118TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPT. 118–353
Part 1

TAX RELIEF FOR AMERICAN FAMILIES AND WORKERS ACT OF 2024

R E P O R T

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ON

H.R. 7024

TOGETHER WITH

ADDITIONAL VIEWS

JANUARY 23, 2024.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Part 1

TAX RELIEF FOR AMERICAN FAMILIES AND WORKERS ACT OF 2024

JANUARY 23, 2024.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. SMITH of Missouri, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

ADDITIONAL VIEWS

[To accompany H.R. 7024]

The Committee on Ways and Means, to whom was referred the bill (H.R. 7024) to make improvements to the child tax credit, to provide tax incentives to promote economic growth, to provide special rules for the taxation of certain residents of Taiwan with income from sources within the United States, to provide tax relief with respect to certain Federal disasters, to make improvements to the low-income housing tax credit, and for other purposes, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE; TABLE OF CONTENTS; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Relief for American Families and Workers Act of 2024".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents of this Act is as follows:

TITLE I—TAX RELIEF FOR WORKING FAMILIES

SEC. 101. PER-CHILD CALCULATION OF REFUNDABLE PORTION OF CHILD TAX CREDIT.

(a) IN GENERAL.—Subparagraph (A) of section 24(h)(5) is amended to read as follows:

"(A) IN GENERAL.—In applying subsection (d)—

"(i) the amount determined under paragraph (1)(A) of such subsection with respect to any qualifying child shall not exceed $1,400, and such paragraph shall be applied without regard to paragraph (4) of this subsection, and

"(ii) paragraph (1)(B) of such subsection shall be applied by multiplying each of—

"(I) the amount determined under clause (i) thereof, and

"(II) the excess determined under clause (ii) thereof,

by the number of qualifying children of the taxpayer.".

(b) CONFORMING AMENDMENT.—The heading of paragraph (5) of section 24(h) is amended by striking "MAXIMUM AMOUNT OF" and inserting "SPECIAL RULES FOR".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2022.

SEC. 102. INCREASE IN REFUNDABLE PORTION.

(a) IN GENERAL.—Paragraph (5) of section 24(h) is amended by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

"(B) AMOUNTS FOR 2023, 2024, AND 2025.—In the case of a taxable year beginning after 2022, subparagraph (A) shall be applied by substituting for '$1,400'—

"(i) in the case of taxable year 2023, '$1,800',

"(ii) in the case of taxable year 2024, '$1,900', and

"(iii) in the case of taxable year 2025, '$2,000'.".

(b) CONFORMING AMENDMENT.—Subparagraph (C) of section 24(h)(5), as redesignated by subsection (a), is amended by inserting "and before 2023" after "2018".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2022.

SEC. 103. INFLATION OF CREDIT AMOUNT.

(a) IN GENERAL.—Paragraph (2) of section 24(h) is amended—

(1) by striking "AMOUNT.—Subsection" and inserting "AMOUNT.—

"(A) IN GENERAL.—Subsection", and

(2) by adding at the end the following new subparagraph:

"(B) ADJUSTMENT FOR INFLATION.—In the case of a taxable year beginning after 2023, the $2,000 amounts in subparagraph (A) and paragraph (5)(B)(iii) shall each be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting '2022' for '2016' in subparagraph (A)(ii) thereof.

If any increase under this clause is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2023.

SEC. 104. RULE FOR DETERMINATION OF EARNED INCOME.

(a) IN GENERAL.—Paragraph (6) of section 24(h) of the Internal Revenue Code of 1986 is amended—

(1) by striking "CREDIT.—Subsection" and inserting "CREDIT.—

"(A) IN GENERAL.—Subsection", and

(2) by adding at the end the following new subparagraphs

"(B) RULE FOR DETERMINATION OF EARNED INCOME.—

"(i) IN GENERAL.—In the case of a taxable year beginning after 2023, if the earned income of the taxpayer for such taxable year is less than the earned income of the taxpayer for the preceding taxable year, subsection (d)(1)(B)(i) may, at the election of the taxpayer, be applied by substituting—

"(I) the earned income for such preceding taxable year, for

"(II) the earned income for the current taxable year.

"(ii) APPLICATION TO JOINT RETURNS.—For purposes of clause (i), in the case of a joint return, the earned income of the taxpayer for the preceding taxable year shall be the sum of the earned income of each spouse for such preceding taxable year.".

(b) ERRORS TREATED AS MATHEMATICAL ERRORS.—Paragraph (2) of section 6213(g) of the Internal Revenue Code of 1986 is amended by striking "and" at the end of subparagraph (U), by striking the period at the end of subparagraph (V) and inserting ", and", and by inserting after subparagraph (V) the following new subparagraph:

"(W) in the case of a taxpayer electing the application of section 24(h)(6)(B) for any taxable year, an entry on a return of earned income pursuant to such section which is inconsistent with the amount of such earned income determined by the Secretary for the preceding taxable year.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2023.

