual retirement
2 plan other than a Roth IRA during any taxable
3 year if—

4 “(i) the taxpayer’s adjusted gross in-
5 come for such taxable year exceeds
6 \$100,000, or

7 “(ii) the taxpayer is a married indi-
8 vidual filing a separate return.

9 “(C) MARITAL STATUS.—Section 31(g)(4)
10 shall apply for purposes of this paragraph.

11 “(4) CONTRIBUTIONS PERMITTED AFTER AGE
12 70½.—CONTRIBUTIONS TO A ROTH IRA MAY BE
13 MADE EVEN AFTER THE INDIVIDUAL FOR WHOM
14 THE ACCOUNT IS MAINTAINED HAS ATTAINED AGE
15 70½.

16 “(5) MANDATORY DISTRIBUTION RULES NOT
17 TO APPLY BEFORE DEATH.—Notwithstanding sub-
18 sections (a)(6) and (b)(3) of section 408 (relating to
19 required distributions), the following provisions shall
20 not apply to any Roth IRA:

21 “(A) Section 401(a)(9)(A).

22 “(B) The incidental death benefit require-
23 ments of section 401(a).

24 “(6) TIME WHEN CONTRIBUTIONS MADE.—A
25 taxpayer shall be deemed to have made a contribu-

1 tion to a Roth IRA during a year if the contribution
2 is made on account of such year and is made not
3 later than April 15 of the following year.

4 “(d) EXCLUSION FROM INCOME.—For purposes of
5 this chapter—

6 “(1) GENERAL RULES.—A distribution from a
7 Roth IRA shall not be includible in gross income.

8 “(2) NONQUALIFIED DISTRIBUTION.—The
9 automatic exclusion from gross income under para-
10 graph (1) shall not apply to any distribution, other
11 than a qualified special purpose distribution if—

12 “(A) it is made within the 5-taxable year
13 period beginning with the 1st taxable year for
14 which the individual made a contribution to a
15 Roth IRA (or such individual’s spouse made a
16 contribution to a Roth IRA) established for
17 such individual, or

18 “(B) in the case of a payment or distribu-
19 tion properly allocable (as determined in the
20 manner prescribed by the Secretary) to a quali-
21 fied rollover contribution from an individual re-
22 tirement plan other than a Roth IRA (or in-
23 come allocable thereto), it is made within the 5-
24 taxable year period beginning with the taxable

1 year in which the rollover contribution was
2 made.

3 “(3) NONQUALIFIED DISTRIBUTIONS.—In ap-
4 plying section 33 to any distribution from a Roth
5 IRA described in paragraph (2), such distribution
6 shall be treated as made from contributions to the
7 Roth IRA to the extent that such distribution, when
8 added to all previous distributions from the Roth
9 IRA, does not exceed the aggregate amount of con-
10 tributions to the Roth IRA. Only distributions at-
11 tributable to earnings on accounts (as opposed to
12 distributions of contributions) shall be included in
13 gross income.

14 “(4) ROLLOVERS FROM AN IRA OTHER THAN A
15 ROTH IRA.—

16 “(A) IN GENERAL.—Notwithstanding sec-
17 tion 408(d)(3), in the case of any distribution
18 to which this paragraph applies there shall be
19 included in gross income any amount which
20 would be includible were it not part of a quali-
21 fied rollover contribution.

22 “(B) DISTRIBUTIONS TO WHICH PARA-
23 GRAPH APPLIES.—This paragraph shall apply
24 to a distribution from an individual retirement
25 plan (other than a Roth IRA) maintained for

1 the benefit of an individual which is contributed
2 to a Roth IRA maintained for the benefit of
3 such individual in a qualified rollover contribu-
4 tion.

5 “(C) CONVERSIONS.—The conversion of an
6 individual retirement plan (other than a Roth
7 IRA) to a Roth IRA shall be treated for pur-
8 poses of this paragraph as a distribution to
9 which this paragraph applies.

10 “(D) CONVERSION OF EXCESS CONTRIBU-
11 TIONS.—If, no later than the due date for filing
12 the return of tax for any taxable year (without
13 regard to extensions), an individual transfers,
14 from an individual retirement plan (other than
15 a Roth IRA), contributions for such taxable
16 year (and any earnings allocable thereto) to a
17 Roth IRA, no such amount shall be includible
18 in gross income to the extent no deduction was
19 allowed with respect to such amount.

20 “(E) ADDITIONAL REPORTING REQUIRE-
21 MENTS.—Trustees of Roth IRAs, trustees of in-
22 dividual retirement plans, or both, whichever is
23 appropriate, shall include such additional infor-
24 mation in reports required under section 408(i)
25 as the Secretary may require to ensure that

1 amounts required to be included in gross in-
2 come under subparagraph (A) are so included.

3 “(4) COORDINATION WITH INDIVIDUAL RETIRE-
4 MENT ACCOUNTS.—Section 408(d)(2) shall be ap-
5 plied separately with respect to Roth IRAs and other
6 individual retirement plans.

7 “(5) QUALIFIED SPECIAL PURPOSE DISTRIBUTION.—‘Qualified special purpose distribution’
8 means—
9

10 “(i) DISTRIBUTIONS UPON DEATH.—
11 Distributions made to a beneficiary (or to
12 the estate of the individual) on or after the
13 death of the individual.

14 “(ii) DISTRIBUTIONS UPON DIS-
15 ABILITY.—Distributions attributable to the
16 individual’s being disabled.

17 “(iii) DISTRIBUTIONS TO PAY MED-
18 ICAL EXPENSES.—Distributions made to
19 the individual for amounts paid during the
20 year for medical care, but only to the ex-
21 tent that the amounts paid for medical
22 care exceed 7.5% of the adjusted gross in-
23 come of the taxpayer. (determined without
24 regard to whether the employee itemizes
25 deductions for such taxable year).

1 “(iv) QDROS.—Any distribution to
2 an alternate payee pursuant to a qualified
3 domestic relations order (within the mean-
4 ing of section 414(p)(1)).

5 “(v) DISTRIBUTIONS TO UNEMPLOYED
6 INDIVIDUALS FOR HEALTH INSURANCE
7 PREMIUMS.—Distributions to an
8 individual—

9 “(I) if such individual has re-
10 ceived unemployment compensation
11 for 12 consecutive weeks under any
12 Federal or State unemployment com-
13 pensation law by reason of such sepa-
14 ration (or in the case of a self-em-
15 ployed individual, to the extent pro-
16 vided in regulations, if the individual
17 would have received unemployment
18 compensation but for the fact the in-
19 dividual was self-employed),

20 “(II) if such distributions are
21 made during any taxable year during
22 which such unemployment compensa-
23 tion is paid or the succeeding taxable
24 year,

1 “(III) to the extent such distribu-
2 tions do not exceed the amount paid
3 during the taxable year for insurance
4 for the diagnosis, cure, mitigation,
5 treatment, or prevention of disease, or
6 for the purpose of affecting any struc-
7 ture or function of the body (or for
8 transportation primarily for and es-
9 sential to such medical care) (includ-
10 ing amounts paid as premiums under
11 part B of title XVIII of the Social Se-
12 curity Act, relating to supplementary
13 medical insurance for the aged) or for
14 any qualified long-term care insurance
15 contract (as defined in section
16 7702B(b)) with respect to the indi-
17 vidual and the individual’s spouse and
18 dependents, and

19 “(IV) such distributions are not
20 made after the individual has been
21 employed for at least 60 days after
22 the separation from employment to
23 which clause (I) applies.

24 “(V) DISTRIBUTIONS TO PAY HIGHER
25 EDUCATION EXPENSES.—Distributions to

1 the extent such distributions do not exceed
2 the qualified higher education expenses (as
3 defined in section 10(a)(2)) of—

4 “(I) the taxpayer,

5 “(II) the taxpayer’s spouse, or

6 “(III) any child or grandchild of
7 the taxpayer or the taxpayer’s spouse.

8 “(vi) DISTRIBUTIONS FOR FIRST
9 HOME PURCHASES.—Distributions which
10 are qualified first-time homebuyer distribu-
11 tions (as defined in paragraph (6)).

12 “(6) QUALIFIED FIRST-TIME HOMEBUYER DIS-
13 TRIBUTIONS.—

14 “(A) IN GENERAL.—‘Qualified first-time
15 homebuyer distribution’ means any payment or
16 distribution received by an individual to the ex-
17 tent such payment or distribution is used by the
18 individual before the close of the 120th day
19 after the day on which such payment or dis-
20 tribution is received to pay qualified acquisition
21 costs with respect to a principal residence of a
22 first-time homebuyer who is such individual, the
23 spouse of such individual, or any child, grand-
24 child, or ancestor of such individual or the indi-
25 vidual’s spouse.

1 “(B) LIFETIME DOLLAR LIMITATION.—

2 The aggregate amount of payments or distribu-
3 tions received by an individual which may be
4 treated as qualified first-time homebuyer dis-
5 tributions for any taxable year shall not exceed
6 the excess (if any) of—

7 “(i) \$10,000, over

8 “(ii) the aggregate amounts treated as
9 qualified first-time homebuyer distributions
10 with respect to such individual for all prior
11 taxable years.

12 “(C) QUALIFIED ACQUISITION COSTS.—

13 ‘Qualified acquisition costs’ means the costs of
14 acquiring, constructing, or reconstructing a res-
15 idence. Such term includes any usual or reason-
16 able settlement, financing, or other closing
17 costs.

18 “(D) FIRST-TIME HOMEBUYER; OTHER
19 DEFINITIONS.—For purposes of this
20 paragraph—

21 “(i) FIRST-TIME HOMEBUYER.—

22 ‘First-time homebuyer’ means any indi-
23 vidual if such individual (and if married,
24 such individual’s spouse) had no present
25 ownership interest in a principal residence

1 during the 2-year period ending on the
2 date of acquisition of the principal resi-
3 dence to which this paragraph applies, and

4 “(ii) DATE OF ACQUISITION.—‘Date
5 of acquisition’ means the date—

6 “(I) on which a binding contract
7 to acquire the principal residence to
8 which subparagraph (A) applies is en-
9 tered into, or

10 “(II) on which construction or re-
11 construction of such a principal resi-
12 dence is commenced.

13 “(E) SPECIAL RULE WHERE DELAY IN AC-
14 QUISITION.—The Secretary shall prescribe rules
15 under which a distribution will not be penalized
16 if made in anticipation of being a qualified
17 first-time homeowner distribution but construc-
18 tion delays or other unanticipated factors delay
19 the closing.

20 “(e) QUALIFIED ROLLOVER CONTRIBUTION.—For
21 purposes of this section, the term qualified rollover con-
22 tribution means a rollover contribution to a Roth IRA
23 from another such account, or from an individual retire-
24 ment plan, but only if such rollover contribution meets the
25 requirements of section 408(d)(3). For purposes of section

1 408(d)(3)(B), there shall be disregarded any qualified roll-
2 over contribution from an individual retirement plan
3 (other than a Roth IRA) to a Roth IRA.

4 “(f) PERMITTED INVESTMENTS.—

5 “(1) INVESTMENT PERMITTED.—A Roth IRA
6 shall not cease to be an individual retirement ac-
7 count pursuant to section 408(e)(2) solely because
8 funds from such account are used to make a debt
9 or equity investment in a controlled business entity.

10 “(2) LOANS TO A CONTROLLED BUSINESS ENTI-
11 TY.—

12 “(A) EXCESS RETURN.—If funds in a
13 Roth IRA are loaned to a controlled business
14 entity, any return on such loans in excess of a
15 fair return shall be treated as gross income of
16 the beneficiary that is then deposited in the
17 Roth IRA.

18 “(B) LOAN.—For purposes of this section,
19 an amount shall be treated as loaned to a con-
20 trolled business entity only if—

21 “(i) the amount is treated in the
22 books and records of the business entity as
23 a loan,

1 “(ii) the transaction is reflected in a
2 written note or other evidence of indebted-
3 ness, and

4 “(iii) the business entity is required to
5 pay interest at least once per year and at
6 the time such loan is made it is reasonable
7 to expect that such interest will be paid on
8 a timely basis.

9 “(C) FAIR RETURN.—For purposes of this
10 subsection, a ‘fair return’ with respect to a loan
11 is interest at a rate not in excess of 3 percent-
12 age points plus the minimum rate of interest
13 that would have to be charged with respect to
14 such loan to prevent it from being a below-mar-
15 ket loan for purposes of section 7872 (deter-
16 mined as if section 7872 applied to such loan).

17 “(3) EQUITY INVESTMENT IN A CONTROLLED
18 BUSINESS ENTITY.—If funds in a Roth IRA are con-
19 tributed to the capital of, applied to acquire stock or
20 other equity interest in, or otherwise transferred to,
21 a controlled business entity in a transaction that is
22 not considered a loan for purposes of this sub-
23 section, any return on such equity shall be treated
24 as gross income of the beneficiary that is then de-

1 posited in the Roth IRA. The preceding sentence
2 shall not apply to—

3 “(A) the proceeds of the sale of such eq-
4 uity interest to a third party, or

5 “(B) the proceeds received by the Roth
6 IRA as the result of a complete redemption of
7 the beneficiary’s interest in the business entity
8 (including any interests held through a Roth
9 IRA).

10 “(4) CONTROLLED BUSINESS ENTITY.—‘Con-
11 trolled business entity’ means any business entity in
12 which the beneficiary of the Roth IRA holds at least
13 a 5 percent interest in the profits and losses (after
14 taking into account the investment through the Roth
15 IRA) and in which an investment would cause the
16 Roth IRA to cease to be an individual retirement
17 account by reason of section 408(e)(2) but for this
18 subsection.

19 “(5) APPLICATION OF SECTION 4975.—Section
20 4975 shall not apply to a loan or equity investment
21 by a Roth IRA in a controlled business entity.

22 “(6) TAX AND PENALTY AVOIDANCE.—The Sec-
23 retary shall prescribe regulations that prohibit the
24 provisions of this subsection to be used to cir-
25 cumvent the application of subsection (d)(2) (relat-

1 ing to taxable distributions). The regulations shall
2 not prohibit bona fide investments in controlled busi-
3 ness entities. The regulations shall address loans to
4 and investments in a controlled business entity that
5 are used to fund distributions or dividends from the
6 business entity to the account beneficiary or a mem-
7 ber of the beneficiary’s family.

8 **“SEC. 31. DEDUCTIBLE IRAS.**

9 “(a) ALLOWANCE OF DEDUCTION.—The ‘qualified
10 IRA deduction’ shall be an amount equal to the qualified
11 retirement contributions of the individual for the taxable
12 year, except as limited by subsection (b).

13 “(b) MAXIMUM AMOUNT OF DEDUCTION.—

14 “(1) IN GENERAL.—The amount allowable as a
15 deduction under subsection (a) to any individual for
16 any taxable year shall not exceed the lesser of—

17 “(A) \$2,000, or

18 “(B) an amount equal to the compensation
19 includible in the individual’s gross income for
20 such taxable year.

21 “(2) SPECIAL RULE FOR EMPLOYER CONTRIBU-
22 TIONS UNDER SIMPLIFIED EMPLOYEE PENSIONS.—
23 This section shall not apply with respect to an em-
24 ployer contribution to a simplified employee pension.

1 “(3) GRANDFATHERED PLANS.—Notwith-
2 standing paragraph (1), the amount allowable as a
3 deduction under subsection (a) with respect to any
4 contributions on behalf of an employee to a plan de-
5 scribed in section 501(c)(18) of the Internal Rev-
6 enue Code of 1986 shall not exceed the lesser of—

7 “(A) \$7,000, or

8 “(B) an amount equal to 25 percent of the
9 compensation (as defined in section 415(c)(3))
10 includible in the individual’s gross income for
11 such taxable year.

12 “(4) SPECIAL RULE FOR SIMPLE RETIREMENT
13 ACCOUNTS.—This section shall not apply with re-
14 spect to any amount contributed to a simple retire-
15 ment account established under section 408(p).

16 “(c) SPECIAL RULES FOR CERTAIN MARRIED INDI-
17 VIDUALS.—

18 “(1) IN GENERAL.—In the case of an individual
19 to whom this paragraph applies for the taxable year,
20 the limitation of paragraph (1) of subsection (b)
21 shall be equal to the lesser of—

22 “(A) the dollar amount in effect under
23 subsection (b)(1)(A) for the taxable year, or

24 “(B) the sum of—

1 “(i) the compensation includible in
2 such individual’s gross income for the tax-
3 able year, plus

4 “(ii) the compensation includible in
5 the gross income of such individual’s
6 spouse for the taxable year reduced by—

7 “(I) the amount allowed as a de-
8 duction under subsection (a) to such
9 spouse for such taxable year, and

10 “(II) the amount of any contribu-
11 tion on behalf of such spouse to a
12 Roth IRA under section 30 for such
13 taxable year.

14 “(2) INDIVIDUALS TO WHOM PARAGRAPH (1)
15 APPLIES.—Paragraph (1) shall apply to any indi-
16 vidual if—

17 “(A) such individual files a joint return for
18 the taxable year, and

19 “(B) the amount of compensation (if any)
20 includible in such individual’s gross income for
21 the taxable year is less than the compensation
22 includible in the gross income of such individ-
23 ual’s spouse for the taxable year.

24 “(d) OTHER LIMITATIONS AND RESTRICTIONS.—

1 “(1) BENEFICIARY MUST BE UNDER AGE
2 70½.—No deduction shall be allowed under this sec-
3 tion with respect to any qualified retirement con-
4 tribution for the benefit of an individual if such indi-
5 vidual has attained age 70½ before the close of such
6 individual’s taxable year for which the contribution
7 was made.

8 “(2) RECONTRIBUTED AMOUNTS.—No deduc-
9 tion shall be allowed under this section with respect
10 to a rollover contribution described in section 402(c),
11 403(a)(4), 403(b)(8), or 408(d)(3).

12 “(3) AMOUNTS CONTRIBUTED UNDER ENDOW-
13 MENT CONTRACT.—In the case of an endowment
14 contract described in section 408(b), no deduction
15 shall be allowed under this section for that portion
16 of the amounts paid under the contract for the tax-
17 able year which is properly allocable, under regula-
18 tions prescribed by the Secretary, to the cost of life
19 insurance.

20 “(4) DENIAL OF DEDUCTION FOR AMOUNT
21 CONTRIBUTED TO INHERITED ANNUITIES OR AC-
22 COUNTS.—No deduction shall be allowed under this
23 section with respect to any amount paid to an inher-
24 ited individual retirement account or individual re-

1 tirement annuity (within the meaning of section
2 408(d)(3)(C)(ii)).

3 “(e) QUALIFIED RETIREMENT CONTRIBUTION.—For
4 purposes of this section, the term ‘qualified retirement
5 contribution’ means—

6 “(1) any amount paid in cash for the taxable
7 year by or on behalf of an individual to an individual
8 retirement plan for such individual’s benefit, and

9 “(2) any amount contributed on behalf of any
10 individual to a plan described in section 501(c)(18)
11 of the Internal Revenue Code of 1986.

12 “(f) OTHER DEFINITIONS AND SPECIAL RULES.—

13 “(1) COMPENSATION.—For purposes of this
14 section, the term ‘compensation’ includes earned in-
15 come (as defined in section 401(c)(2)). The term
16 ‘compensation’ does not include any amount received
17 as a pension or annuity and does not include any
18 amount received as deferred compensation. The term
19 ‘compensation’ shall include any alimony, child sup-
20 port and separate maintenance payments includible
21 in the individual’s gross income with respect to a di-
22 vorce or separation instrument. For purposes of this
23 paragraph, section 401(c)(2) shall be applied as if
24 the term trade or business for purposes of section
25 1402 included service described in subsection (c)(6).

1 “(2) MARRIED INDIVIDUALS.—The maximum
2 deduction under subsection (b) shall be computed
3 separately for each individual, and this section shall
4 be applied without regard to any community prop-
5 erty laws.

6 “(3) TIME WHEN CONTRIBUTIONS DEEMED
7 MADE.—For purposes of this section, a taxpayer
8 shall be deemed to have made a contribution to an
9 individual retirement plan during a year if the con-
10 tribution is made on account of such year and is
11 made not later than April 15 of the following year.

12 “(4) REPORTS.—The Secretary shall prescribe
13 regulations which prescribe the time and the manner
14 in which reports to the Secretary and plan partici-
15 pants shall be made by the plan administrator of a
16 qualified employer or government plan receiving
17 qualified voluntary employee contributions.

18 “(5) EMPLOYER PAYMENTS.—For purposes of
19 this title, any amount paid by an employer to an in-
20 dividual retirement plan shall be treated as payment
21 of compensation to the employee (other than a self-
22 employed individual who is an employee within the
23 meaning of section 401(c)(1)) includible in his gross
24 income in the taxable year for which the amount was
25 contributed, whether or not a deduction for such

1 payment is allowable under this section to the em-
2 ployee.

3 “(6) EXCESS CONTRIBUTIONS TREATED AS
4 CONTRIBUTION MADE DURING SUBSEQUENT YEAR
5 FOR WHICH THERE IS AN UNUSED LIMITATION.—

6 “(A) IN GENERAL.—If for the taxable year
7 the maximum amount allowable as a deduction
8 under this section for contributions to an indi-
9 vidual retirement plan exceeds the amount con-
10 tributed, then the taxpayer shall be treated as
11 having made an additional contribution for the
12 taxable year in an amount equal to the lesser
13 of—

14 “(i) the amount of such excess, or

15 “(ii) the amount of the excess con-
16 tributions for such taxable year (deter-
17 mined under section 4973(b)(2) without
18 regard to subparagraph (C) thereof).

19 “(B) AMOUNT CONTRIBUTED.—For pur-
20 poses of this paragraph, the amount
21 contributed—

22 “(i) shall be determined without re-
23 gard to this paragraph, and

24 “(ii) shall not include any rollover
25 contribution.

1 “(C) SPECIAL RULE WHERE EXCESS DE-
2 DUCTION WAS ALLOWED FOR CLOSED YEAR.—
3 Proper reduction shall be made in the amount
4 allowable as a deduction by reason of this para-
5 graph for any amount allowed as a deduction
6 under this section for a prior taxable year for
7 which the period for assessing deficiency has ex-
8 pired if the amount so allowed exceeds the
9 amount which should have been allowed for
10 such prior taxable year.

11 “(7) ELECTION NOT TO DEDUCT CONTRIBU-
12 TIONS.—For election not to deduct contributions to
13 individual retirement plans, see section
14 408(o)(2)(B)(ii).

15 “(g) LIMITATION ON DEDUCTION FOR ACTIVE PAR-
16 TICIPANTS IN CERTAIN PENSION PLANS.—

17 “(1) IN GENERAL.—If (for any part of any plan
18 year ending with or within a taxable year) an indi-
19 vidual is an active participant, each of the dollar
20 limitations contained in subsections (b)(1)(A) and
21 (c)(1)(A) for such taxable year shall be reduced (but
22 not below zero) by the amount determined under
23 paragraph (2).

24 “(2) AMOUNT OF REDUCTION.—

1 “(A) IN GENERAL.—The amount deter-
2 mined under this paragraph with respect to any
3 dollar limitation shall be the amount which
4 bears the same ratio to such limitation as—

5 “(i) the excess of—

6 “(I) the taxpayer’s adjusted
7 gross income for such taxable year,
8 over

9 “(II) the applicable dollar
10 amount, bears to

11 “(ii) \$10,000 (\$20,000 in the case of
12 a joint return for a taxable year beginning
13 after December 31, 2009).

14 “(B) NO REDUCTION BELOW \$200 UNTIL
15 COMPLETE PHASE-OUT.—No dollar limitation
16 shall be reduced below \$200 under paragraph
17 (1) unless (without regard to this subpara-
18 graph) such limitation is reduced to zero.

19 “(C) ROUNDING.—Any amount determined
20 under this paragraph which is not a multiple of
21 \$10 shall be rounded to the next lowest \$10.

22 “(3) ADJUSTED GROSS INCOME; APPLICABLE
23 DOLLAR AMOUNT.—For purposes of this
24 subsection—

1 “(A) ADJUSTED GROSS INCOME.—Ad-
 2 justed gross income of any taxpayer shall be de-
 3 termined without regard to the qualified IRA
 4 deduction.

5 “(B) APPLICABLE DOLLAR AMOUNT.—The
 6 term ‘applicable dollar amount’ means the fol-
 7 lowing:

8 “(i) In the case of a taxpayer filing a
 9 joint return:

“For taxable years beginning in:	“The applicable dollar amount is:
2002	\$51,000
2003	\$52,000
2004	\$53,000
2005	\$54,000
2006	\$60,000
2007	\$65,000
2008	\$70,000
2009	\$75,000
2010 and thereafter	\$80,000.

10 “(ii) In the case of any other taxpayer
 11 (other than a married individual filing a
 12 separate return):

For taxable years beginning in:	The applicable dollar amount is:
2002	\$31,000
2003	\$32,000
2004	\$33,000
2005	\$34,000
2006	\$40,000
2007	\$45,000
2008 and thereafter	\$50,000.

13 “(iii) In the case of a married indi-
 14 vidual filing a separate return, zero.

1 “(4) SPECIAL RULE FOR MARRIED INDIVIDUALS
2 FILING SEPARATELY AND LIVING APART.—A hus-
3 band and wife who—

4 “(A) file separate returns for any taxable
5 year, and

6 “(B) live apart at all times during such
7 taxable year, shall not be treated as married in-
8 dividuals for purposes of this subsection.

9 “(5) ACTIVE PARTICIPANT.—For purposes of
10 this subsection, the term ‘active participant’ means,
11 with respect to any plan year, an individual—

12 “(A) who is an active participant in—

13 “(i) a plan described in section 401(a)
14 which includes a trust exempt from tax,

15 “(ii) an annuity plan described in sec-
16 tion 403(a),

17 “(iii) a plan established for its em-
18 ployees by the United States, by a State or
19 political subdivision thereof, or by an agen-
20 cy or instrumentality of any of the fore-
21 going,

22 “(iv) an annuity contract described in
23 section 403(b),

24 “(v) a simplified employee pension
25 (within the meaning of section 408(k)), or

1 “(vi) any simple retirement account
2 (within the meaning of section 408(p), or
3 “(B) who makes deductible contributions
4 to a trust described in section 501(e)(18).

5 The determination of whether an individual is an ac-
6 tive participant shall be made without regard to
7 whether or not such individual’s rights under a plan,
8 trust, or contract are nonforfeitable. An eligible de-
9 ferred compensation plan (within the meaning of
10 section 457(b) of the Internal Revenue Code of
11 1986) shall not be treated as a plan described in
12 subparagraph (A)(iii).

13 “(6) CERTAIN INDIVIDUALS NOT TREATED AS
14 ACTIVE PARTICIPANTS.—For purposes of this sub-
15 section, any individual described in any of the fol-
16 lowing subparagraphs shall not be treated as an ac-
17 tive participant for any taxable year solely because
18 of any participation so described:

19 “(A) MEMBERS OF RESERVE COMPO-
20 NENTS.—Participation in a plan described in
21 subparagraph (A)(iii) of paragraph (5) by rea-
22 son of service as a member of a reserve compo-
23 nent of the Armed Forces (as defined in section
24 10101 of title 10, unless such individual has
25 served in excess of 90 days on active duty

1 (other than active duty for training) during the
2 year.

3 “(B) VOLUNTEER FIREFIGHTERS.—A vol-
4 unteer firefighter—

5 “(i) who is a participant in a plan de-
6 scribed in subparagraph (A)(iii) of para-
7 graph (5) based on his activity as a volun-
8 teer firefighter, and

9 “(ii) whose accrued benefit as of the
10 beginning of the taxable year is not more
11 than an annual benefit of \$1,800 (when
12 expressed as a single life annuity com-
13 mencing at age 65).

14 “(7) SPECIAL RULE FOR CERTAIN SPOUSES.—
15 In the case of an individual who is an active partici-
16 pant at no time during any plan year ending with
17 or within the taxable year but whose spouse is an
18 active participant for any part of any such plan
19 year—

20 “(A) the applicable dollar amount under
21 paragraph (3)(B)(i) with respect to the tax-
22 payer shall be \$150,000, and

23 “(B) the amount applicable under para-
24 graph (2)(A)(ii) shall be \$10,000.

1 “(h) CROSS REFERENCE.—For failure to provide re-
2 quired reports, see section 6652(g).

3 **“SEC. 32. EFFECT OF REPEAL OF SPECIAL SAVINGS PROVI-
4 SIONS.**

5 “(a) EDUCATION IRA’S.—

6 “(1) IN GENERAL.—An account that qualifies
7 as an education IRA under the Internal Revenue
8 Code of 1986 as in effect immediately before adop-
9 tion of the Simplified USA Tax Act shall be treated
10 as a Roth IRA for purposes of this chapter (includ-
11 ing rules allowing for tax-free rollover).

12 “(2) NO NEW CONTRIBUTIONS.—Neither para-
13 graph (1) nor section 530 of the Internal Revenue
14 Code of 1986 shall apply to an education IRA to
15 which contributions are made after December 31,
16 2001.

17 “(3) SPECIAL RULE.—For purposes of applying
18 section 30 to an account that was an educational
19 IRA, the designated beneficiary of such account
20 shall be treated as described in a subclause of clause
21 (vi) of section 30(d)(5).

22 “(b) MEDICAL SAVINGS ACCOUNTS.—

23 “(1) EQUIVALENT OF DEDUCTIBLE IRA.—A
24 medical savings account shall be treated as an indi-

1 vidual retirement plan other than a Roth IRA for
2 purposes of this chapter and chapter 3.

3 “(2) SPECIAL ROLLOVER RULES.—

4 “(A) NO INCOME LIMIT.—The income lim-
5 its of section 30(c)(3)(B) shall not apply to the
6 rollover of a medical savings account into a
7 Roth IRA.

8 “(B) MEDICAL DISTRIBUTIONS.—For pur-
9 poses of applying section 30 to the amount of
10 any medical savings account rolled over to a
11 Roth IRA, subclause (iii) of section 30(d)(5)
12 shall apply without regard to the limitation
13 based on adjusted gross income.

14 “(3) MEDICAL SAVINGS ACCOUNT.—‘Medical
15 savings account’ means an account established under
16 section 220 of the Internal Revenue Code of 1986.

17 “(c) QUALIFIED STATE TUITION PROGRAMS.—

18 “(1) EDUCATION SAVINGS ACCOUNT PRO-
19 GRAMS.—No account shall fail to qualify as a Roth
20 IRA merely because in addition to the beneficiary of
21 the account, there is a ‘designated beneficiary’ whose
22 education expenses the beneficiary expects to pay or
23 have paid with the proceeds of the account. The pay-
24 ment of such expenses with the proceeds of an ac-

1 count shall be treated as a distribution from the ac-
2 count.

3 “(2) PREPAID TUITION CERTIFICATES.—

4 “(A) CONTRIBUTION TO ACCOUNTS.—An
5 individual may contribute prepaid tuition cer-
6 tificates to a Roth IRA before January 1, 2005,
7 without recognizing gross income on the con-
8 tribution of such certificates. For purposes of
9 section 30, the amount contributed shall equal
10 the cost of the certificates.

11 “(B) PURCHASE OF PREPAID TUITION
12 CERTIFICATES.—A Roth IRA account may pur-
13 chase prepaid tuition certificates without vio-
14 lating section 408.

15 “(C) PREPAID TUITION CERTIFICATES.—
16 ‘Prepaid tuition certificates’ means credits or
17 certificates that entitle a designated beneficiary
18 of such certificates to the waiver or payment of
19 qualified higher education expenses of the des-
20 ignated beneficiary.

21 “(3) ROLLOVER OF ACCOUNTS.—An account to
22 which section 529 of the Internal Revenue Code of
23 1986 (before adoption of the Simplified USA Tax
24 Act) shall be treated as a Roth IRA for purposes of
25 rules relating to qualified rollovers (except that in

1 the case of any such rollover, any contributions
 2 made to the section 529 account after July 1, 2001,
 3 shall be treated as contributions to the Roth IRA in
 4 the year of the rollover for purposes of section
 5 30(c)(2)).

6 “(4) TRANSITION.—

7 “(A) TRANSITION PERIOD.—Subsections
 8 (a) and (c) of section 529 of the Internal Rev-
 9 enue Code of 1986 shall apply until January 1,
 10 2005.

11 “(B) TRANSITION.—The Secretary shall
 12 prescribe rules to facilitate use of the Roth IRA
 13 rules to exempt earnings on accounts and cer-
 14 tificates previously exempted under section 529
 15 of the Internal Revenue Code of 1986.

16 “(5) QUALIFIED HIGHER EDUCATION EX-
 17 PENSES.—For purposes of this subsection, the defi-
 18 nition ‘qualified higher education expenses’ in sec-
 19 tion 529(e)(3) of the Internal Revenue Code of 1986
 20 shall apply.

21 **“SEC. 33. ANNUITIES, CERTAIN PROCEEDS OF ENDOWMENT**
 22 **AND LIFE INSURANCE CONTRACTS.**

23 “(a) GENERAL RULE FOR ANNUITIES.—Except as
 24 otherwise provided in this chapter, gross income includes
 25 any amount received as an annuity (whether for a period

1 certain or during one or more lives) under an annuity, en-
2 dowment, or life insurance contract.

3 “(b) EXCLUSION RATIO.—

4 “(1) IN GENERAL.—Gross income does not in-
5 clude that part of any amount received as an annu-
6 ity under an annuity, endowment, or life insurance
7 contract which bears the same ratio to such amount
8 as the investment in the contract (as of the annuity
9 starting date) bears to the expected return under the
10 contract (as of such date).

11 “(2) EXCLUSION LIMITED TO INVESTMENT.—

12 The portion of any amount received as an annuity
13 which is excluded from gross income under para-
14 graph (1) shall not exceed the unrecovered invest-
15 ment in the contract immediately before the receipt
16 of such amount.

17 “(3) DEDUCTION WHERE ANNUITY PAYMENTS
18 CEASE BEFORE ENTIRE INVESTMENT RECOVERED.—

19 “(A) IN GENERAL.—If—

20 “(i) after the annuity starting date,
21 payments as an annuity under the contract
22 cease by reason of the death of an annu-
23 itant, and

1 “(ii) as of the date of such cessation,
2 there is unrecovered investment in the con-
3 tract,
4 the amount of such unrecovered investment (in
5 excess of any amount specified in subsection
6 (e)(5) which was not included in gross income)
7 shall be allowed as a deduction from adjusted
8 gross income in determining taxable income of
9 the annuitant for his last taxable year.

10 “(B) PAYMENTS TO OTHER PERSONS.—In
11 the case of any contract which provides for pay-
12 ments meeting the requirements of subpara-
13 graphs (B) and (C) of subsection (c)(2), the de-
14 duction under subparagraph (A) shall be al-
15 lowed to the person entitled to such payments
16 for the taxable year in which such payments are
17 received.

18 “(c) DEFINITIONS.—

19 “(1) INVESTMENT IN THE CONTRACT.—For
20 purposes of subsection (b), the investment in the
21 contract as of the annuity starting date is—

22 “(A) the aggregate amount of premiums or
23 other consideration paid for the contract (in-
24 cluding any amounts earned on the contract

1 which were included in gross income and rein-
2 vested in the contract), minus

3 “(B) the aggregate amount received under
4 the contract before such date, to the extent that
5 such amount was excludable from gross income
6 under this subtitle or prior income tax laws.

7 “(2) OTHER TERMS USED IN SUBSECTION
8 (b).—Calculations under subsections (a) and (b)
9 shall be made in accordance with regulations pre-
10 scribed by the Secretary, which regulations shall
11 generally be consistent with the section 72 of the In-
12 ternal Revenue Code of 1986.

13 “(d) SPECIAL RULES FOR QUALIFIED EMPLOYER
14 RETIREMENT PLANS.—

15 “(1) SIMPLIFIED METHOD OF TAXING ANNUITY
16 PAYMENTS.—

17 “(A) IN GENERAL.—In the case of any
18 amount received as an annuity under a quali-
19 fied employer retirement plan—

20 “(i) subsection (b) shall not apply,
21 and

22 “(ii) the investment in the contract
23 shall be recovered as provided in this para-
24 graph.

1 “(B) METHOD OF RECOVERING INVEST-
2 MENT IN CONTRACT.—

3 “(i) IN GENERAL.—Gross income
4 shall not include so much of any monthly
5 annuity payment under a qualified em-
6 ployer retirement plan as does not exceed
7 the amount obtained by dividing—

8 “(I) the investment in the con-
9 tract (as of the annuity starting date),
10 by

11 “(II) the number of anticipated
12 payments determined under the table
13 contained in clause (iii) (or, in the
14 case of a contract to which subsection
15 (c)(3)(B) applies, the number of
16 monthly annuity payments under such
17 contract).

18 “(ii) CERTAIN RULES MADE APPLICA-
19 BLE.—Rules similar to the rules of para-
20 graphs (2) and (3) of subsection (b) shall
21 apply for purposes of this paragraph.

22 “(iii) NUMBER OF ANTICIPATED PAY-
23 MENTS.—If the annuity is payable over the
24 life of a single individual, the number of

1 anticipated payments shall be determined
 2 as follows:

If the age of the annuitant on the annuity starting date is:	The number:
Not more than 55	360
More than 55 but not more than 60.	310
More than 60 but not more than 65.	260
More than 65 but not more than 70.	210
More than 70	160

3 “(iv) NUMBER OF ANTICIPATED PAY-
 4 MENTS WHERE MORE THAN ONE LIFE.—If
 5 the annuity is payable over the lives of
 6 more than 1 individual, the number of an-
 7 ticipated payments shall be determined as
 8 follows:

If the combined ages of the annuitants are:	The number:
Not more than 110	410
More than 110 but not more than 120.	360
More than 120 but not more than 130.	310
More than 130 but not more than 140.	260
More than 140	210

9 “(C) SPECIAL RULE WHERE LUMP SUM
 10 PAID IN CONNECTION WITH COMMENCEMENT
 11 OF ANNUITY PAYMENTS.—If, in connection with
 12 the commencement of annuity payments under
 13 any qualified employer retirement plan, the tax-
 14 payer receives a lump sum payment—

1 “(i) such payment shall be taxable
2 under subsection (e) as if received before
3 the annuity starting date, and

4 “(ii) the investment in the contract
5 for purposes of this paragraph shall be de-
6 termined as if such payment had been so
7 received.

8 “(D) EXCEPTION.—This paragraph shall
9 not apply in any case where the primary annu-
10 tant has attained age 75 on the annuity start-
11 ing date unless there are fewer than 5 years of
12 guaranteed payments under the annuity.

13 “(E) ADJUSTMENT WHERE ANNUITY PAY-
14 MENTS NOT ON A MONTHLY BASIS.—In any
15 case where the annuity payments are not made
16 on a monthly basis, appropriate adjustments in
17 the application of this paragraph shall be made
18 to take into account the period on the basis of
19 which such payments are made.

20 “(F) QUALIFIED EMPLOYER RETIREMENT
21 PLAN.—For purposes of this paragraph, the
22 term ‘qualified employer retirement plan’ means
23 any plan or contract described in paragraph
24 (1), (2), or (3) of section 4974(c).

1 “(2) TREATMENT OF EMPLOYEE CONTRIBU-
2 TIONS UNDER DEFINED CONTRIBUTION PLANS.—
3 For purposes of this section, employee contributions
4 (and any income allocable thereto) under a defined
5 contribution plan may be treated as a separate con-
6 tract.

7 “(e) AMOUNTS NOT RECEIVED AS ANNUITIES.—

8 “(1) APPLICATION OF SUBSECTION.—

9 “(A) IN GENERAL.—This subsection shall
10 apply to any amount which—

11 “(i) is received under an annuity, en-
12 dowment, or life insurance contract, and

13 “(ii) is not received as an annuity,
14 if no provision of this subtitle (other than this
15 subsection) applies with respect to such
16 amount.

17 “(B) DIVIDENDS.—For purposes of this
18 section, any amount received which is in the na-
19 ture of a dividend or similar distribution shall
20 be treated as an amount not received as an an-
21 nuity.

22 “(2) GENERAL RULE.—Any amount to which
23 this subsection applies—

1 “(A) if received on or after the annuity
2 starting date, shall be included in gross income,
3 or

4 “(B) if received before the annuity starting
5 date—

6 “(i) shall be included in gross income
7 to the extent allocable to income on the
8 contract, and

9 “(ii) shall not be included in gross in-
10 come to the extent allocable to the invest-
11 ment in the contract.

12 “(3) ALLOCATION OF AMOUNTS TO INCOME
13 AND INVESTMENT.—For purposes of paragraph
14 (2)(B):

15 “(A) Any amount to which this subsection
16 applies shall be treated as allocable to income
17 on the contract to the extent that such amount
18 does not exceed the excess (if any) of—

19 “(i) the cash value of the contract
20 (determined without regard to any sur-
21 render charge) immediately before the
22 amount is received, over

23 “(ii) the investment in the contract at
24 such time.

1 “(B) Any amount to which this subsection
2 applies shall be treated as allocable to invest-
3 ment in the contract to the extent that such
4 amount is not allocated to income under sub-
5 paragraph (A).

6 “(4) SPECIAL RULES FOR APPLICATION OF
7 PARAGRAPH (2)(B).—For purposes of paragraph
8 (2)(B):

9 “(A) LOANS TREATED AS DISTRIBUTIONS.—If, during any taxable year, an
10 individual—

11 “(i) receives (directly or indirectly)
12 any amount as a loan under any contract
13 to which this subsection applies, or
14 “(ii) assigns or pledges (or agrees to

15 assign or pledge) any portion of the value
16 of any such contract,
17 such amount or portion shall be treated as re-

18 ceived under the contract as an amount not re-
19 ceived as an annuity. The preceding sentence
20 shall not apply for purposes of determining in-
21 vestment in the contract, except that the invest-
22 ment in the contract shall be increased by any
23 amount included in gross income by reason of
24

1 the amount treated as received under the pre-
2 ceding sentence.

3 “(B) TREATMENT OF TRANSFERS WITH-
4 OUT ADEQUATE CONSIDERATION.—

5 “(i) IN GENERAL.—If an individual
6 who holds an annuity contract transfers it
7 without full and adequate consideration,
8 such individual shall be treated as receiv-
9 ing an amount equal to the excess of—

10 “(I) the cash surrender value of
11 such contract at the time of transfer,
12 over

13 “(II) the investment in such con-
14 tract at such time,

15 under the contract as an amount not re-
16 ceived as an annuity.

17 “(ii) EXCEPTION FOR CERTAIN
18 TRANSFERS BETWEEN SPOUSES OR
19 FORMER SPOUSES.—Clause (i) shall not
20 apply to any transfer to which section
21 77(c) (relating to transfers of property be-
22 tween spouses or incident to divorce) ap-
23 plies.

24 “(iii) ADJUSTMENT TO INVESTMENT
25 IN CONTRACT OF TRANSFEREE.—If under

1 clause (i) an amount is included in the
2 gross income of the transferor of an annu-
3 ity contract, the investment in the contract
4 of the transferee in such contract shall be
5 increased by the amount so included.

6 “(5) RETENTION OF EXISTING RULES IN CER-
7 TAIN CASES.—Paragraph (5) of section 72(e) of the
8 Internal Revenue Code of 1986 shall apply to con-
9 tracts described in subparagraph (B) of such para-
10 graph to the extent provided therein.

11 “(6) INVESTMENT IN THE CONTRACT.—For
12 purposes of this subsection, the investment in the
13 contract as of any date is—

14 “(A) the aggregate amount of premiums or
15 other consideration paid for the contract before
16 such date, minus

17 “(B) the aggregate amount received under
18 the contract before such date, to the extent that
19 such amount was excludable from gross income
20 under this subtitle or prior income tax laws.

21 “(7) APPLICATION OF PARAGRAPH (2)(B) TO
22 QUALIFIED PLANS.—

23 “(A) IN GENERAL.—Notwithstanding any
24 other provision of this subsection, in the case of
25 any amount received before the annuity starting

1 date from a trust or contract described in para-
2 graph (5)(D), paragraph (2)(B) shall apply to
3 such amounts.

4 “(B) ALLOCATION OF AMOUNT RE-
5 CEIVED.—For purposes of paragraph (2)(B),
6 the amount allocated to the investment in the
7 contract shall be the portion of the amount de-
8 scribed in subparagraph (A) which bears the
9 same ratio to such amount as the investment in
10 the contract bears to the account balance. The
11 determination under the preceding sentence
12 shall be made as of the time of the distribution
13 or at such other time as the Secretary may pre-
14 scribe.

15 “(C) TREATMENT OF FORFEITABLE
16 RIGHTS.—If an employee does not have a non-
17 forfeitable right to any amount under any trust
18 or contract to which subparagraph (A) applies,
19 such amount shall not be treated as part of the
20 account balance.

21 “(D) INVESTMENT IN THE CONTRACT BE-
22 FORE 1987.—In the case of a plan which on
23 May 5, 1986, permitted withdrawal of any em-
24 ployee contributions before separation from
25 service, subparagraph (A) shall apply only to

1 the extent that amounts received before the an-
2 nuity starting date (when increased by amounts
3 previously received under the contract after De-
4 cember 31, 1986) exceed the investment in the
5 contract as of December 31, 1986.

6 “(8) TREATMENT OF MODIFIED ENDOWMENT
7 CONTRACTS.—

8 “(A) IN GENERAL.—Notwithstanding para-
9 graph (5)(C), in the case of any modified en-
10 dowment contract (as defined in section
11 7702A)—

12 “(i) paragraphs (2)(B) and (4)(A)
13 shall apply, and

14 “(ii) in applying paragraph (4)(A),
15 ‘any person’ shall be substituted for ‘an in-
16 dividual’.

17 “(B) TREATMENT OF CERTAIN BURIAL
18 CONTRACTS.—Notwithstanding subparagraph
19 (A), paragraph (4)(A) shall not apply to any as-
20 signment (or pledge) of a modified endowment
21 contract if such assignment (or pledge) is solely
22 to cover the payment of expenses referred to in
23 section 7702(e)(2)(C)(iii) and if the maximum
24 death benefit under such contract does not ex-
25 ceed \$25,000.

1 “(9) ANTI-ABUSE RULES.—

2 “(A) IN GENERAL.—For purposes of deter-
3 mining the amount includible in gross income
4 under this subsection—

5 “(i) all modified endowment contracts
6 issued by the same company to the same
7 policyholder during any calendar year shall
8 be treated as 1 modified endowment con-
9 tract, and

10 “(ii) all annuity contracts issued by
11 the same company to the same policyholder
12 during any calendar year shall be treated
13 as 1 annuity contract.

14 The preceding sentence shall not apply to any
15 contract described in paragraph (5)(D).

16 “(B) REGULATORY AUTHORITY.—The Sec-
17 retary may by regulations prescribe such addi-
18 tional rules as may be necessary or appropriate
19 to prevent avoidance of the purposes of this
20 subsection through serial purchases of contracts
21 or otherwise.

22 “(f) SPECIAL RULES FOR COMPUTING EMPLOYEES’
23 CONTRIBUTIONS.—In computing, for purposes of sub-
24 section (c)(1)(A), the aggregate amount of premiums or
25 other consideration paid for the contract, and for purposes

1 of subsection (e)(6), the aggregate premiums or other con-
2 sideration paid, amounts contributed by the employer shall
3 be included, but only to the extent that—

4 “(1) such amounts were includible in the gross
5 income of the employee under this subtitle or prior
6 income tax laws; or

7 “(2) if such amounts had been paid directly to
8 the employee at the time they were contributed, they
9 would not have been includible in the gross income
10 of the employee under the law applicable at the time
11 of such contribution.

12 “(g) RULES FOR TRANSFEREE WHERE TRANSFER
13 WAS FOR VALUE.—Where any contract (or any interest
14 therein) is transferred (by assignment or otherwise) for
15 a valuable consideration, to the extent that the contract
16 (or interest therein) does not, in the hands of the trans-
17 feree, have a basis which is determined by reference to
18 the basis in the hands of the transferor, then—

19 “(1) for purposes of this section, only the ac-
20 tual value of such consideration, plus the amount of
21 the premiums and other consideration paid by the
22 transferee after the transfer, shall be taken into ac-
23 count in computing the aggregate amount of the
24 premiums or other consideration paid for the con-
25 tract;

1 “(2) for purposes of subsection (c)(1)(B), there
2 shall be taken into account only the aggregate
3 amount received under the contract by the trans-
4 feree before the annuity starting date, to the extent
5 that such amount was excludable from gross income
6 under this subtitle or prior income tax laws; and

7 “(3) the annuity starting date is January 1,
8 1954, or the first day of the first period for which
9 the transferee received an amount under the con-
10 tract as an annuity, whichever is the later.

11 “(h) OPTION TO RECEIVE ANNUITY IN LIEU OF
12 LUMP SUM.—If—

13 “(1) a contract provides for payment of a lump
14 sum in full discharge of an obligation under the con-
15 tract, subject to an option to receive an annuity in
16 lieu of such lump sum;

17 “(2) the option is exercised within 60 days after
18 the day on which such lump sum first became pay-
19 able; and

20 “(3) part or all of such lump sum would (but
21 for this subsection) be includible in gross income by
22 reason of subsection (e)(1),

23 then, for purposes of this subtitle, no part of such lump
24 sum shall be considered as includible in gross income at
25 the time such lump sum first became payable.

1 “(i) INTEREST.—Notwithstanding any other provi-
2 sion of this section, if any amount is held under an agree-
3 ment to pay interest thereon, the interest payments shall
4 be included in gross income.

5 “(j) FACE-AMOUNT CERTIFICATES.—For purposes of
6 this section, the term ‘endowment contract’ includes a
7 face-amount certificate, as defined in section 2(a)(15) of
8 the Investment Company Act of 1940 (15 U.S.C., sec.
9 80a-2), issued after December 31, 1954.

10 “(k) SPECIAL RULES APPLICABLE TO EMPLOYEE
11 ANNUITIES AND DISTRIBUTIONS UNDER EMPLOYEE
12 PLANS.—

13 “(1) COMPUTATION OF CONSIDERATION PAID
14 BY THE EMPLOYEE.—In computing—

15 “(A) the aggregate amount of premiums or
16 other consideration paid for the contract for
17 purposes of subsection (c)(1)(A) (relating to the
18 investment in the contract), and

19 “(B) the aggregate premiums or other con-
20 sideration paid for purposes of subsection (e)(6)
21 (relating to certain amounts not received as an
22 annuity),

23 any amount allowed as a deduction with respect to
24 the contract under section 404 which was paid while
25 the employee was an employee within the meaning of

1 section 401(c)(1) shall be treated as consideration
2 contributed by the employer, and there shall not be
3 taken into account any portion of the premiums or
4 other consideration for the contract paid while the
5 employee was an owner-employee which is properly
6 allocable (as determined under regulations pre-
7 scribed by the Secretary) to the cost of life, accident,
8 health, or other insurance.

9 “(2) LIFE INSURANCE CONTRACTS.—

10 “(A) This paragraph shall apply to any life
11 insurance contract—

12 “(i) purchased as a part of a plan de-
13 scribed in section 403(a), or

14 “(ii) purchased by a trust described in
15 section 401(a) which is exempt from tax if
16 the proceeds of such contract are payable
17 directly or indirectly to a participant in
18 such trust or to a beneficiary of such par-
19 ticipant.

20 “(B) Any contribution to a plan described
21 in subparagraph (A)(i) or a trust described in
22 subparagraph (A)(ii) which is allowed as a de-
23 duction under section 404, and any income of
24 a trust described in subparagraph (A)(ii), which
25 is determined in accordance with regulations

1 prescribed by the Secretary to have been ap-
2 plied to purchase the life insurance protection
3 under a contract described in subparagraph
4 (A), is includible in the gross income of the par-
5 ticipant for the taxable year when so applied.

6 “(C) In the case of the death of an indi-
7 vidual insured under a contract described in
8 subparagraph (A), an amount equal to the cash
9 surrender value of the contract immediately be-
10 fore the death of the insured shall be treated as
11 a payment under such plan or a distribution by
12 such trust, and the excess of the amount pay-
13 able by reason of the death of the insured over
14 such cash surrender value shall not be includ-
15 ible in gross income under this section and shall
16 be treated as provided in section 101.

17 “(3) PENALTIES APPLICABLE TO CERTAIN
18 AMOUNTS RECEIVED BY 5-PERCENT OWNERS.—

19 “(A) This paragraph applies to amounts
20 which are received from a qualified trust de-
21 scribed in section 401(a) or under a plan de-
22 scribed in section 403(a) at any time by an in-
23 dividual who is, or has been, a 5-percent owner,
24 or by a successor of such an individual, but only
25 to the extent such amounts are determined,

1 under regulations prescribed by the Secretary,
2 to exceed the benefits provided for such indi-
3 vidual under the plan formula.

4 “(B) If a person receives an amount to
5 which this paragraph applies, his tax under this
6 chapter for the taxable year in which such
7 amount is received shall be increased by an
8 amount equal to 10 percent of the portion of
9 the amount so received which is includible in
10 his gross income for such taxable year.

11 “(C) For purposes of this paragraph, the
12 term ‘5-percent owner’ means any individual
13 who, at any time during the 5 plan years pre-
14 ceeding the plan year ending in the taxable year
15 in which the amount is received, is a 5-percent
16 owner (as defined in section 416(i)(1)(B)).

17 “(4) OWNER-EMPLOYEE DEFINED.—For pur-
18 poses of this subsection, the term ‘owner-employee’
19 has the meaning assigned to it by section 401(c)(3)
20 and includes an individual for whose benefit an indi-
21 vidual retirement account or annuity described in
22 section 408(a) or (b) is maintained. For purposes of
23 the preceding sentence, the term ‘owner-employee’
24 shall include an employee within the meaning of sec-
25 tion 401(c)(1).

1 “(5) MEANING OF DISABLED.—For purposes of
2 this section, an individual shall be considered to be
3 disabled if he is unable to engage in any substantial
4 gainful activity by reason of any medically deter-
5 minable physical or mental impairment which can be
6 expected to result in death or to be of long-continued
7 and indefinite duration. An individual shall not be
8 considered to be disabled unless he furnishes proof
9 of the existence thereof in such form and manner
10 as the Secretary may require.

11 “(6) DETERMINATION OF INVESTMENT IN THE
12 CONTRACT IN THE CASE OF QUALIFIED DOMESTIC
13 RELATIONS ORDERS.—Under regulations prescribed
14 by the Secretary, in the case of a distribution or
15 payment made to an alternate payee who is the
16 spouse or former spouse of the participant pursuant
17 to a qualified domestic relations order (as defined in
18 section 414(p)), the investment in the contract as of
19 the date prescribed in such regulations shall be allo-
20 cated on a pro rata basis between the present value
21 of such distribution or payment and the present
22 value of all other benefits payable with respect to the
23 participant to which such order relates.

24 “(1) ANNUITIES UNDER RETIRED SERVICEMAN’S
25 FAMILY PROTECTION PLAN OR SURVIVOR BENEFIT

1 PLAN.—Subsection (b) shall not apply in the case of
2 amounts received after December 31, 1965, as an annuity
3 under chapter 73 of title 10 of the United States Code,
4 but all such amounts shall be excluded from gross income
5 until there has been so excluded (under section 122(b)(1)
6 of the Internal Revenue Code of 1986, section 93, or this
7 section, including amounts excluded before January 1,
8 1966) an amount equal to the consideration for the con-
9 tract (as defined by section 122(b)(2) of the Internal Rev-
10 enue Code of 1986). Thereafter all amounts so received
11 shall be included in gross income.

12 “(m) SPECIAL RULES FOR DISTRIBUTIONS FROM
13 QUALIFIED PLANS TO WHICH EMPLOYEE MADE DE-
14 DUCTIBLE CONTRIBUTIONS.—

15 “(1) TREATMENT OF CONTRIBUTIONS.—For
16 purposes of this section and sections 402 and 403,
17 notwithstanding section 414(h), any deductible em-
18 ployee contribution made to a qualified employer
19 plan or government plan shall be treated as an
20 amount contributed by the employer which is not in-
21 cludible in the gross income of the employee.

22 “(2) AMOUNTS CONSTRUCTIVELY RECEIVED.—

23 “(A) IN GENERAL.—For purposes of this
24 subsection, rules similar to the rules provided

1 by subsection (n) (other than the exception con-
2 tained in paragraph (2) thereof) shall apply.

3 “(B) PURCHASE OF LIFE INSURANCE.—To
4 the extent any amount of accumulated deduct-
5 ible employee contributions of an employee are
6 applied to the purchase of life insurance con-
7 tracts, such amount shall be treated as distrib-
8 uted to the employee in the year so applied.

9 “(3) SPECIAL RULE FOR TREATMENT OF ROLL-
10 OVER AMOUNTS.—For purposes of sections 402(c),
11 403(a)(4), and 408(d)(3), the Secretary shall pre-
12 scribe regulations providing for such allocations of
13 amounts attributable to accumulated deductible em-
14 ployee contributions, and for such other rules, as
15 may be necessary to insure that such accumulated
16 deductible employee contributions do not become eli-
17 gible for additional tax benefits (or freed from limi-
18 tations) through the use of rollovers.

19 “(4) ORDERING RULES.—Unless the plan speci-
20 fies otherwise, any distribution from such plan shall
21 not be treated as being made from the accumulated
22 deductible employee contributions, until all other
23 amounts to the credit of the employee have been dis-
24 tributed.

1 “(n) LOANS TREATED AS DISTRIBUTIONS.—For pur-
2 poses of this section—

3 “(1) TREATMENT AS DISTRIBUTIONS.—

4 “(A) LOANS.—If during any taxable year a
5 participant or beneficiary receives (directly or
6 indirectly) any amount as a loan from a quali-
7 fied employer plan, such amount shall be treat-
8 ed as having been received by such individual as
9 a distribution under such plan.

10 “(B) ASSIGNMENTS OR PLEDGES.—If dur-
11 ing any taxable year a participant or beneficiary
12 assigns (or agrees to assign) or pledges (or
13 agrees to pledge) any portion of his interest in
14 a qualified employer plan, such portion shall be
15 treated as having been received by such indi-
16 vidual as a loan from such plan.

17 “(2) EXCEPTION FOR CERTAIN LOANS.—

18 “(A) GENERAL RULE.—Paragraph (1)
19 shall not apply to any loan to the extent that
20 such loan (when added to the outstanding bal-
21 ance of all other loans from such plan whether
22 made on, before, or after August 13, 1982),
23 does not exceed the lesser of—

24 “(i) \$50,000, reduced by the excess (if
25 any) of—

1 “(I) the highest outstanding bal-
2 ance of loans from the plan during the
3 1-year period ending on the day be-
4 fore the date on which such loan was
5 made, over

6 “(II) the outstanding balance of
7 loans from the plan on the date on
8 which such loan was made, or

9 “(ii) the greater of (I) one-half of the
10 present value of the nonforfeitable accrued
11 benefit of the employee under the plan, or
12 (II) \$10,000.

13 for purposes of clause (ii), the present value of
14 the nonforfeitable accrued benefit shall be de-
15 termined without regard to any accumulated
16 deductible employee contributions (as defined in
17 subsection (m)(5)(B)).

18 “(B) REQUIREMENT THAT LOAN BE RE-
19 PAYABLE WITHIN 5 YEARS.—

20 “(i) IN GENERAL.—Subparagraph (A)
21 shall not apply to any loan unless such
22 loan, by its terms, is required to be repaid
23 within 5 years.

24 “(ii) EXCEPTION FOR HOME LOANS.—
25 Clause (i) shall not apply to any loan used

1 to acquire any dwelling unit which within
2 a reasonable time is to be used (deter-
3 mined at the time the loan is made) as the
4 principal residence of the participant.

5 “(C) REQUIREMENT OF LEVEL AMORTIZA-
6 TION.—Except as provided in regulations, this
7 paragraph shall not apply to any loan unless
8 substantially level amortization of such loan
9 (with payments not less frequently than quar-
10 terly) is required over the term of the loan.

11 “(D) RELATED EMPLOYERS AND RELATED
12 PLANS.—For purposes of this paragraph—

13 “(i) the rules of subsections (b), (c),
14 and (m) of section 414 shall apply, and

15 “(ii) all plans of an employer (deter-
16 mined after the application of such sub-
17 sections) shall be treated as 1 plan.

18 “(o) 10-PERCENT PENALTY FOR PREMATURE DIS-
19 TRIBUTIONS FROM ANNUITY CONTRACTS.—

20 “(1) IMPOSITION OF PENALTY.—If any tax-
21 payer receives any amount under an annuity con-
22 tract, the taxpayer’s tax under this chapter for the
23 taxable year in which such amount is received shall
24 be increased by an amount equal to 10 percent of

1 the portion of such amount which is includible in
2 gross income.

3 “(2) SUBSECTION NOT TO APPLY TO CERTAIN
4 DISTRIBUTIONS.—Paragraph (1) shall not apply to
5 any distribution—

6 “(A) made on or after the date on which
7 the taxpayer attains age 59½,

8 “(B) made on or after the death of the
9 holder (or, where the holder is not an indi-
10 vidual, the death of the primary annuitant),

11 “(C) attributable to the taxpayer’s becom-
12 ing disabled within the meaning of subsection
13 (k)(5),

14 “(D) which is a part of a series of substan-
15 tially equal periodic payments (not less fre-
16 quently than annually) made for the life (or life
17 expectancy) of the taxpayer or the joint lives
18 (or joint life expectancies) of such taxpayer and
19 his designated beneficiary,

20 “(E) from a plan, contract, account, trust,
21 or annuity described in section 72(e)(5)(D) of
22 the Internal Revenue Code of 1986,

23 “(F) allocable to investment in the con-
24 tract before August 14, 1982,

25 “(G) under a qualified funding asset,

1 “(H) to which subsection (r) applies (with-
2 out regard to paragraph (2) thereof),

3 “(I) under an immediate annuity contract,
4 or

5 “(J) which is purchased by an employer
6 upon the termination of a plan described in sec-
7 tion 401(a) or 403(a) and which is held by the
8 employer until such time as the employee sepa-
9 rates from service.

10 “(3) CHANGE IN SUBSTANTIALLY EQUAL PAY-
11 MENTS.—If—

12 “(A) paragraph (1) does not apply to a
13 distribution by reason of paragraph (2)(D), and

14 “(B) the series of payments under such
15 paragraph are subsequently modified (other
16 than by reason of death or disability)—

17 “(i) before the close of the 5-year pe-
18 riod beginning on the date of the first pay-
19 ment and after the taxpayer attains age
20 59½, or

21 “(ii) before the taxpayer attains age
22 59½,

23 the taxpayer’s tax for the 1st taxable year in which
24 such modification occurs shall be increased by an
25 amount, determined under regulations, equal to the

1 tax which (but for paragraph (2)(D)) would have
2 been imposed, plus interest for the deferral period
3 (within the meaning of subsection (r)(4)(B)).

4 “(p) CERTAIN RAILROAD RETIREMENT BENEFITS
5 TREATED AS RECEIVED UNDER EMPLOYER PLANS.—

6 “(1) IN GENERAL.—Notwithstanding any other
7 provision of law, any benefit provided under the
8 Railroad Retirement Act of 1974 (other than a tier
9 1 railroad retirement benefit) shall be treated for
10 purposes of this title as a benefit provided under an
11 employer plan which meets the requirements of sec-
12 tion 401(a).

13 “(2) TIER 2 TAXES TREATED AS CONTRIBU-
14 TIONS.—For purposes of paragraph (1)—

15 “(i) the tier 2 portion of the tax im-
16 posed by section 3201 (relating to tax on
17 employees) shall be treated as an employee
18 contribution,

19 “(ii) the tier 2 portion of the tax im-
20 posed by section 3211 (relating to tax on
21 employee representatives) shall be treated
22 as an employee contribution, and

23 “(iii) the tier 2 portion of the tax im-
24 posed by section 3221 (relating to tax on

1 employers) shall be treated as an employer
2 contribution.

3 “(B) TIER 2 PORTION.—For purposes of
4 subparagraph (A)—

5 “(1) AFTER 1984.—With respect to compensa-
6 tion paid after 1984, the tier 2 portion shall be the
7 taxes imposed by sections 3201(b), 3211(a)(2), and
8 3221(b).

9 “(2) BEFORE 1985.—With respect to compensa-
10 tion paid before 1985, see section 72(r) of Internal
11 Revenue Code of 1986 for the definition of tier 2
12 portion.

13 “(C) CONTRIBUTIONS NOT ALLOCABLE TO
14 SUPPLEMENTAL ANNUITY OR WINDFALL BENE-
15 FITS.—For purposes of paragraph (1), no
16 amount treated as an employee contribution
17 under this paragraph shall be allocated to—

18 “(i) any supplemental annuity paid
19 under section 2(b) of the Railroad Retire-
20 ment Act of 1974, or

21 “(ii) any benefit paid under section
22 3(h), 4(e), or 4(h) of such Act.

23 “(3) TIER 1 RAILROAD RETIREMENT BEN-
24 EFIT.—For purposes of paragraph (1), the term

1 ‘tier 1 railroad retirement benefit’ has the meaning
2 given such term by section 3(b)(2)(B).

3 “(q) REQUIRED DISTRIBUTIONS WHERE HOLDER
4 DIES BEFORE ENTIRE INTEREST IS DISTRIBUTED.—

5 “(1) IN GENERAL.—A contract shall not be
6 treated as an annuity contract for purposes of this
7 chapter unless it provides that—

8 “(A) if any holder of such contract dies on
9 or after the annuity starting date and before
10 the entire interest in such contract has been
11 distributed, the remaining portion of such inter-
12 est will be distributed at least as rapidly as
13 under the method of distributions being used as
14 of the date of his death, and

15 “(B) if any holder of such contract dies be-
16 fore the annuity starting date, the entire inter-
17 est in such contract will be distributed within 5
18 years after the death of such holder.

19 “(2) EXCEPTION FOR CERTAIN AMOUNTS PAY-
20 ABLE OVER LIFE OF BENEFICIARY.—If—

21 “(A) any portion of the holder’s interest is
22 payable to (or for the benefit of) a designated
23 beneficiary,

24 “(B) such portion will be distributed (in
25 accordance with regulations) over the life of

1 such designated beneficiary (or over a period
2 not extending beyond the life expectancy of
3 such beneficiary), and

4 “(C) such distributions begin not later
5 than 1 year after the date of the holder’s death
6 or such later date as the Secretary may by reg-
7 ulations prescribe,

8 then for purposes of paragraph (1), the portion re-
9 ferred to in subparagraph (A) shall be treated as
10 distributed on the day on which such distributions
11 begin.

12 “(3) SPECIAL RULE WHERE SURVIVING SPOUSE
13 BENEFICIARY.—If the designated beneficiary re-
14 ferred to in paragraph (2)(A) is the surviving spouse
15 of the holder of the contract, paragraphs (1) and (2)
16 shall be applied by treating such spouse as the hold-
17 er of such contract.

18 “(4) DESIGNATED BENEFICIARY.—For pur-
19 poses of this subsection, the term ‘designated bene-
20 ficiary’ means any individual designated a bene-
21 ficiary by the holder of the contract.

22 “(5) EXCEPTION FOR CERTAIN ANNUITY CON-
23 TRACTS.—This subsection shall not apply to any an-
24 nuity contract—

25 “(A) which is provided—

1 “(i) under a plan described in section
2 401(a) which includes a trust exempt from
3 tax under section 501, or

4 “(ii) under a plan described in section
5 403(a),

6 “(B) which is described in section 403(b),

7 “(C) which is an individual retirement an-
8 nuity or provided under an individual retire-
9 ment account or annuity, or

10 “(D) which is a qualified funding asset.

11 “(6) SPECIAL RULE WHERE HOLDER IS COR-
12 PORATION OR OTHER NON-INDIVIDUAL.—

13 “(A) IN GENERAL.—For purposes of this
14 subsection, if the holder of the contract is not
15 an individual, the primary annuitant shall be
16 treated as the holder of the contract.

17 “(B) PRIMARY ANNUITANT.—For purposes
18 of subparagraph (A), the term ‘primary annu-
19 itant’ means the individual, the events in the
20 life of whom are of primary importance in af-
21 fecting the timing or amount of the payout
22 under the contract.

23 “(7) TREATMENT OF CHANGES IN PRIMARY AN-
24 NUITANT WHERE HOLDER OF CONTRACT IS NOT AN
25 INDIVIDUAL.—For purposes of this subsection, in

1 the case of a holder of an annuity contract which
2 is not an individual, if there is a change in a pri-
3 mary annuitant (as defined in paragraph (6)(B)),
4 such change shall be treated as the death of the
5 holder.

6 “(r) 10-PERCENT ADDITIONAL TAX ON EARLY DIS-
7 TRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.—

8 “(1) IMPOSITION OF ADDITIONAL TAX.—If any
9 taxpayer receives any amount from a qualified re-
10 tirement plan (as defined in section 4974(c)), the
11 taxpayer’s tax under this chapter for the taxable
12 year in which such amount is received shall be in-
13 creased by an amount equal to 10 percent of the
14 portion of such amount which is includible in gross
15 income.

16 “(2) SUBSECTION NOT TO APPLY TO CERTAIN
17 DISTRIBUTIONS.—Except as provided in paragraphs
18 (3) and (4), paragraph (1) shall not apply to any of
19 the following distributions:

20 “(A) IN GENERAL.—Distributions which
21 are—

22 “(i) made on or after the date on
23 which the employee attains age 59½,

1 “(ii) made to a beneficiary (or to the
2 estate of the employee) on or after the
3 death of the employee,

4 “(iii) attributable to the employee’s
5 being disabled within the meaning of sub-
6 section 72(m)(7) of the Internal Revenue
7 Code of 1986,

8 “(iv) part of a series of substantially
9 equal periodic payments (not less fre-
10 quently than annually) made for the life
11 (or life expectancy) of the employee or the
12 joint lives (or joint life expectancies) of
13 such employee and his designated bene-
14 ficiary,

15 “(v) made to an employee after sepa-
16 ration from service after attainment of age
17 55,

18 “(vi) dividends paid with respect to
19 stock of a corporation which are described
20 in section 404(k), or

21 “(vii) made from a Roth IRA (other
22 than a distribution described in section
23 30(d)(2)).

24 “(B) MEDICAL EXPENSES.—Distributions
25 made to the employee (other than distributions

1 described in subparagraph (A), (C), or (D)) to
2 the extent such distributions do not exceed the
3 amount allowable as a deduction under section
4 31 to the employee for amounts paid during the
5 taxable year for medical care (determined with-
6 out regard to whether the employee itemizes de-
7 ductions for such taxable year).

8 “(C) PAYMENTS TO ALTERNATE PAYEES
9 PURSUANT TO QUALIFIED DOMESTIC RELA-
10 TIONS ORDERS.—Any distribution to an alter-
11 nate payee pursuant to a qualified domestic re-
12 lations order (within the meaning of section
13 414(p)(1)).

14 “(D) DISTRIBUTIONS TO UNEMPLOYED IN-
15 DIVIDUALS FOR HEALTH INSURANCE PRE-
16 MIUMS.—

17 “(i) IN GENERAL.—Distributions from
18 an individual retirement plan to an indi-
19 vidual after separation from employment—

20 “(I) if such individual has re-
21 ceived unemployment compensation
22 for 12 consecutive weeks under any
23 Federal or State unemployment com-
24 pensation law by reason of such sepa-
25 ration,

1 “(II) if such distributions are
2 made during any taxable year during
3 which such unemployment compensa-
4 tion is paid or the succeeding taxable
5 year, and

6 “(III) to the extent such distribu-
7 tions do not exceed the amount paid
8 during the taxable year for insurance
9 described in section 213(d)(1)(D) of
10 the Internal Revenue Code of 1986
11 with respect to the individual and the
12 individual’s spouse and dependents.

13 “(ii) DISTRIBUTIONS AFTER REEM-
14 PLOYMENT.—Clause (i) shall not apply to
15 any distribution made after the individual
16 has been employed for at least 60 days
17 after the separation from employment to
18 which clause (i) applies.

19 “(iii) SELF-EMPLOYED INDIVID-
20 UALS.—To the extent provided in regula-
21 tions, a self-employed individual shall be
22 treated as meeting the requirements of
23 clause (i)(I) if, under Federal or State law,
24 the individual would have received unem-

1 employment compensation but for the fact the
2 individual was self-employed.

3 “(E) DISTRIBUTIONS FROM INDIVIDUAL
4 RETIREMENT PLANS FOR HIGHER EDUCATION
5 EXPENSES.—Distributions to an individual
6 from an individual retirement plan to the extent
7 such distributions do not exceed the qualified
8 higher education expenses (as defined in para-
9 graph (7)) of the taxpayer for the taxable year.
10 Distributions shall not be taken into account
11 under the preceding sentence if such distribu-
12 tions are described in subparagraph (A), (C), or
13 (D) or to the extent paragraph (1) does not
14 apply to such distributions by reason of sub-
15 paragraph (B).

16 “(F) DISTRIBUTIONS FROM CERTAIN
17 PLANS FOR FIRST HOME PURCHASES.—Dis-
18 tributions to an individual from an individual
19 retirement plan which are qualified first-time
20 homebuyer distributions (as defined in para-
21 graph (8)). Distributions shall not be taken into
22 account under the preceding sentence if such
23 distributions are described in subparagraph (A),
24 (C), (D), or (E) or to the extent paragraph (1)

1 does not apply to such distributions by reason
2 of subparagraph (B).

3 “(3) LIMITATIONS.—

4 “(A) CERTAIN EXCEPTIONS NOT TO APPLY
5 TO INDIVIDUAL RETIREMENT PLANS.—Sub-
6 paragraphs (A)(v), and (C) of paragraph (2)
7 shall not apply to distributions from an indi-
8 vidual retirement plan.

9 “(B) PERIODIC PAYMENTS UNDER QUALI-
10 FIED PLANS MUST BEGIN AFTER SEPARA-
11 TION.—Paragraph (2)(A)(iv) shall not apply to
12 any amount paid from a trust described in sec-
13 tion 401(a) which is exempt from tax under
14 section 501(a) or from a contract described in
15 section 72(e)(5)(D)(ii) of the Internal Revenue
16 Code of 1986 unless the series of payments be-
17 gins after the employee separates from service.

18 “(4) CHANGE IN SUBSTANTIALLY EQUAL PAY-
19 MENTS.—

20 “(A) IN GENERAL.—If—

21 “(i) paragraph (1) does not apply to
22 a distribution by reason of paragraph
23 (2)(A)(iv), and

24 “(ii) the series of payments under
25 such paragraph are subsequently modified

1 (other than by reason of death or dis-
2 ability)—

3 “(I) before the close of the 5-year
4 period beginning with the date of the
5 first payment and after the employee
6 attains age 59½, or

7 “(II) before the employee attains
8 age 59½, the taxpayer’s tax for the
9 1st taxable year in which such modi-
10 fication occurs shall be increased by
11 an amount, determined under regula-
12 tions, equal to the tax which (but for
13 paragraph (2)(A)(iv)) would have
14 been imposed, plus interest for the de-
15 ferral period.

16 “(B) DEFERRAL PERIOD.—For purposes
17 of this paragraph, the term ‘deferral period’
18 means the period beginning with the taxable
19 year in which (without regard to paragraph
20 (2)(A)(iv)) the distribution would have been in-
21 cludible in gross income and ending with the
22 taxable year in which the modification described
23 in subparagraph (A) occurs.

24 “(5) EMPLOYEE.—For purposes of this sub-
25 section, the term ‘employee’ includes any partici-

1 pant, and in the case of an individual retirement
2 plan, the individual for whose benefit such plan was
3 established.

4 “(6) SPECIAL RULES FOR SIMPLE RETIREMENT
5 ACCOUNTS.—In the case of any amount received
6 from a simple retirement account (within the mean-
7 ing of section 408(p) during the 2-year period begin-
8 ning on the date such individual first participated in
9 any qualified salary reduction arrangement main-
10 tained by the individual’s employer under section
11 408(p)(2), paragraph (1) shall be applied by sub-
12 stituting ‘25 percent’ for ‘10 percent’.

13 “(7) QUALIFIED HIGHER EDUCATION EX-
14 PENSES.—For purposes of paragraph (2)(E)—

15 “(A) IN GENERAL.—The term ‘qualified
16 higher education expenses’ means qualified
17 higher education expenses (as defined in section
18 10(b)(2)) for education furnished to—

19 “(i) the taxpayer,

20 “(ii) the taxpayer’s spouse, or

21 “(iii) any child or grandchild of the
22 taxpayer or the taxpayer’s spouse, at an el-
23 igible educational institution (as defined in
24 section 10(b)(2)(B)).

1 “(B) COORDINATION WITH OTHER PROVI-
2 SIONS.—For purposes of this subsection, sec-
3 tion 30 and section 32, qualified higher edu-
4 cation expenses in any taxable year shall be
5 treated as first paid with distributions under
6 section 32, next with distributions to which sec-
7 tion 30(d)(5)(v) (relating to early withdrawals
8 from Roth IRAs to pay higher education ex-
9 penses) applies, and finally from withdrawals to
10 which this subsection applies.

11 “(8) QUALIFIED FIRST-TIME HOMEBUYER DIS-
12 TRIBUTIONS.—For purposes of this subsection, the
13 term ‘qualified first-time homebuyer distribution’
14 has the meaning given to it in section 30(d)(6) and
15 the limits contained in such section shall apply on a
16 combined basis to this subsection and section 30.
17 Qualified acquisition costs (as defined in section
18 30(d)(6)) taken into account for purposes of section
19 30(d)(5)(vi) shall not also be taken into account sep-
20 arately for purposes of this subsection. A taxpayer
21 may elect to treat distributions from an account
22 other than Roth IRAs to which this subsection ap-
23 plies as a qualified first-time homeowner distribution
24 before determining whether a distribution from a

1 Roth IRA is a qualified first-time homeowner dis-
2 tribution.

3 “(r) 10-PERCENT ADDITIONAL TAX FOR TAXABLE
4 DISTRIBUTIONS FROM MODIFIED ENDOWMENT CON-
5 TRACTS.—

6 “(1) IMPOSITION OF ADDITIONAL TAX.—If any
7 taxpayer receives any amount under a modified en-
8 dowment contract (as defined in section 7702A), the
9 taxpayer’s tax under this chapter for the taxable
10 year in which such amount is received shall be in-
11 creased by an amount equal to 10 percent of the
12 portion of such amount which is includible in gross
13 income.

14 “(2) SUBSECTION NOT TO APPLY TO CERTAIN
15 DISTRIBUTIONS.—Paragraph (1) shall not apply to
16 any distribution—

17 “(A) made on or after the date on which
18 the taxpayer attains age 59½,

19 “(B) which is attributable to the tax-
20 payer’s becoming disabled (within the meaning
21 of subsection (m)(7)), or

22 “(C) which is part of a series of substan-
23 tially equal periodic payments (not less fre-
24 quently than annually) made for the life (or life
25 expectancy) of the taxpayer or the joint lives

1 (or joint life expectancies) of such taxpayer and
2 his beneficiary.

3 **“Subchapter C—Basis, Business Transactions**
4 **and Nonrecognition Transactions**

“Sec. 71. Gain or loss on the sale of an asset.

“Sec. 72. Basis.

“Sec. 73. Basis in business entities.

“Sec. 74. Gratuitous transfers.

“Sec. 75. Transactions involving business entities.

“Sec. 76. Rollover on residence sale.

“Sec. 77. Other nonrecognition transactions.

“Sec. 78. Wash sales and straddles.

5 **“SEC. 71. GAIN OR LOSS ON THE SALE OF AN ASSET.**

6 “(a) IN GENERAL.—Except as otherwise provided in
7 this chapter, the amount of gross income to be recognized
8 on the sale, exchange, or other disposition of property
9 equals the excess of—

10 “(1) the amount realized from the disposition,
11 over

12 “(2) the taxpayer’s adjusted basis in the prop-
13 erty.

14 “(b) AMOUNT REALIZED.—The amount realized from
15 the disposition of property shall be sum of money received
16 plus the fair market value of the property (other than
17 money) received. See section 122(c) for the treatment of
18 installment sales.

19 “(c) NONRECOGNITION TRANSACTION.—Subsection
20 (a) shall not apply to nonrecognition transactions de-
21 scribed in this chapter.

1 “(d) CONTRACTS MARKED TO MARKET.—

2 “(1) IN GENERAL.—Under regulations pre-
3 scribed by the Secretary, a markable contract held
4 by the taxpayer at the end of the year shall be treat-
5 ed as sold and reacquired for its fair market value
6 on the last business day of the taxable year. The
7 regulations shall adopt principles and definitions
8 similar to those that applied under section 1256 of
9 the Internal Revenue Code of 1986.

10 “(2) MARKABLE CONTRACT.—For purposes of
11 this subsection, ‘markable contract’ means—

12 “(A) any regulated futures contract,

13 “(B) any foreign currency contract,

14 “(C) any nonequity option,

15 “(D) any dealer equity option

16 as such terms were defined for purposes of section
17 1256 of the Internal Revenue Code of 1986.

18 **“SEC. 72. BASIS.**

19 “(a) BASIS, SALE, OR EXCHANGE.—Except to the ex-
20 tent inconsistent with provisions of this chapter, adjusted
21 basis and the existence of a sale or exchange shall be de-
22 termined in accordance with principles applicable under
23 the Internal Revenue Code of 1986.

24 “(b) DEFINITION OF BASIS.—For purposes of this
25 chapter, ‘basis’ means the adjusted basis of property. The

1 adjusted basis of property is generally its cost, as adjusted
2 for actions or transactions that increase or decrease the
3 basis of property. Except as provided in section 73 (relat-
4 ing to business entities and basis in business entities), the
5 taxpayer's adjusted basis on January 1, 2002, in an asset
6 acquired before that date, shall be its adjusted basis as
7 of December 31, 2001, as determined under the Internal
8 Revenue Code of 1986.

9 **“SEC. 73. BASIS IN BUSINESS ENTITIES.**

10 “(a) RULES FOR ALL BUSINESS ENTITIES.—

11 “(1) IN GENERAL.—A taxpayer's basis in an in-
12 terest in a business entity shall equal—

13 “(A) the cost of acquiring the interest,

14 “(B) increased by the amount of cash and
15 basis of any property contributed to the entity,
16 and

17 “(C) decreased by the portion of any liqui-
18 dating distributions from the entity that are
19 treated as returns of capital in accordance with
20 rules prescribed by the Secretary.

21 “(2) INITIAL BASIS.—Except as otherwise pro-
22 vided in this section, a taxpayer's basis on January
23 1, 2002, or any interest in a business entity held as
24 of December 31, 2001, shall be the basis of such in-

1 terest as of December 31, 2001, as determined
2 under the Internal Revenue Code of 1986.

3 “(3) CROSS REFERENCES.—See section 75 for
4 rules relating to the effect of certain business trans-
5 actions on a taxpayer’s basis.

6 “(4) SPECIAL RULE FOR CONTRIBUTION OF
7 PERSONAL USE PROPERTY.—If a taxpayer contrib-
8 utes personal-use property (as defined in section
9 210(b)(3)(B)), the taxpayer’s basis in the property
10 shall not be increased by an amount in excess of the
11 fair market value of the property contributed.

12 “(b) SPECIAL RULES FOR PARTNERSHIP INTER-
13 ESTS.—

14 “(1) INITIAL BASIS IN OLD PARTNERSHIPS.—A
15 partner’s basis in a partnership interest as of Janu-
16 ary 1, 2002, equals—

17 “(A) the partner’s basis in the partnership
18 as of the end of the taxable year ending on De-
19 cember 31, 2001, minus

20 “(B) the amount of the partner’s share of
21 the indebtedness of the partnership taken into
22 account in determining such basis.

23 “(2) NEGATIVE BASIS.—If the amount deter-
24 mined under paragraph (1) is negative, the taxpayer
25 has a negative basis in the partnership and such

1 negative basis shall increase the gain on the sale or
2 disposition of the partnership interest (except to the
3 extent such negative basis has been adjusted by rea-
4 son of capital contributions).

5 “(3) ADJUSTMENT TO BASIS.—Except as other-
6 wise provided in this section, a partner’s basis in a
7 partnership interest shall be determined in accord-
8 ance with the general principles of this chapter ap-
9 plicable to an individual’s basis in an interest in a
10 business entity. A partner’s basis in a partnership
11 shall not be adjusted by reason of any—

12 “(A) distribution from the partnership (ex-
13 cept to the extent such distribution is treated as
14 distribution of basis in accordance with the gen-
15 eral principles of this chapter applicable to an
16 individual’s basis in an interest in a business
17 entity),

18 “(B) income, earnings, or loss of the part-
19 nership, or

20 “(C) any change in the partner’s share of
21 the partnership’s indebtedness.

22 “(4) SPECIAL RULE FOR TRANSITION DISTRIBU-
23 TIONS.—

1 “(A) EFFECT OF TRANSITION DISTRIBUTION.—A transition distribution from partnership to a partner shall—

2 “(i) reduce the partner’s basis in the
3 partnership, and

4 “(ii) not be included in gross income.

5 “(B) DEFINITION.—A ‘transition distribution’ is a distribution by a business entity to an
6 individual made during the first three months
7 of 2002 but only to the extent that such distribution,
8 when added to all other distributions
9 of the entity to the individual after March 31,
10 2001, does not exceed the amount of taxable income
11 allocated by the entity to the individual
12 during the taxable year of the entity ending on
13 December 31, 2001.

14 “(5) PARTNERSHIP.—For purposes of this section,
15 ‘partnership’ includes a limited liability company
16 that was taxable as a partnership under the
17 Internal Revenue Code of 1986.

18 “(c) SPECIAL RULES FOR SHARES OF S CORPORATIONS.—Rules similar to those contained in subsection (b)
19 shall apply with respect to the basis of stock of a corporation
20 that was treated as an S corporation under the Internal Revenue Code of 1986.
21 shall apply with respect to the basis of stock of a corporation
22 that was treated as an S corporation under the Internal Revenue Code of 1986.
23 shall apply with respect to the basis of stock of a corporation
24 that was treated as an S corporation under the Internal Revenue Code of 1986.
25 shall apply with respect to the basis of stock of a corporation
 that was treated as an S corporation under the Internal Revenue Code of 1986.

1 “(d) SPECIAL RULES FOR PROPRIETORSHIPS.—

2 “(1) OLD PROPRIETORSHIP.—A proprietor’s
3 basis in any business activity conducted before Janu-
4 ary 1, 2002, which is treated as a business activity
5 as of such date equals—

6 “(A) the proprietor’s adjusted basis in the
7 assets of such business entity as of the end of
8 the taxable year ending on December 31, 2001,
9 minus

10 “(B) the balance of any indebtedness the
11 interest on which the proprietor had treated as
12 business interest under section 163(h)(2)(A) of
13 the Internal Revenue Code of 1986.

14 “(2) NEGATIVE BASIS.—If the amount deter-
15 mined under paragraph (1) is negative, the propri-
16 etor has a negative basis in the proprietorship and
17 such negative basis shall increase the gain on the
18 sale or disposition of the entity (except to the extent
19 such negative basis has been adjusted by reason of
20 capital contributions).

21 “(3) ADJUSTMENT TO BASIS.—Except as other-
22 wise provided in this section, a proprietor’s basis in
23 a proprietorship shall be determined in accordance
24 with the general principles of this chapter applicable

1 to an individual's basis in an interest in a business
2 entity.

3 “(4) PROPRIETORSHIP.—‘Proprietorship’
4 includes—

5 “(A) any family business that is not a
6 partnership, and

7 “(B) any business activity conducted by a
8 taxpayer other than as an employee if such ac-
9 tivity constitutes a business entity.

10 “(e) ANTI-AVOIDANCE RULE.—

11 “(1) IN GENERAL.—If a pass-through entity's
12 distributions to an individual in its taxable year or
13 taxable years ending in 2001 exceeds 125 percent of
14 the individual's distributive share of income for such
15 period, the amount of such excess distribution shall
16 be treated as a cash distribution to the partner on
17 January 1, 2002, and shall not reduce the partner's
18 basis in his partnership interest.

19 “(2) PASS THROUGH ENTITY.—‘Pass through
20 entity’ means a partnership, proprietorship, or S
21 corporation.

22 **“SEC. 74. GRATUITOUS TRANSFERS.**

23 “(a) IN GENERAL.—If after December 31, 2001, a
24 taxpayer receives any property by gift, inheritance, or

1 other gratuitous transfer, the taxpayer's basis in the prop-
2 erty shall be the lesser of—

3 “(1) the fair market value of the property at
4 the time of transfer, or

5 “(2) the transferee's basis in the property at
6 the time of transfer.

7 “(b) **PROOF REQUIRED.**—A taxpayer's basis in an
8 asset received by gift, inheritance, or other gratuitous
9 transfer shall be presumed to be zero unless the taxpayer
10 can demonstrate to the satisfaction of the Secretary the
11 basis claimed by the taxpayer.

12 **“SEC. 75. DISTRIBUTIONS FROM BUSINESS ENTITIES.**

13 “(a) **IN GENERAL.**—Except as otherwise provided in
14 this section or in regulations issued by the Secretary in
15 accordance with this section—

16 “(1) **CASH DISTRIBUTIONS.**—Distributions of
17 cash by a business entity with respect to its equity
18 ownership shall be treated as dividends and included
19 in gross income.

20 “(2) **DISTRIBUTIONS OF PROPERTY.**—If a busi-
21 ness entity distributes property (other than stock or
22 other equity ownership described in paragraph (3) in
23 connection with a merger, acquisition or reorganiza-
24 tion), the fair market value of the property received

1 shall be treated as a dividend and included in gross
2 income.

3 “(3) DISTRIBUTIONS OF STOCK OR OTHER EQ-
4 UITY OWNERSHIP.—If a taxpayer receives with re-
5 spect to its ownership interest in a business entity
6 stock or other ownership interests in such business
7 entity (as reorganized) or in another business entity
8 that is controlled by such business entity or is ac-
9 quiring or merging with such business entity, no
10 gain or loss shall be recognized on the distribution.

11 “(b) BASIS IN BUSINESS DIVISIONS.—In the case of
12 a spin-off, split-off, or split-up of a business entity in
13 which a taxpayer has basis, the taxpayer’s basis in the
14 original business entity shall be allocated among the new
15 and surviving entities in accordance with the relative fair
16 market values of the taxpayer’s interests in those entities.
17 If interests in the entities are publicly traded, fair market
18 values shall be based on public trading prices. In other
19 cases, the Secretary shall accept any reasonable allocation
20 made by the taxpayer if the taxpayer notifies the Secretary
21 of the allocation in an attachment to its tax return for
22 the taxable year of the transaction.

23 “(c) DISTRIBUTIONS CONSTITUTING RETURN OF
24 BASIS.—

25 “(1) COMPLETE LIQUIDATIONS.—

1 “(A) IN GENERAL.—In the case of a dis-
2 tribution in complete liquidation of a business
3 entity, a taxpayer shall be treated as receiving
4 cash and assets of the entity in exchange for
5 the taxpayer’s equity in the business entity. In
6 such case, the taxpayer shall recognize gain to
7 the extent that the sum of the cash and fair
8 market value of assets received exceeds the tax-
9 payer’s basis in its interest in the business enti-
10 ty or shall recognize loss to the extent that the
11 basis exceeds the fair market value of cash and
12 assets received.

13 “(B) DISTRIBUTION OF EQUITY INTER-
14 ESTS.—In the case of a complete liquidation in
15 which at least 90 percent of the value of assets
16 and cash distributed to an equity holder is eq-
17 uity interests in other business entities con-
18 trolled by the distributing entity—

19 “(i) subparagraph (A) shall not apply,

20 “(ii) paragraph (3) of subsection (a)
21 shall apply,

22 “(iii) the cash and fair market value
23 of assets other than equity interests in
24 controlled entities shall be applied to re-
25 duce the taxpayer’s basis in the distrib-

1 uting entity and gain will be recognized
2 only to the extent that the cash and such
3 fair market value exceeds the taxpayer's
4 basis in the distributing entity, and

5 “(iv) the taxpayer's remaining basis
6 shall be allocated among the distributed
7 equity interests in controlled entities in ac-
8 cordance with the relative fair market val-
9 ues of such interests.

10 “(C) DISTRIBUTION OF BUSINESS PROP-
11 PERTY.—Under regulations prescribed by the
12 Secretary, rules similar to those that applied to
13 partnerships under the Internal Revenue Code
14 of 1986 shall apply in lieu of subparagraph (A)
15 to distributions that include property used in a
16 trade or business if such property is contributed
17 to a new business entity within 180 days of the
18 distribution.

19 “(2) TRANSITION RULES.—See subsections (b)
20 and (d) of section 73 for transition rules relating to
21 partnerships and proprietorships.

22 “(c) DEFINITIONS AND SPECIAL RULES.—

23 “(1) CERTAIN RULES OF APPLICATION.—

1 “(A) PRINCIPLES APPLICABLE TO INTER-
2 NAL REVENUE CODE.—This section shall be ap-
3 plied without regard to—

4 “(i) continuity of business interest,

5 “(ii) continuity of ownership interest,

6 “(iii) requirements of section 355 of
7 the Internal Revenue Code of 1986 for
8 spin-offs, split-offs and split-ups,

9 “(iv) business purposes for a cor-
10 porate reorganization or restructuring (ex-
11 cept if the transaction is potentially abu-
12 sive), and

13 “(v) except as provided in paragraph
14 (3), rules treating dividends as returns of
15 capital because of the absence of earnings
16 and profits.

17 “(B) CONSTRUCTIVE RECEIPT.—If a tax-
18 payer is given the choice of receiving cash or an
19 equity interest in a business entity, the tax-
20 payer will be treated for purposes of this sec-
21 tion as if he received the cash and purchased
22 the equity interest.

23 “(C) DEBT VERSUS EQUITY.—The prin-
24 ciples distinguishing debt and equity that ap-
25 plied prior to the adopt of the Simplified USA

1 Tax generally shall apply for purposes of apply-
2 ing this section. An investment in a business
3 entity shall not be considered debt unless—

4 “(i) it is reflected in the books and
5 records of the business entity as debt, and

6 “(ii) there is written evidence of the
7 investment that treats such investment as
8 indebtedness.

9 “(2) CONTROL.—For purposes of this section,
10 ‘control’ of a business entity means—

11 “(A) ownership of more than 50% of the
12 voting power held by equity holders of such en-
13 tity, or

14 “(B) ownership of rights to more than
15 50% of the periodic distributions that the busi-
16 ness entity may make to its equity holders and
17 50% of the distributions if the business entity
18 were liquidated.

19 “(3) REGULATIONS.—

20 “(A) SIGNIFICANT DOWNSIZING AND PAR-
21 TIAL LIQUIDATIONS.—The Secretary is author-
22 ized to issue regulations under which distribu-
23 tions resulting from a significant downsizing of
24 a business entity will be treated in part as re-
25 turn of equity holders’ capital.

1 “(B) ASSUMPTION AND RELEASE OF LI-
2 ABILITY.—The Secretary shall prescribe regula-
3 tions addressing the consequences of a
4 distributee’s assumption of the liabilities of the
5 distributor.

6 **“SEC. 76. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL**
7 **RESIDENCE.**

8 “(a) EXCLUSION.—Gross income shall not include
9 gain from the sale or exchange of property if, during the
10 5-year period ending on the date of the sale or exchange,
11 such property has been owned and used by the taxpayer
12 as the taxpayer’s principal residence for periods aggre-
13 gating 2 years or more.

14 “(b) LIMITATIONS.—

15 “(1) IN GENERAL.—The amount of gain ex-
16 cluded from gross income under subsection (a) with
17 respect to any sale or exchange shall not exceed
18 \$250,000.

19 “(2) \$500,000 LIMITATION FOR CERTAIN JOINT
20 RETURNS.—Paragraph (1) shall be applied by sub-
21 stituting ‘\$500,000’ for ‘\$250,000’ if—

22 “(A) a husband and wife make a joint re-
23 turn for the taxable year of the sale or ex-
24 change of the property,

1 “(B) either spouse meets the ownership re-
2 quirements of subsection (a) with respect to
3 such property,

4 “(C) both spouses meet the use require-
5 ments of subsection (a) with respect to such
6 property, and

7 “(D) neither spouse is ineligible for the
8 benefits of subsection (a) with respect to such
9 property by reason of paragraph (3).

10 “(3) APPLICATION TO ONLY 1 SALE OR EX-
11 CHANGE EVERY 2 YEARS.—

12 “(A) IN GENERAL.—Subsection (a) shall
13 not apply to any sale or exchange by the tax-
14 payer if, during the 2-year period ending on the
15 date of such sale or exchange, there was any
16 other sale or exchange by the taxpayer to which
17 subsection (a) applied.

18 “(B) PRE-MAY 7, 1997, SALES NOT TAKEN
19 INTO ACCOUNT.—Subparagraph (A) shall be
20 applied without regard to any sale or exchange
21 before May 7, 1997.

22 “(c) EXCLUSION FOR TAXPAYERS FAILING TO MEET
23 CERTAIN REQUIREMENTS.—

24 “(1) IN GENERAL.—In the case of a sale or ex-
25 change to which this subsection applies, the owner-

1 ship and use requirements of subsection (a) shall not
2 apply and subsection (b)(3) shall not apply; but the
3 amount of gain excluded from gross income under
4 subsection (a) with respect to such sale or exchange
5 shall not exceed—

6 “(A) the amount which bears the same
7 ratio to the amount which would be so excluded
8 under this section if such requirements had
9 been met, as

10 “(B) the shorter of—

11 “(i) the aggregate periods, during the
12 5-year period ending on the date of such
13 sale or exchange, such property has been
14 owned and used by the taxpayer as the
15 taxpayer’s principal residence, or

16 “(ii) the period after the date of the
17 most recent prior sale or exchange by the
18 taxpayer to which subsection (a) applied
19 and before the date of such sale or ex-
20 change,

21 bears to 2 years.

22 “(2) SALES AND EXCHANGES TO WHICH SUB-
23 SECTION APPLIES.—This subsection shall apply to
24 any sale or exchange if—

1 “(A) subsection (a) would not (but for this
2 subsection) apply to such sale or exchange by
3 reason of—

4 “(i) a failure to meet the ownership
5 and use requirements of subsection (a), or

6 “(ii) subsection (b)(3), and

7 “(B) such sale or exchange is by reason of
8 a change in place of employment, health, or, to
9 the extent provided in regulations, unforeseen
10 circumstances.

11 “(d) SPECIAL RULES.—

12 “(1) JOINT RETURNS.—If a husband and wife
13 make a joint return for the taxable year of the sale
14 or exchange of the property, subsections (a) and (c)
15 shall apply if either spouse meets the ownership and
16 use requirements of subsection (a) with respect to
17 such property.

18 “(2) PROPERTY OF DECEASED SPOUSE.—For
19 purposes of this section, in the case of an unmarried
20 individual whose spouse is deceased on the date of
21 the sale or exchange of property, the period such un-
22 married individual owned and used such property
23 shall include the period such deceased spouse owned
24 and used such property before death.

1 “(3) PROPERTY OWNED BY SPOUSE OR FORMER
2 SPOUSE.—For purposes of this section—

3 “(A) PROPERTY TRANSFERRED TO INDI-
4 VIDUAL FROM SPOUSE OR FORMER SPOUSE.—

5 In the case of an individual holding property
6 transferred to such individual by such individ-
7 ual’s spouse or former spouse in a transaction
8 incident to divorce, the period such individual
9 owns such property shall include the period the
10 transferor owned the property.

11 “(B) PROPERTY USED BY FORMER SPOUSE
12 PURSUANT TO DIVORCE DECREE, ETC.—Solely
13 for purposes of this section, an individual shall
14 be treated as using property as such individ-
15 ual’s principal residence during any period of
16 ownership while such individual’s spouse or
17 former spouse is granted use of the property
18 under a divorce or separation instrument.

19 “(4) TENANT-STOCKHOLDER IN COOPERATIVE
20 HOUSING CORPORATION.—For purposes of this sec-
21 tion, if the taxpayer holds stock as a tenant-stock-
22 holder in a cooperative housing corporation—

23 “(A) the holding requirements of sub-
24 section (a) shall be applied to the holding of
25 such stock, and

1 “(B) the use requirements of subsection
2 (a) shall be applied to the house or apartment
3 which the taxpayer was entitled to occupy as
4 such stockholder.

5 “(5) INVOLUNTARY CONVERSIONS.—For pur-
6 poses of this section, the destruction, theft, seizure,
7 requisition, or condemnation of property shall be
8 treated as the sale of such property.

9 “(6) DETERMINATION OF USE DURING PERIODS
10 OF OUT-OF-RESIDENCE CARE.—In the case of a tax-
11 payer who—

12 “(A) becomes physically or mentally in-
13 capable of self-care, and

14 “(B) owns property and uses such property
15 as the taxpayer’s principal residence during the
16 5-year period described in subsection (a) for pe-
17 riods aggregating at least 1 year,

18 then the taxpayer shall be treated as using such
19 property as the taxpayer’s principal residence during
20 any time during such 5-year period in which the tax-
21 payer owns the property and resides in any facility
22 (including a nursing home) licensed by a State or
23 political subdivision to care for an individual in the
24 taxpayer’s condition.

1 “(7) SALES OF REMAINDER INTERESTS.—For
2 purposes of this section—

3 “(A) IN GENERAL.—At the election of the
4 taxpayer, this section shall not fail to apply to
5 the sale or exchange of an interest in a prin-
6 cipal residence by reason of such interest being
7 a remainder interest in such residence, but this
8 section shall not apply to any other interest in
9 such residence which is sold or exchanged sepa-
10 rately.

11 “(B) EXCEPTION FOR SALES TO RELATED
12 PARTIES.—Subparagraph (A) shall not apply to
13 any sale to, or exchange with, a related party
14 (as defined in section 171).

15 “(e) DENIAL OF EXCLUSION FOR EXPATRIATES.—
16 This section shall not apply to any sale or exchange by
17 an individual if rules relating to expatriation to avoid tax
18 apply to such individual.

19 “(f) ELECTION TO HAVE SECTION NOT APPLY.—
20 This section shall not apply to any sale or exchange with
21 respect to which the taxpayer elects not to have this sec-
22 tion apply.

23 “(g) RESIDENCES ACQUIRED IN ROLLOVERS UNDER
24 SECTION 1034.—For purposes of this section, in the case
25 of property the acquisition of which by the taxpayer re-

1 sulted under section 1034 of the Internal Revenue Code
2 of 1986 (as in effect on the day before the date of the
3 enactment of the Taxpayer Relief Act of 1997) in the non-
4 recognition of any part of the gain realized on the sale
5 or exchange of another residence, in determining the pe-
6 riod for which the taxpayer has owned and used such
7 property as the taxpayer's principal residence, there shall
8 be included the aggregate periods for which such other
9 residence (and each prior residence taken into account in
10 determining the holding period of such property) had been
11 so owned and used.

12 **“SEC. 77. OTHER NONRECOGNITION TRANSACTIONS.**

13 “(a) INVOLUNTARY CONVERSIONS.—Under regula-
14 tions prescribed by the Secretary, the involuntary conver-
15 sion of property held by an individual shall not result in
16 gross income to the individual to the extent that the indi-
17 vidual receives property in exchange for the involuntarily
18 converted property. To the extent that income is not rec-
19 ognized under this subsection, the taxpayer's basis in the
20 converted property shall carry over to the new property.

21 “(b) CERTAIN REACQUISITIONS OF REAL PROP-
22 erty.—Under regulations prescribed by the Secretary,
23 gross income shall not be recognized in the case of certain
24 reacquisitions of real property. The regulations shall adopt

1 principles similar to those under section 1038 of the Inter-
2 nal Revenue Code of 1986.

3 “(c) TRANSFERS OF PROPERTY BETWEEN SPOUSES
4 OR INCIDENT TO DIVORCE.—

5 “(1) GENERAL RULE.—Gross income shall not
6 be recognized on the transfer of property from an
7 individual to (or in trust for the benefit of)—

8 “(A) a spouse, or

9 “(B) a former spouse, but only if the
10 transfer is incident to divorce.

11 “(2) TRANSFER TREATED AS A GIFT.—

12 Any transfer described in paragraph (1) shall
13 be treated as a gift.

14 “(d) CERTAIN EXCHANGES OF INSURANCE POLI-
15 CIES.—Under regulations prescribed by the Secretary,
16 gross income shall not be recognized on the exchange of
17 insurance policies or another life insurance policy or an
18 annuity contract or the exchange of annuity contracts.
19 The regulations shall adopt principles similar to those
20 under section 1035 of the Internal Revenue Code of 1986.

21 “(e) CERTAIN EXCHANGES OF UNITED STATES OB-
22 LIGATIONS.—When so provided by regulations promul-
23 gated by the Secretary in connection with the issue of obli-
24 gations of the United States, no gain or loss shall be rec-
25 ognized on the surrender to the United States of obliga-

1 tions of the United States issued under chapter 31 of title
2 31 in exchange solely for other obligations issued under
3 such chapter.

4 **“SEC. 78. WASH SALES AND STRADDLES.**

5 “(a) LOSSES FROM WASH SALES OF STOCK OR SE-
6 CURITIES.—Under regulations prescribed by the Sec-
7 retary, no loss shall be recognized on the wash sale of
8 stock or securities. The regulations shall adopt principles
9 similar to those under section 1091 of the Internal Rev-
10 enue Code of 1986.

11 “(b) STRADDLES.—Under regulations prescribed by
12 the Secretary, the loss that can be taken into account from
13 1 or more straddle positions shall be limited. The regula-
14 tions shall adopt principles similar to those under section
15 1038 of the Internal Revenue Code of 1986.

16 **“SEC. 79. LIMITATION ON LOSSES FROM CAPITAL TRANS-**
17 **ACTIONS.**

18 “(a) NO LOSS ON PERSONAL USE PROPERTY.—No
19 loss shall be recognized on the sale or exchange of personal
20 use property (as defined in section 210(b)(3)(B)).

21 “(b) LIMITATION ON NET CAPITAL LOSS.—

22 “(1) IN GENERAL.—Losses from sales or ex-
23 changes of capital assets in a taxable year shall be
24 allowed only to the extent of the gains from such

1 sales or exchanges, plus \$3,000 (\$1,500 in the case
2 of a married individual filing a separate return).

3 “(2) CAPITAL LOSS CARRYOVERS.—Under regu-
4 lations prescribed by the Secretary, any loss not al-
5 lowed by reason of paragraph (1) shall be carried
6 over to the following taxable year and treated as a
7 capital loss incurred in such year. There shall be no
8 limit on the number of years that a capital loss can
9 be carried forward.

10 “(3) CAPITAL ASSETS.—Under regulations pre-
11 scribed by the Secretary, the principles of the Inter-
12 nal Revenue Code of 1986 (including, without limi-
13 tation, sections 1234 (relating to options), 1234A
14 (relating to gains or losses from certain termi-
15 nations), 1253 (relating to franchises and trade-
16 marks) and 1258 (gain from certain financial trans-
17 actions) shall apply for purposes of determining
18 what is a capital asset and whether an event is to
19 be treated as a sale or exchange of capital assets, ex-
20 cept to the extent inconsistent with principles of this
21 chapter.

22 “(4) RECAPTURE.—If a taxpayer claimed de-
23 preciation, amortization or other cost recovery de-
24 ductions under the Internal Revenue Code of 1986
25 with respect to property which is subsequently sold

1 or exchanged in a transaction that is not treated as
2 transaction of a business entity, the amount of gain
3 on the exchange of such property which is treated as
4 gain from the sale or exchange of a capital asset
5 shall be reduced (but not below zero) by the amount
6 of such deductions claimed with respect to the prop-
7 erty.

8 **“Subchapter D—Rules for Exclusions from**
9 **Gross Income**

“Sec. 91. Interest on tax-exempt bonds.

“Sec. 92. Combat pay.

“Sec. 93. Qualified military benefits.

“Sec. 94. Qualified foster care payments.

“Sec. 95. Compensation for injury and sickness.

“Sec. 96. Meals or lodging for convenience of employer.

“Sec. 97. Certain fringe benefits.

10 **“SEC. 91. INTEREST ON TAX-EXEMPT BONDS.**

11 “(a) EXCLUSION.—Except as provided in subsection
12 (b), gross income does not include interest on any State
13 or local bond.

14 “(b) EXCEPTIONS.—Subsection (a) shall not apply
15 to—

16 “(1) PRIVATE ACTIVITY BOND WHICH IS NOT A
17 QUALIFIED BOND.—Any private activity bond which
18 is not a qualified bond (within the meaning of para-
19 graph (3) of subsection (c)).

20 “(2) ARBITRAGE BOND.—Any arbitrage bond.

1 “(3) BOND NOT IN REGISTERED FORM, ETC.—
2 Any bond unless such bond meets the applicable re-
3 quirements set forth in regulations.

4 “(c) DEFINITIONS—For purposes of this section—

5 “(1) STATE OR LOCAL BOND.—‘State or local
6 bond’ means an obligation of a State or political
7 subdivision thereof.

8 “(2) STATE.—‘State’ includes the District of
9 Columbia and any possession of the United States.

10 “(3) QUALIFIED BOND.—‘Qualified bond’
11 means any private activity bond if—

12 “(A) IN GENERAL.—Such bond is—

13 “(i) an exempt facility bond,

14 “(ii) a qualified mortgage bond,

15 “(iii) a qualified veterans’ mortgage
16 bond,

17 “(iv) a qualified small issue bond,

18 “(v) a qualified student loan bond,

19 “(vi) a qualified 253(c)(3) bond.

20 “(B) VOLUME CAP.—Such bond is issued
21 as part of an issue which meets the applicable
22 volume cap requirements set forth in regula-
23 tions.

1 “(C) OTHER REQUIREMENTS.—Such bond
2 meets the applicable requirements set forth in
3 regulations.

4 “(d) REGULATIONS.—

5 “(1) STATUTORY REGULATIONS.—The Sec-
6 retary shall publish as regulations governing the ap-
7 plication of this section the text of part IV of sub-
8 chapter B of chapter 1 of the Internal Revenue Code
9 of 1986 (sections 141 through 149) with only such
10 changes as are required to conform cross references.

11 “(2) OTHER REGULATIONS.—The Secretary
12 shall have the authority to promulgate such other
13 regulations as he deems necessary or proper to im-
14 plement this section, except that no such regulations
15 shall conflict with the regulations mandated by para-
16 graph (1) except as provided in this subtitle.

17 **“SEC. 92. COMBAT PAY.**

18 “(a) ENLISTED PERSONNEL.—Gross income does not
19 include compensation received for active service as a mem-
20 ber below the grade of commissioned officer in the Armed
21 Forces of the United States for any month during any
22 part of which such member—

23 “(1) served in a combat zone, or

24 “(2) was hospitalized as a result of wounds, dis-
25 ease, or injury incurred while serving in a combat

1 zone; but this paragraph shall not apply for any
2 month beginning more than 2 years after the date
3 of the termination of combatant activities in such
4 zone.

5 “(b) COMMISSIONED OFFICERS.—Gross income does
6 not include so much of the compensation as does not ex-
7 ceed \$500 received for active service as a commissioned
8 officer in the Armed Forces of the United States for any
9 month during any part of which such officer—

10 “(1) served in a combat zone, or

11 “(2) was hospitalized as a result of wounds, dis-
12 ease, or injury incurred while serving in a combat
13 zone; but this paragraph shall not apply for any
14 month beginning more than 2 years after the date
15 of the termination of combatant activities in such
16 zone.

17 “(c) DEFINITIONS.—For purposes of this section—

18 “(1) ‘Commissioned officer’ does not include a
19 commissioned warrant officer.

20 “(2) ‘Combat zone’ means any area which the
21 President of the United States by Executive Order
22 designates, for purposes of this section or cor-
23 responding provisions of prior income tax laws, an
24 area in which Armed Forces of the United States

1 are or have (after June 24, 1950) engaged in com-
2 bat.

3 “(3) Service is performed in a combat zone only
4 if performed on or after the date designated by the
5 President by Executive Order as the date of the
6 commencing of combatant activities in such zone,
7 and on or before the date designated by the Presi-
8 dent by Executive Order as the date of the termi-
9 nation of combatant activities in such zone; except
10 that June 25, 1950, shall be considered the date of
11 the commencing of combatant activities in the com-
12 bat zone designated in Executive Order 10195.

13 “(4) The term ‘compensation’ does not include
14 pensions and retirement pay.

15 **“SEC. 93. QUALIFIED MILITARY BENEFIT.**

16 “(a) IN GENERAL.—‘Qualified military benefit’
17 means any allowance or in-kind benefit (other than per-
18 sonal use of a vehicle) which—

19 “(1) is received by any member or former mem-
20 ber of the uniformed service of the United States or
21 any dependent of such member by reason of such
22 member’s status or service as a member of such uni-
23 formed services, and

24 “(2) was excludable from gross income on Sep-
25 tember 9, 1986, under any provision of law, regula-

1 tion, or administrative practice which was in effect
2 on such date (other than a provision of this title).

3 “(b) NO OTHER BENEFIT TO BE EXCLUDABLE AS
4 PROVIDED BY THIS TITLE.—Notwithstanding any other
5 provision of law, no benefit shall be treated as a qualified
6 military benefit unless such benefit—

7 “(1) is a benefit described in subsection (a), or

8 “(2) is excludable from gross income under this
9 title without regard to any provision of law which is
10 not contained in this title and which is not contained
11 in a revenue Act.

12 “(c) LIMITATIONS ON MODIFICATIONS.—

13 “(1) IN GENERAL.—Except as provided in para-
14 graph (2), no modification or adjustment of any
15 qualified military benefit after September 9, 1986,
16 shall be taken into account.

17 “(2) EXCEPTION FOR CERTAIN ADJUSTMENTS
18 TO CASH BENEFITS.—Paragraph (1) shall not apply
19 to any adjustment to any qualified military benefit
20 payable in cash which—

21 “(A) is pursuant to a provision of law or
22 regulation (as in effect on September 9, 1986),
23 and

1 “(B) is determined by reference to any
2 fluctuation in cost, price, currency, or other
3 similar index.

4 **“SEC. 94. QUALIFIED FOSTER CARE PAYMENTS.**

5 “(a) QUALIFIED FOSTER CARE PAYMENT DE-
6 FINED.—

7 “(1) IN GENERAL.—‘Qualified foster care pay-
8 ment’ means any amount—

9 “(A) which is paid by a state or political
10 subdivision thereof or by a placement agency
11 which is described in section 253(c)(3) and ex-
12 empt from tax under section 253(a), and

13 “(B) which is—

14 “(i) paid to the foster care provider
15 for caring for a qualified foster individual
16 in the foster care provider’s home, or

17 “(ii) a difficulty of care payment.

18 “(2) QUALIFIED FOSTER INDIVIDUAL.—‘Quali-
19 fied foster individual’ means any individual who is
20 living in a foster family home in which such indi-
21 vidual was placed by—

22 “(A) an agency of a State or a political
23 subdivision thereof, or

24 “(B) in the case of an individual who has
25 not attained age 19, an organization which is li-

1 censed by a State (or political subdivision there-
2 of) as a placement agency and which is de-
3 scribed in section 253(c)(3) and exempt from
4 tax under section 253(a).

5 “(3) LIMITATION BASED ON NUMBER OF INDI-
6 VIDUALS OVER THE AGE OF 18.—In the case of any
7 foster home in which there is a qualified foster care
8 individual who has attained age 19, foster care pay-
9 ments (other than difficulty of care payments) for
10 any period to which such payments relate shall not
11 be excludable from gross income under subsection
12 (a) to the extent such payments are made for more
13 than 5 such qualified foster individuals.

14 “(b) DIFFICULTY OF CARE PAYMENTS.—For pur-
15 poses of this section—

16 “(1) DIFFICULTY OF CARE PAYMENTS.—‘Dif-
17 ficulty of care payments’ means payments to individ-
18 uals which are not described in subsection
19 (a)(1)(B)(i), and which—

20 “(A) are compensation for providing the
21 additional care of a qualified foster individual
22 which is—

23 “(i) required by reason of a physical,
24 mental, or emotional handicap of such in-
25 dividual with respect to which the State

1 has determined that there is a need for ad-
2 ditional compensation, and

3 “(ii) provided in the home of the fos-
4 ter care provider, and

5 “(B) are designated by the payor as com-
6 pensation described in subparagraph (A).

7 “(2) LIMITATION BASED ON NUMBER OF INDI-
8 VIDUALS.—In the case of any foster home, difficulty
9 of care payments for any period to which such pay-
10 ments relate shall not be excludable from gross in-
11 come under subsection (a) to the extent such pay-
12 ments are made for more than—

13 “(A) 10 qualified foster individuals who
14 have not attained age 19, and

15 “(B) 5 qualified foster individuals not de-
16 scribed in subparagraph (A).

17 **“SEC. 95. COMPENSATION FOR INJURIES OR SICKNESS.**

18 “(a) IN GENERAL.—Gross income does not include—

19 “(1) amounts received under workers’ com-
20 pensation acts as compensation for personal injuries
21 or sickness;

22 “(2) the amount of any damages received
23 (whether by suit or agreement and whether as lump
24 sums or as periodic payments) on account of per-
25 sonal injuries or sickness;

1 “(3) amounts received through accident or
2 health insurance for medical care;

3 “(4) amounts received through accident or
4 health insurance for personal injuries or sickness
5 (other than for medical care), but only to the extent
6 such amounts (A) are not attributable to contribu-
7 tions by the employer which were not includible in
8 the gross income of the employee, and are (B) not
9 paid by the employer;

10 “(5) amounts received as pension, annuity, or
11 similar allowance for personal injuries or sickness re-
12 sulting from active service in the armed forces of
13 any country or in the Coast and Geodetic Survey or
14 the Public Health Service, or as a disability annuity
15 payable under the provisions of section 808 of the
16 Foreign Service Act of 1980; and

17 “(6) amounts received by an individual as dis-
18 ability income attributable to injuries incurred as a
19 direct result of a violent attack which the Secretary
20 of State determines to be a terrorist attack and
21 which occurred while such individual was an em-
22 ployee of the United States engaged in the perform-
23 ance of his official duties outside the United States.

1 Paragraph (2) shall not apply to any punitive dam-
2 ages in connection with a case not involving physical
3 injury or physical sickness.

4 “(b) TERMINATION OF APPLICATION OF SUBSECTION
5 (a)(4) IN CERTAIN CASES.—

6 “(1) IN GENERAL.—Subsection (a)(4) shall not
7 apply in the case of an individual who is not de-
8 scribed in paragraph (2).

9 “(2) INDIVIDUALS TO WHOM SUBSECTION
10 (a)(4) CONTINUES TO APPLY.—An individual is de-
11 scribed in this paragraph if—

12 “(A) on or before September 24, 1975, he
13 was entitled to receive any amount described in
14 subsection (a)(4),

15 “(B) on September 24, 1975, he was a
16 member of any organization (or reserve compo-
17 nent thereof) referred to in subsection (a)(4) or
18 under a binding written commitment to become
19 such a member,

20 “(C) he receives an amount described in
21 subsection (a)(4) by reason of a combat-related
22 injury, or

23 “(D) on application therefore, he would be
24 entitled to receive disability compensation from
25 the Veterans’ Administration.

1 “(3) SPECIAL RULES FOR COMBAT-RELATED IN-
2 JURIES.—For purposes of this subsection, the term
3 ‘combat-related injury’ means personal injury or
4 sickness—

5 “(A) which is incurred—

6 “(i) as a direct result of armed con-
7 flict,

8 “(ii) while engaged in extrahazardous
9 service, or

10 “(iii) under conditions simulating war;

11 or

12 “(B) which is caused by an instrumentality
13 of war.

14 In the case of an individual who is not described in
15 subparagraph (A) or (B) of paragraph (2), except as
16 provided in paragraph (4), the only amounts taken
17 into account under subsection (a)(4) shall be the
18 amounts which he receives by reason of a combat-
19 related injury.

20 “(4) AMOUNT EXCLUDED TO BE NOT LESS
21 THAN VETERANS’ DISABILITY COMPENSATION.—In
22 the case of any individual described in paragraph
23 (2), the amounts excludable under subsection (a)(4)
24 for any period with respect to any individual shall
25 not be less than the maximum amount which such

1 individual, on application therefor, would be entitled
2 to receive as disability compensation from the Vet-
3 erans' Administration.

4 **“SEC. 96. MEALS OR LODGING FURNISHED FOR THE CON-**
5 **VENIENCE OF THE EMPLOYER.**

6 “(a) MEALS AND LODGING FURNISHED TO EM-
7 PLOYEE, HIS SPOUSE, AND HIS DEPENDENTS, PURSU-
8 ANT TO EMPLOYMENT.—There shall be excluded from
9 gross income of an employee the value of any meals or
10 lodging furnished to him, his spouse, or any of his depend-
11 ents by or on behalf of his employer for the convenience
12 of the employer, but only if—

13 “(1) in the case of meals, the meals are fur-
14 nished on the business premises of the employer, or

15 “(2) in the case of lodging, the employee is re-
16 quired to accept such lodging on the business prem-
17 ises of his employer as a condition of his employ-
18 ment.

19 “(b) SPECIAL RULES.—For the purposes of sub-
20 section (a)—

21 “(1) PROVISIONS OF EMPLOYMENT CONTRACT
22 OR STATE STATUTE NOT TO BE DETERMINATIVE.—

23 In determining whether meals or lodging are fur-
24 nished for the convenience of the employer, the pro-
25 visions of an employment contract or of a State stat-

1 ute fixing terms of employment shall not be deter-
2 minative of whether the meals or lodging are in-
3 tended as compensation.

4 “(2) CERTAIN FACTORS NOT TAKEN INTO AC-
5 COUNT WITH RESPECT TO MEALS.—In determining
6 whether meals are furnished for the convenience of
7 the employer, the fact that a charge is made for
8 such meals, and the fact that the employee may ac-
9 cept or decline such meals, shall not be taken into
10 account.

11 “(3) CERTAIN FIXED CHARGES FOR MEALS.—

12 “(A) IN GENERAL.—If—

13 “(i) an employee is required to pay on
14 a periodic basis a fixed charge for his
15 meals, and

16 “(ii) such meals are furnished by the
17 employer for the convenience of the em-
18 ployer,

19 there shall be excluded from the employee’s
20 gross income an amount equal to such fixed
21 charge.

22 “(B) APPLICATION OF SUBPARAGRAPH
23 (A).—Subparagraph (A) shall apply—

1 “(i) whether the employee pays the fixed charge
2 out of his stated compensation or out of his own
3 funds, and

4 “(ii) only if the employee is required to make
5 the payment whether he accepts or declines the
6 meals.

7 “(c) EMPLOYEES LIVING IN CERTAIN CAMPS.—

8 “(1) IN GENERAL.—In the case of an individual
9 who is furnished lodging in a camp located in a for-
10 eign country by or on behalf of his employer, such
11 camp shall be considered to be part of the business
12 premises of the employer.

13 “(2) CAMP.—For purposes of this section, a
14 camp constitutes lodging which is—

15 “(A) provided by or on behalf of the em-
16 ployer for the convenience of the employer be-
17 cause the place at which such individual renders
18 services is in a remote area where satisfactory
19 housing is not available on the open market,

20 “(B) located, as near as practicable, in the
21 vicinity of the place at which such individual
22 renders services, and

23 “(C) furnished in a common area (or en-
24clave) which is not available to the public and

1 which normally accommodates 10 or more em-
2 ployees.

3 “(d) LODGING FURNISHED BY CERTAIN EDU-
4 CATIONAL INSTITUTIONS TO EMPLOYEES.—

5 “(1) IN GENERAL.—In the case of an employee
6 of an educational institution, gross income shall not
7 include the value of qualified campus lodging fur-
8 nished to such employee during the taxable year.

9 “(2) EXCEPTION IN CASES OF INADEQUATE
10 RENT.—Paragraph (1) shall not apply to the extent
11 of the excess of—

12 “(A) the lesser of—

13 “(i) 5 percent of the appraised value
14 of the qualified campus lodging, or

15 “(ii) the average of the rentals paid
16 by individuals (other than employees or
17 students of the educational institution)
18 during such calendar year for lodging pro-
19 vided by the educational institution which
20 is comparable to the qualified campus lodg-
21 ing provided to the employee, over

22 “(B) the rent paid by the employee for the
23 qualified campus lodging during such calendar
24 year.

1 The appraised value under subparagraph (A)(i) shall
2 be determined as of the close of the calendar year
3 in which the taxable year begins, or, in the case of
4 a rental period not greater than 1 year, at any time
5 during the calendar year in which such period be-
6 gins.

7 “(3) QUALIFIED CAMPUS LODGING.—For pur-
8 poses of this subsection, the term ‘qualified campus
9 lodging’ means lodging to which subsection (a) does
10 not apply and which is—

11 “(A) located on, or in the proximity of, a
12 campus of the educational institution, and

13 “(B) furnished to the employee, his spouse,
14 and any of his dependents by or on behalf of
15 such institution for use as a residence.

16 “(4) EDUCATIONAL INSTITUTION.—For pur-
17 poses of this paragraph, the term ‘educational insti-
18 tution’ means an eligible educational institution as
19 defined in section 10(b)(2)(B).

20 **“SEC. 97. CERTAIN FRINGE BENEFITS.**

21 “(a) PURPOSE.—This section includes definitions and
22 rules applicable to the exclusion from gross income for cer-
23 tain fringe benefits.

1 “(b) NO-ADDITIONAL-COST SERVICE DEFINED.—

2 ‘No-additional-cost service’ means any service provided by

3 an employer to an employee for use by such employee if—

4 “(1) such service is offered for sale to cus-

5 tomers in the ordinary course of the line of business

6 of the employer in which the employee is performing

7 services, and

8 “(2) the employer incurs no substantial addi-

9 tional cost (including forgone revenue) in providing

10 such service to the employee (determined without re-

11 gard to any amount paid by the employee for such

12 service).

13 “(c) QUALIFIED EMPLOYEE DISCOUNT DEFINED.—

14 “(1) QUALIFIED EMPLOYEE DISCOUNT.—The

15 term ‘qualified employee discount’ means any em-

16 ployee discount with respect to qualified property or

17 services to the extent such discount does not

18 exceed—

19 “(A) in the case of property, the gross

20 profit percentage of the price at which the prop-

21 erty is being offered by the employer to cus-

22 tomers, or

23 “(B) in the case of services, 20 percent of

24 the price at which the services are being offered

25 by the employer to customers.

1 “(2) GROSS PROFIT PERCENTAGE.—

2 “(A) IN GENERAL.—‘Gross profit percent-
3 age’ means the percent which—

4 “(i) the excess of the aggregate sales
5 price of property sold by the employer to
6 customers over the aggregate cost of such
7 property to the employer, is of

8 “(ii) the aggregate sales price of such
9 property.

10 “(B) DETERMINATION OF GROSS PROFIT
11 PERCENTAGE.—Gross profit percentage shall be
12 determined on the basis of—

13 “(i) all property offered to customers
14 in the ordinary course of the line of busi-
15 ness of the employer in which the employee
16 is performing services (or a reasonable
17 classification of property selected by the
18 employer), and

19 “(ii) the employer’s experience during a
20 representative period.

21 “(3) EMPLOYEE DISCOUNT DEFINED.—‘Em-
22 ployee discount’ means the amount by which—

23 “(A) the price at which the property or
24 services are provided by the employer to an em-
25 ployee for use by such employee, is less than

1 “(B) the price at which such property or
2 services are being offered by the employer to
3 customers.

4 “(4) QUALIFIED PROPERTY OR SERVICES.—
5 ‘Qualified property or services’ means any property
6 (other than real property and other than personal
7 property of a kind held for investment) or services
8 which are offered for sale to customers in the ordi-
9 nary course of the line of business of the employer
10 in which the employee is performing services.

11 “(c) DE MINIMIS FRINGE DEFINED.—

12 “(1) IN GENERAL.—‘De minimis fringe’ means
13 any property or service the value of which is (after
14 taking into account the frequency with which similar
15 fringes are provided by the employer to the employ-
16 er’s employees) so small as to make accounting for
17 it unreasonable or administratively impracticable.

18 “(2) TREATMENT OF CERTAIN EATING FACILI-
19 TIES.—The operation by an employer of any eating
20 facility for employees shall be treated as a de mini-
21 mis fringe if—

22 “(A) such facility is located on or near the
23 business premises of the employer, and

1 “(B) revenue derived from such facility
2 normally equals or exceeds the direct operating
3 costs of such facility.

4 The preceding sentence shall apply with respect to
5 any highly compensated employee only if access to
6 the facility is available on substantially the same
7 terms to each member of a group of employees
8 which is defined under a reasonable classification set
9 up by the employer which does not discriminate in
10 favor of highly compensated employees.

11 “(3) ON-PREMISES GYMS AND OTHER ATHLETIC
12 FACILITIES.—

13 “(A) IN GENERAL.—De minimis fringe
14 benefits include the provision of on-premises
15 athletic facility by an employer to its employees.

16 “(B) ON-PREMISES ATHLETIC FACILITY.—
17 For purposes of this paragraph, ‘on-premises
18 athletic facility’ means any gym or other ath-
19 letic facility—

20 “(i) which is located on the premises
21 of the employer,

22 “(ii) which is operated by the em-
23 ployer, and

1 “(iii) substantially all the use of which
2 is by employees of the employer, their
3 spouses, and their dependent children.

4 “(d) CERTAIN EDUCATIONAL TRAINING BENE-
5 FITS.—Amounts paid or expenses incurred by the em-
6 ployer for education or training provided to the employee
7 shall be excluded from gross income under section 4 if
8 (and only if) such amounts or expenses are ordinary and
9 necessary business expenses and are not for an advanced
10 degree or to qualify an employee for a new line of work.

11 “(e) REGULATIONS.—The Secretary shall prescribe
12 regulations under this section, including regulations that
13 continue certain rules contained in section 132 to the In-
14 ternal Revenue Code of 1986 related to the fringe benefits
15 described in this section.

16 **“Subchapter E—Rules Relating to Deductions**

“Sec. 101. Charitable, etc. organizations.

“Sec. 102. Private foundations.

17 **“SEC. 101. CHARITABLE, ETC. ORGANIZATIONS.**

18 “(a) PURPOSE.—This section provides definitions for
19 purposes of determining the philanthropic transfer deduc-
20 tion and for other purposes of this chapter and chapter
21 2.

22 “(b) REGULAR CHARITY.—

23 “(1) IN GENERAL.—

1 “(A) REGULAR CHARITY.—‘Regular char-
2 ity’ means—

3 “(i) a church or a convention or asso-
4 ciation of churches,

5 “(ii) an educational organization
6 which normally maintains a regular faculty
7 and curriculum and normally has a regu-
8 larly enrolled body of pupils or students in
9 attendance at the place where its edu-
10 cational activities are regularly carried on,

11 “(iii) an organization the principal
12 purpose or functions of which are the pro-
13 viding of medical or hospital care or med-
14 ical education or medical research, if the
15 organization is a hospital, or if the organi-
16 zation is a medical research organization
17 directly engaged in the continuous active
18 conduct of medical research in conjunction
19 with a hospital,

20 “(iv) an organization which normally
21 receives a substantial part of its support
22 (exclusive of income received in the exer-
23 cise or performance by such organization
24 of its charitable, educational, or other pur-
25 pose or function constituting the basis for

1 its exemption under section 253(a)) from
2 the United States or any State or political
3 subdivision thereof or from direct or indi-
4 rect contributions from the general public,
5 and which is organized and operated exclu-
6 sively to receive, hold, invest, and admin-
7 ister property and to make expenditures to
8 or for the benefit of a college or university
9 which is an organization referred to in
10 clause (ii) of this subparagraph and which
11 is an agency or instrumentality of a State
12 or political subdivision thereof, or which is
13 owned or operated by a State or political
14 subdivision thereof or by an agency or in-
15 strumentality of one or more States or po-
16 litical subdivisions,

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

19 “(vi) an organization referred to in
20 subsection (c)(2) which normally receives a
21 substantial part of its support (exclusive of
22 income received in the exercise or perform-
23 ance by such organization of its charitable,
24 educational, or other purpose or function
25 constituting the basis for its exemption

1 under section 253(a)) from a governmental
2 unit referred to in subsection (c)(1) or
3 from direct or indirect contributions from
4 the general public,

5 “(vii) a private foundation described
6 in subparagraph (C), or

7 “(viii) an organization described in
8 section 102(a) (2) or (3).

9 “(B) SPECIAL RULE FOR MEDICAL RE-
10 SEARCH ORGANIZATIONS.—For purposes of de-
11 termining whether a contribution is to a regular
12 charity, a medical research organization shall
13 not be treated as described in clause (iii) of
14 paragraph (2) unless during the calendar year
15 in which the contribution is made such organi-
16 zation is committed to spend such contributions
17 for such research before January 1 of the fifth
18 calendar year which begins after the date such
19 contribution is made,

20 “(C) CERTAIN PRIVATE FOUNDATIONS.—
21 The private foundations referred to in subpara-
22 graph (A)(vii) and subsection (e)(1)(B) are—

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

1 “(ii) any other private foundation (as
2 defined in section 102(a)) which, not later
3 than the 15th day of the third month after
4 the close of the foundation’s taxable year
5 in which contributions are received, makes
6 qualifying distributions (as defined in sec-
7 tion 4942(g), without regard to paragraph
8 (3) thereof), which are treated, after the
9 application of section 4942(g)(3), as dis-
10 tributions out of corpus (in accordance
11 with section 4942(h)) in an amount equal
12 to 100 percent of such contributions, and
13 with respect to which the taxpayer obtains
14 adequate records or other sufficient evi-
15 dence from the foundation showing that
16 the foundation made such qualifying dis-
17 tributions, and

18 “(iii) a private foundation all of the
19 contributions to which are pooled in a com-
20 mon fund and which would be described in
21 section 102(a)(3) but for the right of any
22 substantial contributor (hereafter in this
23 clause called ‘donor’) or his spouse to des-
24 ignate annually the recipients, from among
25 organizations described in paragraph (1) of

1 section 102(a), of the income attributable
2 to the donor's contribution to the fund and
3 to direct (by deed or by will) the payment,
4 to an organization described in such para-
5 graph (1), of the corpus in the common
6 fund attributable to the donor's contribu-
7 tion; but this clause shall apply only if all
8 of the income of the common fund is re-
9 quired to be (and is) distributed to one or
10 more organizations described in such para-
11 graph (1) not later than the 15th day of
12 the third month after the close of the tax-
13 able year in which the income is realized
14 by the fund and only if all of the corpus
15 attributable to any donor's contribution to
16 the fund is required to be (and is) distrib-
17 uted to one or more of such organizations
18 not later than one year after his death or
19 after the death of his surviving spouse if
20 she has the right to designate the recipi-
21 ents of such corpus.

22 “(2) REFERENCES.—Any reference in other law
23 or in legal documents to an organization described
24 in a clause of section 170(b)(1)(A) of the Internal
25 Revenue Code of 1986 shall constitute a reference to

1 an organization described in the same clause of sec-
2 tion 101(b)(1)(A).

3 “(c) CHARITY.—For purposes of determining the de-
4 ductibility of a philanthropic transfer, ‘charitable contribu-
5 tion’ means a contribution or gift for the use of—

6 “(1) A State, a possession of the United States,
7 or any political subdivision of any of the foregoing,
8 or the United States or the District of Columbia,
9 but only if the contribution or gift is made for exclu-
10 sively public purposes.

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

13 “(A) created or organized in the United
14 States or in any possession thereof, or under
15 the law of the United States, any State, the
16 District of Columbia, or any possession of the
17 United States;

18 “(B) organized and operated exclusively
19 for religious, charitable, scientific, literary, or
20 educational purposes (but only if no part of its
21 activities involve the provision of athletic facili-
22 ties or equipment) or for the prevention of cru-
23 elty to children or animals,

1 “(C) no part of the net earnings of which
2 inures to the benefit of any private shareholder
3 or individual, and

4 “(D) which qualifies for exemption from
5 the business tax under section 253(c) and is not
6 disqualified for tax exemption by reason of at-
7 tempting to influence legislation, and which
8 does not participate in, or intervene in (includ-
9 ing the publishing or distributing of state-
10 ments), any political campaign on behalf of (or
11 in opposition to) any candidate for public office.

12 “(3) [intentionally deleted]

13 “(4) In the case of a contribution or gift by an
14 individual, a domestic fraternal society, order, or as-
15 sociation, operating under the lodge system, but only
16 if such contribution or gift is to be used exclusively
17 for religious, charitable, scientific, literary, or edu-
18 cational purposes, or for the prevention of cruelty to
19 children or animals.

20 “(5) A cemetery company owned and operated
21 exclusively for the benefit of its members, or any
22 corporation chartered solely for burial purposes as a
23 cemetery corporation and not permitted by its char-
24 ter to engage in any business not necessarily inci-
25 dent to that purpose, if such company or corporation

1 is not operated for profit and no part of the net
2 earnings of such company or corporation inures to
3 the benefit of any private shareholder or individual.

4 “(d) RULES FOR SUBSECTION (c).—

5 “(1) LIMITATIONS.—A contribution or gift by a
6 corporation to a trust, chest, fund, or foundation
7 shall be deductible by reason of subsection (c)(2)(B)
8 only if it is to be used within the United States or
9 any of its possessions exclusively for purposes speci-
10 fied in subparagraph (B).

11 “(2) REFERENCES.—Any reference in other law
12 or in legal documents to an organization described
13 in a paragraph of section 170(c) of the Internal Rev-
14 enue Code of 1986 shall constitute a reference to an
15 organization described in the same paragraph num-
16 ber of section 101(c) if an organization is described
17 in such paragraph.

18 “(e) QUALIFIED CONSERVATION CONTRIBUTION.—

19 “(1) IN GENERAL.—‘Qualified conservation con-
20 tribution’ means a contribution—

21 “(A) of a qualified real property interest,

22 “(B) to a qualified organization,

23 “(C) exclusively for conservation purposes.

1 “(2) QUALIFIED REAL PROPERTY INTEREST.—
2 ‘Qualified real property interest’ means any of the
3 following interests in real property:

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

6 “(B) a remainder interest, and

7 “(C) a restriction (granted in perpetuity)
8 on the use which may be made of the real prop-
9 erty.

10 “(3) QUALIFIED ORGANIZATION.—For purposes
11 of paragraph (1), the term ‘qualified organization’
12 means an organization which—

13 “(A) is described in clause (v) or (vi) of
14 subsection (b)(1)(A), or

15 “(B) is described in section 253(c)(3)
16 and—

17 “(i) meets the requirements of section
18 102(a)(2), or

19 “(ii) meets the requirements of sec-
20 tion 102(a)(3) and is controlled by an or-
21 ganization described in subparagraph (A)
22 or in clause (i) of this subparagraph.

23 “(4) CONSERVATION PURPOSE DEFINED.—

1 “(A) IN GENERAL.—For purposes of this
2 subsection, the term ‘conservation purpose’
3 means—

4 “(i) the preservation of land areas for
5 outdoor recreation by, or the education of,
6 the general public,

7 “(ii) the protection of a relatively nat-
8 ural habitat of fish, wildlife, or plants, or
9 similar ecosystem,

10 “(iii) the preservation of open space
11 (including farmland and forest land) where
12 such preservation is—

13 “(I) for the scenic enjoyment of
14 the general public, or

15 “(II) pursuant to a clearly delin-
16 eated Federal, State, or local govern-
17 mental conservation policy, and will
18 yield a significant public benefit, or

19 “(iv) the preservation of an histori-
20 cally important land area or a certified his-
21 toric structure.

22 “(B) CERTIFIED HISTORIC STRUCTURE.—
23 For purposes of subparagraph (A)(iv), the term
24 ‘certified historic structure’ means any building,
25 structure, or land area which—

1 “(i) is listed in the National Register,
2 or

3 “(ii) is located in a registered historic
4 district and is certified by the Secretary of
5 the Interior to the Secretary as being of
6 historic significance to the district.

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

13 “(5) EXCLUSIVELY FOR CONSERVATION PUR-
14 POSES.—For purposes of this subsection—

15 “(A) CONSERVATION PURPOSE MUST BE
16 PROTECTED.—A contribution shall not be treat-
17 ed as exclusively for conservation purposes un-
18 less the conservation purpose is protected in
19 perpetuity.

20 “(B) NO SURFACE MINING PERMITTED.—

21 “(i) IN GENERAL.—Except as pro-
22 vided in clause (ii), in the case of a con-
23 tribution of any interest where there is a
24 retention of a qualified mineral interest,
25 subparagraph (A) shall not be treated as

1 met if at any time there may be extraction
2 or removal of minerals by any surface min-
3 ing method.

4 “(ii) SPECIAL RULE.—With respect to
5 any contribution of property in which the
6 ownership of the surface estate and min-
7 eral interests were separated before June
8 13, 1976, and remain so separated, sub-
9 paragraph (A) shall be treated as met if
10 the probability of surface mining occurring
11 on such property is so remote as to be neg-
12 ligible.

13 “(6) QUALIFIED MINERAL INTEREST.—For
14 purposes of this subsection, the term ‘qualified min-
15 eral interest’ means—

16 “(A) subsurface oil, gas, or other minerals,
17 and

18 “(B) the right to access to such minerals.

19 “(f) DENIAL OF DEDUCTION FOR CERTAIN TRAVEL
20 EXPENSES.—No deduction shall be allowed under section
21 211 for traveling expenses (including amounts expended
22 for meals and lodging) while away from home, whether
23 paid directly or by reimbursement, unless there is no sig-
24 nificant element of personal pleasure, recreation, or vaca-
25 tion in such travel.

1 “(g) TREATMENT OF CERTAIN AMOUNTS PAID TO OR
 2 FOR THE BENEFIT OF INSTITUTIONS OF HIGHER EDU-
 3 CATION.—For purposes of section 11, if as the result of
 4 a contribution to or for the benefit of an educational
 5 organization—

6 “(1) which is described in subsection
 7 (b)(1)(A)(ii), and

8 “(2) which is an institution of higher education
 9 (as defined in section 3304(f))

10 the taxpayer receives (directly or indirectly) as a result
 11 of paying such amount the right to purchase tickets for
 12 seating at an athletic event in an athletic stadium of such
 13 institution, 80 percent of such contribution shall be treat-
 14 ed as a charitable contribution (but only if such amount
 15 would be allowable as a deduction but for the fact that
 16 the taxpayer received the right to purchase tickets). If any
 17 portion of a payment is for the purchase of such tickets,
 18 such portion and the remaining portion (if any) of such
 19 payment shall be treated as separate amounts for purposes
 20 of this subsection.

21 **“Subchapter F—Special Business Activities**

“Sec. 111. Rules for rental of real estate.

22 **“SEC. 111. RULES FOR RENTAL OF REAL ESTATE.**

23 “(a) IN GENERAL.—Except as provided in subsection
 24 (b)—

1 “(1) the activity of rental of real estate is a
2 business activity to which the Simplified USA Tax
3 for businesses under chapter 2 applies,

4 “(2) a taxpayer shall not be entitled to any de-
5 ductions under this chapter with respect to rental
6 property, and

7 “(3) a taxpayer shall recognize gross income
8 only with respect to distributions from the rental ac-
9 tivity.

10 “(b) INSUBSTANTIAL RENTAL ACTIVITY.—

11 “(1) NOT RENTAL PROPERTY.—If an individual
12 or individuals own property, such individual or indi-
13 viduals and their families use the property on more
14 than 14 days during the taxable year for nonbusi-
15 ness purposes, the property is rented for no more
16 than 14 days during the taxable year, and the total
17 rental received by the individuals with respect to
18 such property does not exceed \$10,000, the property
19 shall not be considered rental property or used in
20 the activity of rental of real estate during the tax-
21 able year for purposes of subsection (a) and the
22 Simplified USA Tax for businesses under chapter 2.

23 “(2) RENTS FROM NONRENTAL PROPERTY.—
24 Any rent from property described in paragraph (1)

1 shall be included in gross income for purposes of the
2 Simplified USA Income Tax.

3 “(c) USE FOR A NONBUSINESS PURPOSE.—For pur-
4 poses of this section, ‘use for a nonbusiness purpose’
5 means use other than—

6 “(1) use for which fair rent is paid,

7 “(2) use in connection with the preparation of
8 the property for rental, or

9 “(3) use that serves a clear business purpose.

10 Use during any part of a day shall constitute use for that
11 day.

12 **“Subchapter G—Accounting Methods and** 13 **Periods**

“Sec. 121. Taxable year.

“Sec. 122. Cash method of accounting; installment sales.

14 **“SEC. 121. TAXABLE YEAR.**

15 “(a) IN GENERAL.—The taxable year for all individ-
16 uals subject to tax under this chapter shall be the calendar
17 year except as provided in subsection (b).

18 “(b) SHORT TAXABLE YEARS.—

19 “(1) BIRTH.—An individual’s taxable year in
20 year of his birth shall begin on the date of his birth.

21 “(2) DEATH.—An individual’s taxable year in
22 the year of his death shall end on the date of his
23 death.

1 **“SEC. 122. CASH METHOD OF ACCOUNTING; INSTALLMENT**
2 **SALES.**

3 “(a) IN GENERAL.—All individuals shall determine
4 their income and deductions using the cash receipts and
5 disbursement method.

6 “(b) OID RULES.—

7 “(1) IN GENERAL.—Original issue discount
8 shall not be included in gross income until received.

9 “(2) PREVIOUSLY RECOGNIZED OID.—Original
10 issue discount included in income under the Internal
11 Revenue Code of 1986 shall increase the adjusted
12 basis of the instrument to which the original issue
13 discount related and shall not again be included in
14 income when received.

15 “(c) INSTALLMENT SALES.—

16 “(1) IN GENERAL.—Taxpayers shall take into
17 account income from installment sales when re-
18 ceived.

19 “(2) REGULATIONS.—The Secretary shall pro-
20 mulgate regulations implementing paragraph (1).
21 Such regulations shall generally follow the principles
22 of sections 453, 453A and 453B of the Internal Rev-
23 enue Code of 1986, except to the extent such prin-
24 ciples are inconsistent with other provisions of this
25 chapter.

1 “(d) CONSTRUCTIVE RECEIPT.—Income shall be
2 treated as received when constructively received.

3 “(e) EFFECT OF CHANGE OF ACCOUNTING METH-
4 OD.—Rules similar to those under section 226 shall apply
5 to ensure that a taxpayer does not deduct the same ex-
6 pense twice or include the same item in income twice.

7 **“Subchapter H—Nonresident Aliens**

“Sec. 131. Tax on nonresident alien individuals.

“Sec. 132. Tax treatment of certain community income of nonresident aliens.

8 **“SEC. 131. TAX ON NONRESIDENT ALIEN INDIVIDUALS.**

9 “(a) NONBUSINESS INCOME.—

10 “(1) INCOME OTHER THAN CERTAIN GAINS.—
11 There is hereby imposed for each taxable year a tax
12 of 30 percent of the amount received from sources
13 within the United States by a nonresident alien indi-
14 vidual as—

15 “(A) interest (other than portfolio interest
16 (as defined in subsection (b)(2)), deposit inter-
17 est (as defined in subsection (b)(3)) and origi-
18 nal issue discount, dividends, rents, salaries,
19 wages, premiums, annuities, compensations, re-
20 munerations, emoluments, and other fixed or
21 determinable annual periodical gains, profits
22 and income,

1 “(B) gains from the disposal of timber,
2 coal, or iron ore with a retained economic inter-
3 est,

4 “(C) in the case of the sale of an original
5 discount obligation or payment on an original
6 issue discount obligation, the interest accrued
7 while the individual was a nonresident alien,
8 and

9 “(D) includible social security benefits (as
10 defined in section 3(b)(2)).

11 “(2) CAPITAL GAINS OF CERTAIN ALIENS.—In
12 the case of a nonresident alien individual present in
13 the United States for a period or periods aggregating 183 days or more during the taxable year,
14 there is hereby imposed a tax of 30 percent of the
15 amount by which the gains, derived from sources
16 within the United States, from the sale or exchange
17 at any time during such year exceeds his losses, allo-
18 cable to sources within the United States, from the
19 sale or exchange at any time during such year of
20 capital assets.

22 “(3) TAX DOES NOT APPLY TO BUSINESS IN-
23 COME.—The taxes imposed by this section shall not
24 apply to the income of any business entity, except to

1 the extent such income is distributed as compensa-
2 tion, dividends, or interest.

3 “(b) SPECIAL RULES AND DEFINITIONS.—

4 “(1) CERTAIN ANNUITIES.—The taxes imposed
5 by subsection (a) shall not apply to any amount re-
6 ceived as an annuity under a qualified annuity plan
7 described in section 403(a)(1), or from a qualified
8 trust described in section 401(a) and exempt under
9 section 253(a) if—

10 “(A) all of the personal services by reason
11 of which the annuity is payable were either—

12 “(i) personal services performed out-
13 side the United States by an individual
14 who, at the time of performance of such
15 personal services, was a nonresident alien,
16 or

17 “(ii) personal services by a non-
18 resident alien temporarily present in the
19 United States for a period or periods not
20 exceeding 90 days during a taxable year,
21 whose compensation for such services did
22 not exceed \$3,000, and who performed
23 such services for—

24 “(I) a nonresident alien indi-
25 vidual, foreign partnership, or foreign

1 corporation, not engaged in a trade or
2 business within the United States, or
3 “(II) for an office or place of
4 business maintained in a foreign coun-
5 try or in a possession of the United
6 States by an individual who is a cit-
7 izen or resident of the United States
8 or by a domestic partnership or a do-
9 mestic corporation, and

10 “(B) at the time the first amount is paid
11 as annuity under the annuity plan or by the
12 trust, 90 percent or more of the employees for
13 whom contributions or benefits are provided
14 under such plan are citizens or residents of the
15 United States.

16 “(2) PORTFOLIO INTEREST.—

17 “(A) IN GENERAL.—‘Portfolio interest’
18 means—

19 “(i) interest on obligations in reg-
20 istered form if the United States person
21 who would otherwise be required to with-
22 hold tax on such interest under section
23 1441(a) receives a statement that the ben-
24 efiticial owner of the obligation is not a
25 United States person, and

1 “(ii) interest on obligations in nonreg-
2 istered form if appropriate precautions are
3 taken to ensure that such obligations will
4 be sold only to persons who are not United
5 States persons and such interest is paid
6 outside the United States.

7 “(B) EXCEPTIONS.—Under rules to be
8 prescribed by the Secretary, portfolio interest
9 does not include—

10 “(i) interest received by a 10-percent
11 equity owner, or

12 “(ii) contingent interest.

13 “(3) DEPOSIT INTEREST.—‘Deposit interest’
14 means interest on deposits which are—

15 “(A) deposits with persons carrying on a
16 banking business (including savings and loans),
17 and

18 “(B) amounts held by an insurance com-
19 pany under an agreement to pay interest there-
20 on.

21 “(4) OTHER EXCEPTIONS.—The taxes imposed
22 by subsection (a) shall not apply to—

23 “(A) a percentage of any dividend paid by
24 a business entity, 80 percent of whose gross re-
25 ceipts are not taken into account under chapter

1 1 because they are from outside the United
2 States, equal to the percentage of gross receipts
3 not so taken into account,

4 “(B) gambling winnings (except to the ex-
5 tent that the Secretary determines by regula-
6 tion that the collection of the tax is administra-
7 tively feasible),

8 “(C) compensation paid by a foreign em-
9 ployer to a nonresident alien individual for the
10 period he is temporarily present in the United
11 States as a nonimmigrant under subparagraph
12 (F) or (J) of section 101(a)(15) of the Immi-
13 gration and Nationality Act, as amended,

14 “(D) interest from a series E or series H
15 savings bond if the individual acquired the bond
16 while a resident of the Ryuku Islands or the
17 Trust Territory of the Pacific Islands, or

18 “(E) amounts earned or payable to any
19 person who is a bona fide resident of Puerto
20 Rico, Guam, American Samoa, or the Northern
21 Mariana Islands (and, therefore, is subject to
22 the tax imposed by subchapter A).

23 “(c) EXPATRIATION TO AVOID TAX.—

24 “(1) IN GENERAL.—A nonresident alien indi-
25 vidual who at any time within the 10-year period im-

1 mediately preceding the close of the taxable year lost
2 United States citizenship shall be taxable in the
3 manner described in paragraph (2) unless none of
4 the principal purposes of losing citizenship was
5 avoidance of tax under subchapter A or subtitle B.

6 “(2) ALTERNATIVE TAX.—A nonresident alien
7 individual described in paragraph (1) shall be sub-
8 ject to tax on the items taxable under subsection (a)
9 as determined without regard to exceptions listed or
10 based on definitions contained in subsection (b)
11 using the rate schedule for single individuals under
12 section 215. If the taxes determined under sub-
13 section (a) are greater than the tax determined
14 under this subsection, the greater tax shall apply.

15 **“SEC. 132. TAX TREATMENT OF CERTAIN COMMUNITY IN-**
16 **COME OF NONRESIDENT ALIENS.**

17 “(a) GENERAL RULE.—In the case of a married cou-
18 ple one or both of whom are nonresident alien individuals
19 and who have community income for the taxable year,
20 such community income shall be treated as follows:

21 “(1) Compensation income shall be treated as
22 income of the spouse who rendered the services,

23 “(2) Partnership distributions shall be treated
24 as the related distributive shares of partnership in-
25 come would be treated under section 1402(a)(5),

1 “(3) Community income which is derived from
2 the separate property of a spouse shall be treated as
3 income of that spouse, and

4 “(4) All other such community income shall be
5 treated as provided in the applicable community
6 property law.

7 “(b) EXCEPTION WHERE ELECTION UNDER SEC-
8 TION 6013(g) IS IN EFFECT.—Subsection (a) shall not
9 apply if an election under subsection (g) or (h) of section
10 6013 (relating to election to treat nonresident alien indi-
11 viduals as residents of the United States) is in effect.

12 **“SEC. 133. RELATIONSHIP WITH TREATIES.**

13 “(a) STATEMENT OF POLICY.—It is the intention of
14 the USA Tax Code to promote a worldwide tax system
15 in which each nation taxes—

16 “(1) under an individual tax, only the income of
17 individuals who are residents or citizens of that na-
18 tion, and

19 “(2) under a business tax only the business ac-
20 tivity in such nation.

21 “(b) EFFECT OF TREATIES.—No tax shall be im-
22 posed under section 131(a) on income that is exempt from
23 tax by reason of a treaty between the nation of which the
24 nonresident alien is a citizen or resident and the United
25 States. If any such treaty requires that a lower rate of

1 tax be imposed on some or all of the items of income sub-
 2 ject to tax under section 331(a), such lower rate shall
 3 apply to such items in the case of persons to whom such
 4 treaty applies.

5 “(c) EFFECT OF UNILATERAL ACTION BY FOREIGN
 6 NATION.—No tax shall be imposed under section 331(a)
 7 on nonresident aliens who are citizens or residents of an-
 8 other nation if—

9 “(1) such nation exempts from its income and
 10 withholding taxes nonresident alien individuals who
 11 are residents or citizens of the United States,

12 “(2) such nation has entered into a tax infor-
 13 mation sharing agreement with the United States,
 14 and

15 “(3) the Secretary certifies that the preceding
 16 two requirements have been satisfied.

17 **“Subchapter I—Trusts and Estates**

“Sec. 140. Prepayment of tax by trusts and estates.

“Sec. 141. Application of tax.

“Sec. 142. Special rules for credits and deductions.

“Sec. 143. Definitions and rules applicable to subchapter I.

“Sec. 144. Deduction for trusts distributing current income only.

“Sec. 145. Inclusion of amounts in gross income of beneficiaries of trusts dis-
 tributing current income only.

“Sec. 146. Deduction for estates and trusts accumulating income or distrib-
 uting corpus.

“Sec. 147. Inclusion of amounts in gross income of beneficiaries of estates and
 trusts accumulating income or distributing corpus.

“Sec. 148. Special rules applicable to sections 146 and 147.

“Sec. 149. Charitable remainder trusts.

“Sec. 150. Definitions applicable to excess distribution rules.

“Sec. 151. Accumulation distribution allocated to preceding years.

“Sec. 152. Treatment of amounts deemed distributed by trust in preceding
 years.

“Sec. 153. Trust income, deductions, and credits attributable to grantors and others as substantial owners.

“Sec. 154. Definitions and rules.

“Sec. 155. Reversionary interests.

“Sec. 156. Power to control beneficial enjoyment.

“Sec. 157. Administrative powers.

“Sec. 158. Power to revoke.

“Sec. 159. Income for benefit of grantor.

“Sec. 160. Person other than grantor treated as substantial owner.

“Sec. 161. Foreign trusts having one or more United States beneficiaries.

“Sec. 162. Limitation on charitable deduction.

“Sec. 163. Income of an estate or trust in case of divorce, etc.

“Sec. 164. Recognition of gain on certain transfers to certain foreign persons and estates.

“Sec. 165. Treatment of funeral trusts.

“Sec. 166. Income in respect of a decedent.

1 **“SEC. 140. PREPAYMENT OF TAX BY TRUSTS AND ESTATES.**

2 “(a) PREPAYMENT OF TAX.—A trust or estate shall
3 prepay the Simplified USA Tax for individuals in accord-
4 ance with the provisions of this subchapter.

5 “(b) IMPOSITION OF TAX.—There is hereby imposed
6 a tax on the taxable income of trusts and estates (as deter-
7 mined in accordance with this subchapter) a tax deter-
8 mined as follows:

“If taxable income is:

Not over \$1,600

Over \$1,600, but not over \$3,800

Over \$3,800

The tax is:

15% of taxable income.

\$240, plus 25% of the excess over
\$1,600.

\$790, plus 30% of the excess over
\$3,800.

9 “(c) INFLATION ADJUSTMENT.—The schedule in
10 subsection (b) shall be adjusted for inflation in accordance
11 with section 23.

12 “(d) BUSINESS ACTIVITIES.—

13 “(1) TAX ON BUSINESS ACTIVITY DETERMINED
14 AT BUSINESS LEVEL.—If a trust engages in business
15 activity (as defined in section 206(b)), it shall be

1 considered a business entity with respect to such ac-
2 tivities for purposes of the business tax under chap-
3 ter 2. The business entity shall be considered an
4 asset of the trust.

5 “(2) BUSINESS ENTITY AS SOLE BENE-
6 FICIARY.—If the only beneficiaries of a trust are
7 business entities, no tax shall be imposed on such
8 trust under this subchapter.

9 **“SEC. 141. APPLICATION OF TAX.**

10 “(a) IN GENERAL.—The tax imposed by section 140
11 shall apply to the taxable income of estates or of any kind
12 of property held in trust, including—

13 “(1) income accumulated in trust for the ben-
14 efit of unborn or unascertained persons or persons
15 with contingent interests, and income accumulated
16 or held for future distribution under the terms of
17 the will or trust;

18 “(2) income which is to be distributed currently
19 by the fiduciary to the beneficiaries, and income col-
20 lected by a guardian of an infant which is to be held
21 or distributed as the court may direct;

22 “(3) income received by estates of deceased per-
23 sons during the period of administration or settle-
24 ment of the estate; and

1 “(4) income which, in the discretion of the fidu-
2 ciary, may be either distributed to the beneficiaries
3 or accumulated.

4 “(b) COMPUTATION AND PAYMENT.—The taxable in-
5 come of an estate or trust shall be computed in the same
6 manner as in the case of an individual, except as otherwise
7 provided in this subchapter. The tax shall be computed
8 on such taxable income and shall be paid by the fiduciary.
9 For purposes of this subsection, a foreign trust or foreign
10 estate shall be treated as a nonresident alien individual
11 who is not present in the United States at any time.

12 “(c) EXCLUSION OF INCLUDIBLE GAIN FROM TAX-
13 ABLE INCOME.—The taxable income of a trust does not
14 include the amount of any includible gain as defined in
15 section 144(b) reduced by any deductions properly allo-
16 cable thereto.

17 **“SEC. 142. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.**

18 “(a) USA DEDUCTION AND FAMILY LIVING ALLOW-
19 ANCE.—

20 “(1) NO DEDUCTION OR ALLOWANCE.—A trust
21 or estate shall not be allowed any USA Deductions
22 or a Family Living Allowance.

23 “(2) SPECIAL DEDUCTION.—For purposes of
24 determining taxable income, trusts and estates shall

1 be entitled to the following deductions from gross
2 income—

3 “(A) ESTATE.—An estate shall be allowed
4 a deduction of \$600.

5 “(B) DISTRIBUTING TRUST.—A trust
6 which, under its governing instrument, is re-
7 quired to distribute all of its income currently
8 shall be allowed a deduction of \$300.

9 “(C) OTHER TRUSTS.—Trusts not de-
10 scribed in subparagraph (B) shall be allowed a
11 deduction of \$100.

12 “(b) DEDUCTION FOR AMOUNTS PAID OR PERMA-
13 NENTLY SET ASIDE FOR A CHARITABLE PURPOSE.—

14 “(1) GENERAL RULE.—In the case of an estate
15 or trust, there shall be allowed as a deduction in
16 computing its taxable income (in lieu of the philan-
17 thropic transfer deduction) any amount of the gross
18 income, without limitation, which pursuant to the
19 terms of the governing instrument is, during the
20 taxable year, paid for a purpose specified in section
21 101(c) (determined without regard to section
22 101(c)(2)(A)). If a charitable contribution is paid
23 after the close of such taxable year and on or before
24 the last day of the year following the close of such
25 taxable year, then the trustee or administrator may

1 elect to treat such contribution as paid during such
2 taxable year. The election shall be made at such
3 time and in such manner as the Secretary prescribes
4 by regulations.

5 “(2) POOLED INCOME FUNDS.—In the case of
6 a pooled income fund (as defined in paragraph (3)),
7 there shall also be allowed as a deduction in com-
8 puting its taxable income any amount of the gross
9 income attributable to gain from the sale of a capital
10 asset held for more than 1 year, without limitation,
11 which pursuant to the terms of the governing instru-
12 ment is, during the taxable year, permanently set
13 aside for a purpose specified in section 101(c).

14 “(3) DEFINITION OF POOLED INCOME FUND.—
15 For purposes of paragraph (2), a pooled income
16 fund is a trust—

17 “(A) to which each donor transfers prop-
18 erty, contributing an irrevocable remainder in-
19 terest in such property to or for the use of an
20 organization described in section 101(b)(1)(A)
21 (other than in clauses (vii) or (viii)), and retain-
22 ing an income interest for the life of one or
23 more beneficiaries (living at the time of such
24 transfer),

1 “(B) in which the property transferred by
2 each donor is commingled with property trans-
3 ferred by other donors who have made or make
4 similar transfers,

5 “(C) which cannot have investments in se-
6 curities which are exempt from taxes imposed
7 by this subtitle,

8 “(D) which includes only amounts received
9 from transfers which meet the requirements of
10 this paragraph,

11 “(E) which is maintained by the organiza-
12 tion to which the remainder interest is contrib-
13 uted and of which no donor or beneficiary of an
14 income interest is a trustee, and

15 “(F) from which each beneficiary of an in-
16 come interest receives income, for each year for
17 which he is entitled to receive the income inter-
18 est referred to in subparagraph (A), determined
19 by the rate of return earned by the trust for
20 such year.

21 For purposes of determining the amount of any
22 charitable contribution allowable by reason of a
23 transfer of property to a pooled fund, the value of
24 the income interest shall be determined on the basis
25 of the highest rate of return earned by the fund for

1 any of the 3 taxable years immediately preceding the
2 taxable year of the fund in which the transfer is
3 made. In the case of funds in existence less than 3
4 taxable years preceding the taxable year of the fund
5 in which a transfer is made the rate of return shall
6 be deemed to be 6 percent per annum, except that
7 the Secretary may prescribe a different rate of re-
8 turn.

9 “(c) UNUSED LOSS CARRYOVERS.—If on the termi-
10 nation of an estate or trust, the estate or trust has a loss
11 carryover then such carryover shall be allowed as a deduc-
12 tion, in accordance with regulations prescribed by the Sec-
13 retary, to the beneficiaries succeeding to the property of
14 the estate or trust.

15 “(d) CERTAIN DISTRIBUTIONS BY CEMETERY PER-
16 PETUAL CARE FUNDS.—In the case of a cemetery per-
17 petual care fund which—

18 “(1) was created pursuant to local law by a tax-
19 able cemetery corporation for the care and mainte-
20 nance of cemetery property, and

21 “(2) is treated for the taxable year as a trust
22 for purposes of this subchapter,
23 any amount distributed by such fund for the care and
24 maintenance of gravesites which have been purchased
25 from the cemetery corporation before the beginning of the

1 taxable year of the trust and with respect to which there
2 is an obligation to furnish care and maintenance shall be
3 considered to be a distribution solely for purposes of sec-
4 tions 144 and 146, but only to the extent that the aggre-
5 gate amount so distributed during the taxable year does
6 not exceed \$5 multiplied by the aggregate number of such
7 gravesites.

8 **“SEC. 143. DEFINITIONS AND RULES APPLICABLE TO SUB-**
9 **CHAPTER I.**

10 “For purposes of this subchapter—

11 “(a) **DISTRIBUTABLE NET INCOME.**—‘Distributable
12 net income’ means, with respect to any taxable year, the
13 taxable income of the estate or trust computed with the
14 following modifications—

15 “(1) No deduction shall be taken under sections
16 144 and 146 (relating to additional deductions).

17 “(2) No deduction shall be taken under section
18 142(a)(2) (relating to deduction for personal exemp-
19 tions).

20 “(3) Gains from the sale or exchange of capital
21 assets shall be excluded to the extent that such gains
22 are allocated to corpus and are not (A) paid, cred-
23 ited, or required to be distributed to any beneficiary
24 during the taxable year, or (B) paid, permanently
25 set aside, or to be used for the purposes specified

1 in section 142(b). Losses from the sale or exchange
2 of capital assets shall be excluded, except to the ex-
3 tent such losses are taken into account in deter-
4 mining the amount of gains from the sale or ex-
5 change of capital assets which are paid, credited, or
6 required to be distributed to any beneficiary during
7 the taxable year.

8 “(4) For purposes only of rules under section
9 _____, there shall be excluded those items of gross in-
10 come constituting extraordinary dividends or taxable
11 stock dividends which the fiduciary, acting in good
12 faith, does not pay or credit to any beneficiary by
13 reason of his determination that such dividends are
14 allocable to corpus under the terms of the governing
15 instrument and applicable local law.

16 “(5) There shall be included any tax-exempt in-
17 terest.

18 “(6) In the case of a foreign trust—

19 “(A) There shall be included the amounts
20 of gross income from sources without the
21 United States, reduced by any amounts which
22 would be deductible in respect of disbursements
23 allocable to such income but for the provisions
24 of section 265(a)(1) (relating to disallowance of
25 certain deductions).

1 “(B) Gross income from sources within the
2 United States shall be determined without re-
3 gard to section 894 (relating to income exempt
4 under treaty).

5 “(C) Paragraph (3) shall not apply to a
6 foreign trust. In the case of such a trust, there
7 shall be included gains from the sale or ex-
8 change of capital assets, reduced by losses from
9 such sales or exchanges to the extent such
10 losses do not exceed gains from such sales or
11 exchanges.

12 If the estate or trust is allowed a deduction under section
13 142(b), the amount of the modifications specified in para-
14 graphs (5) and (6) shall be reduced to the extent that the
15 amount of income which is paid, permanently set aside,
16 or to be used for the purposes specified in section 142(b)
17 is deemed to consist of items specified in those para-
18 graphs. For this purpose, such amount shall (in the ab-
19 sence of specific provisions in the governing instrument)
20 be deemed to consist of the same proportion of each class
21 of items of income of the estate or trust as the total of
22 each class bears to the total of all classes.

23 “(b) INCOME.—‘Income’, when not preceded by the
24 words ‘taxable’, ‘distributable net’, ‘undistributed net’, or
25 ‘gross’, means the amount of income of the estate or trust

1 for the taxable year determined under the terms of the
2 governing instrument and applicable local law. Items of
3 gross income constituting extraordinary dividends or tax-
4 able stock dividends which the fiduciary, acting in good
5 faith, determines to be allocable to corpus under the terms
6 of the governing instrument and applicable local law shall
7 not be considered income.

8 “(c) BENEFICIARY.—‘Beneficiary’ includes heir, leg-
9 atee, devisee.

10 “(d) TREATMENT OF PROPERTY DISTRIBUTED IN
11 KIND.—

12 “(1) BASIS OF BENEFICIARY.—The basis of any
13 property received by a beneficiary in a distribution
14 from an estate or trust shall be—

15 “(A) the adjusted basis of such property in
16 the hands of the estate or trust immediately be-
17 fore the distribution, adjusted for

18 “(B) any gain or loss recognized to the es-
19 tate or trust on the distribution.

20 “(2) AMOUNT OF DISTRIBUTION.—In the case
21 of any distribution of property (other than cash), the
22 amount taken into account under sections 146(a)(2)
23 and 147(a)(2) shall be the lesser of—

1 “(A) the basis of such property in the
2 hands of the beneficiary (as determined under
3 paragraph (1)), or

4 “(B) the fair market value of such prop-
5 erty.

6 “(3) ELECTION TO RECOGNIZE GAIN.—

7 “(A) IN GENERAL.—In the case of any dis-
8 tribution of property (other than cash) to which
9 an election under this paragraph applies—

10 “(i) paragraph (2) shall not apply,

11 “(ii) gain or loss shall be recognized
12 by the estate or trust in the same manner
13 as if such property had been sold to the
14 distributee at its fair market value, and

15 “(iii) the amount taken into account
16 under sections 146(a)(2) and 147(a)(2)
17 shall be the fair market value of such
18 property.

19 “(B) ELECTION.—Any election under this
20 paragraph shall apply to all distributions made
21 by the estate or trust during a taxable year and
22 shall be made on the return of such estate or
23 trust for such taxable year.

24 Any such election, once made, may be revoked
25 only with the consent of the Secretary.

1 “(4) EXCEPTION FOR DISTRIBUTIONS DE-
2 SCRIBED IN SECTION 148(a).—This subsection shall
3 not apply to any distribution described in section
4 148(a).

5 “(f) TREATMENT OF MULTIPLE TRUSTS.—For pur-
6 poses of this subchapter, under regulations prescribed by
7 the Secretary, 2 or more trusts shall be treated as 1 trust
8 if—

9 “(1) such trusts have substantially the same
10 grantor or grantors and substantially the same pri-
11 mary beneficiary or beneficiaries, and

12 “(2) a principal purpose of such trusts is the
13 avoidance of the tax imposed by this chapter.

14 For purposes of the preceding sentence, a husband and
15 wife shall be treated as 1 person.

16 “(g) CERTAIN PAYMENTS OF ESTIMATED TAX
17 TREATED AS PAID BY BENEFICIARY.—Under rules pre-
18 scribed by the Secretary, a trustee may elect to treat any
19 portion of a payment of estimated tax made by such trust
20 for any taxable year of the trust as a payment made by
21 a beneficiary of such trust. This rule shall also apply in
22 the case of a taxable year reasonably expected to be the
23 last taxable year of an estate.

24 “(h) FOREIGN TRUSTS AND FOREIGN INCOME.—The
25 Secretary shall prescribe special rules for foreign trusts

1 and foreign income of trusts. Those rules should generally
2 be consistent with the rules under subchapter J of chapter
3 1 of the Internal Revenue Code of 1986, except that they
4 shall take into account the principles of the Simplified
5 USA Tax.

6 “(i) CERTAIN REVOCABLE TRUSTS TREATED AS
7 PART OF ESTATE.—

8 “(1) IN GENERAL.—If both the executor (if
9 any) of an estate and the trustee of a qualified rev-
10 ocable trust elect the treatment provided in this sec-
11 tion, such trust shall be treated and taxed as part
12 of such estate (and not as a separate trust) for all
13 taxable years of the estate ending after the date of
14 the decedent’s death and before the applicable date.

15 “(2) QUALIFIED REVOCABLE TRUST.—For pur-
16 poses of this subsection, ‘qualified revocable trust’
17 means any trust (or portion thereof) which was
18 treated under section 158 as owned by the decedent
19 of the estate referred to in paragraph (1) by reason
20 of a power in the grantor (determined without re-
21 gard to section 154(e).

22 “(3) APPLICABLE DATE.—For purposes of this
23 subsection, ‘applicable date’ means—

24 “(A) if no return of tax imposed by chap-
25 ter 11 is required to be filed, the date which is

1 2 years after the date of the decedent's death,
2 and

3 “(B) if such a return is required to be
4 filed, the date which is 6 months after the date
5 of the final determination of the liability for tax
6 imposed by chapter 11.

7 “(4) ELECTION.—The election under this sub-
8 section shall be made not later than the time pre-
9 scribed for filing the return of tax imposed by this
10 chapter for the first taxable year of the estate (de-
11 termined with regard to extensions) and, once made,
12 shall be irrevocable.

13 **“SEC. 144. DEDUCTION FOR TRUSTS DISTRIBUTING CUR-**
14 **RENT INCOME ONLY.**

15 “(a) DEDUCTION.—In the case of any trust the terms
16 of which—

17 “(1) provide that all of its income is required
18 to be distributed currently, and

19 “(2) do not provide that any amounts are to be
20 paid, permanently set aside, or used for the purposes
21 specified in section 142(b) (relating to deduction for
22 charitable, etc., purposes),

23 there shall be allowed as a deduction in computing the
24 taxable income of the trust the amount of the income for
25 the taxable year which is required to be distributed cur-

1 rently. This section shall not apply in any taxable year
2 in which the trust distributes amounts other than amounts
3 of income described in paragraph (1).

4 “(b) LIMITATION ON DEDUCTION.—If the amount of
5 income required to be distributed currently exceeds the
6 distributable net income of the trust for the taxable year,
7 the deduction shall be limited to the amount of the distrib-
8 utable net income. For this purpose, the computation of
9 distributable net income shall not include items of income
10 which are not included in the gross income of the trust
11 and the deductions allocable thereto.

12 **“SEC. 145. INCLUSION OF AMOUNTS IN GROSS INCOME OF**
13 **BENEFICIARIES OF TRUSTS DISTRIBUTING**
14 **CURRENT INCOME ONLY.**

15 “(a) INCLUSION.—Subject to subsection (b), the
16 amount of income for the taxable year required to be dis-
17 tributed currently by a trust described in section 144 shall
18 be included in the gross income of the beneficiaries to
19 whom the income is required to be distributed, whether
20 distributed or not. If such amount exceeds the distribut-
21 able net income, there shall be included in the gross in-
22 come of each beneficiary an amount which bears the same
23 ratio to distributable net income as the amount of income
24 required to be distributed to such beneficiary bears to the

1 amount of income required to be distributed to all bene-
2 ficiaries.

3 “(b) CHARACTER OF AMOUNTS.—The amounts speci-
4 fied in subsection (a) shall have the same character in the
5 hands of the beneficiary as in the hands of the trust. For
6 this purpose, the amounts shall be treated as consisting
7 of the same proportion of each class of items entering into
8 the computation of distributable net income of the trust
9 as the total of each class bears to the total distributable
10 net income of the trust, unless the terms of the trust spe-
11 cifically allocate different classes of income to different
12 beneficiaries. In the application of the preceding sentence,
13 the items of deduction entering into the computation of
14 distributable net income shall be allocated among the
15 items of distributable net income in accordance with regu-
16 lations prescribed by the Secretary.

17 **“SEC. 146. DEDUCTION FOR ESTATES AND TRUSTS ACCU-**
18 **MULATING INCOME OR DISTRIBUTING COR-**
19 **PUS.**

20 “(a) DEDUCTION.—In any taxable year there shall be
21 allowed as a deduction in computing the taxable income
22 of an estate or trust (other than a trust described in sec-
23 tion 144), the sum of—

24 “(1) any amount of income for such taxable
25 year required to be distributed currently (including

1 any amount required to be distributed which may be
2 paid out of income or corpus to the extent such
3 amount is paid out of income for such taxable year);
4 and

5 “(2) any other amounts properly paid or cred-
6 ited or required to be distributed for such taxable
7 year;

8 but such deduction shall not exceed the distributable
9 net income of the estate or trust.

10 “(b) CHARACTER OF AMOUNTS DISTRIBUTED.—The
11 amount determined under subsection (a) shall be treated
12 as consisting of the same proportion of each class of items
13 entering into the computation of distributable net income
14 of the estate or trust as the total of each class bears to
15 the total distributable net income of the estate or trust
16 in the absence of the allocation of different classes of in-
17 come under the specific terms of the governing instru-
18 ment. In the application of the preceding sentence, the
19 items of deduction entering into the computation of dis-
20 tributable net income (including the deduction allowed
21 under section 142(b)) shall be allocated among the items
22 of distributable net income in accordance with regulations
23 prescribed by the Secretary.

24 “(c) LIMITATION ON DEDUCTION.—No deduction
25 shall be allowed under subsection (a) in respect of any por-

1 tion of the amount allowed as a deduction under that sub-
2 section (without regard to this subsection) which is treated
3 under subsection (b) as consisting of any item of distribut-
4 able net income which is not included in the gross income
5 of the estate or trust.

6 **“SEC. 147. INCLUSION OF AMOUNTS IN GROSS INCOME OF**
7 **BENEFICIARIES OF ESTATES AND TRUSTS AC-**
8 **CUMULATING INCOME OR DISTRIBUTING**
9 **CORPUS.**

10 “(a) INCLUSION.—Subject to subsection (b), there
11 shall be included in the gross income of a beneficiary to
12 whom an amount specified in section 146(a) is paid, cred-
13 ited, or required to be distributed (by an estate or trust
14 described in section 146), the sum of the following
15 amounts:

16 “(1) AMOUNTS REQUIRED TO BE DISTRIBUTED
17 CURRENTLY.—The amount of income for the taxable
18 year required to be distributed currently to such
19 beneficiary, whether distributed or not. If the
20 amount of income required to be distributed cur-
21 rently to all beneficiaries exceeds the distributable
22 net income (computed without the deduction allowed
23 by section 142(b), relating to deduction for chari-
24 table, etc., purposes) of the estate or trust, then, in
25 lieu of the amount provided in the preceding sen-

1 tence, there shall be included in the gross income of
2 the beneficiary an amount which bears the same
3 ratio to distributable net income (as so computed) as
4 the amount of income required to be distributed cur-
5 rently to such beneficiary bears to the amount re-
6 quired to be distributed currently to all beneficiaries.
7 For purposes of this section, the phrase ‘the amount
8 of income for the taxable year required to be distrib-
9 uted currently’ includes any amount required to be
10 paid out of income or corpus to the extent such
11 amount is paid out of income for such taxable year.

12 “(2) OTHER AMOUNTS DISTRIBUTED.—All
13 other amounts properly paid, credited, or required to
14 be distributed to such beneficiary for the taxable
15 year. If the sum of—

16 “(A) the amount of income for the taxable
17 year required to be distributed currently to all
18 beneficiaries, and

19 “(B) all other amounts properly paid, cred-
20 ited, or required to be distributed to all bene-
21 ficiaries

22 exceeds the distributable net income of the estate or
23 trust, then, in lieu of the amount provided in the
24 preceding sentence, there shall be included in the
25 gross income of the beneficiary an amount which

1 bears the same ratio to distributable net income (re-
2 duced by the amounts specified in (A)) as the other
3 amounts properly paid, credited or required to be
4 distributed to the beneficiary bear to the other
5 amounts properly paid, credited, or required to be
6 distributed to all beneficiaries.

7 “(b) CHARACTER OF AMOUNTS.—The amounts de-
8 termined under subsection (a) shall have the same char-
9 acter in the hands of the beneficiary as in the hands of
10 the estate or trust. For this purpose, the amounts shall
11 be treated as consisting of the same proportion of each
12 class of items entering into the computation of distribut-
13 able net income as the total of each class bears to the
14 total distributable net income of the estate or trust unless
15 the terms of the governing instrument specifically allocate
16 different classes of income to different beneficiaries. In the
17 application of the preceding sentence, the items of deduc-
18 tion entering into the computation of distributable net in-
19 come (including the deduction allowed under section
20 142(b)) shall be allocated among the items of distributable
21 net income in accordance with regulations prescribed by
22 the Secretary. In the application of this subsection to the
23 amount determined under paragraph (1) of subsection (a),
24 distributable net income shall be computed without regard

1 to any portion of the deduction under section 142(b) which
2 is not attributable to income of the taxable year.

3 **“SEC. 148. SPECIAL RULES APPLICABLE TO SECTIONS 146**
4 **AND 147.**

5 “(a) EXCLUSIONS.—There shall not be included as
6 amounts falling within section 146(a) or 147(a)—

7 “(1) GIFTS, BEQUESTS, ETC.—Any amount
8 which, under the terms of the governing instrument,
9 is properly paid or credited as a gift or bequest of
10 a specific sum of money or of specific property and
11 which is paid or credited all at once or in not more
12 than 3 installments. For this purpose an amount
13 which can be paid or credited only from the income
14 of the estate or trust shall not be considered as a
15 gift or bequest of a specific sum of money.

16 “(2) CHARITABLE, ETC., DISTRIBUTIONS.—Any
17 amount paid or permanently set aside or otherwise
18 qualifying for the deduction provided in section
19 142(b) (computed without regard to sections 508(d),
20 162, and 4948(c)(4)).

21 “(3) DENIAL OF DOUBLE DEDUCTION.—Any
22 amount paid, credited, or distributed in the taxable
23 year, if section 144 or section 146 applied to such
24 amount for a preceding taxable year of an estate or

1 trust because credited or required to be distributed
2 in such preceding taxable year.

3 “(b) DISTRIBUTIONS IN FIRST SIXTY-FIVE DAYS OF
4 TAXABLE YEAR.—

5 “(1) GENERAL RULE.—If within the first 65
6 days of any taxable year of an estate or a trust, an
7 amount is properly paid or credited, such amount
8 shall be considered paid or credited on the last day
9 of the preceding taxable year.

10 “(2) LIMITATION.—Paragraph (1) shall apply
11 with respect to any taxable year of an estate or a
12 trust only if the executor of such estate or the fidu-
13 ciary of such trust (as the case may be) elects, in
14 such manner and at such time as the Secretary pre-
15 scribes by regulations, to have paragraph (1) apply
16 for such taxable year.

17 “(c) SEPARATE SHARES TREATED AS SEPARATE ES-
18 TATES OR TRUSTS.—For the sole purpose of determining
19 the amount of distributable net income in the application
20 of sections 146 and 147, in the case of a single trust hav-
21 ing more than one beneficiary, substantially separate and
22 independent shares of different beneficiaries in the trust
23 shall be treated as separate trusts. Rules similar to the
24 rules of the preceding provisions of this subsection shall
25 apply to treat substantially separate and independent

1 shares of different beneficiaries in an estate having more
2 than 1 beneficiary as separate estates. The existence of
3 such substantially separate and independent shares and
4 the manner of treatment as separate trusts or estates, in-
5 cluding the application of sections 150 through 152, shall
6 be determined in accordance with regulations prescribed
7 by the Secretary.

8 **“SEC. 149. CHARITABLE REMAINDER TRUSTS.**

9 “(a) GENERAL RULE.—Notwithstanding any other
10 provision of this subchapter, the provisions of this section
11 shall, in accordance with regulations prescribed by the
12 Secretary, apply in the case of a charitable remainder an-
13 nuity trust and a charitable remainder unitrust.

14 “(b) CHARACTER OF DISTRIBUTIONS.—Amounts dis-
15 tributed by a charitable remainder annuity trust or by a
16 charitable remainder unitrust shall be considered as hav-
17 ing the following characteristics in the hands of a bene-
18 ficiary to whom is paid the annuity described in subsection
19 (d)(1)(A) or the payment described in subsection
20 (d)(2)(A):

21 “(1) First, as amounts of income (other than
22 gains, and amounts treated as gains, from the sale
23 or other disposition of capital assets) includible in
24 gross income to the extent of such income of the

1 trust for the year and such undistributed income of
2 the trust for prior years;

3 “(2) Second, as a capital gain to the extent of
4 the capital gain of the trust for the year and the un-
5 distributed capital gain of the trust for prior years;

6 “(3) Third, as other income to the extent of
7 such income of the trust for the year and such un-
8 distributed income of the trust for prior years; and

9 “(4) Fourth, as a distribution of trust corpus.

10 For purposes of this section, the trust shall determine the
11 amount of its undistributed capital gain on a cumulative
12 net basis.

13 “(c) EXEMPTION FROM INCOME TAXES.—A chari-
14 table remainder annuity trust and a charitable remainder
15 unitrust shall, for any taxable year, not be subject to any
16 tax imposed by this chapter. Any such trust shall be liable
17 for tax on its unrelated business taxable income (within
18 the meaning of section 255).

19 “(d) DEFINITIONS.—

20 “(1) CHARITABLE REMAINDER ANNUITY
21 TRUST.—For purposes of this section, a charitable
22 remainder annuity trust is a trust—

23 “(A) from which a sum certain (which is
24 not less than 5 percent nor more than 50 per-
25 cent of the initial net fair market value of all

1 property placed in trust) is to be paid, not less
2 often than annually, to one or more persons (at
3 least one of which is not an organization de-
4 scribed in section 101(c) and, in the case of in-
5 dividuals, only to an individual who is living at
6 the time of the creation of the trust) for a term
7 of years (not in excess of 20 years) or for the
8 life or lives of such individual or individuals,

9 “(B) from which no amount other than the
10 payments described in subparagraph (A) and
11 other than qualified gratuitous transfers de-
12 scribed in subparagraph (C) may be paid to or
13 for the use of any person other than an organi-
14 zation described in section 101(c),

15 “(C) following the termination of the pay-
16 ments described in subparagraph (A), the re-
17 mainder interest in the trust is to be trans-
18 ferred to, or for the use of, an organization de-
19 scribed in section 101(c) or is to be retained by
20 the trust for such a use or, to the extent the
21 remainder interest is in qualified employer secu-
22 rities (as defined in subsection (g)(4)), all or
23 part of such securities are to be transferred to
24 an employee stock ownership plan (as defined in

1 section 4975(e)(7) in a qualified gratuitous
2 transfer (as defined by subsection (g)).

3 “(D) the value (determined under section
4 7520 of such remainder interest is at least 10
5 percent of the initial net fair market value of all
6 property placed in the trust.

7 “(2) CHARITABLE REMAINDER UNITRUST.—For
8 purposes of this section, a charitable remainder
9 unitrust is a trust—

10 “(A) from which a fixed percentage (which
11 is not less than 5 percent nor more than 50
12 percent) of the net fair market value of its as-
13 sets, valued annually, is to be paid, not less
14 often than annually, to one or more persons (at
15 least one of which is not an organization de-
16 scribed in section 101(c) and, in the case of in-
17 dividuals, only to an individual who is living at
18 the time of the creation of the trust) for a term
19 of years (not in excess of 20 years) or for the
20 life or lives of such individual or individuals,

21 “(B) from which no amount other than the
22 payments described in subparagraph (A) and
23 other than qualified gratuitous transfers de-
24 scribed in subparagraph (C) may be paid to or

1 for the use of any person other than an organi-
2 zation described in section 101(c),

3 “(C) following the termination of the pay-
4 ments described in subparagraph (A), the re-
5 mainder interest in the trust is to be trans-
6 ferred to, or for the use of, an organization de-
7 scribed in section 101(c) or is to be retained by
8 the trust for such a use or, to the extent the
9 remainder interest is in qualified employer secu-
10 rities (as defined in subsection (g)(4)), all or
11 part of such securities are to be transferred to
12 an employee stock ownership plan (as defined in
13 section 4975(e)(7) in a qualified gratuitous
14 transfer (as defined by subsection (g)).

15 “(D) with respect to each contribution of
16 property to the trust, the value (determined
17 under section 7520 of such remainder interest
18 in such property is at least 10 percent of the
19 net fair market value of such property as of the
20 date such property is contributed to the trust.

21 “(3) EXCEPTION.—Notwithstanding the provi-
22 sions of paragraphs (2)(A) and (B), the trust instru-
23 ment may provide that the trustee shall pay the in-
24 come beneficiary for any year—

1 “(A) the amount of the trust income, if
2 such amount is less than the amount required
3 to be distributed under paragraph (2)(A), and

4 “(B) any amount of the trust income
5 which is in excess of the amount required to be
6 distributed under paragraph (2)(A), to the ex-
7 tent that (by reason of subparagraph (A)) the
8 aggregate of the amounts paid in prior years
9 was less than the aggregate of such required
10 amounts.

11 “(4) SEVERANCE OF CERTAIN ADDITIONAL
12 CONTRIBUTIONS.—If—

13 “(A) any contribution is made to a trust
14 which before the contribution is a charitable re-
15 mainder unitrust, and

16 “(B) such contribution would (but for this
17 paragraph) result in such trust ceasing to be a
18 charitable unitrust by reason of paragraph
19 (2)(D), such contribution shall be treated as a
20 transfer to a separate trust under regulations
21 prescribed by the Secretary.

22 “(e) VALUATION FOR PURPOSES OF CHARITABLE
23 CONTRIBUTION.—For purposes of determining the
24 amount of any charitable contribution, the remainder in-
25 terest of a charitable remainder annuity trust or charitable

1 remainder unitrust shall be computed on the basis that
2 an amount equal to 5 percent of the net fair market value
3 of its assets (or a greater amount, if required under the
4 terms of the trust instrument) is to be distributed each
5 year.

6 “(f) CERTAIN CONTINGENCIES PERMITTED.—

7 “(1) GENERAL RULE.—If a trust would, but for
8 a qualified contingency, meet the requirements of
9 paragraph (1)(A) or (2)(A) of subsection (d), such
10 trust shall be treated as meeting such requirements.

11 “(2) VALUE DETERMINED WITHOUT REGARD
12 TO QUALIFIED CONTINGENCY.—For purposes of de-
13 termining the amount of any charitable contribution
14 (or the actuarial value of any interest), a qualified
15 contingency shall not be taken into account.

16 “(3) QUALIFIED CONTINGENCY.—For purposes
17 of this subsection, the term ‘qualified contingency’
18 means any provision of a trust which provides that,
19 upon the happening of a contingency, the payments
20 described in paragraph (1)(A) or (2)(A) of sub-
21 section (d) (as the case may be) will terminate not
22 later than such payments would otherwise terminate
23 under the trust.

24 “(g) QUALIFIED GRATUITOUS TRANSFER OF QUALI-
25 FIED EMPLOYER SECURITIES.—

1 “(1) IN GENERAL.—For purposes of this sec-
2 tion, the term ‘qualified gratuitous transfer’ means
3 a transfer of qualified employer securities to an em-
4 ployee stock ownership plan (as defined in section
5 4975(e)(7) but only to the extent that—

6 “(A) the securities transferred previously
7 passed from a decedent dying before January 1,
8 2002, to a trust described in paragraph (1) or
9 (2) of subsection (d),

10 “(B) no deduction under section 404 is al-
11 lowable with respect to such transfer,

12 “(C) such plan contains the provisions re-
13 quired by paragraph (3),

14 “(D) such plan treats such securities as
15 being attributable to employer contributions but
16 without regard to the limitations otherwise ap-
17 plicable to such contributions under section
18 404, and

19 “(E) the employer whose employees are
20 covered by the plan described in this paragraph
21 files with the Secretary a verified written state-
22 ment consenting to the application of sections
23 4978 and 4979A with respect to such employer.

24 “(2) EXCEPTION.—The term ‘qualified gratu-
25 itous transfer’ shall not include a transfer of quali-

1 fied employer securities to an employee stock owner-
2 ship plan unless—

3 “(A) such plan was in existence on August
4 1, 1996,

5 “(B) at the time of the transfer, the dece-
6 dent and members of the decedent’s family
7 (within the meaning of section 171(a)(6)(D))
8 own (directly or through constructive ownership
9 rules) no more than 10 percent of the value of
10 the stock of the corporation referred to in para-
11 graph (4), and

12 “(C) immediately after the transfer, such
13 plan owns (after the application of section
14 318(a)(4) at least 60 percent of the value of the
15 outstanding stock of the corporation.

16 “(3) PLAN REQUIREMENTS.—A plan contains
17 the provisions required by this paragraph if such
18 plan provides that—

19 “(A) the qualified employer securities so
20 transferred are allocated to plan participants in
21 a manner consistent with section 401(a)(4),

22 “(B) plan participants are entitled to di-
23 rect the plan as to the manner in which such
24 securities which are entitled to vote and are al-

1 located to the account of such participant are to
2 be voted,

3 “(C) an independent trustee votes the se-
4 curities so transferred which are not allocated
5 to plan participants,

6 “(D) each participant who is entitled to a
7 distribution from the plan has the rights de-
8 scribed in subparagraphs (A) and (B) of section
9 409(h)(1),

10 “(E) such securities are held in a suspense
11 account under the plan to be allocated each
12 year, up to the limitations under section 415(c),
13 after first allocating all other annual additions
14 for the limitation year, up to the limitations
15 under sections 415 (c) and (e), and

16 “(F) on termination of the plan, all securi-
17 ties so transferred which are not allocated to
18 plan participants as of such termination are to
19 be transferred to, or for the use of, an organi-
20 zation described in section 101(c). For purposes
21 of the preceding sentence, the term ‘inde-
22 pendent trustee’ means any trustee who is not
23 a member of the family (within the meaning of
24 section 171(a)(6)(D)) of the decedent or a 5-
25 percent shareholder. A plan shall not fail to be

1 treated as meeting the requirements of section
2 401(a) by reason of meeting the requirements
3 of this subsection.

4 “(4) QUALIFIED EMPLOYER SECURITIES.—For
5 purposes of this section, the term ‘qualified employer
6 securities’ means employer securities (as defined in
7 section 409(l)) which are issued by a domestic
8 corporation—

9 “(A) which has no outstanding stock which
10 is readily tradable on an established securities
11 market, and

12 “(B) which has only 1 class of stock.

13 “(5) TREATMENT OF SECURITIES ALLOCATED
14 BY EMPLOYEE STOCK OWNERSHIP PLAN TO PER-
15 SONS RELATED TO DECEDENT OR 5-PERCENT
16 SHAREHOLDERS.—

17 “(A) IN GENERAL.—If any portion of the
18 assets of the plan attributable to securities ac-
19 quired by the plan in a qualified gratuitous
20 transfer are allocated to the account of—

21 “(i) any person who is related to the
22 decedent (within the meaning of section
23 171(a)(5) or a member of the decedent’s
24 family (within the meaning of section
25 171(a)(6)(D), or

1 “(ii) any person who, at the time of
2 such allocation or at any time during the
3 1-year period ending on the date of the ac-
4 quisition of qualified employer securities by
5 the plan, is a 5-percent shareholder of the
6 employer maintaining the plan, the plan
7 shall be treated as having distributed (at
8 the time of such allocation) to such person
9 or shareholder the amount so allocated.

10 “(B) 5-PERCENT SHAREHOLDER.—For
11 purposes of subparagraph (A), the term ‘5-per-
12 cent shareholder’ means any person who owns
13 (directly or through the application of construc-
14 tive ownership rules) more than 5 percent of
15 the outstanding stock of the corporation which
16 issued such qualified employer securities or of
17 any corporation which is a member of the same
18 controlled group of corporations (within the
19 meaning of section 409(l)(4)) as such corpora-
20 tion.

21 “(C) CROSS REFERENCE.—For excise tax
22 on allocations described in subparagraph (A),
23 see section 4979A.

24 “(6) TAX ON FAILURE TO TRANSFER
25 UNALLOCATED SECURITIES TO CHARITY ON TERMI-

1 NATION OF PLAN.—If the requirements of paragraph
2 (3)(F) are not met with respect to any securities,
3 there is hereby imposed a tax on the employer main-
4 taining the plan in an amount equal to the sum of—

5 “(A) the amount of the increase in the tax
6 which would be imposed by chapter 11 if such
7 securities were not transferred as described in
8 paragraph (1), and

9 “(B) interest on such amount at the un-
10 derpayment rate under section 6621 (and com-
11 pounded daily) from the due date for filing the
12 return of the tax imposed by chapter 11.

13 **“SEC. 150. DEFINITIONS APPLICABLE TO EXCESS DISTRIBU-**
14 **TION RULES.**

15 “(a) **UNDISTRIBUTED NET INCOME.**—For purposes
16 of sections 150 through 152, the term ‘undistributed net
17 income’ for any taxable year means the amount by which
18 the distributable net income of the trust for such taxable
19 year exceeds the sum of—

20 “(1) the amounts for such taxable year speci-
21 fied in paragraphs (1) and (2) of section 146(a),
22 and

23 “(2) the amount of taxes imposed on the trust
24 attributable to such distributable net income.

1 “(b) ACCUMULATION DISTRIBUTION.—For purposes
2 of sections 150 through 152, except as provided in sub-
3 section (c), the term ‘accumulation distribution’ means,
4 for any taxable year of the trust, the amount by which—

5 “(1) the amounts specified in paragraph (2) of
6 section 146(a) for such taxable year, exceed

7 “(2) distributable net income for such year re-
8 duced (but not below zero) by the amounts specified
9 in paragraph (1) of section 146(a).

10 For purposes of section 152 (other than subsection (c)
11 thereof, relating to multiple trusts), the amounts specified
12 in paragraph (2) of section 146(a) shall not include
13 amounts properly paid, credited, or required to be distrib-
14 uted to a beneficiary from a trust (other than a foreign
15 trust) as income accumulated before the birth of such ben-
16 efiary or before such beneficiary attains the age of 21.
17 If the amounts properly paid, credited, or required to be
18 distributed by the trust for the taxable year do not exceed
19 the income of the trust for such year, there shall be no
20 accumulation distribution for such year.

21 “(c) EXCEPTION FOR ACCUMULATION DISTRIBUTIONS FROM CERTAIN DOMESTIC TRUSTS.—For purposes
22 of sections 150 through 152—

24 “(1) IN GENERAL.—In the case of a qualified
25 trust, any distribution in any taxable year beginning

1 after the date of the enactment of this subsection
2 shall be computed without regard to any undistrib-
3 uted net income.

4 “(2) QUALIFIED TRUST.—For purposes of this
5 subsection, the term ‘qualified trust’ means any
6 trust other than—

7 “(A) a foreign trust (or, except as provided
8 in regulations, a domestic trust which at any
9 time was a foreign trust), or

10 “(B) a trust created before March 1, 1984,
11 unless it is established that the trust would not
12 be aggregated with other trusts under section
13 143(f) if such section applied to such trust.

14 “(d) TAXES IMPOSED ON THE TRUST.—For purposes
15 of sections 150 through 152—

16 “(1) IN GENERAL.—The term ‘taxes imposed
17 on the trust’ means the amount of the taxes which
18 are imposed for any taxable year of the trust under
19 this chapter (without regard to sections 150 through
20 152) and which, under regulations prescribed by the
21 Secretary, are properly allocable to the undistributed
22 portions of distributable net income and gains in ex-
23 cess of losses from sales or exchanges of capital as-
24 sets. The amount determined in the preceding sen-
25 tence shall be reduced by any amount of such taxes

1 deemed distributed under section 151(b) and (c) to
2 any beneficiary.

3 “(2) FOREIGN TRUSTS.—In the case of any for-
4 eign trust, the term ‘taxes imposed on the trust’ in-
5 cludes the amount, reduced as provided in the last
6 sentence of paragraph (1), of any income, war prof-
7 its, and excess profits taxes imposed by any foreign
8 country or possession of the United States on such
9 foreign trust which, as determined under paragraph
10 (1), are so properly allocable. Under rules or regula-
11 tions prescribed by the Secretary, in the case of any
12 foreign trust of which the settlor or another person
13 would be treated as owner of any portion of the
14 trust but for section 154(f), the term ‘taxes imposed
15 on the trust’ includes the allocable amount of any
16 income, war profits, and excess profits taxes imposed
17 by any foreign country or possession of the United
18 States on the settlor or such other person in respect
19 of trust income.

20 **“SEC. 151. ACCUMULATION DISTRIBUTION ALLOCATED TO**
21 **PRECEDING YEARS.**

22 “(a) AMOUNT ALLOCATED.—In the case of a trust
23 which is subject to sections 146 through 149, the amount
24 of the accumulation distribution of such trust for a taxable
25 year shall be deemed to be an amount within the meaning

1 of paragraph (2) of section 146(a) distributed on the last
2 day of each of the preceding taxable years, commencing
3 with the earliest of such years, to the extent that such
4 amount exceeds the total of any undistributed net income
5 for all earlier preceding taxable years. The amount deemed
6 to be distributed in any such preceding taxable year under
7 the preceding sentence shall not exceed the undistributed
8 net income for such preceding taxable year. For purposes
9 of this subsection, undistributed net income for each of
10 such preceding taxable years shall be computed without
11 regard to such accumulation distribution and without re-
12 gard to any accumulation distribution determined for any
13 succeeding taxable year.

14 “(b) TOTAL TAXES DEEMED DISTRIBUTED.—If any
15 portion of an accumulation distribution for any taxable
16 year is deemed under subsection (a) to be an amount with-
17 in the meaning of paragraph (2) of section 146(a) distrib-
18 uted on the last day of any preceding taxable year, and
19 such portion of such distribution is not less than the un-
20 distributed net income for such preceding taxable year, the
21 trust shall be deemed to have distributed on the last day
22 of such preceding taxable year an additional amount with-
23 in the meaning of paragraph (2) of section 146(a). Such
24 additional amount shall be equal to the taxes imposed on
25 the trust for such preceding taxable year attributable to

1 the undistributed net income. For purposes of this sub-
2 section, the undistributed net income and the taxes im-
3 posed on the trust for such preceding taxable year attrib-
4 utable to such undistributed net income shall be computed
5 without regard to such accumulation distribution and
6 without regard to any accumulation distribution deter-
7 mined for any succeeding taxable year.

8 “(c) PRO RATA PORTION OF TAXES DEEMED DIS-
9 TRIBUTED.—If any portion of an accumulation distribu-
10 tion for any taxable year is deemed under subsection (a)
11 to be an amount within the meaning of paragraph (2) of
12 section 146(a) distributed on the last day of any preceding
13 taxable year and such portion of the accumulation dis-
14 tribution is less than the undistributed net income for such
15 preceding taxable year, the trust shall be deemed to have
16 distributed on the last day of such preceding taxable year
17 an additional amount within the meaning of paragraph (2)
18 of section 146(a). Such additional amount shall be equal
19 to the taxes imposed on the trust for such taxable year
20 attributable to the undistributed net income multiplied by
21 the ratio of the portion of the accumulation distribution
22 to the undistributed net income of the trust for such year.
23 For purposes of this subsection, the undistributed net in-
24 come and the taxes imposed on the trust for such pre-
25 ceding taxable year attributable to such undistributed net

1 income shall be computed without regard to the accumula-
2 tion distribution and without regard to any accumulation
3 distribution determined for any succeeding taxable year.

4 “(d) RULE WHEN INFORMATION IS NOT AVAIL-
5 ABLE.—If adequate records are not available to determine
6 the proper application of this subchapter to an amount
7 distributed by a trust, such amount shall be deemed to
8 be an accumulation distribution consisting of undistrib-
9 uted net income earned during the earliest preceding tax-
10 able year of the trust in which it can be established that
11 the trust was in existence.

12 “(e) DENIAL OF REFUND TO TRUSTS AND BENE-
13 FICIARIES.—No refund or credit shall be allowed to a trust
14 or a beneficiary of such trust for any preceding taxable
15 year by reason of a distribution deemed to have been made
16 by such trust in such year under this section.

17 **“SEC. 152. TREATMENT OF AMOUNTS DEEMED DISTRIB-**
18 **UTED BY TRUST IN PRECEDING YEARS.**

19 “(a) GENERAL RULE.—The total of the amounts
20 which are treated under section 151 as having been dis-
21 tributed by a trust in a preceding taxable year shall be
22 included in the income of a beneficiary of the trust when
23 paid, credited, or required to be distributed to the extent
24 that such total would have been included in the income
25 of such beneficiary under section 147(a)(2) (and, with re-

1 spect to any tax-exempt interest to which section 103 ap-
2 plies, under section 147(b)) if such total had been paid
3 to such beneficiary on the last day of such preceding tax-
4 able year. The tax imposed by this subtitle on a beneficiary
5 for a taxable year in which any such amount is included
6 in his income shall be determined only as provided in this
7 section and shall consist of the sum of—

8 “(1) a partial tax computed on the taxable in-
9 come reduced by an amount equal to the total of
10 such amounts, at the rate and in the manner as if
11 this section had not been enacted,

12 “(2) a partial tax determined as provided in
13 subsection (b) of this section, and

14 “(3) in the case of a foreign trust, the interest
15 charge determined as provided in section 152.

16 “(b) TAX ON DISTRIBUTION.—

17 “(1) IN GENERAL.—The partial tax imposed by
18 subsection (a)(2) shall be determined.

19 “(A) by determining the number of pre-
20 ceeding taxable years of the trust on the last day
21 of which an amount is deemed under section
22 151(a) to have been distributed,

23 “(B) by taking from the 5 taxable years
24 immediately preceding the year of the accumu-
25 lation distribution the 1 taxable year for which

1 the beneficiary's taxable income was the highest
2 and the 1 taxable year for which his taxable in-
3 come was the lowest,

4 “(C) by adding to the beneficiary's taxable
5 income for each of the 3 taxable years remain-
6 ing after the application of subparagraph (B)
7 an amount determined by dividing the amount
8 deemed distributed under section 151 and re-
9 quired to be included in income under sub-
10 section (a) by the number of preceding taxable
11 years determined under subparagraph (A), and

12 “(D) by determining the average increase
13 in tax for the 3 taxable years referred to in sub-
14 paragraph (C) resulting from the application of
15 such subparagraph.

16 The partial tax imposed by subsection (a)(2) shall be
17 the excess (if any) of the average increase in tax de-
18 termined under subparagraph (D), multiplied by the
19 number of preceding taxable years determined under
20 subparagraph (A), over the amount of taxes (other
21 than the amount of taxes described in section
22 150(d)(2)) deemed distributed to the beneficiary
23 under sections 151 (b) and (c).

24 “(2) TREATMENT OF LOSS YEARS.—For pur-
25 poses of paragraph (1), the taxable income of the

1 beneficiary for any taxable year shall be deemed to
2 be not less than zero.

3 “(3) CERTAIN PRECEDING TAXABLE YEARS NOT
4 TAKEN INTO ACCOUNT.—For purposes of paragraph
5 (1), if the amount of the undistributed net income
6 deemed distributed in any preceding taxable year of
7 the trust is less than 25 percent of the amount of
8 the accumulation distribution divided by the number
9 of preceding taxable years to which the accumulation
10 distribution is allocated under section 151(a), the
11 number of preceding taxable years of the trust with
12 respect to which an amount is deemed distributed to
13 a beneficiary under section 151(a) shall be deter-
14 mined without regard to such year.

15 “(4) EFFECT OF OTHER ACCUMULATION DIS-
16 TRIBUTIONS.—In computing the partial tax under
17 paragraph (1) for any beneficiary, the income of
18 such beneficiary for each of his prior taxable years
19 shall include amounts previously deemed distributed
20 to such beneficiary in such year under section 151
21 as a result of prior accumulation distributions
22 (whether from the same or another trust).

23 “(5) MULTIPLE DISTRIBUTIONS IN THE SAME
24 TAXABLE YEAR.—In the case of accumulation dis-
25 tributions made from more than one trust which are

1 includible in the income of a beneficiary in the same
2 taxable year, the distributions shall be deemed to
3 have been made consecutively in whichever order the
4 beneficiary shall determine. Generation-skipping
5 transfer bears to the total accumulation distribution.

6 “(c) SPECIAL RULE FOR MULTIPLE TRUSTS.—

7 “(1) IN GENERAL.—If, in the same prior tax-
8 able year of the beneficiary in which any part of the
9 accumulation distribution from a trust (hereinafter
10 in this paragraph referred to as “third trust”) is
11 deemed under section 151(a) to have been distrib-
12 uted to such beneficiary, some part of prior distribu-
13 tions by each of 2 or more other trusts is deemed
14 under section 151(a) to have been distributed to
15 such beneficiary, then subsections (b) and (c) of sec-
16 tion 151 shall not apply with respect to such part
17 of the accumulation distribution from such third
18 trust.

19 “(2) ACCUMULATION DISTRIBUTIONS FROM
20 TRUST NOT TAKEN INTO ACCOUNT UNLESS THEY
21 EQUAL OR EXCEED \$1,000.—For purposes of para-
22 graph (1), an accumulation distribution from a trust
23 to a beneficiary shall be taken into account only if
24 such distribution, when added to any prior accumu-
25 lation distributions from such trust which are

1 deemed under section 151(a) to have been distrib-
2 uted to such beneficiary for the same prior taxable
3 year of the beneficiary, equals or exceeds \$1,000.

4 **“SEC. 153. TRUST INCOME, DEDUCTIONS, AND CREDITS AT-**
5 **TRIBUTABLE TO GRANTORS AND OTHERS AS**
6 **SUBSTANTIAL OWNERS.**

7 “Where it is specified in sections 153 through 161
8 that the grantor or another person shall be treated as the
9 owner of any portion of a trust, there shall then be in-
10 cluded in computing the taxable income and credits of the
11 grantor or the other person those items of income, deduc-
12 tions, and credits against tax of the trust which are attrib-
13 utable to that portion of the trust to the extent that such
14 items would be taken into account under this chapter in
15 computing taxable income or credits against the tax of an
16 individual. Any remaining portion of the trust shall be
17 subject to sections 140 through 152. No items of a trust
18 shall be included in computing the taxable income and
19 credits of the grantor or of any other person solely on the
20 grounds of his dominion and control over the trust under
21 section 61 (relating to definition of gross income) or any
22 other provision of this title, except as specified in this sub-
23 part.

1 **“SEC. 154. DEFINITIONS AND RULES.**

2 “(a) ADVERSE PARTY.—For purposes of sections 153
3 through 160, ‘adverse party’ means any person having a
4 substantial beneficial interest in the trust which would be
5 adversely affected by the exercise or nonexercise of the
6 power which he possesses respecting the trust. A person
7 having a general power of appointment over the trust
8 property shall be deemed to have a beneficial interest in
9 the trust.

10 “(b) NONADVERSE PARTY.—For purposes of sections
11 153 through 160, ‘nonadverse party’ means any person
12 who is not an adverse party.

13 “(c) RELATED OR SUBORDINATE PARTY.—For pur-
14 poses of sections 153 through 161, ‘related or subordinate
15 party’ means any nonadverse party who is—

16 “(1) the grantor’s spouse if living with the
17 grantor;

18 “(2) any one of the following: The grantor’s fa-
19 ther, mother, issue, brother or sister; an employee of
20 the grantor; a corporation or any employee of a cor-
21 poration in which the stock holdings of the grantor
22 and the trust are significant from the viewpoint of
23 voting control; a subordinate employee of a corpora-
24 tion in which the grantor is an executive.

25 For purposes of subsection (f) and sections 156 and 157,
26 a related or subordinate party shall be presumed to be

1 subservient to the grantor in respect of the exercise or
2 nonexercise of the powers conferred on him unless such
3 party is shown not to be subservient by a preponderance
4 of the evidence.

5 “(d) RULE WHERE POWER IS SUBJECT TO CONDI-
6 TION PRECEDENT.—A person shall be considered to have
7 a power described in sections 153 through 161 even
8 though the exercise of the power is subject to a precedent
9 giving of notice or takes effect only on the expiration of
10 a certain period after the exercise of the power.

11 “(e) GRANTOR TREATED AS HOLDING ANY POWER
12 OR INTEREST OF GRANTOR’S SPOUSE.—

13 “(1) IN GENERAL.—For purposes of sections
14 153 through 160, a grantor shall be treated as hold-
15 ing any power or interest held by—

16 “(A) any individual who was the spouse of
17 the grantor at the time of the creation of such
18 power or interest, or

19 “(B) any individual who became the spouse
20 of the grantor after the creation of such power
21 or interest, but only with respect to periods
22 after such individual became the spouse of the
23 grantor.

24 “(2) MARITAL STATUS.—For purposes of para-
25 graph (1)(A), an individual legally separated from

1 his spouse under a decree of divorce or of separate
2 maintenance shall not be considered as married.

3 “(f) RULES NOT TO RESULT IN FOREIGN OWNER-
4 SHIP.—

5 “(1) IN GENERAL.—Notwithstanding any other
6 provision in sections 153 through 160, sections 153
7 through 160 shall apply only to the extent such ap-
8 plication results in an amount (if any) being cur-
9 rently taken into account (directly or through 1 or
10 more entities) under this chapter in computing the
11 income of a citizen or resident of the United States
12 or a domestic corporation.

13 “(2) EXCEPTIONS.—

14 “(A) CERTAIN REVOCABLE AND IRREV-
15 OCABLE TRUSTS.—Paragraph (1) shall not
16 apply to any portion of a trust if—

17 “(i) the power to revest absolutely in
18 the grantor title to the trust property to
19 which such portion is attributable is exer-
20 cisable solely by the grantor without the
21 approval or consent of any other person or
22 with the consent of a related or subordi-
23 nate party who is subservient to the grant-
24 or, or

1 “(ii) the only amounts distributable
2 from such portion (whether income or cor-
3 pus) during the lifetime of the grantor are
4 amounts distributable to the grantor or the
5 spouse of the grantor.

6 “(B) COMPENSATORY TRUSTS.—Except as
7 provided in regulations, paragraph (1) shall not
8 apply to any portion of a trust distributions
9 from which are taxable as compensation for
10 services rendered.

11 “(3) SPECIAL RULES.—Except as otherwise
12 provided in regulations prescribed by the Secretary,
13 a controlled foreign corporation shall be treated as
14 a domestic corporation for purposes of paragraph
15 (1).

16 “(4) RECHARACTERIZATION OF PURPORTED
17 GIFTS.—In the case of any transfer directly or indi-
18 rectly from a partnership or foreign corporation
19 which the transferee treats as a gift or bequest, the
20 Secretary may recharacterize such transfer in such
21 circumstances as the Secretary determines to be ap-
22 propriate to prevent the avoidance of the purposes of
23 this subsection.

24 “(5) SPECIAL RULE WHERE GRANTOR IS FOR-
25 EIGN PERSON.—If—

1 “(A) but for this subsection, a foreign per-
2 son would be treated as the owner of any por-
3 tion of a trust, and

4 “(B) such trust has a beneficiary who is a
5 United States person,

6 such beneficiary shall be treated as the grantor of
7 such portion to the extent such beneficiary has made
8 (directly or indirectly) transfers of property (other
9 than in a sale for full and adequate consideration)
10 to such foreign person.

11 “(6) REGULATIONS.—The Secretary shall pre-
12 scribe such regulations as may be necessary or ap-
13 propriate to carry out the purposes of this sub-
14 section, including regulations providing that para-
15 graph (1) shall not apply in appropriate cases.

16 **“SEC. 155. REVERSIONARY INTERESTS.**

17 “(a) GENERAL RULE.—The grantor shall be treated
18 as the owner of any portion of a trust in which he has
19 a reversionary interest in either the corpus or the income
20 therefrom, if, as of the inception of that portion of the
21 trust, the value of such interest exceeds 5 percent of the
22 value of such portion.

23 “(b) REVERSIONARY INTEREST TAKING EFFECT AT
24 DEATH OF MINOR LINEAL DESCENDANT BENE-
25 FICIARY.—In the case of any beneficiary who—

1 “(1) is a lineal descendant of the grantor, and

2 “(2) holds all of the present interests in any

3 portion of a trust,

4 the grantor shall not be treated under subsection (a) as

5 the owner of such portion solely by reason of a rever-

6 sionary interest in such portion which takes effect upon

7 the death of such beneficiary before such beneficiary at-

8 tains age 21.

9 “(c) SPECIAL RULE FOR DETERMINING VALUE OF

10 REVERSIONARY INTEREST.—For purposes of subsection

11 (a), the value of the grantor’s reversionary interest shall

12 be determined by assuming the maximum exercise of dis-

13 cretion in favor of the grantor.

14 “(d) POSTPONEMENT OF DATE SPECIFIED FOR RE-

15 ACQUISITION.—Any postponement of the date specified for

16 the reacquisition of possession or enjoyment of the rever-

17 sionary interest shall be treated as a new transfer in trust

18 commencing with the date on which the postponement is

19 effective and terminating with the date prescribed by the

20 postponement. However, income for any period shall not

21 be included in the income of the grantor by reason of the

22 preceding sentence if such income would not be so includ-

23 ible in the absence of such postponement.

1 **“SEC. 156. POWER TO CONTROL BENEFICIAL ENJOYMENT.**

2 “(a) GENERAL RULE.—The grantor shall be treated
3 as the owner of any portion of a trust in respect of which
4 the beneficial enjoyment of the corpus or the income there-
5 from is subject to a power of disposition, exercisable by
6 the grantor or a nonadverse party, or both, without the
7 approval or consent of any adverse party.

8 “(b) EXCEPTIONS FOR CERTAIN POWERS.—Sub-
9 section (a) shall not apply to the following powers regard-
10 less of by whom held:

11 “(1) POWER TO APPLY INCOME TO SUPPORT OF
12 A DEPENDENT.—A power described in section
13 159(b) to the extent that the grantor would not be
14 subject to tax under that section.

15 “(2) POWER AFFECTING BENEFICIAL ENJOY-
16 MENT ONLY AFTER OCCURRENCE OF EVENT.—A
17 power, the exercise of which can only affect the ben-
18 efiticial enjoyment of the income for a period com-
19 mencing after the occurrence of an event such that
20 a grantor would not be treated as the owner under
21 section 155 if the power were a reversionary inter-
22 est; but the grantor may be treated as the owner
23 after the occurrence of the event unless the power is
24 relinquished.

25 “(3) POWER EXERCISABLE ONLY BY WILL.—A
26 power exercisable only by will, other than a power in

1 the grantor to appoint by will the income of the
2 trust where the income is accumulated for such dis-
3 position by the grantor or may be so accumulated in
4 the discretion of the grantor or a nonadverse party,
5 or both, without the approval or consent of any ad-
6 verse party.

7 “(4) POWER TO ALLOCATE AMONG CHARITABLE
8 BENEFICIARIES.—A power to determine the bene-
9 ficial enjoyment of the corpus or the income there-
10 from if the corpus or income is irrevocably payable
11 for a purpose specified in section 101(e) (relating to
12 definition of charitable contributions) or to an em-
13 ployee stock ownership plan (as defined in section
14 4975(e)(7)) in a qualified gratuitous transfer (as de-
15 fined in section 149(g)(1)).

16 “(5) POWER TO DISTRIBUTE CORPUS.—A
17 power to distribute corpus either—

18 “(A) to or for a beneficiary or beneficiaries
19 or to or for a class of beneficiaries (whether or
20 not income beneficiaries) provided that the
21 power is limited by a reasonably definite stand-
22 ard which is set forth in the trust instrument;
23 or

24 “(B) to or for any current income bene-
25 ficiary, provided that the distribution of corpus

1 must be chargeable against the proportionate
2 share of corpus held in trust for the payment
3 of income to the beneficiary as if the corpus
4 constituted a separate trust.

5 A power does not fall within the powers described in
6 this paragraph if any person has a power to add to
7 the beneficiary or beneficiaries or to a class of bene-
8 ficiaries designated to receive the income or corpus,
9 except where such action is to provide for after-born
10 or after-adopted children.

11 “(6) POWER TO WITHHOLD INCOME TEMPO-
12 RARILY.—A power to distribute or apply income to
13 or for any current income beneficiary or to accumu-
14 late the income for him, provided that any accumu-
15 lated income must ultimately be payable—

16 “(A) to the beneficiary from whom dis-
17 tribution or application is withheld, to his es-
18 tate, or to his appointees (or persons named as
19 alternate takers in default of appointment) pro-
20 vided that such beneficiary possesses a power of
21 appointment which does not exclude from the
22 class of possible appointees any person other
23 than the beneficiary, his estate, his creditors, or
24 the creditors of his estate, or

1 “(B) on termination of the trust, or in con-
2 junction with a distribution of corpus which is
3 augmented by such accumulated income, to the
4 current income beneficiaries in shares which
5 have been irrevocably specified in the trust in-
6 strument.

7 Accumulated income shall be considered so payable
8 although it is provided that if any beneficiary does
9 not survive a date of distribution which could rea-
10 sonably have been expected to occur within the bene-
11 ficiary’s lifetime, the share of the deceased bene-
12 ficiary is to be paid to his appointees or to one or
13 more designated alternate takers (other than the
14 grantor or the grantor’s estate) whose shares have
15 been irrevocably specified. A power does not fall
16 within the powers described in this paragraph if any
17 person has a power to add to the beneficiary or
18 beneficiaries or to a class of beneficiaries designated
19 to receive the income or corpus except where such
20 action is to provide for after-born or after-adopted
21 children.

22 “(7) POWER TO WITHHOLD INCOME DURING
23 DISABILITY OF A BENEFICIARY.—A power exer-
24 cisable only during—

1 “(A) the existence of a legal disability of
2 any current income beneficiary, or

3 “(B) the period during which any income
4 beneficiary shall be under the age of 21 years,
5 to distribute or apply income to or for such bene-
6 ficiary or to accumulate and add the income to cor-
7 pus. A power does not fall within the powers de-
8 scribed in this paragraph if any person has a power
9 to add to the beneficiary or beneficiaries or to a
10 class of beneficiaries designated to receive the in-
11 come or corpus, except where such action is to pro-
12 vide for after-born or after-adopted children.

13 “(8) POWER TO ALLOCATE BETWEEN CORPUS
14 AND INCOME.—A power to allocate receipts and dis-
15 bursements as between corpus and income, even
16 though expressed in broad language.

17 “(c) EXCEPTION FOR CERTAIN POWERS OF INDE-
18 PENDENT TRUSTEES.—Subsection (a) shall not apply to
19 a power solely exercisable (without the approval or consent
20 of any other person) by a trustee or trustees, none of
21 whom is the grantor, and no more than half of whom are
22 related or subordinate parties who are subservient to the
23 wishes of the grantor—

1 “(1) to distribute, apportion, or accumulate in-
2 come to or for a beneficiary or beneficiaries, or to,
3 for, or within a class of beneficiaries; or

4 “(2) to pay out corpus to or for a beneficiary
5 or beneficiaries or to or for a class of beneficiaries
6 (whether or not income beneficiaries).

7 A power does not fall within the powers described in this
8 subsection if any person has a power to add to the bene-
9 ficiary or beneficiaries or to a class of beneficiaries des-
10 igned to receive the income or corpus, except where such
11 action is to provide for after-born or after-adopted chil-
12 dren. For periods during which an individual is the spouse
13 of the grantor (within the meaning of section 154(e)(2)),
14 any reference in this subsection to the grantor shall be
15 treated as including a reference to such individual.

16 “(d) POWER TO ALLOCATE INCOME IF LIMITED BY
17 A STANDARD.—Subsection (a) shall not apply to a power
18 solely exercisable (without the approval or consent of any
19 other person) by a trustee or trustees, none of whom is
20 the grantor or spouse living with the grantor, to distribute,
21 apportion, or accumulate income to or for a beneficiary
22 or beneficiaries, or to, for, or within a class of bene-
23 ficiaries, whether or not the conditions of paragraph (6)
24 or (7) of subsection (b) are satisfied, if such power is lim-
25 ited by a reasonably definite external standard which is

1 set forth in the trust instrument. A power does not fall
2 within the powers described in this subsection if any per-
3 son has a power to add to the beneficiary or beneficiaries
4 or to a class of beneficiaries designated to receive the in-
5 come or corpus except where such action is to provide for
6 after-born or after-adopted children.

7 **“SEC. 157. ADMINISTRATIVE POWERS.**

8 “The grantor shall be treated as the owner of any
9 portion of a trust in respect of which—

10 “(1) POWER TO DEAL FOR LESS THAN ADE-
11 QUATE AND FULL CONSIDERATION.—A power exer-
12 cisable by the grantor or a nonadverse party, or
13 both, without the approval or consent of any adverse
14 party enables the grantor or any person to purchase,
15 exchange, or otherwise deal with or dispose of the
16 corpus or the income therefrom for less than an ade-
17 quate consideration in money or money’s worth.

18 “(2) POWER TO BORROW WITHOUT ADEQUATE
19 INTEREST OR SECURITY.—A power exercisable by
20 the grantor or a nonadverse party, or both, enables
21 the grantor to borrow the corpus or income, directly
22 or indirectly, without adequate interest or without
23 adequate security except where a trustee (other than
24 the grantor) is authorized under a general lending

1 power to make loans to any person without regard
2 to interest or security.

3 “(3) BORROWING OF THE TRUST FUNDS.—The
4 grantor has directly or indirectly borrowed the cor-
5 pus or income and has not completely repaid the
6 loan, including any interest, before the beginning of
7 the taxable year. The preceding sentence shall not
8 apply to a loan which provides for adequate interest
9 and adequate security, if such loan is made by a
10 trustee other than the grantor and other than a re-
11 lated or subordinate trustee subservient to the
12 grantor. For periods during which an individual is
13 the spouse of the grantor (within the meaning of
14 section 154(e)(2)), any reference in this paragraph
15 to the grantor shall be treated as including a ref-
16 erence to such individual.

17 “(4) GENERAL POWERS OF ADMINISTRATION.—
18 A power of administration is exercisable in a non-
19 fiduciary capacity by any person without the ap-
20 proval or consent of any person in a fiduciary capac-
21 ity. For purposes of this paragraph, the term ‘power
22 of administration’ means any one or more of the fol-
23 lowing powers: (A) a power to vote or direct the vot-
24 ing of stock or other securities of a corporation in
25 which the holdings of the grantor and the trust are

1 significant from the viewpoint of voting control; (B)
2 a power to control the investment of the trust funds
3 either by directing investments or reinvestments, or
4 by vetoing proposed investments or reinvestments, to
5 the extent that the trust funds consist of stocks or
6 securities of corporations in which the holdings of
7 the grantor and the trust are significant from the
8 viewpoint of voting control; or (C) a power to reac-
9 quire the trust corpus by substituting other property
10 of an equivalent value.

11 **“SEC. 158. POWER TO REVOKE.**

12 “(a) GENERAL RULE.—The grantor shall be treated
13 as the owner of any portion of a trust, whether or not
14 he is treated as such owner under any other provision of
15 this part, where at any time the power to revert in the
16 grantor title to such portion is exercisable by the grantor
17 or a non-adverse party, or both.

18 “(b) POWER AFFECTING BENEFICIAL ENJOYMENT
19 ONLY AFTER OCCURRENCE OF EVENT.—Subsection (a)
20 shall not apply to a power the exercise of which can only
21 affect the beneficial enjoyment of the income for a period
22 commencing after the occurrence of an event such that
23 a grantor would not be treated as the owner under section
24 155 if the power were a reversionary interest. But the

1 grantor may be treated as the owner after the occurrence
2 of such event unless the power is relinquished.

3 **“SEC. 159. INCOME FOR BENEFIT OF GRANTOR.**

4 “(a) GENERAL RULE.—The grantor shall be treated
5 as the owner of any portion of a trust, whether or not
6 he is treated as such owner under section 156, whose in-
7 come without the approval or consent of any adverse party
8 is, or, in the discretion of the grantor or a nonadverse
9 party, or both, may be—

10 “(1) distributed to the grantor or the grantor’s
11 spouse;

12 “(2) held or accumulated for future distribution
13 to the grantor or the grantor’s spouse; or

14 “(3) applied to the payment of premiums on
15 policies of insurance on the life of the grantor or the
16 grantor’s spouse (except policies of insurance irrev-
17 ocably payable for a purpose specified in section
18 101(c) (relating to definition of charitable contribu-
19 tions)).

20 This subsection shall not apply to a power the exercise
21 of which can only affect the beneficial enjoyment of the
22 income for a period commencing after the occurrence of
23 an event such that the grantor would not be treated as
24 the owner under section 153 if the power were a rever-
25 sionary interest; but the grantor may be treated as the

1 owner after the occurrence of the event unless the power
2 is relinquished.

3 “(b) OBLIGATIONS OF SUPPORT.—Income of a trust
4 shall not be considered taxable to the grantor under sub-
5 section (a) or any other provision of this chapter merely
6 because such income in the discretion of another person,
7 the trustee, or the grantor acting as trustee or co-trustee,
8 may be applied or distributed for the support or mainte-
9 nance of a beneficiary (other than the grantor’s spouse)
10 whom the grantor is legally obligated to support or main-
11 tain, except to the extent that such income is so applied
12 or distributed. In cases where the amounts so applied or
13 distributed are paid out of corpus or out of other than
14 income for the taxable year, such amounts shall be consid-
15 ered to be an amount paid or credited within the meaning
16 of paragraph (2) of section 146(a) and shall be taxed to
17 the grantor under section 147.

18 **“SEC. 160. PERSON OTHER THAN GRANTOR TREATED AS**
19 **SUBSTANTIAL OWNER.**

20 “(a) GENERAL RULE.—A person other than the
21 grantor shall be treated as the owner of any portion of
22 a trust with respect to which:

23 “(1) such person has a power exercisable solely
24 by himself to vest the corpus or the income there-
25 from in himself, or

1 “(2) such person has previously partially re-
2 leased or otherwise modified such a power and after
3 the release or modification retains such control as
4 would, within the principles of sections 153 to 159,
5 inclusive, subject a grantor of a trust to treatment
6 as the owner thereof.

7 “(b) EXCEPTION WHERE GRANTOR IS TAXABLE.—
8 Subsection (a) shall not apply with respect to a power over
9 income, as originally granted or thereafter modified, if the
10 grantor of the trust or a transferor (to whom section 161
11 applies) is otherwise treated as the owner under sections
12 153 through 159 or section 161.

13 “(c) OBLIGATIONS OF SUPPORT.—Subsection (a)
14 shall not apply to a power which enables such person, in
15 the capacity of trustee or cotrustee, merely to apply the
16 income of the trust to the support or maintenance of a
17 person whom the holder of the power is obligated to sup-
18 port or maintain except to the extent that such income
19 is so applied. In cases where the amounts so applied or
20 distributed are paid out of corpus or out of other than
21 income of the taxable year, such amounts shall be consid-
22 ered to be an amount paid or credited within the meaning
23 of paragraph (2) of section 146(a) and shall be taxed to
24 the holder of the power under section 147.

1 “(d) EFFECT OF RENUNCIATION OR DISCLAIMER.—
2 Subsection (a) shall not apply with respect to a power
3 which has been renounced or disclaimed within a reason-
4 able time after the holder of the power first became aware
5 of its existence.

6 **“SEC. 161. FOREIGN TRUSTS HAVING ONE OR MORE**
7 **UNITED STATES BENEFICIARIES.**

8 “(a) TRANSFEROR TREATED AS OWNER.—

9 “(1) IN GENERAL.—A United States person
10 who directly or indirectly transfers property to a for-
11 eign trust (other than a trust described in section
12 6048(a)(3)(B)(ii)) shall be treated as the owner for
13 his taxable year of the portion of such trust attrib-
14 utable to such property if for such year there is a
15 United States beneficiary of any portion of such
16 trust.

17 “(2) EXCEPTIONS.—Paragraph (1) shall not
18 apply—

19 “(A) TRANSFERS BY REASON OF DEATH.—
20 To any transfer by reason of the death of the
21 transferor.

22 “(B) TRANSFERS AT FAIR MARKET
23 VALUE.—To any transfer of property to a trust
24 in exchange for consideration of at least the fair
25 market value of the transferred property. For

1 purposes of the preceding sentence, consider-
2 ation other than cash shall be taken into ac-
3 count at its fair market value.

4 “(3) CERTAIN OBLIGATIONS NOT TAKEN INTO
5 ACCOUNT UNDER FAIR MARKET VALUE EXCEP-
6 TION.—

7 “(A) IN GENERAL.—In determining wheth-
8 er paragraph (2)(B) applies to any transfer by
9 a person described in clause (ii) or (iii) of sub-
10 paragraph (C), there shall not be taken into
11 account—

12 “(i) except as provided in regulations,
13 any obligation of a person described in
14 subparagraph (C), and

15 “(ii) to the extent provided in regula-
16 tions, any obligation which is guaranteed
17 by a person described in subparagraph (C).

18 “(B) TREATMENT OF PRINCIPAL PAY-
19 MENTS ON OBLIGATION.—Principal payments
20 by the trust on any obligation referred to in
21 subparagraph (A) shall be taken into account
22 on and after the date of the payment in deter-
23 mining the portion of the trust attributable to
24 the property transferred.

1 “(C) PERSONS DESCRIBED.—The persons
2 described in this subparagraph are—

3 “(i) the trust,

4 “(ii) any grantor, owner, or bene-
5 ficiary of the trust, and

6 “(iii) any person who is related (with-
7 in the meaning of section 143(i)(2)(B) to
8 any grantor, owner, or beneficiary of the
9 trust.

10 “(4) SPECIAL RULES APPLICABLE TO FOREIGN
11 GRANTOR WHO LATER BECOMES A UNITED STATES
12 PERSON.—

13 “(A) IN GENERAL.—If a nonresident alien
14 individual has a residency starting date within
15 5 years after directly or indirectly transferring
16 property to a foreign trust, this section and sec-
17 tion 6048 shall be applied as if such individual
18 transferred to such trust on the residency start-
19 ing date an amount equal to the portion of such
20 trust attributable to the property transferred by
21 such individual to such trust in such transfer.

22 “(B) TREATMENT OF UNDISTRIBUTED IN-
23 COME.—For purposes of this section, undistrib-
24 uted net income for periods before such individ-
25 ual’s residency starting date shall be taken into

1 account in determining the portion of the trust
2 which is attributable to property transferred by
3 such individual to such trust but shall not oth-
4 erwise be taken into account.

5 “(C) RESIDENCY STARTING DATE.—For
6 purposes of this paragraph, an individual’s resi-
7 dency starting date is the residency starting
8 date determined under section 7701(b)(2)(A).

9 “(5) OUTBOUND TRUST MIGRATIONS.—If—

10 “(A) an individual who is a citizen or resi-
11 dent of the United States transferred property
12 to a trust which was not a foreign trust, and

13 “(B) such trust becomes a foreign trust
14 while such individual is alive, then this section
15 and section 6048 shall be applied as if such in-
16 dividual transferred to such trust on the date
17 such trust becomes a foreign trust an amount
18 equal to the portion of such trust attributable
19 to the property previously transferred by such
20 individual to such trust. A rule similar to the
21 rule of paragraph (4)(B) shall apply for pur-
22 poses of this paragraph.

23 “(b) TRUSTS ACQUIRING UNITED STATES BENE-
24 FICIARIES.—If—

1 “(1) subsection (a) applies to a trust for the
2 transferor’s taxable year, and

3 “(2) subsection (a) would have applied to the
4 trust for his immediately preceding taxable year but
5 for the fact that for such preceding taxable year
6 there was no United States beneficiary for any por-
7 tion of the trust,

8 then, for purposes of this chapter, the transferor shall be
9 treated as having income for the taxable year (in addition
10 to his other income for such year) equal to the undistrib-
11 uted net income (at the close of such immediately pre-
12 ceding taxable year) attributable to the portion of the
13 trust referred to in subsection (a).

14 “(c) TRUSTS TREATED AS HAVING A UNITED
15 STATES BENEFICIARY.—

16 “(1) IN GENERAL.—For purposes of this sec-
17 tion, a trust shall be treated as having a United
18 States beneficiary for the taxable year unless—

19 “(A) under the terms of the trust, no part
20 of the income or corpus of the trust may be
21 paid or accumulated during the taxable year to
22 or for the benefit of a United States person,
23 and

24 “(B) if the trust were terminated at any
25 time during the taxable year, no part of the in-

1 come or corpus of such trust could be paid to
2 or for the benefit of a United States person.

3 “(2) **ATTRIBUTION OF OWNERSHIP.**—For pur-
4 poses of paragraph (1), an amount shall be treated
5 as paid or accumulated to or for the benefit of a
6 United States person if such amount is paid to or
7 accumulated for a foreign corporation, foreign part-
8 nership, or foreign trust or estate, and—

9 “(A) in the case of a foreign corporation,
10 such corporation is a controlled foreign corpora-
11 tion,

12 “(B) in the case of a foreign partnership,
13 a United States person is a partner of such
14 partnership, or

15 “(C) in the case of a foreign trust or es-
16 tate, such trust or estate has a United States
17 beneficiary (within the meaning of paragraph
18 (1)).

19 “(3) **CERTAIN UNITED STATES BENEFICIARIES**
20 **DISREGARDED.**—A beneficiary shall not be treated
21 as a United States person in applying this section
22 with respect to any transfer of property to foreign
23 trust if such beneficiary first became a United
24 States person more than 5 years after the date of
25 such transfer.

1 a sum which is payable for the support of minor children
2 of such husband. In case such income is less than the
3 amount specified in the decree, agreement, or instrument,
4 for the purpose of applying the preceding sentence, such
5 income, to the extent of such sum payable for such sup-
6 port, shall be considered a payment for such support.

7 “(b) WIFE CONSIDERED A BENEFICIARY.—For pur-
8 poses of computing the taxable income of the estate or
9 trust and the taxable income of a wife to whom subsection
10 (a) applies, such wife shall be considered as the bene-
11 ficiary.

12 “(c) CROSS REFERENCE.—For definitions of ‘hus-
13 band’ and ‘wife’, as used in this section, see section
14 7701(a)(17).

15 **“SEC. 164. RECOGNITION OF GAIN ON CERTAIN TRANSFERS**
16 **TO CERTAIN FOREIGN TRUSTS AND ESTATES.**

17 “(a) IN GENERAL.—Except as provided in regula-
18 tions, in the case of any transfer of property by a United
19 States person to a foreign estate or trust, for purposes
20 of this subtitle, such transfer shall be treated as a sale
21 or exchange for an amount equal to the fair market value
22 of the property transferred, and the transferor shall recog-
23 nize as gain the excess of—

24 “(1) the fair market value of the property so
25 transferred, over

1 “(2) the adjusted basis (for purposes of deter-
2 mining gain) of such property in the hands of the
3 transferor.

4 “(b) EXCEPTION.—Subsection (a) shall not apply to
5 a transfer to a trust by a United States person to the
6 extent that any person is treated as the owner of such
7 trust under section 153.

8 “(c) TREATMENT OF TRUSTS WHICH BECOME FOR-
9 EIGN TRUSTS.—If a trust which is not a foreign trust be-
10 comes a foreign trust, such trust shall be treated for pur-
11 poses of this section as having transferred, immediately
12 before becoming a foreign trust, all of its assets to a for-
13 eign trust.

14 **“SEC. 165. TREATMENT OF FUNERAL TRUSTS.**

15 “(a) IN GENERAL.—In the case of a qualified funeral
16 trust, sections 144 through 161 shall not apply, and no
17 deduction shall be allowed by section 142(b).

18 “(b) QUALIFIED FUNERAL TRUST.—‘Qualified fu-
19 neral trust’ means any trust (other than a foreign trust)
20 if—

21 “(1) the trust arises as a result of a contract
22 with a person engaged in the trade or business of
23 providing funeral or burial services or property nec-
24 essary to provide such services,

1 “(2) the sole purpose of the trust is to hold, in-
2 vest, and reinvest funds in the trust and to use such
3 funds solely to make payments for such services or
4 property for the benefit of the beneficiaries of the
5 trust,

6 “(3) the only beneficiaries of such trust are in-
7 dividuals with respect to whom such services or
8 property are to be provided at their death under
9 contracts described in paragraph (1),

10 “(4) the only contributions to the trust are con-
11 tributions by or for the benefit of such beneficiaries,

12 “(5) the trustee elects the application of this
13 subsection, and

14 “(6) the trust would (but for the election de-
15 scribed in paragraph (5)) be treated as owned under
16 sections 153 through 161 by the purchasers of the
17 contracts described in paragraph (1).

18 “(c) DOLLAR LIMITATION ON CONTRIBUTIONS.—

19 “(1) IN GENERAL.—Any trust which accepts
20 aggregate contributions by or for the benefit of an
21 individual in excess of \$7,000 shall not be a quali-
22 fied funeral trust.

23 “(2) RELATED TRUSTS.—For purposes of para-
24 graph (1), all trusts having trustees which are re-
25 lated persons shall be treated as 1 trust. For pur-

1 poses of the preceding sentence, persons are related
2 if—

3 “(A) the relationship between such persons
4 is described in section 171(a)(5), or

5 “(B) the Secretary determines that treat-
6 ing such persons as related is necessary to pre-
7 vent avoidance of the purposes of this section.

8 “(3) INFLATION ADJUSTMENT.—In the case of
9 any contract referred to in subsection (b)(1) which
10 is entered into during any calendar year after 2001,
11 the dollar amount referred to in paragraph (1) shall
12 be adjusted for inflation in accordance with section
13 23.

14 “(d) APPLICATION OF RATE SCHEDULE.—Section
15 140(b) shall be applied to each qualified funeral trust by
16 treating each beneficiary’s interest in each such trust as
17 a separate trust.

18 “(e) TREATMENT OF AMOUNTS REFUNDED TO PUR-
19 CHASER ON CANCELLATION.—No gain or loss shall be rec-
20 ognized to a purchaser of a contract described in sub-
21 section (b)(1) by reason of any payment from such trust
22 to such purchaser by reason of cancellation of such con-
23 tract. If any payment referred to in the preceding sentence
24 consists of property other than money, the basis of such
25 property in the hands of such purchaser shall be the same

1 as the trust's basis in such property immediately before
2 the payment.

3 “(f) SIMPLIFIED REPORTING.—The Secretary may
4 prescribe rules for simplified reporting of all trusts having
5 a single trustee.

6 **“SEC. 166. INCOME IN RESPECT OF A DECEDENT.**

7 “(a) INCLUSION IN GROSS INCOME.—

8 “(1) GENERAL USE.—The amount of all items
9 of gross income in respect of a decedent which are
10 not properly includible in respect of a taxable period
11 in which falls the date of his death, or a prior pe-
12 riod, shall be included in gross income, for the tax-
13 able year when received, of—

14 “(A) the estate of the decedent, if the right
15 to receive the amount is acquired by the dece-
16 dent's estate,

17 “(B) the person who, by reason of the
18 death of the decedent, acquires the right to re-
19 ceive the amount, if the right to receive the
20 amount is not acquired by the decedent's estate
21 from the decedent,

22 “(C) the person who acquires from the de-
23 cedent the right to receive the amount by be-
24 quest, devise or inheritance, if the amount is re-

1 posed by section 201 and, to the extent required by
2 the context, the provisions of chapter 2.

3 “(3) INTERNAL REVENUE CODE OF 1986.—‘In-
4 ternal Revenue Code of 1986’ means the Internal
5 Revenue Code of 1986 as in effect immediately be-
6 fore the enactment of the Simplified USA Tax Act
7 of 2001.

8 “(4) UNITED STATES.—‘United States’ means
9 the States and the District of Columbia.

10 “(5) RELATED PARTY.—‘Related party’
11 means—

12 “(A) Members of a family, as defined in
13 paragraph (6)(D);

14 “(B) An individual and a business entity
15 more than 50 percent in value of which is
16 owned, directly or indirectly, by or for such in-
17 dividual (applying rules of constructive owner-
18 ship);

19 “(C) Two business entities that are eligible
20 to file a consolidated return under chapter 2;

21 “(D) A grantor and a fiduciary of any
22 trust;

23 “(E) A fiduciary of a trust and a fiduciary
24 of another trust, if the same person is a grantor
25 of both trusts;

1 “(F) A fiduciary of a trust and a bene-
2 ficiary of such trust;

3 “(G) A fiduciary of a trust and a bene-
4 ficiary of another trust, if the same person is
5 a grantor of both trusts;

6 “(H) A fiduciary of a trust and a corpora-
7 tion more than 50 percent in value of the out-
8 standing stock of which is owned, directly or in-
9 directly, by or for the trust or by or for a per-
10 son who is a grantor of the trust;

11 “(I) A person and an organization to
12 which section 251 (relating to certain edu-
13 cational and charitable organizations which are
14 exempt from tax) applies and which is con-
15 trolled directly or indirectly by such person or
16 (if such person is an individual) by members of
17 the family of such individual;

18 “(J) Two business entities if the same per-
19 sons own more than 50 percent of the value of
20 each (applying rules of constructive ownership),
21 with value measured by—

22 “(i) the value of the outstanding stock
23 in the case of a corporation,

24 “(ii) the capital interest or the profits
25 interest, whichever is greater, in the case

1 of a partnership or limited liability com-
2 pany;

3 “(K) Except in the case of a sale or ex-
4 change in satisfaction of a pecuniary bequest,
5 an executor of an estate and a beneficiary of
6 such estate.

7 “(6) CONSTRUCTIVE OWNERSHIP.—For pur-
8 poses of determining, in applying paragraph (5), the
9 ownership of a business entity—

10 “(A) Stock or other equity interest owned,
11 directly or indirectly, by or for a corporation,
12 partnership, estate, or trust shall be considered
13 as being owned proportionately by or for its
14 shareholders, partners, or beneficiaries;

15 “(B) An individual shall be considered as
16 owning the stock or other equity interest owned,
17 directly or indirectly, by or for his family;

18 “(C) An individual owning (otherwise than
19 by the application of subparagraph (B)) any
20 stock in a corporation or other equity interest
21 in another form of business entity shall be con-
22 sidered as owning the stock owned, directly or
23 indirectly, by or for his partner;

24 “(D) The family of an individual shall in-
25 clude only his brothers and sisters (whether by

1 the whole or half blood), spouse, ancestors, and
2 lineal descendants; and

3 “(E) Stock or other equity interest con-
4 structively owned by a person by reason of the
5 application of subparagraph (A) shall, for the
6 purpose of applying subparagraph (A), (B), or
7 (C), be treated as actually owned by such per-
8 son, but stock or other equity interest construc-
9 tively owned by an individual by reason of the
10 application of subparagraph (B) or (C) shall
11 not be treated as owned by him for the purpose
12 of again applying either of such paragraphs in
13 order to make another the constructive owner of
14 such stock or equity interest.

15 “(6) EARNED INCOME.—

16 “(A) IN GENERAL.—‘Earned income’
17 means—

18 “(i) wages, salaries, tips, and other
19 employee compensation, plus

20 “(ii) the amount of the taxpayer’s net
21 earnings from self-employment for the tax-
22 able year (within the meaning of section
23 1402(a)).

24 “(B) SPECIAL RULES.—For purposes of
25 subparagraph (A)—

1 “(i) the earned income of an indi-
2 vidual shall be computed without regard to
3 any community property laws,

4 “(ii) no amount received as a pension
5 or annuity shall be taken into account,

6 “(iii) no income of nonresident alien
7 individuals not connected with United
8 States business shall be taken into ac-
9 count, and

10 “(iv) no amount received for services
11 provided by an individual while the indi-
12 vidual is an inmate at a penal institution
13 shall be taken into account.

14 “(b) TERMS DEFINED IN CHAPTER 1.—If a term
15 that is used but not defined in this chapter or in section
16 7701 is defined in chapter 2, the definition in chapter 2
17 shall apply except if manifestly incompatible with the in-
18 tent of the provision in which the term is used.

19 **“SEC. 172. RULES OF APPLICATION.**

20 “(a) DEFINITIONS.—Any definition included in this
21 chapter shall apply for all purposes of this chapter
22 unless—

23 “(1) such definition is limited to the purposes
24 of a particular chapter, section, or subsection, or

1 “(2) the definition clearly would not be applica-
2 ble in a particular context.

3 “(b) INTERPRETATIONS CONSISTENT WITH INTER-
4 NAL REVENUE CODE OF 1986.—Terms not defined in this
5 chapter or elsewhere in this title, but defined in the Inter-
6 nal Revenue Code of 1986, shall be interpreted in a man-
7 ner consistent with the Internal Revenue Code of 1986,
8 except to the extent such interpretation would be incon-
9 sistent with the principles and purposes of this chapter.”

10 (c) EXEMPTION FROM PROHIBITED TRANSACTION
11 TAX.—Section 4975(g) of the Code is amended by—

12 (1) striking “or” at the end of paragraph (2),

13 (2) deleting the period at the end of paragraph

14 (3) and inserting “; or”,

15 (3) and inserting the following new paragraph

16 (4):

17 “(4) to a Roth IRA in the case of a loan to or
18 equity investment in a controlled business entity as
19 permitted by section 30(f).”

1 **TITLE III—SIMPLIFIED USA TAX**
 2 **FOR BUSINESSES**

3 **SEC. 301. REPEAL OF CORPORATE INCOME TAX; NEW TAX**
 4 **PAID BY CORPORATIONS AND OTHER BUSI-**
 5 **NESSES.**

6 (a) IN GENERAL.—Chapter 2 of the Internal Rev-
 7 enue Code is renumbered chapter 3 and following new
 8 chapter is inserted after chapter 1:

9 **“CHAPTER 2—SIMPLIFIED USA TAX FOR**
 10 **BUSINESSES**

“Subchapter A. Imposition of tax.

“Subchapter B. Basic rules for business tax.

“Subchapter C. Capital contributions, mergers, acquisitions, and distributions.

“Subchapter D. Accounting methods.

“Subchapter E. Land and rental property.

“Subchapter F. Insurance and financial products.

“Subchapter G. Financial intermediation and financial institutions.

“Subchapter H. Tax-exempt organizations.

“Subchapter I. Cooperatives.

“Subchapter J. Sourcing rules.

“Subchapter K. Business conducted in a possession.

“Subchapter L. Payroll tax credit.

“Subchapter M. Import tax.

“Subchapter N. Transition rules.

“Subchapter O. Rules for administration, consolidated returns.

“Subchapter P. Definitions and rules of applications.

11 **“Subchapter A—Imposition of Tax**

“Sec. 201. Tax imposed.

12 **“SEC. 201. TAX IMPOSED.**

13 “(a) TAXABLE BUSINESS ACTIVITY.—A tax is im-
 14 posed on the sale of goods and services in the United
 15 States by a business entity. The amount of the tax equals
 16 the amount by which—

1 “(1) the business tax exceeds,

2 “(2) the payroll tax credit.

3 “(b) BUSINESS TAX IMPOSED.—

4 “(1) IN GENERAL.—The ‘business tax’ imposed
5 on a business entity that sells or leases property or
6 sells services in the United States equals the sum
7 of—

8 “(A) 8 percent of the portion of the gross
9 profits of the business entity for the taxable
10 year that does not exceed \$150,000, and

11 “(B) 12 percent of such portion of the
12 gross profits of the business entity for the tax-
13 able year that exceeds \$150,000.

14 “(2) LIMITATION ON APPLICATION OF BENE-
15 FITS OF GRADUATED RATE SCHEDULE.—The Sec-
16 retary shall prescribe rules under which the gross
17 profits of business entities under common control
18 are aggregated for purposes of applying the benefit
19 of the lower rate described in subparagraph (A) of
20 paragraph (1). Such rules shall be similar to rules
21 applicable under sections 1551 and 1561 of the In-
22 ternal Revenue Code of 1986.

23 “(c) PAYROLL TAX CREDIT.—The ‘payroll tax credit’
24 is a credit for the social security, railroad retirement and
25 hospital insurance taxes paid by an employer, as deter-

1 mined in accordance with subchapter L (sections 281
2 through 283).

3 “(d) IMPORT TAX.—For rules relating to the import
4 tax imposed by this chapter, see subchapter M (sections
5 286 through 288).

6 **“Subchapter B—Basic Rules for Business Tax**

“Sec. 202. Gross profits.

“Sec. 203. Taxable receipts.

“Sec. 204. Deductible amounts.

“Sec. 205. Cost of business purchases.

“Sec. 206. Business entity and business activity.

“Sec. 207. Loss carryover deduction.

7 **“SEC. 202. GROSS PROFITS.**

8 “‘Gross profits’ means for a taxable year of a busi-
9 ness entity the amount by which—

10 “(1) the taxable receipts of the business entity
11 for the taxable year exceed,

12 “(2) the deductible amounts for the business
13 entity for the taxable year.

14 **“SEC. 203. TAXABLE RECEIPTS.**

15 “(a) IN GENERAL.—‘Taxable receipts’ means all re-
16 ceipts from the sale of property, use of property, and per-
17 formance of services in the United States.

18 “(b) GAMES OF CHANCE.—Amounts received for
19 playing games of chance by business entities engaging in
20 the activity of providing such games shall be treated as
21 receipts from the sale of property or services.

1 “(c) IN-KIND RECEIPTS.—The taxable receipts at-
2 tributable to the receipt of property, use of property or
3 services in whole or partial exchange for property, use of
4 property or services equal the fair market value of the
5 services or property received.

6 “(d) TAXES.—Taxable receipts do not include any ex-
7 cise tax, sales tax, custom duty, or other separately stated
8 levy imposed by a Federal, State, or local government re-
9 ceived by a business entity in connection with the sale of
10 property or services or the use of property.

11 “(e) FINANCIAL RECEIPTS.—

12 “(1) IN GENERAL.—Except as provided in sub-
13 chapter G (relating to financial intermediation and
14 financial institutions), taxable receipts do not in-
15 clude financial receipts.

16 “(2) FINANCIAL RECEIPTS.—‘Financial re-
17 ceipts’ include—

18 “(A) interest,

19 “(B) dividends and other distributions by a
20 business entity,

21 “(C) proceeds from the sale of stock, other
22 ownership interests in business entities, or
23 other financial instruments (as defined in sec-
24 tion 242(b)(3)),

25 “(D) proceeds from life insurance policies,

1 “(E) proceeds from annuities,

2 “(F) proceeds from currency hedging or
3 exchanges, and

4 “(G) proceeds from other financial trans-
5 actions.

6 “(f) CROSS REFERENCES.—

7 “(1) FINANCIAL INTERMEDIATION.—See sub-
8 chapters F and G for rules relating to financial
9 intermediation.

10 “(2) EXPORTS, SALES IN THE UNITED
11 STATES.—See subchapter J for the exclusion from
12 gross receipts for export sales and for rules on sales
13 of property and services in the United States.

14 “(3) LAND.—See subchapter E for rules relat-
15 ing to certain sales of land.

16 “(4) INSURANCE PROCEEDS.—See section 237
17 for rules on the inclusion of certain insurance pro-
18 ceeds in taxable receipts.

19 **“SEC. 204. DEDUCTIBLE AMOUNTS.**

20 “(a) IN GENERAL.—‘Deductible amounts’ for a busi-
21 ness entity in a taxable year include—

22 “(1) the cost of business purchases in the tax-
23 able year (as determined under section 205),

24 “(2) such entity’s loss carryover deduction (as
25 determined under section 207) , and

1 “(3) the transition basis deduction (as deter-
2 mined under section 290).

3 “(b) FINANCIAL INTERMEDIATION.—See subchapters
4 F and G for special rules for business entities engaging
5 in financial intermediation.

6 **“SEC. 205. COST OF BUSINESS PURCHASES.**

7 “(a) BUSINESS PURCHASES.—

8 “(1) IN GENERAL.—‘Business purchases’ means
9 the acquisition of—

10 “(A) property,

11 “(B) the use of property, or

12 “(C) services

13 in the United States for use in a business activity.

14 “(2) EXAMPLES.—Business purchases include
15 (without limitation) the—

16 “(A) purchase or rental of real property,

17 “(B) purchase or rental of capital equip-
18 ment,

19 “(C) purchase of supplies and inventory,

20 “(D) purchase of services from inde-
21 pendent contractors,

22 “(E) purchase of financial intermediation
23 services (as determined in accordance with sec-
24 tion 236),

1 “(F) purchase of a business loss policy (as
2 determined in accordance with section 237),
3 and

4 “(G) imports for use in a business activity.

5 “(3) EXCLUSIONS.—Business purchases do not
6 include—

7 “(A) payments for use of money or capital,
8 such as interest or dividends (except to the ex-
9 tent that a portion so paid is a fee for financial
10 intermediation services),

11 “(B) premiums for life insurance,

12 “(C) the acquisition of savings assets or
13 other financial instruments (as defined in sec-
14 tion 242(b)(3)).

15 “(D) property acquired outside the United
16 States (but such property shall be taken into
17 account as an import if imported),

18 “(E) services performed outside the United
19 States (unless treated as imported into the
20 United States),

21 “(F) compensation expenses for an indi-
22 vidual (other than amounts paid to an indi-
23 vidual in his capacity as a business entity), or

24 “(G) taxes (except as provided in sub-
25 section (b)(2) relating to product taxes).

1 “(4) COMPENSATION EXPENSES.—‘Compensa-
2 tion expenses’ means—

3 “(A) wages, salaries or other cash payable
4 for services,

5 “(B) any taxes imposed on the recipient
6 that are withheld by the business entity,

7 “(C) the cost of property purchased to pro-
8 vide employees with compensation (other than
9 property incidental to the provision of fringe
10 benefits that are excluded from income under
11 the individual tax),

12 “(D) the cost of fringe benefits which are
13 includible in an employee’s, partner’s, or propri-
14 etor’s income under the Simplified USA Income
15 Tax (or are excluded solely because they con-
16 stitute employee savings), including (without
17 limitation)—

18 “(i) contributions to retirement and
19 severance benefit plans,

20 “(ii) premiums for the cost of life,
21 health, accident, disability and other insur-
22 ance policies for which the service provider,
23 members of his family, or persons des-
24 ignated by him or members of his family
25 are the beneficiaries,

1 “(iii) rental of parking spaces or park-
2 ing fees (unless the parking space is used
3 for a vehicle that is regularly used in a
4 business activity);

5 “(iv) employer paid educational bene-
6 fits;

7 “(v) employer paid housing (other
8 than housing provided for the convenience
9 of the employer); and

10 “(vi) employer paid meals (other than
11 meals provided for the convenience of the
12 employer).

13 “(b) COST OF BUSINESS PURCHASES.—

14 “(1) IN GENERAL.—The ‘cost of a business
15 purchase’ is the amount paid or to be paid for the
16 business purchase.

17 “(2) TAXES.—

18 “(A) IN GENERAL.—The ‘cost of business
19 purchases’ includes any product taxes paid with
20 respect to the property or services purchased.

21 “(B) PRODUCT TAX.—‘Product tax’ means
22 any excise tax, sales or use tax, custom duty, or
23 other separately stated levy imposed by a Fed-
24 eral, State, or local government on the produc-
25 tion, severance or consumption of property or

1 on the provision of services, whether or not sep-
2 arately stated, and including any such taxes
3 that are technically imposed on the seller of
4 property or services.

5 “(C) TAXES NOT PRODUCT TAXES.—Prod-
6 uct taxes do not include—

7 “(i) the import tax,

8 “(ii) state and local property taxes,

9 “(iii) franchise or income taxes,

10 “(iv) payroll taxes and self-employ-
11 ment taxes, or

12 “(v) the business tax.

13 “(3) IMPORTS.—In the case of an import by a
14 business entity, the cost of the import is the import
15 price for purposes of the import tax. The import tax
16 is not part of the cost of the import.

17 “(c) PROPERTY AND SERVICES ACQUIRED FOR
18 PROPERTY.—If a business entity receives property or serv-
19 ices from a business entity in whole or partial exchange
20 for property or services, the property or services acquired
21 shall be treated as if they were purchased for an amount
22 equal to the fair market value of the services or property
23 received. For purposes of this section, property includes
24 stock and other equity interests in business other than
25 stock or an equity interest in the business entity acquiring

1 the property or services. See section 210(b) for rules on
2 property or services received in exchange for an equity in-
3 terest in the recipient.

4 “(d) GAMBLING PAYMENTS.—In the case of a busi-
5 ness involving gambling, lotteries, or other games of
6 chance, business purchases include amounts paid to win-
7 ners.

8 “(e) SAVINGS ASSETS.—‘Savings assets’ means
9 stocks, bonds, securities, certificates of deposits, invest-
10 ments in partnerships and limited liability companies,
11 shares of mutual funds, life insurance policies, annuities,
12 and other similar savings or investment assets.

13 “(f) CROSS REFERENCES.—

14 “(1) FINANCIAL INTERMEDIATION AND INSUR-
15 ANCE.—For rules relating to fees for financial inter-
16 mediation services and insurance, see subchapter F.

17 “(2) LAND.—For special rules relating to the
18 acquisition of land, see subchapter E.

19 “(3) RENTAL REAL ESTATE.—For special rules
20 relating to the rental of real estate previously occu-
21 pied by an owner of the real estate, see section 232.

22 “(4) OUTSIDE THE UNITED STATES.—For spe-
23 cial rules relating to services performed outside the
24 United States but used inside the United States and
25 international services, see subchapter J.

1 **“SEC. 206. BUSINESS ENTITY AND BUSINESS ACTIVITY.**

2 “(a) BUSINESS ENTITY.—For purposes of the busi-
3 ness tax, ‘business entity’ means any corporation, unincor-
4 porated association, partnership, limited liability company,
5 proprietorship, independent contractor, individual, or any
6 other person engaging in business activity in the United
7 States. An individual shall be considered a business entity
8 only with respect to the individual’s business activities.

9 “(b) BUSINESS ACTIVITY.—‘Business activity’ means
10 the sale of property or services, the leasing of property,
11 the development of property or services for subsequent
12 sale or use in producing property or services for subse-
13 quent sale. ‘Business activity’ does not include casual or
14 occasional sales of property used by an individual (other
15 than in a business activity), such as the sale by an indi-
16 vidual of a vehicle used by the individual.

17 “(c) EXCEPTION FOR CERTAIN EMPLOYEES.—

18 “(1) IN GENERAL.—‘Business activity’ does not
19 include—

20 “(A) the performance of services by an em-
21 ployee for an employer that is a business entity
22 with respect to the activity in which the em-
23 ployee is engaged, or

24 “(B) the performance of regular domestic
25 household services (including babysitting,
26 housecleaning, and lawn cutting) by an em-

1 ployee of an employer that is an individual or
2 family.

3 “(2) EMPLOYEE DEFINED.—For purposes of
4 this subsection, ‘employee’ includes an individual
5 partner who provides services to a partnership or an
6 individual member who provides services to a limited
7 liability company, or a proprietor with respect to
8 compensation for services from his proprietorship.

9 **“SEC. 207. LOSS CARRYOVER DEDUCTION.**

10 “(a) DEDUCTION.—The ‘loss carryover deduction’ for
11 a taxable year is the lesser of—

12 “(1) the business entity’s gross profits for the
13 taxable year (determined without the loss carryover
14 deduction), or

15 “(2) the amount of the loss carryover to the
16 taxable year.

17 “(b) LOSS CARRYOVER.—

18 “(1) GENERAL RULE.—A loss for any taxable
19 year shall be a loss carryover to each of the 215 tax-
20 able years following the taxable year of the loss.

21 “(2) LOSS CARRYOVERS TO A TAXABLE YEAR.—

22 The loss carryover to a taxable year is the sum of
23 the loss carryovers from all prior taxable years be-
24 ginning on or after January 1, 2002, that can be
25 carried over to the taxable year.

1 “(3) REDUCTION OF LOSS CARRYOVERS AS A
2 RESULT OF THE DEDUCTION.—A business entity’s
3 loss carryovers shall be reduced each year by the
4 amount of the loss carryover deduction for the year.
5 Loss carryovers shall be reduced in the order that
6 they arose.

7 “(c) LOSS FOR TAXABLE YEAR.—A business entity’s
8 loss (if any) for the taxable year equals the excess (if any)
9 of—

10 “(1) the sum of—

11 “(A) the cost of business purchases for the
12 taxable year, and

13 “(B) the transition basis adjustment for
14 the taxable year, over

15 “(2) taxable receipts for the taxable year.

16 “(d) SPECIAL RULES.—

17 “(1) CONSOLIDATED RETURNS.—In the case of
18 a consolidated return, the loss for a taxable year
19 shall be determined on a consolidated group basis.
20 In the case of a deconsolidation, the loss carryovers
21 from the consolidated group shall be allocated in ac-
22 cordance with rules to be prescribed by the Sec-
23 retary.

24 “(2) LOSS CARRYOVERS OF ACQUIRED BUSI-
25 NESS ENTITY.—

1 “(A) IN GENERAL.—If a business entity
2 acquires another business entity in a trans-
3 action that is considered the acquisition of a
4 business entity and the two entities file a con-
5 solidated return or if two business entities
6 merge, the loss carryovers will survive and can
7 be applied against the taxable receipts attrib-
8 utable to the business activities carried on (or
9 in the case of a merger formerly carried on) by
10 either entity.

11 “(B) ASSET ACQUISITION.—If a business
12 entity acquires all or substantially all of the as-
13 sets of another entity in a transaction that is
14 considered an asset acquisition rather than the
15 acquisition of a business entity, the acquirer
16 will be treated as if it acquired the loss
17 carryovers of the selling entity. For purposes of
18 this rule, the assets of a business entity include
19 ownership interests in other business entities.

20 “(C) SUBSTANTIALLY ALL.—For purposes
21 of this paragraph ‘substantially all’ means more
22 than 80 percent of the fair market value of a
23 business entity’s net assets. Under rules pre-
24 scribed by the Secretary, the parties to a trans-
25 action may elect to treat acquisitions in excess

1 of 70 percent of the fair market value of a busi-
 2 ness entity's net assets as acquisitions of 'sub-
 3 stantially all' of a business entity's net assets.

4 **“Subchapter C—Capital Contributions,**
 5 **Mergers, Acquisitions, and Distributions**

“Sec. 210. Contributions to a business entity.

“Sec. 211. Distributions of property.

“Sec. 212. Asset acquisitions.

“Sec. 213. Mergers and stock acquisitions.

“Sec. 214. Spin-offs, split-off, etc.

“Sec. 215. Allocation of certain tax attributes.

6 **“SEC. 210. CONTRIBUTIONS TO A BUSINESS ENTITY.**

7 “(a) BY BUSINESS ENTITY.—

8 “(1) CASH.—If a business entity contributes
 9 cash to a business entity of which it is or becomes
 10 a partial or full owner, the amount contributed is
 11 not a deductible amount to the contributor or a tax-
 12 able receipt to the recipient.

13 “(2) PROPERTY OR SERVICES.—If a business
 14 entity contributes property or services to a business
 15 entity of which it is or becomes a partial or full
 16 owner, the transaction will not result in taxable re-
 17 ceipts to the contributor or a deduction for a busi-
 18 ness purchase for the recipient and will not con-
 19 stitute a sale resulting in taxable receipts to the con-
 20 tributor.

21 “(b) BY INDIVIDUAL.—

1 “(1) CASH.—If an individual contributes cash
2 to a business entity, the cash received is not a tax-
3 able receipt.

4 “(2) NEW PROPERTY.—If an individual contrib-
5 utes to a business entity property that the individual
6 purchased for the business entity but which was not
7 used by any person after its purchase, the property
8 shall be considered purchased by such business enti-
9 ty from the person from which the individual pur-
10 chased the property.

11 “(3) PERSONAL USE PROPERTY.—

12 “(A) IN GENERAL.—If an individual con-
13 tributes personal use property to a business en-
14 tity in which the individual has an ownership
15 interest or for which the individual receives an
16 ownership interest, the business entity shall not
17 be permitted to deduct the value of the property
18 received as a business expense. The business
19 entity will have a tax basis in the contributed
20 property equal to the contributor’s basis.

21 “(B) PERSONAL USE PROPERTY.—‘Per-
22 sonal use property’ means any property used by
23 an individual at any time other than in a busi-
24 ness activity.

1 “(4) SERVICES.—If an individual contributes
2 services to a business entity in which the individual
3 has an ownership interest or receives an ownership
4 interest, the business entity shall not be permitted to
5 deduct the value of the services received (or the
6 value of the equity interest provided to the services
7 provider).

8 **“SEC. 211. DISTRIBUTIONS OF PROPERTY.**

9 “(a) DISTRIBUTIONS OTHER THAN TO CONTROL-
10 LING BUSINESS.—If a business entity distributes all or a
11 portion of its assets to its owners (other than a controlling
12 business entity), the business entity will be treated as if
13 it sold the assets to its owners at fair market value. The
14 fair market value will be determined by the distributing
15 corporation and those determinations, unless unreason-
16 able, will be binding on the recipients.

17 “(b) DISTRIBUTIONS TO A CONTROLLING BUSI-
18 NESS.—If a business entity distributes all or a portion of
19 its assets to a controlling business, the controlling busi-
20 ness will assume the distributing entity’s tax attributes
21 with respect to the assets and neither entity will have tax-
22 able receipts or a deduction as a result of the transaction.

23 “(c) DISTRIBUTION OF PERSONAL USE PROP-
24 ERTY.—If personal use property is distributed to the indi-
25 vidual who contributed the personal use property to a busi-

1 ness entity, the fair market value of the property for pur-
2 poses of paragraph (a) shall equal the basis of the prop-
3 erty plus any enhancement in value of the property attrib-
4 utable to business purchases with respect to the property.

5 “(d) CONTROLLING BUSINESS ENTITY.—A business
6 entity is a ‘controlling business entity’ with respect to an-
7 other business entity if it owns directly or indirectly more
8 than 50 percent of the profits or capital interest in the
9 other business entity.

10 “(e) APPLICATION OF THIS SECTION.—This section
11 applies to both liquidating and nonliquidating distribu-
12 tions. Property shall be treated as distributed if the prop-
13 erty is used for a nonbusiness purpose (as defined in sec-
14 tion 232) for more than an insubstantial period of time
15 during a taxable year. See section 232 for rules relating
16 to certain rental property.

17 **“SEC. 212. ASSET ACQUISITIONS.**

18 “(a) IN GENERAL.—If a business entity transfers
19 some or all of its assets, the consideration received for
20 such assets shall be allocated among the assets transferred
21 in the same manner as was required by section 1060 of
22 the Internal Revenue Code of 1986. If the transferee and
23 transferor agree in writing on the allocation of any consid-
24 eration, or as to the fair market value of any of the assets,
25 such agreement shall be binding on both the transferor

1 and transferee unless the Secretary determines that such
2 allocation (or fair market value) is not appropriate.

3 “(b) TAX CONSEQUENCES.—The tax consequences of
4 an asset acquisition shall be determined in accordance
5 with the rules of this chapter and shall be dependent upon
6 allocations made under subsection (a). In general, consid-
7 eration allocable to savings assets, such as stock in an-
8 other business entity, would not be included in taxable re-
9 cepts of the transferor and would not be a business pur-
10 chase of the purchaser, but consideration allocable to the
11 sale of tangible property and intangible property (other
12 than savings assets) will constitute taxable receipts of the
13 seller and a business purchase of the purchaser.

14 “(c) ELECTION TO TREAT ASSET ACQUISITION AS A
15 STOCK ACQUISITION.—In the case of the sale of substan-
16 tially all of the assets of a business entity or substantially
17 all of the assets of a line of business or a separately stand-
18 ing business of a business entity, the transferee and trans-
19 feror can jointly elect to treat the acquisition as if it were
20 an acquisition of the stock of a business entity holding
21 the assets so transferred. In such case, the rules of section
22 213 shall apply.

23 “(d) AUTHORITY TO REQUIRE ALLOCATION AGREE-
24 MENT AND NOTICE TO THE SECRETARY.—If the Sec-
25 retary determines that certain types of asset acquisitions

1 have significant possibilities of tax avoidance, the Sec-
2 retary may require—

3 “(1) parties to such types of acquisitions to
4 enter into agreements allocating consideration,

5 “(2) parties to acquisitions involving certain
6 kinds of assets to enter into agreements allocating
7 part of the consideration to those assets, or

8 “(3) parties to certain acquisitions to report in-
9 formation to the Secretary.

10 “(e) ASSET ACQUISITION RULES DO NOT APPLY IF
11 CONSIDERATION INCLUDES EQUITY IN PURCHASER.—

12 “(1) IN GENERAL.—If a business entity issues
13 its own equity or equity in a subsidiary or other con-
14 trolled entity as part of the consideration for the
15 transfer of assets to it, the transaction shall not be
16 treated as an asset acquisition and the rules of sec-
17 tion 13 shall apply.

18 “(2) EQUITY.—For purposes of this subsection,
19 equity means—

20 “(A) stock, in the case of a corporation,

21 “(B) partnership or similar interest, in the
22 case of a partnership or limited liability com-
23 pany, and

24 “(C) an ownership interest or interest in
25 profits in the case of any other business entity.

1 **“SEC. 213. MERGERS AND STOCK ACQUISITIONS.**

2 “(a) MERGERS.—A merger of one business entity
3 into another or two businesses entities into a third busi-
4 ness entity or any other similar transaction shall have no
5 direct consequences under the business tax. The surviving
6 entity shall assume the tax attributes of the merged cor-
7 porations, including any loss carryovers and credit
8 carryovers.

9 “(b) STOCK ACQUISITION.—The acquisition of all or
10 substantially all of the ownership interest in one business
11 entity either for cash or in exchange for ownership in the
12 acquiring entity or an entity controlled by the acquired
13 entity shall have no direct consequences under the busi-
14 ness tax.

15 **“SEC. 214. SPIN-OFFS, SPLIT-OFFS, ETC.**

16 “A spin-off, split-off or split-up of a business entity
17 shall have no direct tax consequences under the business
18 tax.

19 **“SEC. 215. ALLOCATION OF CERTAIN TAX ATTRIBUTES.**

20 “The Secretary shall prescribe rules for allocation of
21 loss carryovers and payroll tax credit carryovers in cases
22 of substantial shifts of assets from one business entity to
23 another business entity. Under such rules, a portion of a
24 business entity’s carryovers may be deemed transferred
25 when assets are transferred.

1 **“Subchapter D—Accounting Method Rules**

- “Sec. 220. General accounting rules.
- “Sec. 221. Use of the cash method of accounting.
- “Sec. 222. Taxable year.
- “Sec. 223. Long-term contracts.
- “Sec. 224. Post-sale price adjustments and refunds.
- “Sec. 225. Bad debts.
- “Sec. 226. Transition rules.

2 **“SEC. 220. GENERAL ACCOUNTING RULES.**

3 “(a) IN GENERAL.—Except as provided in section
4 221, a business entity shall use an accrual method of ac-
5 counting for purposes of determining the timing of rec-
6 ognition of taxable receipts and deduction of business pur-
7 chases. All business purchases shall be deducted when in-
8 curred (in the case of a business entity using the accrual
9 method of accounting) or when paid (in case of a business
10 entity using the cash method of accounting) without re-
11 gard to whether the business purchases are for or relate
12 to—

13 “(1) inventory,

14 “(2) assets with a useful life of more than one
15 year, or

16 “(3) property that will be used to produce other
17 property.

18 “(b) ECONOMIC PERFORMANCE.—For purposes of
19 determining whether an amount has been incurred, the all
20 events test shall not be treated as met any earlier than
21 when economic performance with respect to such item oc-
22 curs.

1 “(c) CONSISTENT ACCOUNTING METHODS.—Except
2 as otherwise expressly provided in this chapter, a business
3 entity shall secure the consent of the Secretary before
4 changing the method of accounting by which it determines
5 gross profits. This provision shall not apply to changes
6 required by the adoption of the business tax.

7 **“SEC. 221. USE OF THE CASH METHOD OF ACCOUNTING.**

8 “(a) IN GENERAL.—A business entity that was per-
9 mitted to use and used the cash method of accounting
10 under the Internal Revenue Code of 1986 shall be per-
11 mitted to continue to use the cash method of accounting.

12 “(b) NEW BUSINESS ENTITIES.—A new business en-
13 tity shall be permitted to use the cash method of account-
14 ing if permitted to under regulations prescribed by the
15 Secretary.

16 “(c) CHANGE OR EXPANSION OF BUSINESS.—Sub-
17 section (a) shall cease to apply to a business entity that
18 changes or expands its business such that under regula-
19 tions prescribed by the Secretary it is no longer eligible
20 to use the cash method of accounting.

21 “(d) REGULATIONS.—

22 “(1) USE OF CASH METHOD.—The Secretary
23 shall prescribe regulations defining which business
24 entities may use the cash method of accounting. In
25 general, those regulations shall be consistent with

1 the rules under sections 447 and 448 of the Internal
2 Revenue Code of 1986, except that all corporations
3 shall be treated as C corporations were treated
4 under those sections. The regulations shall not re-
5 quire a business entity described in subsection (a) to
6 convert to the accrual method prior to January 1,
7 2003.

8 “(2) CHANGE IN ACCOUNTING METHOD.—The
9 Secretary shall prescribe regulations to prevent dou-
10 ble counting of taxable receipts and deductible ex-
11 penses in the case of a change in accounting method.

12 **“SEC. 222. TAXABLE YEAR.**

13 “(a) COMPUTATION OF GROSS PROFITS.—Gross
14 profits shall be computed on the basis of a business enti-
15 ty’s taxable year.

16 “(b) TAXABLE YEAR.—‘Taxable year’ means—

17 “(1) the taxpayer’s annual accounting period, if
18 it is a calendar year or a fiscal year;

19 “(2) the calendar year, if subsection (g) applies;
20 or

21 “(3) the period for which the return is made if
22 the return is made for a period of less than 12
23 months.

1 “(c) ANNUAL ACCOUNTING PERIOD.—‘Annual ac-
2 counting period’ means the annual period on the basis of
3 which the business entity regularly keeps its books.

4 “(d) CALENDAR YEAR.—‘Calendar year’ means a pe-
5 riod of 12 months ending on December 31.

6 “(e) FISCAL YEAR.—‘Fiscal year’ means a period of
7 12 months ending on the last day of any month other than
8 December. In the case of any business entity that has
9 made the election provided by subsection (f), the term
10 means the annual period (varying from 52 to 53 weeks)
11 so elected.

12 “(f) ELECTION OF 52–53 WEEK YEAR.—

13 “(1) GENERAL RULE.—A business entity which,
14 in keeping its books, regularly computes its income
15 or profits on a basis of an annual period which var-
16 ies from 52 to 53 weeks and ends always on the
17 same day of the week and ends always—

18 “(A) on whatever date such same day of
19 the week last occurs in a calendar month, or

20 “(B) on whatever date such same day of
21 the week falls which is nearest to the last day
22 of a calendar month,

23 may elect to compute its gross profits on the basis
24 of such annual period.

1 “(2) REGULATIONS.—The Secretary shall pre-
2 scribe such regulations as he deems necessary for
3 the application of this subsection, including regula-
4 tions relating to the application of effective dates to
5 taxpayers using a 52–53 week year.

6 “(g) CALENDAR YEAR REQUIRED.—

7 “(1) NO ACCOUNTING PERIOD.—A business en-
8 tity’s taxable year shall be the calendar year if the
9 business entity does not have an annual accounting
10 period or has an annual accounting period that does
11 not qualify as a fiscal year.

12 “(2) NEW BUSINESS ENTITY.—The taxable
13 year of a business entity that begins business activ-
14 ity after December 31, 2001, shall be the calendar
15 year (or a 52–53 week fiscal year ending in Decem-
16 ber) unless the business entity can demonstrate a
17 business reason for selecting an accounting period
18 other than the calendar year.

19 “(h) TRANSITION RULE FOR BUSINESS ENTITIES
20 WITH A FISCAL YEAR.—

21 “(1) IN GENERAL.—A business entity with a
22 taxable year that is not the calendar year shall have
23 a short taxable year ending on December 31, 2001,
24 and a subsequent taxable year beginning on January
25 1, 2002, and ending on the day immediately pre-

1 ceding the beginning of the business entity's next
2 fiscal year.

3 “(2) BUSINESS ENTITIES WITH 52–53 WEEK
4 YEAR ENDING IN DECEMBER.—

5 “(A) IN GENERAL.—If a business entity
6 has a 52–53 week taxable year (under the In-
7 ternal Revenue Code of 1986) that ends in De-
8 cember 2001, it may elect to begin its first tax-
9 able year for the business tax on the first day
10 immediately following the last day of such tax-
11 able year.

12 “(B) NO ELECTION.—If a business entity
13 that has a 52–53 week taxable year that ends
14 in December 2001, does not make the election
15 under subparagraph (A) or is prohibited from
16 making such election by subparagraph (C), the
17 business entity's taxable year under the Inter-
18 nal Revenue Code of 1986 that would end in
19 December 2001 shall end on December 31,
20 2001.

21 “(C) ANTI-ABUSE RULE.—Subparagraph
22 (A) shall not apply to any taxpayer that enters
23 into business transactions in 2001 following the
24 scheduled end of its fiscal year with business
25 entities that are not subject to the business tax

1 at the time of such transactions if such trans-
2 actions deviate from the normal course of busi-
3 ness in order to achieve some tax benefit.

4 **“SEC. 223. LONG-TERM CONTRACTS.**

5 “(a) IN GENERAL.—In the case of a long-term
6 contract—

7 “(1) CONTRACTOR EXPENSES.—The contractor
8 shall be entitled to deduct its business purchases
9 when paid or incurred.

10 “(2) CONTRACTOR RECEIPTS.—The contractor
11 shall recognize taxable receipts—

12 “(A) in the case of a project in which the
13 acquirer has no ownership interest in the
14 project until delivery—

15 “(i) upon delivery of the project, in
16 the case of an accrual basis contractor, or

17 “(ii) upon the later of delivery of the
18 project or the receipt of payment, in the
19 case of cash-basis contractor.

20 “(B) in the case of a project in which the
21 acquirer obtains an ownership interest as the
22 project is constructed—

23 “(i) when the contractor has the right
24 to payments, in the case of an accrual
25 basis contractor, or

1 “(ii) upon the later of when the con-
2 tractor receives the cash or has the right
3 to payments, in the case of a cash basis
4 contractor.

5 “(3) ACQUIRER EXPENSES.—The acquirer that
6 is a business entity shall be entitled to deduct its
7 costs of the business purchase—

8 “(A) in the case of a cash-basis acquirer,
9 at such time as a cash basis contractor would
10 be required to treat the amounts paid as tax-
11 able receipts, or

12 “(B) in the case of an accrual-basis
13 acquirer, at such time as an accrual basis con-
14 tractor would be required to treat the amounts
15 paid or due as taxable receipts.

16 “(b) RIGHT TO PAYMENTS.—

17 “(1) IN GENERAL.—A contractor shall be treat-
18 ed as having a right to payments with respect to a
19 project at any time to the extent that the contractor
20 would not be required to return payments received
21 (or would be entitled to collect payments not yet re-
22 ceived) if the project were terminated at such time
23 by the contractor.

24 “(2) CONTRACTUAL PROVISIONS.—If a long-
25 term contract includes a procedure for paying the

1 contractor as work is completed (for example, by
2 reason of a draw down from a trust account), the
3 contractual provisions shall generally govern when a
4 contractor has a right to payment.

5 “(3) PERCENTAGE COMPLETION METHOD OF
6 ACCOUNTING.—If a long-term contract does not in-
7 clude a mechanism for paying the contractor as
8 work is completed, the percentage-of-completion
9 method of accounting shall be used to determine the
10 timing of taxable receipts of the contractor and busi-
11 ness purchases of the acquirer.

12 “(c) LONG-TERM CONTRACT.—

13 “(1) IN GENERAL.—‘Long-term contract’
14 means—

15 “(A) any contract that covers service or
16 production through parts of two different cal-
17 endar years if the contract includes a formal
18 deposit and draw-down mechanism, and

19 “(B) any contract for the manufacture,
20 building, installation, or construction of prop-
21 erty if such contract is not completed within the
22 taxable year of the contractor in which such
23 contract is entered into.

24 “(2) EXCEPTION.—A contract for the manufac-
25 ture of property shall not be treated as a long-term

1 contract unless such contract involves the manufac-
2 ture of—

3 “(A) any unique item of a type which is
4 not normally included in the finished goods in-
5 ventory of the taxpayer, or

6 “(B) any item which normally requires
7 more than 12 calendar months to complete.

8 “(d) CONSISTENCY.—The Secretary may require
9 business entities to file statements containing such infor-
10 mation with respect to long-term contracts as the Sec-
11 retary may prescribe to ensure consistency in reporting.

12 “(e) FOREIGN CONTRACTS.—This section shall not
13 be construed to permit a deduction for a business purchase
14 for the cost of property produced outside the United
15 States pursuant to a long-term contract at any time prior
16 to the import of such property into the United States.

17 **“SEC. 224. POST-SALE PRICE ADJUSTMENTS AND REFUNDS.**

18 “(a) RECEIPT OF PRICE ADJUSTMENT.—In the case
19 of a post-sale price adjustment attributable to a business
20 purchase which was taken into account in computing gross
21 profits for a prior taxable year, the amount of such adjust-
22 ment shall be treated as a reduction or increase, as the
23 case may be, in the cost of business purchases for the tax-
24 able year in which the adjustment is made or incurred.

1 “(b) ISSUANCE OF PRICE ADJUSTMENT.—In the case
2 of a post-sale price adjustment attributable to a sale the
3 receipts from which were taken into account in deter-
4 mining taxable receipts for a prior taxable year, the
5 amount of such adjustment shall be treated as a reduction
6 or increase, as the case may be, in taxable receipts for
7 the taxable year in which the adjustment is made or in-
8 curred.

9 “(c) POST-SALE PRICE ADJUSTMENT.—‘Post-sale
10 price adjustment’ means a refund, rebate, or other price
11 allowance attributable to a sale of property or services or
12 an upward adjustment in price that was not previously
13 taken into account under the business entity’s method of
14 accounting.

15 **“SEC. 225. BAD DEBTS.**

16 “(a) SELLER.—If an amount owed to an accrual
17 basis business entity for property or services sold—

18 “(1) was taken into account as a taxable receipt
19 in a prior taxable year, and

20 “(2) becomes wholly or partially uncollectible
21 during the taxable year, then the seller shall treat
22 the amount as a reduction in taxable receipts for the
23 taxable year in which it becomes wholly or partially
24 uncollectible.

1 “(b) NOTICE REQUIREMENT.—No reduction shall be
2 allowed under subsection (a) unless the seller notifies the
3 purchaser of the amount which the seller has treated as
4 wholly or partially uncollectible.

5 “(c) SUBSEQUENT COLLECTION.—If an amount
6 which was treated as uncollectible under subsection (a) is
7 subsequently collected, it shall be treated as a taxable re-
8 ceipt when collected.

9 “(d) PURCHASER.—If a purchaser receives notice
10 under subsection (b) from a seller and the purchaser has
11 treated the amount labeled uncollectible as a business pur-
12 chase in a prior taxable year, then the purchaser shall
13 treat such amount as a reduction in the cost of business
14 purchases in the taxable year to which the notice relates.
15 If the purchaser subsequently repays such amount, the re-
16 payment shall constitute the cost of a business purchase.

17 **“SEC. 226. TRANSITION RULES.**

18 “(a) NO DOUBLE DEDUCTIONS.—A business entity
19 shall not be entitled to treat as a ‘cost of business pur-
20 chase’ any amount that the business entity deducted in
21 computing taxable income under the income tax in effect
22 prior the effective date of the business tax.

23 “(b) NO DOUBLE INCLUSION.—A business entity
24 shall not be required to include in taxable receipts any
25 receipt that the business entity took into account in com-

1 putting taxable income under the income tax in effect prior
2 to the effect date of the business tax.

3 “(c) NO LOSS OF DEDUCTION.—An expense which—

4 “(1) a business entity would have been able to
5 deduct as a cost of a business purchase in an ac-
6 counting period before the effective date of the busi-
7 ness tax if the business tax had been in effect in
8 such period, and

9 “(2) the business entity would have been able to
10 deduct as an expense in computing taxable income
11 in a period after the business tax is effective if the
12 income tax had continued in effect,

13 shall be treated as a cost of a business purchase incurred
14 or paid at the time that it would have been paid or in-
15 curred under the income tax if the income tax had contin-
16 ued in effect. This subsection shall not apply to any
17 amount which is to be taken into account under sub-
18 chapter N (relating to amortization of transition basis, in-
19 ventory costs, and safe harbor leases), any amounts which
20 would have been deducted under the income tax through
21 loss carryover deductions, or any deductions deferred by
22 the uniform capitalization rules under section 263A of the
23 Internal Revenue Code of 1986.

24 “(d) ALL TAXABLE RECEIPTS TAXED.—A receipt
25 which—

1 “(1) a business entity would have been required
2 to treat as a taxable receipt in an accounting period
3 before the effective date of the business tax if the
4 business tax had been in effect in such period, and

5 “(2) the business entity would have been re-
6 quired to include in gross income in a period after
7 the business tax is effective if the income tax had
8 continued in effect

9 shall be treated as a taxable receipt at the time that it
10 would have been included in income if the income tax had
11 continued in effect.

12 **“Subchapter E—Land and rental property**

“Sec. 230. No deduction for land purchased for nonbusiness use.

“Sec. 231. Taxable receipts for land held for nonbusiness use.

“Sec. 232. Certain rental property.

13 **“SEC. 230. NO DEDUCTION FOR LAND PURCHASED FOR** 14 **NONBUSINESS USE.**

15 “(a) IN GENERAL.—The acquisition of unimproved
16 land shall not constitute a business purchase if the unim-
17 proved land is not acquired to be used in a business activ-
18 ity or if the land is acquired for—

19 “(1) speculation,

20 “(2) development (including subdivision), or

21 “(3) temporary leasing or other use not com-
22 mensurate with the value of the land,

23 “(4) indefinite future use in a business activity,

24 or

1 “(5) use in compensating employees.

2 “(b) FUTURE USE IN BUSINESS ACTIVITY.—Unim-
3 proved land will not be considered held for ‘indefinite fu-
4 ture use in a business activity’ if promptly upon acquisi-
5 tion, the purchaser or the lessee begins construction of im-
6 provements on the land (other than improvements, such
7 as paving or sewage lines, intended for indefinite future
8 development) that will be used in a business activity. Such
9 improvement must be commensurate with the value of the
10 land.

11 “(c) UNIMPROVED LAND.—‘Unimproved land’
12 means—

13 “(1) land with no buildings on it,

14 “(2) land with improvements if the value of the
15 improvements is relatively small in comparison to
16 the value of the land and it is anticipated that the
17 improvements will be demolished and not used,

18 “(3) land in excess of the amount reasonably
19 needed for the buildings located on it.

20 “(d) CONVERSION TO BUSINESS USE.—If the acqui-
21 sition of land is not treated as a business purchase by rea-
22 son of subsection (a) and the land is subsequently used
23 in a manner for which it could have been treated as a
24 business purchase, the cost of the land will be treated as
25 a business purchase when the improvements on the land

1 are placed in service (or in the case of construction for
2 sale, substantially completed and advertised for sale).

3 **“SEC. 231. TAXABLE RECEIPTS FROM SALE OF LAND HELD**
4 **FOR NONBUSINESS USE.**

5 “(a) TAX BASIS.—A business entity shall have a tax
6 basis in land equal to the cost of the land if such cost
7 is not deductible by reason of section 230(a) and the land
8 has not been converted to business use for purposes of
9 section 230(d).

10 “(b) TAXABLE RECEIPTS OF A LAND SALE.—The
11 taxable receipts from the sale of land (or portion thereof)
12 in which a business entity has a tax basis by reason of
13 subsection (a) shall be the amount by which the proceeds
14 exceed the basis of such land (or portion thereof).

15 **“SEC. 232. CERTAIN RENTAL PROPERTY.**

16 “(a) IN GENERAL.—Except as provided in subsection
17 (b), the activity of rental of real estate is a business activ-
18 ity to which the business tax applies.

19 “(b) NOT RENTAL PROPERTY.—Subsection (a) shall
20 not apply to property described in section 111(b)(1) (relat-
21 ing to property owned by individuals and used for at least
22 14 days for a nonbusiness purpose and rented for no more
23 than 14 days during the taxable year).

24 “(c) RENTAL PROPERTY BECOMES NONRENTAL
25 PROPERTY.—If property which is considered rental prop-

erty for purposes of subsection (a) in one taxable year ceases to be rental property (by reason of subsection (b)) in the following taxable year, the property (and any associated debt) shall be treated as distributed by the business entity to its owners. Section 211(a) shall apply to such distribution.

7 **“Subchapter F—Insurance and** 8 **Financial Products**

“Sec. 235. General rules.

“Sec. 236. Fees for financial intermediation services.

“Sec. 237. Deductible insurance premiums.

“Sec. 238. Nondeductible insurance premiums.

“Sec. 239. Certain implicit fees for financial intermediate services.

9 **“SEC. 235. GENERAL RULES.**

10 “(a) TAXABLE RECEIPTS.—Except in the case of a
11 financial intermediation business, taxable receipts do not
12 include financial receipts (as defined in section 203(e)(2)).

13 “(b) BUSINESS PURCHASES.—Except in the case of
14 a financial intermediation business, business purchases do
15 not include the cost of financial instruments (as defined
16 in section 242(b)(3)) or payments for use of money or cap-
17 ital, other than fees for financial intermediation services.

18 **“SEC. 236. FEES FOR FINANCIAL INTERMEDIATION SERV-** 19 **ICES.**

20 “(a) BUSINESS PURCHASE.—Business purchases in-
21 clude explicit fees and implicit fees for financial intermedi-
22 ation services (except to the extent that such fees are for
23 services treated as performed outside the United States

1 and not imported into the United States or for services
2 treated as exported.).

3 “(b) FINANCIAL INTERMEDIATION SERVICES.—The
4 definition of ‘financial intermediation service’ in section
5 241 applies for purposes of this section.

6 “(c) EXPLICIT FEES.—

7 “(1) IN GENERAL.—‘Explicit fees for financial
8 intermediation services’ means separately stated fees
9 for services provided by a business entity in the fi-
10 nancial intermediation business. Explicit fees do not
11 include fees for use of money or capital.

12 “(2) EXAMPLES.—Explicit fees for financial
13 intermediation services include (without limita-
14 tion)—

15 “(A) separately listed maintenance and
16 service charges of providers of financial inter-
17 mediation services,

18 “(B) loan documentation fees,

19 “(C) brokerage fees,

20 “(D) loan origination fees,

21 “(E) underwriting fees,

22 “(F) trustees’ fees, and

23 “(G) fees for credit checks.

24 “(3) EXCLUSIONS.—Explicit fees for financial
25 intermediation services do not include prepaid inter-

1 est and other fees for use of money or capital even
2 if such fees are separately stated or are labeled as
3 service fees.

4 “(d) IMPLICIT FEES.—

5 “(1) IMPLICIT FEES ATTRIBUTABLE TO BOR-
6 ROWING.—

7 “(A) IN GENERAL.—Implicit fees attrib-
8 utable to borrowing from banks and other fi-
9 nancial institutions shall include the portion of
10 interest payments that the Secretary designates
11 as constituting service fees.

12 “(B) TIMING.—Implicit fees determined
13 under this paragraph shall not be deductible in
14 any taxable year prior to the taxable year in
15 which the interest is paid. If the amount of the
16 interest to which implicit fees relate was de-
17 ducted as original issue discount under the In-
18 ternal Revenue Code of 1986, the implicit fees
19 with respect to such interest shall not constitute
20 a deductible business purchase.

21 “(C) DESIGNATION BY SECRETARY.—

22 “(i) ESTIMATE OF DIFFERENTIAL.—

23 The Secretary shall estimate for each cal-
24 endar year the difference between the cost
25 of funds for banks and the rates of interest

1 (including discount points) charged to the
2 most credit-worthy depositors of banks.
3 The determinations shall be made sepa-
4 rately for—

5 “(I) loans with terms of not more
6 than 3 years,

7 “(II) loans with terms of over 3
8 but not over 9 years, and

9 “(III) loans with terms of over 9
10 years.

11 “(ii) DESIGNATION OF IMPLICIT
12 FEES.—The Secretary shall designate the
13 differences determined under clause (i) as
14 the portion of interest expense on loans
15 from banks and other financial institutions
16 that constitutes an implicit fee for term
17 loans originated during the following cal-
18 endar year for the respective periods listed
19 in subclauses (I) through (III) of clause
20 (i). The difference determined for loans de-
21 scribed in subclause (I) of clause (i) shall
22 apply to determine the implicit fee portion
23 of interest on demand loans outstanding
24 during the following calendar year.

1 “(iii) HISTORICAL DETERMINATION.—

2 The Secretary shall make an historical de-
3 termination in accordance with the prin-
4 ciples of this subparagraph to designate
5 the portion of interest on term loans made
6 before January 1, 2001, that will con-
7 stitute implicit fees.

8 “(2) IMPLICIT FEES FOR OTHER FINANCIAL
9 INTERMEDIATION ACTIVITY.—Implicit fees for finan-
10 cial intermediation services include the portion of the
11 fees or other charges paid to a provider of financial
12 intermediation services (other than lending) as such
13 provider designates in accordance with section 39.

14 **“SEC. 237. DEDUCTIBLE INSURANCE PREMIUMS.**

15 “(a) IN GENERAL.—The cost of insurance premiums
16 on business loss policies that insure risks in the United
17 States constitute costs of business purchases. Proceeds
18 from such policies constitute taxable receipts.

19 “(b) BUSINESS LOSS POLICY.—A ‘business loss pol-
20 icy’ is an insurance policy—

21 “(1) owned by a business entity,

22 “(2) the beneficiary of which is the business en-
23 tity or another business entity doing business with
24 the owner of the policy,

1 “(3) that has no inside buildup or other savings
2 component,

3 “(4) that covers losses on a loss incurred or
4 claims made basis during the term of the policy,

5 “(5) that has a term of not more than 2 years,

6 “(6) that is not a direct or indirect form of
7 compensation, and

8 “(7) that covers direct losses of the business,
9 such as—

10 “(A) damage to or theft of property used
11 in business activity,

12 “(B) tort claims against the business,

13 “(C) loss of use of business premises or
14 services,

15 “(D) malpractice, or

16 “(E) alleged or actual breach of fiduciary
17 obligations.

18 **“SEC. 238. NONDEDUCTIBLE INSURANCE PREMIUMS.**

19 “(a) NONDEDUCTIBILITY.—The cost of insurance
20 policies that are not business loss policies are not deduct-
21 ible costs of business purchases.

22 “(b) PROCEEDS OF NONDEDUCTIBLE POLICIES.—In-
23 surance proceeds from policies described in subsection (a)
24 do not constitute taxable receipts.

1 allocated to it with respect to the immediately
2 preceding calendar year.

3 “(2) MAXIMUM FEES ALLOCATED.—The max-
4 imum amount that may be allocated by a financial
5 intermediation business for a calendar is the excess
6 of—

7 “(A) the gross profits of the financial
8 intermediation business for the calendar year
9 (as reasonably estimated by the financial inter-
10 mediation business), over

11 “(B) the explicit fees for financial inter-
12 mediation services received by the financial
13 intermediation business.

14 “(3) REASONABLE ALLOCATION.—An allocation
15 will not be considered reasonable unless it takes into
16 account and allocates fees to—

17 “(A) both services provided to business en-
18 tities and services provided to individuals (other
19 than in a business capacity), and

20 “(B) both persons who receive money from
21 the financial intermediation business and per-
22 sons who pay money to the financial intermedi-
23 ation business (even though amounts allocated
24 to the former do not constitute implicit fees).

1 “(4) REGULATIONS.—The Secretary shall pre-
2 scribe regulations relating to the allocations under
3 this subsection, including regulations addressing—

4 “(A) rules for timing of deductions of im-
5 plicit fees paid by fiscal year recipients,

6 “(B) subsequent year adjustments if a fi-
7 nancial intermediation business allocates too
8 much in a calendar year,

9 “(C) rules for advance approval from the
10 Secretary for allocation procedures, and

11 “(D) safe-harbor alternatives to the alloca-
12 tion procedures described in this subsection.

13 “(c) NOT APPLICABLE TO LENDING SERVICES.—
14 This section shall not apply to lending services.

15 **“Subchapter G—Financial Intermediation**
16 **and Financial Institutions**

“Sec. 241. Activities constituting a financial intermediation business.

“Sec. 242. General rule for taxation.

“Sec. 243. Special rule for banks.

“Sec. 244. Insurance companies.

“Sec. 245. Financial pass-through entities.

“Sec. 246. Financial intermediation by other businesses.

17 **“SEC. 241. ACTIVITIES CONSTITUTING A FINANCIAL INTER-**
18 **MEDIATION BUSINESS.**

19 “(a) FINANCIAL INTERMEDIATION BUSINESS.—The
20 providing of financial intermediation services shall be con-
21 sidered a business activity. The gross profit of a business
22 entity providing financial intermediation services shall be

1 determined by taking into account the rules of this sub-
2 chapter.

3 “(b) SEPARATE BUSINESS ACTIVITY.—The provision
4 of financial intermediation services for unrelated persons
5 shall be considered a separate business activity and a busi-
6 ness shall be considered a separate entity with respect to
7 such activity. An entity engaging in such business is re-
8 ferred to in this chapter as a ‘financial intermediation
9 business’.

10 “(c) FINANCIAL INTERMEDIATION BY A BUSINESS.—
11 Section 246 shall apply to a business that provides finan-
12 cial intermediation services for itself and related parties
13 but generally does not provide such services for unrelated
14 parties.

15 “(d) DEFINITIONS.—

16 “(1) FINANCIAL INTERMEDIATION SERVICES.—

17 ‘Financial intermediation services’ include—

18 “(A) lending services,

19 “(B) insurance services,

20 “(C) market-making and dealer services,

21 and

22 “(D) any other service provided as busi-
23 ness activity in which a person acts as an inter-
24 mediary in—

1 “(i) the transfer of property, services,
2 or financial assets, liabilities, risks or in-
3 struments (or income or expense derived
4 therefrom) between two or more persons,
5 or

6 “(ii) the pooling of economic risk
7 among other persons

8 and derives all or a portion of such person’s
9 gross receipts from streams of income or ex-
10 pense, discounts, or other financial flows associ-
11 ated with the matter with respect to which such
12 person is acting as an intermediary.

13 “(2) LENDING SERVICES.—‘Lending services’
14 means the regular making of loans and providing
15 credit to, or taking deposits from customers, but
16 does not include an installment or delayed payment
17 arrangement provided by a seller of property or serv-
18 ices under which additional charges or fees are im-
19 posed by the seller for the late payment.

20 “(3) MARKET-MAKING OR DEALER SERVICES.—
21 ‘Market-making or dealer services’ means services
22 provided by a person who—

23 “(A) regularly purchases financial instru-
24 ments from or sells financial instruments to

1 customers in the ordinary course of a trade or
2 business,

3 “(B) regularly offers to enter into, assume,
4 offset, assign, or otherwise terminate positions
5 in financial instruments with customers in the
6 ordinary course of a trade or business.

7 **“SEC. 242. GENERAL RULE FOR TAXATION.**

8 “(a) IN GENERAL.—In the case of a financial inter-
9 mediation business, gross profits shall be computed by—

10 “(1) substituting financial receipts for taxable
11 receipts, and

12 “(2) including financial expenses as business
13 purchases.

14 “(b) DEFINITIONS.—

15 “(1) FINANCIAL RECEIPTS.—‘Financial re-
16 ceipts’ means all receipts other than amounts re-
17 ceived as contributions to capital.

18 “(2) FINANCIAL EXPENSES.—‘Financial ex-
19 penses’ include—

20 “(A) payments for principal and interest
21 that is properly allocable to the provision of fi-
22 nancial intermediation services,

23 “(B) the cost of and payments under fi-
24 nancial instruments (other than financial in-
25 struments in the person subject to the tax im-

1 posed under this chapter and any person re-
2 lated to such person),

3 “(C) claims and cash surrender values paid
4 in connection with insurance or reinsurance
5 services, and

6 “(D) amounts paid for reinsurance.

7 “(3) FINANCIAL INSTRUMENT.—‘Financial in-
8 strument’ means any—

9 “(A) share of stock in a corporation,

10 “(B) equity ownership in any widely held
11 or publicly traded partnership, trust, or other
12 business entity,

13 “(C) note, bond, debenture, or other evi-
14 dence of indebtedness,

15 “(D) interest rate, currency, or equity no-
16 tional principal contract,

17 “(E) evidence or interest in, or a derivative
18 financial instrument in, any financial instru-
19 ment described in subparagraph (A), (B), (C),
20 or (D), or any currency, including any option,
21 forward contract, short position, and any simi-
22 lar financial instrument in such a financial in-
23 strument or currency, and

24 “(F) a position which—

1 “(i) is not a financial instrument de-
2 scribed in subparagraph (A), (B), (C), (D)
3 or (E),

4 “(ii) is a hedge with respect to such
5 a financial instrument, and

6 “(iii) is clearly identified in the deal-
7 er’s records as being described in this sub-
8 paragraph before the close of the day on
9 which it was acquired or entered into.

10 “(c) INTERNATIONAL MATTERS.—For purposes of
11 this section in the case of a financial intermediation busi-
12 ness with activity in and outside the United States—

13 “(1) INCLUSION REGARDLESS OF SOURCE.—

14 “(A) Financial receipts shall be determined
15 without regard to whether they are received for
16 property or service provided in or outside the
17 United States, except that financial receipts do
18 not include amounts that—

19 “(i) are not taxable receipts (as deter-
20 mined without regard to this section), but

21 “(ii) would have been taxable receipts
22 (as determined without regard to this sec-
23 tion) if they had been received for services
24 or property in the United States.

1 “(B) Financial expenses shall be deter-
2 mined without regard to whether they are re-
3 ceived for property or services acquired in or
4 outside the United States.

5 “(2) ALLOCATION.—Under regulations pre-
6 scribed by the Secretary, gross profits (as deter-
7 mined without regard to this paragraph) shall be re-
8 duced by the amount of financial intermediation
9 gross profit attributable to financial intermediation
10 activity provided outside the United States.

11 “(3) GROSS PROFIT ATTRIBUTABLE TO FINAN-
12 CIAL INTERMEDIATION ACTIVITY.—‘Gross profits at-
13 tributable to financial intermediation activity’ means
14 the excess of—

15 “(A) gross profits as determined under
16 this section (but without regard to paragraph
17 (2)), over

18 “(B) gross profits as determined without
19 regard to this subchapter.

20 **“SEC. 243. SPECIAL RULES FOR BANKS.**

21 “(a) IN GENERAL.—In the case of a bank, gross prof-
22 its shall be determined in accordance with section 242, ex-
23 cept that—

24 “(1) FINANCIAL RECEIPTS.—Financial receipts
25 shall include only—

1 “(A) taxable receipts (as determined with-
2 out regard to this subchapter),

3 “(B) interest on loans made or acquired by
4 the bank,

5 “(C) gain on the sale of loans,

6 “(D) discount points received, and

7 “(E) any explicit fees for financial or fidu-
8 ciary services not included in subparagraphs
9 (A) through (E).

10 “(2) FINANCIAL EXPENSES.—Financial ex-
11 penses shall include only—

12 “(A) interest paid to depositors and on
13 other funds borrowed by the bank, and

14 “(B) reasonable additions to reserves for
15 bad debts.

16 “(3) FORECLOSURE PROPERTY.—Gross profits
17 shall properly take into account proceeds from the
18 operation or sale of foreclosure property.

19 “(b) BANK.—

20 “(1) IN GENERAL.—‘Bank’ means a bank or
21 trust company incorporated and doing business
22 under the laws of the United States, the District of
23 Columbia, or any State, a substantial part of the
24 business of which consists of receiving deposits and
25 making loans and discounts, or of exercising fidu-

1 ciary powers similar to those exercised by national
2 banks under the authority of the Comptroller of the
3 Currency, and which is subject by law to supervision
4 and examination by State or Federal authority hav-
5 ing supervision over banking institutions or credit
6 unions. Such term includes domestic building and
7 loan associations and credit unions.

8 “(2) OTHER ACTIVITIES.—If a bank is engaged
9 in significant amounts of activities other than those
10 described in paragraph (1), the bank shall be consid-
11 ered as a separate business entity with respect to
12 such other activity.

13 **“SEC. 244. INSURANCE COMPANIES.**

14 “(a) IN GENERAL.—In the case of companies pro-
15 viding insurance services, gross profits shall be determined
16 in accordance with section 242, except—

17 “(1) subsection (c) of section 242 (relating to
18 international operations) shall not apply, and

19 “(2) the rules of subchapter J (sourcing rules)
20 shall apply to determine financial receipts and finan-
21 cial expenses.

22 “(b) RESULT INCONSISTENT WITH STATUTORY IN-
23 TENT.—If an insurance company determines that the ap-
24 plication of subsection (a) produces results inconsistent
25 with the territorial approach of the business tax, it may

1 apply to the Secretary for permission to apply section
2 242(c) in lieu of subsection (a).

3 **“SEC. 245. FINANCIAL PASS-THROUGH ENTITIES.**

4 “(a) IN GENERAL.—In the case of a financial pass-
5 thru entity, gross profits shall be determined in accord-
6 ance with section 242, except—

7 “(1) financial receipts shall include contribu-
8 tions to capital,

9 “(2) financial expenses shall include—

10 “(A) distributions to persons holding inter-
11 ests in the pass-thru entity,

12 “(B) investments in related entities (in-
13 cluding wholly owned entities) engaging in real
14 estate investment.

15 “(b) PASS-THRU ENTITY.—

16 “(1) IN GENERAL.—‘Pass-thru entity’ means a
17 business entity that is intended to serve as a con-
18 duit. The Secretary shall prescribe regulations defin-
19 ing pass-thru entity. Such term shall include—

20 “(A) entities that would qualify as regu-
21 lated investment companies under the Internal
22 Revenue Code of 1986,

23 “(B) entities that would qualify as real es-
24 tate investment trusts under the Internal Rev-
25 enue Code of 1986,

1 activity (determined as if such activity were activity of a
2 pass-thru entity that paid all costs of such financial inter-
3 mediation activity including—

4 “(1) compensation for persons engaging in such
5 activity,

6 “(2) equipment involved in such activity, and

7 “(3) office space for persons involved in such
8 activity).

9 “(b) PROXY.—A business entity to which subsection
10 (a) applies will be treated as satisfying the requirements
11 of that subsection if it increases its gross receipts by the
12 portion of employee compensation properly allocable to the
13 provision of financial intermediation services.

14 “(c) SIGNIFICANT FINANCIAL INTERMEDIATION.—A
15 business will be considered as engaging in substantial fi-
16 nancial intermediation if—

17 “(1) more than 5 percent of the compensation
18 paid by the business to its employees is for employ-
19 ees whose primary activity is the management of the
20 business’s investments in financial instruments, or

21 “(2) at all times during the taxable year and
22 the immediately preceding full taxable year, more
23 than 10 percent of its assets are financial instru-
24 ments other than—

1 “(A) equity interests in business entities in
2 which it holds more than 50 percent in value of
3 the outstanding equity,

4 “(B) equity interests in joint ventures in
5 which the company is actively participating,

6 “(C) purchase money loans to its cus-
7 tomers, and

8 “(D) business loans and equity invest-
9 ments that serve a direct business purpose.

10 **“Subchapter H—Tax-Exempt Organizations**

“Sec. 251. Exemption for governmental entities.

“Sec. 252. Taxable activity of governmental entities.

“Sec. 253. Tax-exempt organizations.

“Sec. 254. Special rules for (e)(3) organizations.

“Sec. 255. Tax on unrelated business activity.

“Sec. 256. Unrelated business activity.

11 **“SEC. 251. EXEMPTION FOR GOVERNMENTAL ENTITIES.**

12 “(a) STATES.—Except as provided in section 252, a
13 state, political subdivision thereof and the District of Co-
14 lumbia shall be exempt from taxation under this chapter
15 on any gross profits derived from the exercise of any es-
16 sential governmental function.

17 “(b) POSSESSIONS.—The government of any posses-
18 sion of the United States shall be exempt from taxation
19 under this chapter on any gross profits earned by the pos-
20 session.

1 **“SEC. 252. TAXABLE ACTIVITY OF GOVERNMENTAL ENTI-**
2 **TIES.**

3 “(a) CERTAIN ACTIVITIES TAXABLE.—A govern-
4 mental entity shall be considered a business and subject
5 to tax on any business activity of a type frequently pro-
6 vided by business entities subject to tax under this chap-
7 ter.

8 “(b) CERTAIN ACTIVITIES TREATED AS ESSENTIAL
9 GOVERNMENT FUNCTIONS.—Subsection (a) shall not
10 apply to the following activities, which shall be treated as
11 essential government functions:

12 “(1) Provision of mass transportation services.

13 “(2) Provision of public utility services.

14 **“SEC. 253. TAX-EXEMPT ORGANIZATIONS.**

15 “(a) EXEMPTION FROM TAXATION.—An organiza-
16 tion described in subsection (c) or (d) shall be exempt
17 from taxation under this chapter.

18 “(b) TAX ON UNRELATED BUSINESS ACTIVITY.—An
19 organization exempt from taxation under subsection (a)
20 shall be subject to tax to the extent provided in sections
21 255 and 256, but shall be considered a tax-exempt organi-
22 zation for purposes of any law that refers to tax-exempt
23 organizations.

24 “(c) LIST OF EXEMPT ORGANIZATIONS.—The fol-
25 lowing organizations are referred to in subsection (a):

1 “(1) INSTRUMENTALITY OF THE UNITED
2 STATES.—Any corporation organized under Act of
3 Congress which is an instrumentality of the United
4 States but only if such corporation—

5 “(A) is exempt from Federal income
6 taxes—

7 “(i) under such Act as amended and
8 supplemented before July 18, 1984, or

9 “(ii) under this title without regard to
10 any provision of law which is not contained
11 in this title and which is not contained in
12 a revenue Act, or

13 “(B) is described in subsection (h).

14 “(2) TITLE HOLDING COMPANIES.—Corpora-
15 tions organized for the exclusive purpose of holding
16 title to property, collecting income therefrom, and
17 turning over the entire amount thereof, less ex-
18 penses, to an organization which itself is exempt
19 under this section. Rules similar to the rules of sub-
20 paragraph (G) of paragraph (25) shall apply for
21 purposes of this paragraph.

22 “(3) CHARITABLE, EDUCATIONAL AND RELI-
23 GIOUS ORGANIZATIONS.—Corporations, and any
24 community chest, fund, or foundation, organized and
25 operated exclusively for religious, charitable, sci-

1 entific, testing for public safety, literary, or edu-
2 cational purposes, or to foster national or inter-
3 national amateur sports competition (but only if no
4 part of its activities involve the provision of athletic
5 facilities or equipment), or for the prevention of cru-
6 elty to children or animals, no part of the net earn-
7 ings of which inures to the benefit of any private
8 shareholder or individual, no substantial part of the
9 activities of which is carrying on propaganda, or oth-
10 erwise attempting, to influence legislation (except as
11 otherwise provided in subsection (g)), and which
12 does not participate in, or intervene in (including the
13 publishing or distributing of statements), any polit-
14 ical campaign on behalf of (or in opposition to) any
15 candidate for public office.

16 “(4) SOCIAL WELFARE ORGANIZATIONS, ETC.—

17 “(A) Civic leagues or organizations not or-
18 ganized for profit but operated exclusively for
19 the promotion of social welfare, or local associa-
20 tions of employees, the membership of which is
21 limited to the employees of a designated person
22 or persons in a particular municipality, and the
23 net earnings of which are devoted exclusively to
24 charitable, educational, or recreational pur-
25 poses.

1 “(B) Subparagraph (A) shall not apply to
2 an entity unless no part of the net earnings of
3 such entity inures to the benefit of any private
4 shareholder or individual

5 “(5) LABOR AND AGRICULTURAL ORGANIZA-
6 TIONS.—Labor, agricultural, or horticultural organi-
7 zations.

8 “(6) TRADE ASSOCIATIONS.—Business leagues,
9 chambers of commerce, real-estate boards, boards of
10 trade, or professional football leagues (whether or
11 not administering a pension fund for football play-
12 ers) not organized for profit and no part of the net
13 earnings of which inures to the benefit of any pri-
14 vate shareholder or individual.

15 “(7) SOCIAL CLUBS.—Clubs organized for
16 pleasure, recreation, and other nonprofitable pur-
17 poses, substantially all of the activities of which are
18 for such purposes and no part of the net earnings
19 of which inures to the benefit of any private share-
20 holder.

21 “(8) CERTAIN FRATERNAL SOCIETIES.—Fra-
22 ternal beneficiary societies, orders, or associations—

23 “(A) operating under the lodge system or
24 for the exclusive benefit of the members of a

1 fraternity itself operating under the lodge sys-
2 tem, and

3 “(B) providing for the payment of life,
4 sick, accident, or other benefits to the members
5 of such society, order, or association or their
6 dependents.

7 “(9) VEBA’S.—Voluntary employees’ bene-
8 ficiary associations providing for the payment of life,
9 sick, accident, or other benefits to the members of
10 such association or their dependents or designated
11 beneficiaries, if no part of the net earnings of such
12 association inures (other than through such pay-
13 ments) to the benefit of any private shareholder or
14 individual.

15 “(10) OTHER FRATERNAL ORGANIZATIONS.—
16 Domestic fraternal societies, orders, or associations,
17 operating under the lodge system—

18 “(A) the net earnings of which are devoted
19 exclusively to religious, charitable, scientific, lit-
20 erary, educational, and fraternal purposes, and

21 “(B) which do not provide for the payment
22 of life, sick, accident, or other benefits.

23 “(11) LOCAL TEACHERS’ RETIREMENT
24 FUNDS.—Teachers’ retirement fund associations of a
25 purely local character, if—

1 “(A) no part of their net earnings inures
2 (other than through payment of retirement ben-
3 efits) to the benefit of any private shareholder
4 or individual, and

5 “(B) the income consists solely of amounts
6 received from public taxation, amounts received
7 from assessments on the teaching salaries of
8 members, and income in respect of investments.

9 “(12) CERTAIN COOPERATIVES.—

10 “(A) Benevolent life insurance associations
11 of a purely local character, mutual ditch or irri-
12 gation companies, mutual or cooperative tele-
13 phone companies, or like organizations; but only
14 if 85 percent or more of the income consists
15 of amounts collected from members for the sole
16 purpose of meeting losses and expenses.

17 “(B) In the case of a mutual or coopera-
18 tive telephone company, subparagraph (A) shall
19 be applied without taking into account any in-
20 come received or accrued—

21 “(i) from a nonmember telephone
22 company for the performance of commu-
23 nication services which involve members of
24 the mutual or cooperative telephone com-
25 pany,

1 “(ii) from qualified pole rentals,

2 “(iii) from the sale of display listings
3 in a directory furnished to the members of
4 the mutual or cooperative telephone com-
5 pany, or

6 “(iv) from the prepayment of a loan
7 under section 306A, 306B, or 311 of the
8 Rural Electrification Act of 1936 (as in ef-
9 fect on January 1, 1987).

10 “(C) In the case of a mutual or cooperative
11 electric company, subparagraph (A) shall be ap-
12 plied without taking into account any income
13 received or accrued—

14 “(i) from qualified pole rentals, or

15 “(ii) from the prepayment of a loan
16 under section 306A, 306B, or 311 of the
17 Rural Electrification Act of 1936 (as in ef-
18 fect on January 1, 1987).

19 “(D) For purposes of this paragraph, the
20 term ‘qualified pole rental’ means any rental of
21 a pole (or other structure used to support
22 wires) if such pole (or other structure)—

23 “(i) is used by the telephone or elec-
24 tric company to support one or more wires
25 which are used by such company in pro-

1 viding telephone or electric services to its
2 members, and

3 “(ii) is used pursuant to the rental to
4 support one or more wires (in addition to
5 the wires described in clause (i)) for use in
6 connection with the transmission by wire
7 of electricity or of telephone or other com-
8 munications.

9 For purposes of the preceding sentence, the
10 term ‘rental’ includes any sale of the right to
11 use the pole (or other structure).

12 “(13) NONPROFIT CEMETERIES.—Cemetery
13 companies owned and operated exclusively for the
14 benefit of their members or which are not operated
15 for profit; and any corporation chartered solely for
16 the purpose of the disposal of bodies by burial or
17 cremation which is not permitted by its charter to
18 engage in any business not necessarily incident to
19 that purpose and no part of the net earnings of
20 which inures to the benefit of any private share-
21 holder or individual.

22 “(14) GRANDFATHERED MUTUAL FINANCIAL
23 INSTITUTIONS.—

24 “(A) Credit unions without capital stock
25 organized and operated for mutual purposes

1 and without profit, but only if organized before
2 July 1, 2001.

3 “(B) Certain corporations or associations
4 organized before September 1, 1957, and de-
5 scribed in subparagraphs (B) or (C) of section
6 501(c)(14) of the Internal Revenue Code of
7 1986.

8 “(15) GRANDFATHERED SMALL INSURANCE
9 COMPANIES.—Insurance companies organized before
10 July 1, 2001, and described in section 501(c)(15) of
11 the Internal Revenue Code of 1986.

12 “(16) CROP FINANCING ASSOCIATIONS.—Cor-
13 porations organized by an association subject to part
14 IV of this subchapter or members thereof, for the
15 purpose of financing the ordinary crop operations of
16 such members or other producers, and operated in
17 conjunction with such association. Exemption shall
18 not be denied any such corporation because it has
19 capital stock, if the dividend rate of such stock is
20 fixed at not to exceed the legal rate of interest in the
21 State of incorporation or 8 percent per annum,
22 whichever is greater, on the value of the consider-
23 ation for which the stock was issued, and if substan-
24 tially all such stock (other than nonvoting preferred
25 stock, the owners of which are not entitled or per-

1 mitted to participate, directly or indirectly, in the
2 profits of the corporation, on dissolution or other-
3 wise, beyond the fixed dividends) is owned by such
4 association, or members thereof; nor shall exemption
5 be denied any such corporation because there is ac-
6 cumulated and maintained by it a reserve required
7 by State law or a reasonable reserve for any nec-
8 essary purpose.

9 “(17) SUPPLEMENTAL EMPLOYMENT BENEFIT
10 TRUST.—

11 “(A) A trust or trusts forming part of a
12 plan providing for the payment of supplemental
13 unemployment compensation benefits, if—

14 “(i) under the plan, it is impossible,
15 at any time prior to the satisfaction of all
16 liabilities, with respect to employees under
17 the plan, for any part of the corpus or in-
18 come to be (within the taxable year or
19 thereafter) used for, or diverted to, any
20 purpose other than the providing of supple-
21 mental unemployment compensation bene-
22 fits,

23 “(ii) such benefits are payable to em-
24 ployees under a classification which is set
25 forth in the plan and which is found by the

1 Secretary not to be discriminatory in favor
2 of employees who are highly compensated
3 employees (within the meaning of section
4 414(q)), and

5 “(iii) such benefits do not discrimi-
6 nate in favor of employees who are highly
7 compensated employees (within the mean-
8 ing of section 414(q). A plan shall not be
9 considered discriminatory within the mean-
10 ing of this clause merely because the bene-
11 fits received under the plan bear a uniform
12 relationship to the total compensation, or
13 the basic or regular rate of compensation,
14 of the employees covered by the plan.

15 “(B) Rules similar to those contained in
16 subparagraphs (B) through (E) of section
17 501(c)(7) of the Internal Revenue Code of 1986
18 shall apply to subparagraph (A).

19 “(18) GRANDFATHERED TRUSTS.—A trust or
20 trusts created before June 25, 1959, and described
21 in section 501(c)(18) of the Internal Revenue Code
22 of 1986.

23 “(19) CERTAIN VETERANS’ ORGANIZATIONS.—
24 A post or organization of past or present members
25 of the Armed Forces of the United States, or an

1 auxiliary unit or society of, or a trust or foundation
2 for, any such post or organization—

3 “(A) organized in the United States or any
4 of its possessions,

5 “(B) at least 75 percent of the members of
6 which are past or present members of the
7 Armed Forces of the United States and sub-
8 stantially all of the other members of which are
9 individuals who are cadets or are spouses, wid-
10 ows, or widowers of past or present members of
11 the Armed Forces of the United States or of
12 cadets, and

13 “(C) no part of the net earnings of which
14 inures to the benefit of any private shareholder
15 or individual.

16 “(20) LEGAL SERVICE PLAN TRUSTS.—An or-
17 ganization or trust created or organized in the
18 United States, the exclusive function of which is to
19 form part of a qualified group legal services plan or
20 plans.

21 “(21) BLACK LUNG ACT TRUSTS.—A trust or
22 trusts established in writing, created or organized in
23 the United States, and contributed to by any person
24 (except an insurance company) if—

1 “(A) the purpose of such trust or trusts is
2 exclusively—

3 “(i) to satisfy, in whole or in part, the
4 liability of such person for, or with respect
5 to, claims for compensation for disability
6 or death due to pneumoconiosis under
7 Black Lung Acts,

8 “(ii) to pay premiums for insurance
9 exclusively covering such liability,

10 “(iii) to pay administrative and other
11 incidental expenses of such trust in connec-
12 tion with the operation of the trust and the
13 processing of claims against such person
14 under Black Lung Acts, and

15 “(iv) to pay accident or health bene-
16 fits for retired miners and their spouses
17 and dependents (including administrative
18 and other incidental expenses of such trust
19 in connection therewith) or premiums for
20 insurance exclusively covering such bene-
21 fits; and

22 “(B) such trusts meets requirements simi-
23 lar to those contained in section 501(c)(21) of
24 the Internal Revenue Code of 1986.

1 “(22) MULTIEmployer ERISA TRUST.—A trust
2 created or organized in the United States and estab-
3 lished in writing by the plan sponsors of multiem-
4 ployer plans if—

5 “(A) the purpose of such trust is
6 exclusively—

7 “(i) to pay any amount described in
8 section 4223(c) or (h) of the Employee Re-
9 tirement Income Security Act of 1974, and

10 “(ii) to pay reasonable and necessary
11 administrative expenses in connection with
12 the establishment and operation of the
13 trust and the processing of claims against
14 the trust,

15 “(B) no part of the assets of the trust may
16 be used for, or diverted to, any purpose other
17 than—

18 “(i) the purposes described in sub-
19 paragraph (A), or

20 “(ii) prudent investment in securities,
21 obligations, or time or demand deposits,

22 “(C) such trust meets the requirements of
23 paragraphs (2), (3), and (4) of section 4223(b),
24 4223(h), or, if applicable, section 4223(c) of the

1 Employee Retirement Income Security Act of
2 1974, and

3 “(D) the trust instrument provides that,
4 on dissolution of the trust, assets of the trust
5 may not be paid other than to plans which have
6 participated in the plan or, in the case of a
7 trust established under section 4223(h) of such
8 Act, to plans with respect to which employers
9 have participated in the fund.

10 “(23) GRANDFATHERED VETERANS’ INSURANCE
11 ORGANIZATION.—Any association organized before
12 1880 more than 75 percent of the members of which
13 are present or past members of the Armed Forces
14 and a principal purpose of which is to provide insur-
15 ance and other benefits to veterans or their depend-
16 ents.

17 “(24) ERISA TRUST.—A trust described in sec-
18 tion 4049 of the Employee Retirement Income Secu-
19 rity Act of 1974 (as in effect on the date of the en-
20 actment of the Single-Employer Pension Plan
21 Amendments Act of 1986).

22 “(25) REAL TITLE HOLDING CORPORATION OR
23 TRUST.—

24 “(A) Any corporation or trust which—

1 “(i) has no more than 35 shareholders
2 or beneficiaries,

3 “(ii) has only 1 class of stock or bene-
4 ficial interest, and

5 “(iii) is organized for the exclusive
6 purposes of—

7 “(I) acquiring real property and
8 holding title to, and collecting income
9 from, such property, and

10 “(II) remitting the entire amount
11 of income from such property (less ex-
12 penses) to 1 or more organizations de-
13 scribed in subparagraph (C) which are
14 shareholders of such corporation or
15 beneficiaries of such trust.

16 “For purposes of clause (iii), the term ‘real
17 property’ shall not include any interest as a
18 tenant in common (or similar interest) and
19 shall not include any indirect interest.

20 “(B) A corporation or trust shall be de-
21 scribed in subparagraph (A) without regard to
22 whether the corporation or trust is organized by
23 1 or more organizations described in subpara-
24 graph (C).

1 “(C) An organization is described in this
2 subparagraph if such organization is—

3 “(i) a qualified pension, profit shar-
4 ing, or stock bonus plan that meets the re-
5 quirements of section 401(a),

6 “(ii) a governmental plan (within the
7 meaning of section 414(d)),

8 “(iii) the United States, any State or
9 political subdivision thereof, or any agency
10 or instrumentality of any of the foregoing,
11 or

12 “(iv) any organization described in
13 paragraph (3).

14 “(D) A corporation or trust shall in no
15 event be treated as described in subparagraph
16 (A) unless such corporation or trust permits its
17 shareholders or beneficiaries—

18 “(i) to dismiss the corporation’s or
19 trust’s investment adviser, following rea-
20 sonable notice, upon a vote of the share-
21 holders or beneficiaries holding a majority
22 of interest in the corporation or trust, and

23 “(ii) to terminate their interest in the
24 corporation or trust by either, or both, of

1 the following alternatives, as determined by
2 the corporation or trust:

3 “(I) by selling or exchanging
4 their stock in the corporation or inter-
5 est in the trust (subject to any Fed-
6 eral or State securities law) to any or-
7 ganization described in subparagraph
8 (C) so long as the sale or exchange
9 does not increase the number of
10 shareholders or beneficiaries in such
11 corporation or trust above 35, or

12 “(II) by having their stock or in-
13 terest redeemed by the corporation or
14 trust after the shareholder or bene-
15 ficiary has provided 90 days notice to
16 such corporation or trust.

17 “(E)(i) For purposes of this paragraph—

18 “(I) a corporation which is a qualified
19 subsidiary shall not be treated as a sepa-
20 rate corporation, and

21 “(II) all assets, liabilities, and items
22 of income, deduction, and credit of a quali-
23 fied subsidiary shall be treated as assets,
24 liabilities, and such items (as the case may

1 be) of the corporation or trust described in
2 subparagraph (A).

3 “(ii) For purposes of this subparagraph,
4 the term ‘qualified subsidiary’ means any cor-
5 poration if, at all times during the period such
6 corporation was in existence, 100 percent of the
7 stock of such corporation is held by the cor-
8 poration or trust described in subparagraph
9 (A).

10 “(iii) For purposes of this subtitle, if any
11 corporation which was a qualified subsidiary
12 ceases to meet the requirements of clause (ii),
13 such corporation shall be treated as a new cor-
14 poration acquiring all of its assets (and assum-
15 ing all of its liabilities) immediately before such
16 cessation from the corporation or trust de-
17 scribed in subparagraph (A) in exchange for its
18 stock.

19 “(F) For purposes of subparagraph (A),
20 the term ‘real property’ includes any personal
21 property which is leased under, or in connection
22 with, a lease of real property, but only if the
23 rent attributable to such personal property for
24 the taxable year does not exceed 15 percent of
25 the total rent for the taxable year attributable

1 to both the real and personal property leased
2 under, or in connection with, such lease.

3 “(G)(i) An organization shall not be treat-
4 ed as failing to be described in this paragraph
5 merely by reason of the receipt of any otherwise
6 disqualifying income which is incidentally de-
7 rived from the holding of real property.

8 “(ii) Clause (i) shall not apply if the
9 amount of gross income described in such
10 clause exceeds 10 percent of the organization’s
11 gross income for the taxable year unless the or-
12 ganization establishes to the satisfaction of the
13 Secretary that the receipt of gross income de-
14 scribed in clause (i) in excess of such limitation
15 was inadvertent and reasonable steps are being
16 taken to correct the circumstances giving rise to
17 such income.

18 “(26) STATE ESTABLISHED MEDICAL CARE IN-
19 SURER.—Any membership organization if—

20 “(A) such organization is established by a
21 State exclusively to provide coverage for medical
22 care on a not-for-profit basis to individuals de-
23 scribed in subparagraph (B) through—

24 “(i) insurance issued by the organiza-
25 tion, or

1 “(ii) a health maintenance organiza-
2 tion under an arrangement with the orga-
3 nization,

4 “(B) the only individuals receiving such
5 coverage through the organization are
6 individuals—

7 “(i) who are residents of such State,
8 and

9 “(ii) who, by reason of the existence
10 or history of a medical condition—

11 “(I) are unable to acquire med-
12 ical care coverage for such condition
13 through insurance or from a health
14 maintenance organization, or

15 “(II) are able to acquire such
16 coverage only at a rate which is sub-
17 stantially in excess of the rate for
18 such coverage through the member-
19 ship organization,

20 “(C) the composition of the membership in
21 such organization is specified by such State,
22 and

23 “(D) no part of the net earnings of the or-
24 ganization inures to the benefit of any private
25 shareholder or individual. A spouse and any

1 qualifying child) of an individual described in
2 subparagraph (B) (without regard to this sen-
3 tence) shall be treated as described in subpara-
4 graph (B).

5 “(27) GRANDFATHERED WORKERS COMPENSA-
6 TION ORGANIZATION.—Any membership organiza-
7 tion established before June 1, 1996, by a State ex-
8 clusively to reimburse its members for losses arising
9 under workmen’s compensation acts, and described
10 in section 501(c)(27) of the Internal Revenue Code
11 of 1986.

12 “(d) RELIGIOUS AND APOSTOLIC ORGANIZATIONS.—
13 The following organizations are referred to in subsection
14 (a): Religious or apostolic associations or corporations, if
15 such associations or corporations have a common treasury
16 or community treasury, even if such associations or cor-
17 porations engage in business for the common benefit of
18 the members, but only if such activity is treated as unre-
19 lated business activity.

20 “(e) COOPERATIVE HOSPITAL SERVICE ORGANIZA-
21 TIONS.—For purposes of this chapter, an organization
22 shall be treated as an organization organized and operated
23 exclusively for charitable purposes, if—

24 “(1) such organization is organized and oper-
25 ated solely—

1 “(A) to perform, on a centralized basis,
2 one or more of the following services which, if
3 performed on its own behalf by a hospital which
4 is an organization described in subsection (c)(3)
5 and exempt from taxation under subsection (a),
6 would constitute activities in exercising or per-
7 forming the purpose or function constituting
8 the basis for its exemption: data processing,
9 purchasing (including the purchasing of insur-
10 ance on a group basis), warehousing, billing
11 and collection, food, clinical, industrial engi-
12 neering, laboratory, printing, communications,
13 record center, and personnel (including selec-
14 tion, testing, training, and education of per-
15 sonnel) services; and

16 “(B) to perform such services solely for
17 two or more hospitals each of which is—

18 “(i) an organization described in sub-
19 section (c)(3) which is exempt from tax-
20 ation under subsection (a),

21 “(ii) a constituent part of an organi-
22 zation described in subsection (c)(3) which
23 is exempt from taxation under subsection
24 (a) and which, if organized and operated
25 as a separate entity, would constitute an

1 organization described in subsection (c)(3),
2 or

3 “(iii) owned and operated by the
4 United States, a State, the District of Co-
5 lumbia, or a possession of the United
6 States, or a political subdivision or an
7 agency or instrumentality of any of the
8 foregoing;

9 “(2) such organization is organized and oper-
10 ated on a cooperative basis and allocates or pays,
11 within 8½ months after the close of its taxable year,
12 all net earnings to patrons on the basis of services
13 performed for them; and

14 “(3) if such organization has capital stock, all
15 of such stock outstanding is owned by its patrons.

16 “For purposes of this title, any organization which, by rea-
17 son of the preceding sentence, is an organization described
18 in subsection (c)(3) and exempt from taxation under sub-
19 section (a), shall be treated as a hospital and as an organi-
20 zation referred to in section 101(b)(1)(A)(iii).

21 “(f) COOPERATIVE SERVICE ORGANIZATIONS OF OP-
22 ERATING EDUCATIONAL ORGANIZATIONS.—For purposes
23 of this chapter, if an organization is—

24 “(1) organized and operated solely to hold,
25 commingle, and collectively invest and reinvest (in-

1 including arranging for and supervising the perform-
2 ance by independent contractors of investment serv-
3 ices related thereto) in stocks and securities, the
4 moneys contributed thereto by each of the members
5 of such organization, and to collect income there-
6 from and turn over the entire amount thereof, less
7 expenses, to such members,

8 “(2) organized and controlled by one or more
9 such members, and

10 “(3) comprised solely of members that are orga-
11 nizations described in clause (ii) or (iv) of section
12 101(b)(1)(A)—

13 “(A) which are exempt from taxation
14 under subsection (a), or

15 “(B) the gross profits of which are ex-
16 cluded from taxation under section 251(a),

17 then such organization shall be treated as an organization
18 organized and operated exclusively for charitable purposes.

19 “(g) EXPENDITURES BY PUBLIC CHARITIES TO IN-
20 FLUENCE LEGISLATION.—

21 “(1) GENERAL RULE.—In the case of an orga-
22 nization to which this subsection applies, exemption
23 from taxation under subsection (a) shall be denied
24 because a substantial part of the activities of such
25 organization consists of carrying on propaganda, or

1 otherwise attempting, to influence legislation, but
2 only if such organization normally—

3 “(A) makes lobbying expenditures in ex-
4 cess of the lobbying ceiling amount for such or-
5 ganization for each taxable year, or

6 “(B) makes grass roots expenditures in ex-
7 cess of the grass roots ceiling amount for such
8 organization for each taxable year.

9 “(2) DEFINITIONS.—For purposes of this
10 subsection—

11 “(A) LOBBYING EXPENDITURES.—‘Lob-
12 bying expenditures’ means expenditures for the
13 purpose of influencing legislation (as defined in
14 section 4911(d)).

15 “(B) LOBBYING CEILING AMOUNT.—The
16 lobbying ceiling amount for any organization
17 for any taxable year is 150 percent of the lob-
18 bying nontaxable amount for such organization
19 for such taxable year, determined under section
20 4911.

21 “(C) GRASS ROOTS EXPENDITURES.—
22 ‘Grass roots expenditures’ means expenditures
23 for the purpose of influencing legislation (as de-
24 fined in section 4911(d) without regard to para-
25 graph (1)(B) thereof).

1 “(D) GRASS ROOTS CEILING AMOUNT.—

2 The grass roots ceiling amount for any organi-
3 zation for any taxable year is 150 percent of
4 the grass roots nontaxable amount for such or-
5 ganization for such taxable year, determined
6 under section 4911.

7 “(3) ORGANIZATIONS TO WHICH THIS SUB-
8 SECTION APPLIES.—This subsection shall apply to
9 any organization which has elected (in such manner
10 and at such time as the Secretary may prescribe) to
11 have the provisions of this subsection apply to such
12 organization and which, for the taxable year which
13 includes the date the election is made, is described
14 in subsection (c)(3) and is not described in para-
15 graph (4) and is not a private foundation.

16 “(4) DISQUALIFIED ORGANIZATIONS.—This
17 subsection does not apply to—

18 “(A) a church,

19 “(B) an integrated auxiliary of a church or
20 of a convention or association of churches, or

21 “(C) a member of an affiliated group of or-
22 ganizations (within the meaning of section
23 4911(f)(2)) if one or more members of such
24 group is described in subparagraph (A) or (B).

1 “(5) YEARS FOR WHICH ELECTION IS EFFEC-
2 TIVE.—An election by an organization under this
3 subsection shall be effective for all taxable years of
4 such organization which—

5 “(A) end after the date the election is
6 made, and

7 “(B) begin before the date the election is
8 revoked by such organization (under regulations
9 prescribed by the Secretary).

10 “(6) NO EFFECT ON CERTAIN ORGANIZA-
11 TIONS.—With respect to any organization for a tax-
12 able year for which—

13 “(A) such organization is described in
14 paragraph (5), or

15 “(B) an election under this subsection is
16 not in effect for such organization, nothing in
17 this subsection or in section 4911 shall be con-
18 strued to affect the interpretation of the phrase,
19 ‘no substantial part of the activities of which is
20 carrying on propaganda, or otherwise attempt-
21 ing, to influence legislation,’ under subsection
22 (c)(3).

23 “(h) GOVERNMENT CORPORATIONS EXEMPT UNDER
24 SUBSECTION (c)(1).—For purposes of subsection (c)(1),

1 the following organizations are described in this sub-
2 section:

3 “(1) The Central Liquidity Facility established
4 under title III of the Federal Credit Union Act (12
5 U.S.C. 1795 et seq.).

6 “(2) The Resolution Trust Corporation estab-
7 lished under section 21A of the Federal Home Loan
8 Bank Act.

9 “(3) The Resolution Funding Corporation es-
10 tablished under section 21B of the Federal Home
11 Loan Bank Act.

12 “(i) CERTAIN EDUCATIONAL ORGANIZATIONS.—An
13 organization shall not be eligible for exemption as an edu-
14 cational organization under subsection (c)(3) if a substan-
15 tial amount of its activities and funds are devoted to—

16 “(1) conducting seminars and other similar pro-
17 grams,

18 “(2) conducting research to educate Congress
19 or the general public about public policy issues,

20 “(3) producing books and pamphlets, or

21 “(4) a combination of the foregoing.

22 **“SEC. 254. SPECIAL RULES FOR (c)(3) ORGANIZATIONS.**

23 “(a) NEW ORGANIZATIONS MUST NOTIFY SEC-
24 RETARY.—Except as provided in subsection (c), an organi-

1 zation shall not be treated as an organization described
2 in section 253(c)(3)—

3 “(1) unless that it has given notice to the Sec-
4 retary, in such manner as the Secretary may pre-
5 scribe, that it is applying for recognition of such sta-
6 tus, or

7 “(2) for any period before giving of such notice,
8 if such notice is given after the time prescribed by
9 the Secretary by regulations for giving notice under
10 this subsection.

11 “(b) PRESUMPTION THAT ORGANIZATIONS ARE PRI-
12 VATE FOUNDATIONS.—Except as provided in subsection
13 (c), any organization described in section 253(c)(3) and
14 which does not notify the Secretary, at such time and in
15 such manner as the Secretary may by regulations pre-
16 scribe, that it is not a private foundation (as defined in
17 section 102) shall be presumed to be a private foundation.

18 “(c) EXCEPTIONS.—Subsections (a) and (b) shall not
19 apply to—

20 “(1) organizations organized before October 10,
21 1969;

22 “(2) organizations which obtained recognition
23 of tax-exempt status under section 501(c)(3) of the
24 Internal Revenue Code of 1986 (in the case of sub-
25 section (a) only);

1 “(3) organizations which were determined not
2 to be private foundations under the Internal Rev-
3 enue Code of 1986;

4 “(4) churches, their integrated auxiliaries, and
5 conventions and associations of churches;

6 “(5) any organization that is not a private
7 foundation and the gross receipts of which in each
8 taxable year are not more than \$25,000, or

9 “(6) such other classes of organizations which
10 the Secretary may exempt.

11 **“SEC. 255. TAX ON UNRELATED BUSINESS ACTIVITY.**

12 “(a) IN GENERAL.—Each organization described in
13 subsection (b) shall be subject to the Simplified USA Tax
14 for businesses under section 201 on its gross profits from
15 its unrelated business activity.

16 “(b) ORGANIZATIONS SUBJECT TO TAX.—This sec-
17 tion shall apply to—

18 “(1) organizations exempt from the business
19 tax under section 253(a), other than instrumental-
20 ities of the United States described in section
21 253(c)(1).

22 “(2) colleges and universities which are instru-
23 mentalities of any government and corporations
24 owned by one or more such colleges or universities.

1 **“SEC. 256. UNRELATED BUSINESS ACTIVITY.**

2 “(a) IN GENERAL.—‘Unrelated business activity’
3 means any trade or business the conduct of which is not
4 substantially related (aside from the need of such organi-
5 zation for income or funds or the use it makes of the prof-
6 its derived) to the exercise or performance by such organi-
7 zation of its charitable, educational, or other purpose or
8 function constituting the basis for its exemption under
9 section 253, except that such term does not include any
10 trade or business—

11 “(1) in which substantially all the work in car-
12 rying on such trade or business is performed for the
13 organization without compensation; or

14 “(2) which is carried on, in the case of an orga-
15 nization described in section 253(e)(3) or in the case
16 of a college or university described in section 255(b),
17 by the organization primarily for the convenience of
18 its members, students, patients, officers, or employ-
19 ees, which is the selling by the organization of items
20 of work-related clothes and equipment and items
21 normally sold through vending machines, through
22 food dispensing facilities, or by snack bars, for the
23 convenience of its members at their usual places of
24 employment; or

1 “(3) which is the selling of merchandise, sub-
2 stantially all of which has been received by the orga-
3 nization as gifts or contributions.

4 “(b) ADVERTISING, ETC., ACTIVITIES.—For pur-
5 poses of this section, ‘trade or business’ includes any activ-
6 ity which is carried on for the production of income from
7 the sale of goods or the performance of services. For pur-
8 poses of the preceding sentence, an activity does not lose
9 identity as a trade or business merely because it is carried
10 on within a larger aggregate of similar activities or within
11 a larger complex of other endeavors which may, or may
12 not, be related to the exempt purposes of the organization.
13 Where an activity carried on for profit constitutes an un-
14 related trade or business, no part of such trade or business
15 shall be excluded from such classification merely because
16 it does not result in profit.

17 “(c) TRADE OR BUSINESS.—

18 “(1) CERTAIN BUSINESS ACTIVITIES.—An ac-
19 tivity shall not be considered a ‘trade or business’
20 solely because the activity is a business activity
21 (such as certain passive rental activity) that would
22 be subject to the business tax if conducted by a busi-
23 ness entity other than a tax-exempt organization.

24 “(2) REGULATIONS.—The Secretary shall pre-
25 scribe regulations defining a ‘trade or business.’

1 Such regulations shall be consistent with the provi-
 2 sions under sections 511 through 513 of the Internal
 3 Revenue Code of 1986, except to the extent such
 4 provisions are inconsistent with other principles of
 5 the business tax. The regulations shall include exclu-
 6 sions from the definition of ‘trade or business’ simi-
 7 lar to those contained in section 513 of the Internal
 8 Revenue Code for—

9 “(A) certain bingo games,

10 “(B) certain hospital services, and

11 “(C) certain public entertainment activity
 12 at fairs and expositions by an organization
 13 which regularly conducts, as one of its substan-
 14 tial exempt purposes, an agricultural or edu-
 15 cational fair or exhibition.

16 “(3) TRADE SHOWS.—The conduct of trade
 17 shows and conventions shall not be excluded from
 18 the definition of trade or business.

19 **“Subchapter I—Cooperatives**

Sec. 260. Patronage dividends of cooperatives.

20 **“SEC. 260. PATRONAGE DIVIDENDS OF COOPERATIVES.**

21 “(a) PATRONAGE DIVIDENDS PAID BY SUPPLY CO-
 22 OPERATIVES.—A qualified patronage dividend paid by a
 23 supply cooperative to a patron shall be treated as if it is
 24 a refund of a portion of the amounts paid by the patron

1 for goods, services, or use of capital. In general, if the
2 supply cooperative included the amount received from the
3 patron in taxable receipts, the dividend shall reduce tax-
4 able receipts in the year incurred. If the recipient of the
5 dividend is a business entity which deducted the cost of
6 business purchases to which the dividend related, the re-
7 cipient will reduce its cost of business purchases by the
8 amount of the dividend in the year the dividend is paid
9 or incurred.

10 “(b) PATRONAGE DIVIDENDS PAID BY MARKETING
11 COOPERATIVES.—A qualified patronage dividend paid to
12 a patron by a marketing cooperative shall be treated as
13 an upward price adjustment in the amount received by the
14 patron for its goods marketed by the cooperative. In gen-
15 eral, the cooperative will increase its cost of business pur-
16 chases by the amount of the qualified patronage dividend
17 and the recipient will increase its taxable receipts by the
18 amount of the qualified patronage dividend.

19 “(c) DIVIDEND TREATMENT.—Only the portion of a
20 patronage dividend that is not a qualified patronage divi-
21 dend shall be treated as a dividend under this chapter and
22 chapter 2.

23 “(d) DEFINITIONS.—

24 “(1) QUALIFIED PATRONAGE DIVIDEND.—A
25 ‘qualified patronage dividend’ is that part of a pa-

1 tronage dividend that is attributable to the patron’s
2 allocable share of patronage earnings of a marketing
3 cooperative or a supply cooperative.

4 “(2) SUPPLY COOPERATIVE.—A ‘supply cooper-
5 ative’ is a cooperative that sells goods or service to
6 patrons and provided patronage dividends with re-
7 spect to the quantity of purchases of the patrons.

8 “(3) MARKETING COOPERATIVE.—A ‘marketing
9 cooperative’ is a cooperative that sells goods pro-
10 duced by its members and provides patronage divi-
11 dends to the members based on the quantities of
12 goods sold or provided for sale.

13 “(e) SPECIAL RULES.—

14 “(1) NOTICES OF ALLOCATION AND PER-UNIT
15 RETAIN CERTIFICATES.—Except as provided in
16 paragraph (2), a notice of allocation, per-unit retain
17 certificate, or other similar document shall not be
18 treated as a patronage dividend until it is redeemed
19 in cash or property.

20 “(2) OPPORTUNITY TO RECEIVE CASH.—If a
21 patron is given an opportunity to receive a patron-
22 age dividend in cash, but instead chooses to accept
23 a per-unit retain certificate or a qualified notice of
24 allocation, the patron will be treated as receiving

1 cash and simultaneously contributing to the capital
2 of the cooperative.

3 “(3) APPLICATION LIMITED TO QUALIFIED CO-
4 OPERATIVES.—Under rules to be prescribed by the
5 Secretary, this section shall apply only to coopera-
6 tives to which one of the following provisions of the
7 Internal Revenue Code of 1986 would have applied:

8 “(A) Section 501(c)(12) (relating to coop-
9 erative telephone companies and similar organi-
10 zations).

11 “(B) Section 501(c)(14) (relating to cer-
12 tain cooperative banks).

13 “(C) Section 521 (relating to farm co-
14 operatives).

15 “(D) Section 1381 (relating to coopera-
16 tives generally).

17 “(4) REGULATIONS.—The Secretary shall pre-
18 scribe regulations for the application of this section.
19 The regulations shall generally be consistent with
20 subchapter T of chapter 1 of the Internal Revenue
21 Code of 1986 except to the extent that such rules
22 are inconsistent with provisions of this chapter.

23 **“Subchapter J—Sourcing Rules**

“Sec. 265. Exports of property or services.

“Sec. 266. Imports of property or services.

“Sec. 267. Import or export of services.

“Sec. 268. International transportation services.

“Sec. 269. International communications.

“Sec. 270. Insurance.

1 **“SEC. 265. EXPORTS OF PROPERTY OR SERVICES.**

2 “(a) GENERAL RULE.—Taxable receipts do not in-
3 clude amounts received by the exporter thereof for prop-
4 erty or services exported from the United States for use
5 or consumption outside the United States.

6 “(b) EXPORT THROUGH NONBUSINESS ENTITY.—
7 For purposes of subsection (a), if property or services are
8 sold to a governmental entity or a tax-exempt organization
9 for export and are exported other than in an activity of
10 such entity which is subject to the business tax, then the
11 seller of such property or services is deemed to be the ex-
12 porter thereof.

13 “(c) EXPORT OF SERVICES.—See section 267 for
14 rules for determining whether services are exported or im-
15 ported.

16 **“SEC. 266. IMPORTS OF PROPERTY OR SERVICES.**

17 “(a) IN GENERAL.—The import of property or serv-
18 ices for consumption in the United States shall constitute
19 a business purchase if such property or service is to be
20 used in a business activity in the United States. Property
21 being held for sale or retail by a business entity that is
22 in the business of selling goods shall be considered held
23 for ‘use in a business activity’.

24 “(b) AMOUNT OF BUSINESS PURCHASE.—

1 “(1) IN GENERAL.—The cost of business pur-
2 chases with respect to the import of property or
3 services for use or consumption in the United States
4 is the customs value, price or other amount used for
5 purposes of determining the import tax under sec-
6 tion 286 or section 287.

7 “(2) IMPORT TAX.—The cost of business pur-
8 chases does not include any import tax paid. No de-
9 duction shall be allowed with respect to property or
10 service imported by a business entity unless the im-
11 port tax is paid with respect to such import.

12 **“SEC. 267. IMPORT OR EXPORT OF SERVICES.**

13 “(a) IN GENERAL.—Except as otherwise provided in
14 this subchapter or in rules prescribed under subchapter
15 G (relating to financial intermediation business), services
16 shall not be treated as imported or exported from the loca-
17 tion in which they are performed.

18 “(b) IMPORT OF SERVICES.—A business entity shall
19 be treated as importing a service if—

20 “(1) the entire benefit of the service will be re-
21 alized in the United States, and

22 “(2) the benefit will be realized in connection
23 with the United States business activities of the
24 business entity.

1 “(c) EXPORT OF SERVICES.—A business will be
2 treating as exporting a service if—

3 “(1) the entire benefit of the service will be re-
4 realized outside of the United States, and

5 “(2) the benefit will be realized solely in con-
6 nection with the activities of the purchaser occurring
7 outside the United States.

8 “(d) SERVICES ACQUIRED FROM SERVICE PROVIDER
9 THAT PROVIDES SERVICES IN AND OUTSIDE THE UNITED
10 STATES.—

11 “(1) IN GENERAL.—If a business entity ac-
12 quires services from a service provider that provides
13 services both in and outside the United States and
14 the service provider shows on the invoice where the
15 services are provided—

16 “(A) the business entity shall treat the
17 services as provided where stated on the invoice,
18 and

19 “(B) the service provider shall treat as tax-
20 able receipts any services listed as provided in
21 the United States.

22 “(2) NO INVOICE.—If a business entity acquires
23 services from a service provider that provides serv-
24 ices both in and outside the United States and the

1 service provider does not show on an invoice where
2 such services are provided—

3 “(A) the business entity shall treat the
4 services as if provided in the location to which
5 payment is sent, and

6 “(B) the service provider shall treat as tax-
7 able receipts any payments received in the
8 United States.

9 “(e) SPECIAL RULES PREVAIL.—See sections 268
10 and 269 for special rule relating to transportation and
11 communication services.

12 **“SEC. 268. INTERNATIONAL TRANSPORTATION SERVICES.**

13 “(a) TRANSPORTATION OF PROPERTY.—

14 “(1) TAXABLE RECEIPTS.—

15 “(A) EXPORTS.—Taxable receipts do not
16 include receipts from the transportation of
17 property exported from the United States.

18 “(B) IMPORTS.—Taxable receipts include
19 receipts from transportation of property im-
20 ported into the United States only if such costs
21 are not taken into account in determining the
22 import tax.

23 “(C) PRESUMPTIONS.—The Secretary shall
24 prescribe regulations describing situations in
25 which a transporter of property must presume

1 that no import tax has been paid on the cost
2 of its services.

3 “(2) BUSINESS PURCHASES.—

4 “(A) EXPORTS.—Business purchases do
5 not include amounts paid or incurred for the
6 cost of transportation of property exported from
7 the United States.

8 “(B) IMPORTS.—Amounts paid or incurred
9 for transportation of goods imported into the
10 United States, shall constitute a cost of busi-
11 ness purchase only to the extent that they are
12 taken into account in determining the customs
13 value for purposes of section 286(a) (relating
14 to the import tax).

15 “(b) TRANSPORTATION OF PASSENGERS.—

16 “(1) TAXABLE RECEIPTS.—Taxable receipts—

17 “(A) include receipts from the transpor-
18 tation of passengers from the United States to
19 a destination outside the United States, but

20 “(B) do not include receipts from the
21 transportation of passengers from outside the
22 United States to a destination in the United
23 States.

24 “(2) BUSINESS PURCHASES.—Business
25 purchases—

1 “(A) include amounts paid or incurred in
2 a business activity for the transportation of
3 passengers from the United States to a destina-
4 tion outside the United States, but

5 “(B) do not include amounts paid or in-
6 curred for transportation of passengers from
7 outside the United States to a destination in
8 the United States.

9 “(3) SIMPLIFYING RULES.—The Secretary may
10 provide rules that simplify this subsection, including
11 rules under which—

12 “(A) half of receipts attributable to trans-
13 portation to or from the United States are
14 treated as taxable receipts,

15 “(B) half of the cost for business trips to
16 and from the United States are treated as busi-
17 ness purchases, and

18 “(C) all transportation expenses of a busi-
19 ness entity that has no regular business outside
20 the United States are treated as business pur-
21 chases.

22 **“SEC. 269. INTERNATIONAL COMMUNICATIONS.**

23 “(a) IN GENERAL.—For purposes of section 266,
24 communications services shall be treated as provided at

1 the point of origin of the communications and shall not
2 be treated as imported or exported.

3 “(b) COMMUNICATIONS SERVICES.—Communications
4 services include—

5 “(1) telephone communications services,

6 “(2) courier services (except in the case of
7 transportation of property that is imported or ex-
8 ported),

9 “(3) satellite transmission services,

10 “(4) telegraph services,

11 “(5) facsimile transmission services, and

12 “(6) other similar services.

13 **“SEC. 270. INSURANCE.**

14 “(a) IN GENERAL.—Insurance services will be treat-
15 ed as provided at the location of the insurance company
16 providing the services. Except as the Secretary may pre-
17 scribe by regulations, insurance companies will be treated
18 as providing services at the location to which insurance
19 payments are made.

20 “(b) INSURED RISKS IN THE UNITED STATES.—If
21 insurance services are provided outside the United States
22 and the insured risk is located in the United States—

23 “(1) the insurance service shall be treated as
24 imported,

1 “(2) the insurance premiums shall be subject to
2 the import tax, and

3 “(3) payments of insurance benefits shall not be
4 treated as imported.

5 “(c) INSURED RISK OUTSIDE THE UNITED
6 STATES.—If insurance services are provided inside the
7 United States and the insured risk is located outside the
8 United States—

9 “(1) insurance services shall be treated as ex-
10 ported,

11 “(2) payments of insurance benefits shall be
12 treated as payments for services outside the United
13 States, and shall not be deducted as business pur-
14 chases.

15 “(d) INSURANCE SERVICES.—Insurance services
16 means the provision of insurance and services related to
17 insurance other than insurance that is treated as a savings
18 asset.

19 **“SEC. 271. BANKING SERVICES.**

20 “The Secretary shall prescribe regulations on the lo-
21 cation of banking services and the extent to which such
22 services are to be treated as imported or exported.

23 **“Subchapter K—Business Conducted in a**
24 **Possession**

“Sec. 276. Treatment of possessions.

1 **“SEC. 276. TREATMENT OF POSSESSIONS.**

2 “(a) IN GENERAL.—For purposes of the business tax
3 imposed by this chapter, the U.S. possessions shall not
4 be treated as part of the United States.

5 “(b) EFFECT ON PAYROLL TAX CREDIT.—A busi-
6 ness entity may not claim a payroll tax credit with respect
7 to any payroll taxes paid with respect to income of resi-
8 dents of the U.S. possessions.

9 “(c) POSSESSION.—For purposes of this subchapter,
10 ‘U.S. possession’ or ‘possession’ means a possession of the
11 United States and includes the Commonwealth of Puerto
12 Rico and the Virgin Islands.

13 **“Subchapter L—Payroll Tax Credit**

“Sec. 281. Amount of credit.

“Sec. 282. Current-year payroll tax credit.

“Sec. 283. Credit carryover.

14 **“SEC. 281. AMOUNT OF CREDIT.**

15 “(a) AMOUNT OF CREDIT.—The payroll tax credit for
16 a business entity for a taxable year is the lesser of—

17 “(1) the sum of—

18 “(A) the current-year payroll tax credit,

19 and

20 “(B) the credit carryovers to the taxable
21 year, or

22 “(2) the business entity’s business tax for the
23 taxable year (determined without regard to the pay-
24 roll tax credit).

1 “(b) CONSOLIDATED RETURNS.—In the case of busi-
2 ness entities filing consolidated returns, the amount of the
3 credit shall be determined using the combined payroll tax
4 credits and credit carryovers of the business entities and
5 the combined business tax of the business entities.

6 **“SEC. 282. CURRENT-YEAR PAYROLL TAX CREDIT.**

7 “(a) IN GENERAL.—The ‘current-year payroll tax
8 credit’ is an amount equal to the sum of—

9 “(1) the employer’s share of the FICA tax im-
10 posed on wages of its employees during the taxable
11 year,

12 “(2) the employer’s share of the tier 1 railroad
13 retirement tax for its employees during the taxable
14 year,

15 “(3) one-half of the allocable portion of the
16 SECA tax imposed on individuals (other than inde-
17 pendent contractors and other business entities) who
18 provide services to the business entity.

19 “(b) DEFINITIONS.—

20 “(1) EMPLOYER’S SHARE OF THE FICA TAX.—
21 ‘Employer’s share of the FICA tax’ means the old-
22 age, survivors, disability and hospital insurance
23 taxes imposed by section 3111.

1 “(2) EMPLOYER’S SHARE OF THE TIER 1 RAIL-
2 ROAD RETIREMENT TAX.—‘Employer’s share of the
3 tier 1 railroad retirement tax’ means—

4 “(A) the tier 1 railroad retirement tax im-
5 posed by section 3221(a), and

6 “(B) the portion of the tax imposed by sec-
7 tion 3211(a)(1) on employee representatives at-
8 tributable to the tax imposed by section 3111.

9 “(3) ONE-HALF OF THE ALLOCABLE PORTION
10 OF THE SECA TAX.—

11 “(A) SECA TAX.—‘SECA tax’ means the
12 self-employment tax imposed by section 1401.

13 “(B) PARTNERSHIPS.—Until such time as
14 the SECA tax and the Federal Insurance Con-
15 tributions Acts are amended to treat partners
16 of partnerships as employees, if a partner des-
17 ignates a partnership as a principal source of
18 employment income for the taxable year, one-
19 half of the partnership’s allocable portion of the
20 SECA tax of such partner equals the FICA tax
21 that the employer would have been required to
22 pay under section 3111 with respect to such
23 partner if the partner’s self-employment income
24 as reported by the partnership were wages sub-
25 ject to the FICA tax. A partner and partner-

1 ship can agree to treat no portion of a partner's
2 SECA tax as allocable to the partnership.

3 “(C) PROPRIETORSHIP.—In the case of an
4 individual who is a proprietor or sole owner and
5 provider of service to a business entity, the indi-
6 vidual shall allocate the portion of one-half of
7 his SECA tax not allocated pursuant to sub-
8 paragraph (B) to his business entities in ac-
9 cordance with rules prescribed by the Secretary.

10 “(c) SPECIAL RULE.—Under rules prescribed by the
11 Secretary, an individual subject to the self-employment tax
12 shall pay half of the self-employment tax on an amount
13 of self employment income not less than the amount of
14 the individual's self-employment income taken into ac-
15 count by partnerships under subparagraph (B) of sub-
16 section (b)(3).

17 **“SEC. 283. CREDIT CARRYOVER.**

18 “(a) CARRYOVER.—A current-year credit that is not
19 applied in the taxable year in which earned shall constitute
20 a credit carryover until applied but for no more than 15
21 taxable years.

22 “(b) ORDER OF USE.—For purposes of determining
23 which credits are applied under section 281, if the total
24 credit allowable in a taxable year is less than the sum of
25 the current-year payroll credit and the carryover credits,

1 the current-year payroll credit shall be considered applied
2 first and then credit carryovers shall be considered applied
3 in the order earned.

4 **“Subchapter M—Import Tax**

“Sec. 286. Imposition of tax on property.

“Sec. 287. Imposition of tax on import of services.

“Sec. 288. General rules for the import tax.

5 **“SEC. 286. IMPOSITION OF TAX ON PROPERTY.**

6 “(a) GENERAL RULE.—There is hereby imposed a
7 tax equal to 11 percent of the customs value of all prop-
8 erty entered into the United States for consumption, use
9 or warehousing.

10 “(b) LIABILITY FOR TAX.—The tax imposed on the
11 import of property by subsection (a) shall be paid by the
12 person entering the property into the United States for
13 consumption, use or warehousing. Such tax shall be due
14 and payable at the time of import.

15 “(c) IMPORTS OF PREVIOUSLY EXPORTED PROP-
16 erty.—In the case of any article that is classified under
17 a heading or subheading of subchapter I or II of chapter
18 98 of the Tariff Schedules of the United States, the tax
19 under this section shall be imposed only on that portion
20 of the customs value of such article that is dutiable under
21 such heading or subheading.

22 “(d) IMPORTS FOR PERSONAL CONSUMPTION.—The
23 import tax imposed by this section shall not apply to any
24 article entered into the United States duty free under sub-

1 chapters I through VII of chapter 98 of the Tariff Sched-
2 ules of the United States.

3 **“SEC. 287. IMPOSITION OF TAX ON IMPORT OF SERVICES.**

4 “(a) GENERAL RULE.—There is hereby imposed a
5 tax equal to 11 percent of the cost of all services treated
6 as imported into the United States during the taxable year
7 of the service recipient.

8 “(b) LIABILITY FOR THE TAX.—The tax on the im-
9 port of services imposed by subsection (a) shall be paid
10 by the person who receives the imported services. The tax
11 shall be payable as if it were an addition to the business
12 tax imposed by section 201.

13 “(c) IMPORTED SERVICES.—For purposes of this sec-
14 tion, services shall be treated as imported if they are treat-
15 ed as imported under section 267 (general rules on import
16 of services) or section 270 (related to insurance).

17 “(d) SPECIAL RULE FOR INSURANCE.—The seller of
18 insurance that is treated as imported under section 270
19 shall be liable for the collection of the tax imposed by sub-
20 section (a) on the insurance and for paying such tax to
21 the Secretary. The first sentence of subsection (b) (relat-
22 ing to the person liable for the tax) shall apply to insur-
23 ance only to the extent that the seller of the insurance
24 services does not collect such tax.

1 **“SEC. 288. GENERAL RULES FOR THE IMPORT TAX.**

2 “(a) IMPORT TAX.—‘Import tax’ means the tax im-
 3 posed by section 286 on the import of property and the
 4 tax imposed by section 287 on the import of services.

5 “(b) NO PAYROLL TAX CREDIT.—The payroll tax
 6 credit shall not be allowed against the import tax.

7 **“Subchapter N—Transition Rules**

- “Sec. 290. Amortization of transition basis.
- “Sec. 291. Sales of transition basis property.
- “Sec. 292. Safe harbor leases.
- “Sec. 293. Carryovers.
- “Sec. 294. Section 481 adjustments.

8 **“SEC. 290. AMORTIZATION OF TRANSITION BASIS.**

9 “(a) TRANSITION BASIS DEDUCTION.—The ‘transi-
 10 tion basis deduction’ for a taxable year is the sum of the
 11 amortization allowance determined under this section for
 12 the taxable year.

13 “(b) AMORTIZATION RULES.—The amortization al-
 14 lowance for each category of amortizable basis shall be de-
 15 termined by amortizing the amortizable basis of such cat-
 16 egory ratably over the amortization period for the category
 17 beginning January 1, 2002.

18 “(c) AMORTIZATION PERIOD.—The amortization pe-
 19 riods shall be determined in accordance with the following
 20 table:

In the case of:	The amortization period is:
Category I basis	15 years
Category II basis	30 years
Category III basis	40 years
Unrecovered inventory costs	5 years

1 “(d) CATEGORIES.—

2 “(1) CATEGORY I BASIS.—‘Category I basis’ is
3 the sum of the unrecovered bases as of January 1,
4 2002, of all depreciable property placed in service
5 prior to January 1, 2002, and the unamortized por-
6 tion of amortizable costs incurred before January 1,
7 2002, if—

8 “(A) cost recovery or amortization began
9 before January 1, 2002, and

10 “(B) the remaining recovery period or am-
11 ortization period as of January 1, 2002, is less
12 than 15 years.

13 “(2) CATEGORY II BASIS.—‘Category II basis’
14 is the sum of the unrecovered bases as of January
15 1, 2002, of all depreciable property placed in service
16 prior to January 1, 2002, and the unamortized por-
17 tion of amortizable costs incurred before January 1,
18 2002, if—

19 “(A) cost recovery or amortization began
20 before January 1, 2002, and

21 “(B) the remaining recovery period or am-
22 ortization period as of January 1, 2002, is 15
23 years or more.

1 “(3) CATEGORY III BASIS.—‘Category III basis’
2 is the sum of the adjusted basis of each asset satis-
3 fying the following requirements:

4 “(A) The asset was placed in service prior
5 to January 1, 2002,

6 “(B) The asset was used in a business ac-
7 tivity in 2002,

8 “(C) The cost of the asset was capitalized
9 and not depreciable or otherwise recoverable
10 under the Internal Revenue Code of 1986, and

11 “(D) The cost of the asset would have con-
12 stituted deductible expenses under the business
13 tax if such cost had been incurred after 2001.

14 “(4) UNRECOVERED INVENTORY COSTS.—‘Un-
15 recovered inventory costs’ means the cost of goods
16 sold (as determined under the Internal Revenue
17 Code of 1986) if a business entity sold all of its in-
18 ventory (including inventory being produced) on the
19 effective date of the business tax.

20 “(e) RULES OF APPLICATION.—

21 “(1) REMAINING RECOVERY PERIOD.—

22 “(A) TIME OF MEASURE.—The remaining
23 recovery period shall be determined as of De-
24 cember 31, 2001, and shall include each taxable
25 year ending after such date in which a deduc-

1 tion would have been allowed under the Internal
2 Revenue Code of 1986.

3 “(B) ACCOUNTING METHOD.—The remain-
4 ing recovery period shall be determined using
5 the cost recovery method and rules applicable
6 for determining taxable income under the Inter-
7 nal Revenue Code of 1986.

8 “(2) DEPLETABLE ASSETS.—Under rules pre-
9 scribed by the Secretary, this section shall apply to
10 the remaining cost basis of depletable property and
11 to other property for which a cost recovery method
12 other than one based on time is used.

13 **“SEC. 291. SALES OF TRANSITION BASIS PROPERTY.**

14 “(a) IN GENERAL.—Except as provided in subsection
15 (b), for purposes of determining the tax consequences of
16 a sale, retirement, casualty or conversion to personal use
17 of an asset whose basis or cost is taken into account under
18 section 90, the amount to be amortized shall be treated
19 as fully deducted upon the adoption of the business tax.

20 “(b) SUBSTANTIAL SALES.—

21 “(1) IN GENERAL.—In the case of a substantial
22 sale of assets to which the amortization rules of sec-
23 tion 90 apply, the purchaser and seller may jointly
24 elect to have the purchaser assume the amortization

1 deductions attributable to such assets, in which
2 case—

3 “(A) the seller’s taxable receipts from such
4 sale shall be reduced by the amount of
5 unamortized basis or cost assumed by the pur-
6 chaser,

7 “(B) the purchaser may treat as a cost of
8 a business purchase only the portion of the pur-
9 chase price in excess of the amount of
10 unamortized basis or cost assumed,

11 “(C) the unamortized basis or cost as-
12 sumed shall continue to be amortized in the
13 manner amortized by the seller.

14 “(2) SUBSTANTIAL SALE.—A sale of assets by
15 a business entity to another business entity is a sub-
16 stantial sale if—

17 “(A) more than 20 percent (in fair market
18 value or in original cost) of the assets of the
19 seller are sold,

20 “(B) the total consideration for the sale
21 exceeds \$1 million or 20 percent of the taxable
22 receipts of the seller for the taxable year pre-
23 ceding the year of the sale, or

1 “(C) the sale satisfies other criteria estab-
2 lished by the Secretary to prevent distortions in
3 gross profits resulting from asset sales.

4 **“SEC. 292. SAFE HARBOR LEASES.**

5 “(a) IN GENERAL.—In the case of a safe harbor
6 lease, rental payments deemed to occur under the lease
7 and interest payments deemed to be made under the leases
8 shall constitute costs of business purchases, and rental in-
9 come and interest income deemed to be earned under the
10 lease shall constitute taxable receipts. The transition basis
11 deduction rules shall apply to the lessor’s adjusted basis
12 in assets subject to a safe harbor lease.

13 “(b) SAFE HARBOR LEASE.—‘Safe harbor lease’
14 means a sale and leaseback transaction entered into pur-
15 suant to section 168(f)(8) of the Internal Revenue Code,
16 as added by the Economic Recovery Tax Act of 1981,
17 when such provision was in effect but only if such trans-
18 action would not be treated as a sale and leaseback for
19 tax purposes but for that provision.

20 **“SEC. 293. CARRYOVERS.**

21 “(a) NO LOSS CARRYOVERS.—No deduction shall be
22 allowed under the business tax for net operating loss
23 carryovers, capital loss carryovers, or any other loss
24 carryovers from the income tax under the Internal Rev-
25 enue Code of 1986.

1 “(b) NO CREDIT CARRYOVERS.—No credits shall be
2 allowed under the business tax for business credit
3 carryovers, minimum tax credit carryovers, or any other
4 credit carryovers from the income tax under the Internal
5 Revenue Code of 1986.

6 **“SEC. 294. SECTION 481 ADJUSTMENTS.**

7 “(a) POSITIVE NET SECTION 481 ADJUSTMENT
8 AMOUNT.—If, as of January 1, 2002, a business entity
9 has a positive net section 481 adjustment amount, the
10 amount shall be applied to reduce the transition basis in
11 accounts (for purposes of section 290) in the following
12 order:

13 “(1) First, to reduce the category I basis (but
14 not below zero),

15 “(2) Second, to reduce the category II basis
16 (but not below zero),

17 “(3) Third, to reduce the unrecovered inventory
18 costs.

19 “(b) NEGATIVE NET SECTION 481 ADJUSTMENT
20 AMOUNT.—If, as of January 1, 2002, a business entity
21 has a negative net section 481 adjustment amount, the
22 amount shall be applied to increase category I basis for
23 purposes of section 290.

1 “(c) SECTION 481 ADJUSTMENT.—A business enti-
2 ty’s net section 481 adjustment is determined by
3 subtracting—

4 “(1) the sum of all additional deductions to
5 which a business entity would be entitled by reason
6 of section 481 of the Internal Revenue Code of 1986
7 for periods beginning on or after the effective date
8 of the business tax with respect to changes in ac-
9 counting methods made before such effective date,
10 from

11 “(2) the sum of all additional income which a
12 business entity would recognize by reason of section
13 481 of the Internal Revenue Code of 1986 for peri-
14 ods beginning on or after the effective date of the
15 business tax with respect to changes in accounting
16 methods made before such effective date,

17 in each case assuming that the income tax under the In-
18 ternal Revenue Code of 1986 remained in effect.

19 **“Subchapter O—Rules for Administration,**
20 **Consolidated Returns**

“Sec. 301. Returns, due dates, etc.

“Sec. 302. Consolidated returns.

21 **“SEC. 301. RETURNS, DUE DATES, ETC.**

22 “(a) IN GENERAL.—Until subtitle F is amended to
23 reflect the adoption of this chapter, the rules of subtitle

1 F relating to C corporations shall apply to business enti-
2 ties with respect to—

3 “(1) returns and records;

4 “(2) time and place for paying tax;

5 “(3) assessment of taxes;

6 “(4) collections and liens;

7 “(5) abatements, credits, and refunds;

8 “(6) interest on underpayments and overpay-
9 ments;

10 “(7) additions to tax and penalties;

11 “(8) closing agreements and compromises;

12 “(9) crimes;

13 “(10) judicial proceedings;

14 “(11) discovery of liability and enforcement;

15 and

16 “(12) estimated taxes.

17 “(b) INDIVIDUALS ENGAGING IN BUSINESS ACTIVI-
18 TIES.—Under rules prescribed by the Secretary, individ-
19 uals engaging in business activities on their own or with
20 their spouses shall be permitted to file their business tax
21 returns with their individual tax returns and shall be sub-
22 ject to estimated tax rules for individual income tax re-
23 turns.

1 “(1) USA INCOME TAX.—‘USA Income Tax’
2 and ‘Simplified USA Tax’ for individuals mean the
3 tax imposed by chapter 1.

4 “(2) INTERNAL REVENUE CODE OF 1986.—‘In-
5 ternal Revenue Code of 1986’ means the Internal
6 Revenue Code of 1986 as in effect immediately be-
7 fore the enactment of the Simplified USA Tax.

8 “(3) UNITED STATES.—‘United States’ means
9 the States and the District of Columbia.

10 “(b) TERMS DEFINED IN CHAPTER 2.—If a term
11 that is used but not defined in this chapter or in section
12 7701 is defined in chapter 1, the definition in chapter 1
13 shall apply except if manifestly incompatible with the in-
14 tent of the provision in which the term is used.

15 **“SEC. 311. RULES OF APPLICATION.**

16 “(a) DEFINITIONS.—Any definition included in this
17 chapter shall apply for all purposes of this chapter
18 unless—

19 “(1) such definition is limited to the purposes
20 of a particular chapter, section, or subsection, or

21 “(2) the definition clearly would not be applica-
22 ble in a particular context.

23 “(b) INTERPRETATIONS CONSISTENT WITH INTER-
24 NAL REVENUE CODE OF 1986.—Terms not defined in this
25 chapter or elsewhere in this title, but defined in the Inter-

1 nal Revenue Code of 1986, shall be interpreted in a man-
 2 ner consistent with the Internal Revenue Code of 1986,
 3 except to the extent such interpretation would be incon-
 4 sistent with the principles and purposes of this chapter.”

5 (b) The amendments made by this section shall be
 6 effective on January 1, 2002, except to the extent other-
 7 wise specifically provided in the text of such amendments.

8 **SEC. 302. REPEAL OF CHAPTER 6.**

9 Chapter 6 of the Code (relating to consolidated re-
 10 turns) is repealed as of January 1, 2002.

11 **TITLE IV—DEFERRED**
 12 **COMPENSATION PLANS**

13 **SEC. 401. PROVISIONS SAVED.**

14 (a) IN GENERAL.—Except as otherwise provided in
 15 this title, the sections contained in subchapter D of chap-
 16 ter 1 of the Code (relating to deferred compensation, etc.)
 17 are hereby saved as chapter 3.

18 (b) LIMITATIONS ON CHAPTER 3.—The following
 19 new section is inserted before section 401 of the Code (as
 20 saved by subsection (a)):

21 **“SEC. 400. EFFECT OF CHAPTER 3.**

22 “(a) IN GENERAL.—The provisions of chapter 3 (sec-
 23 tions 401 through 420) are included in this subtitle for
 24 purposes of cross-reference and for purposes of deter-
 25 mining whether plans are exempt from the business tax

1 and whether contributions to plans are deductible or ex-
2 cludable from gross income under chapter 1.

3 “(b) EFFECT ON BUSINESS TAX DEDUCTIONS.—
4 Notwithstanding any provision to the contrary in this
5 chapter, no provision of this chapter shall cause any
6 amount to be treated as a cost of business purchase or
7 to otherwise be deducted from gross receipts for purposes
8 of computing the Simplified USA for Tax Businesses
9 under chapter 2.

10 “(c) NO CREDITS.—Notwithstanding any provision
11 to the contrary in this chapter, no provision of this chapter
12 shall result in a tax credit against any tax imposed by
13 chapter 1 or chapter 2.

14 “(d) EFFECT OF FAILURE TO COMPLY WITH PROVI-
15 SIONS.—A failure to comply with applicable provisions in
16 this chapter could cause a plan to lose its exemption from
17 the business tax and, thereby subject certain business ac-
18 tivities of the plan to the business tax and/or result in
19 the constructive distribution of plan assets to plan partici-
20 pants.”

21 (c) SECTION 408A SUSPERSEDED BY SECTION 30.—
22 Section 408A is repealed.

23 **SEC. 402. CLERICAL AMENDMENTS.**

24 (a) TABLE OF SECTIONS.—The table of sections for
25 subpart A of part 1 of chapter 3 of the USA Tax Code

1 (formerly subchapter D of chapter 1 of the Code) is
2 amended by inserting at the beginning of the table:

3 **“CHAPTER 3—DEFERRED COMPENSATION,**
4 **ETC.”**

5 (b) RENUMBERING OF CHAPTERS.—

6 (1) RENUMBER CHAPTERS.—Chapters 2 and 3
7 of the Code are renumbered 4 and 5 respectively.
8 Such renumbering shall be reflected in all tables and
9 headings in the Code.

10 (2) CROSS REFERENCES.—Any cross reference
11 to chapter 2 or 3 of the Code contained in any provi-
12 sion of the Code that is not amended by this Act or
13 in any other statute shall be treated as a reference
14 to such chapter as renumbered by paragraph 1.

15 **TITLE V—REPEAL OF ESTATE**
16 **AND GIFT TAXES**

17 **SEC. 501. REPEAL OF GRATUITOUS TRANSFER TAXES.**

18 Subtitle B of the Code (relating to estate and gift
19 taxes) is repealed.

20 **SEC 502. EFFECTIVE DATE.**

21 Section 501 shall apply to—

22 (1) gifts made after December 31, 2001;

23 (2) the estates of decedents dying after Decem-
24 ber 31, 2001, and

1 (3) generating skipping transfers (within the
2 meaning of subchapter B of chapter 13 as in effect
3 before its repeal by this Act) occurring after Decem-
4 ber 31, 2001.

5 **TITLE VI—TECHNICAL AND AD-**
6 **MINISTRATIVE CHANGES: EF-**
7 **FECTIVE DATES**

8 **SEC. 601. USA TAX CODE.**

9 (a) REDESIGNATION OF THE CODE.—The Internal
10 Revenue Title enacted August 16, 1954, and as heretofore
11 and hereby amended may be cited as the “USA Tax
12 Code”. The USA Tax Code, as hereinafter amended, may
13 be cited as the “USA Tax Code, as amended”.

14 (b) REFERENCES IN LAWS, ETC.—Except where in-
15 appropriate, any reference in any law, Executive order, or
16 other document—

17 (1) to the Internal Revenue Code of 1954 or
18 the Internal Revenue Code of 1986 shall include a
19 reference to the USA Tax Code or the USA Tax
20 Code, as amended,

21 (2) to the USA Tax Code or the USA Tax
22 Code, as amended, shall include a reference, with re-
23 spect to periods before January 1, 2002, to the In-
24 ternal Revenue Code of 1954 or the Internal Rev-
25 enue Code of 1986.

1 **SEC. 602. REVISIONS TO THE CODE.**

2 Not later than January 1, 2003, the Secretary shall
3 submit to Congress proposed changes in the USA Tax
4 Code that—

5 (1) eliminate cross-references to the Internal
6 Revenue Code of 1986 (except with respect to tran-
7 sition issues) and insert provisions similar to the
8 cross-referenced sections of the Internal Revenue
9 Code of 1986,

10 (2) revise subtitles C through J of the USA
11 Tax Code to fully reflect the amendments to subtitle
12 A of the Code made by this Act and the repeal of
13 subtitle B,

14 (3) include statutory definitions or rules in
15 cases where the Secretary concludes that the defini-
16 tions or rules cannot or should not be addressed by
17 regulation,

18 (4) revise chapter 4 of the USA Tax Code (as
19 renumbered by section 402 of this Act) (relating to
20 the self-employment tax) to conform to changes
21 made by this Act, and

22 (5) revise chapter 5 of the USA Tax Code (as
23 renumbered by section 402 of this Act) (relating to
24 withholding on nonresident aliens and foreign cor-
25 porations) to reflect changes made in this Act.

1 **SEC. 603. APPLICATION OF SUBTITLE F.**

2 Until such time as subtitle F of the Code is amended
3 to reflect the amendments made by this Act, the provisions
4 of subtitle F shall be treated as generally applying to the
5 Simplified USA Tax—

6 (1) without regard to specific cross references,

7 (2) without regard to provisions relating to
8 partnerships, and

9 (3) as if the business tax under chapter 2 were
10 the corporate income tax and all business entities
11 were corporations (except for purposes of collection,
12 in which case the owners of noncorporate entities
13 shall be obligated for taxes owned by the entities to
14 the same extent as they would if the entity owed the
15 tax prior to the amendment of the Code).

16 **SEC. 604. CLERICAL AMENDMENT.**

17 The portion of the table at the beginning of the Code
18 listing subtitles and chapters of subtitle A is amended to
19 read as follows:

“Subtitle A. Simplified USA Tax.

“Subtitle B. [deleted].

“Subtitle C. Employment taxes.

“Subtitle D. Miscellaneous excise taxes.

“Subtitle E. Alcohol, tobacco and certain other excise taxes.

“Subtitle F. Procedure and administration.

“Subtitle G. The Joint Committee on Taxation.

“Subtitle H. Financing of presidential election campaigns.

“Subtitle I. Trust Fund Code.

“Subtitle K. Group health plan requirements.

“Subtitle A—Simplified USA Tax

“Chapter 1. Simplified USA Tax for individuals.

“Chapter 2. Simplified USA Tax for businesses.

“Chapter 3. Deferred compensation plans.

“Chapter 4. Tax on self-employment income.

“Chapter 5. Withholding of tax on nonresident aliens and foreign corporations.”

1 **SEC. 605. EFFECTIVE DATES.**

2 (a) IN GENERAL.—Except as otherwise provided in
3 this Act, the amendments made by this Act shall be effec-
4 tive on January 1, 2002, with respect to tax years begin-
5 ning on such date.

6 (b) SPECIAL RULES FOR BUSINESSES WITH 52–53
7 WEEK YEAR.—If a business uses a 52–53 week taxable
8 year the amendments made by this Act shall apply to the
9 business with respect to its tax year beginning in the last
10 week in December except with respect to any transactions
11 occurring during 2001 that were structured to take advan-
12 tage of the application of this Act to such business at a
13 time when this Act did not apply to other businesses or
14 to individuals.

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