SEC. 105. SPECIAL RULE FOR CERTAIN EARLY-FILED 2023 RETURNS.

In the case of an individual who claims, on the taxpayer's return of tax for the first taxable year beginning after December 31, 2022, a credit under section 24 of the Internal Revenue Code of 1986 which is determined without regard to the amendments made by sections 101 and 102 of this Act, the Secretary of the Treasury (or the Secretary's delegate) shall, to the maximum extent practicable—

(1) redetermine the amount of such credit (after taking into account such amendments) on the basis of the information provided by the taxpayer on such return, and

(2) to the extent that such redetermination results in an overpayment of tax, credit or refund such overpayment as expeditiously as possible.

TITLE II—AMERICAN INNOVATION AND GROWTH

SEC. 201. DEDUCTION FOR DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) DELAY OF AMORTIZATION OF DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.—Section 174 is amended by adding at the end the following new subsection:

"(e) SUSPENSION OF APPLICATION OF SECTION TO DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.—In the case of any domestic research or experimental expenditures (as defined in section 174A(b)), this section—

"(1) shall apply to such expenditures paid or incurred in taxable years beginning after December 31, 2025, and

"(2) shall not apply to such expenditures paid or incurred in taxable years beginning on or before such date.".

(b) REINSTATEMENT OF EXPENSING FOR DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.—Part VI of subchapter B of chapter 1 is amended by inserting after section 174 the following new section:

"SEC. 174A. TEMPORARY RULES FOR DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.

"(a) TREATMENT AS EXPENSES.—Notwithstanding section 263, there shall be allowed as a deduction any domestic research or experimental expenditures which are paid or incurred by the taxpayer during the taxable year.

"(b) DOMESTIC RESEARCH OR EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term 'domestic research or experimental expenditures' means research or experimental expenditures paid or incurred by the taxpayer in connection with the taxpayer's trade or business other than such expenditures which are attributable to foreign research (within the meaning of section 41(d)(4)(F)).

"(c) AMORTIZATION OF CERTAIN DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.—

"(1) IN GENERAL.—At the election of the taxpayer, made in accordance with regulations or other guidance provided by the Secretary, in the case of domestic research or experimental expenditures which would (but for subsection (a)) be chargeable to capital account but not chargeable to property of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion), subsection (a) shall not apply and the taxpayer shall—

"(A) charge such expenditures to capital account, and

"(B) be allowed an amortization deduction of such expenditures ratably over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures).

"(2) TIME FOR AND SCOPE OF ELECTION.—The election provided by paragraph (1) may be made for any taxable year, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The method so elected, and the period selected by the taxpayer, shall be adhered to in computing taxable income for the taxable year for which the election is made and for all subsequent taxable years unless, with the approval of the Secretary, a change to a different method (or to a different period) is authorized with respect to part or all of such expenditures. The election shall not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer makes the election.

"(d) ELECTION TO CAPITALIZE EXPENSES.—In the case of a taxpayer which elects (at such time and in such manner as the Secretary may provide) the application of this subsection, subsections (a) and (c) shall not apply and domestic research or experimental expenditures shall be chargeable to capital account. Such election shall not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer makes the election and may be made with respect to part of the expenditures paid or incurred during any taxable year only with the approval of the Secretary.

"(e) SPECIAL RULES.—

"(1) LAND AND OTHER PROPERTY.—This section shall not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion); but for purposes of this section allowances under section 167, and allowances under section 611, shall be considered as expenditures.

"(2) EXPLORATION EXPENDITURES.—This section shall not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

"(3) SOFTWARE DEVELOPMENT.—For purposes of this section, any amount paid or incurred in connection with the development of any software shall be treated as a research or experimental expenditure.

"(f) TERMINATION.—

"(1) IN GENERAL.—This section shall not apply to amounts paid or incurred in taxable years beginning after December 31, 2025.

"(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of a taxpayer's first taxable year beginning after December 31, 2025, paragraph (1) (and the cor-

responding application of section 174) shall be treated as a change in method of accounting for purposes of section 481 and—

"(A) such change shall be treated as initiated by the taxpayer,

"(B) such change shall be treated as made with the consent of the Secretary, and

"(C) such change shall be applied only on a cut-off basis for any domestic research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2025, and no adjustment under section 481(a) shall be made.".

(c) COORDINATION WITH CERTAIN OTHER PROVISIONS.—

(1) RESEARCH CREDIT.—

(A) Section 41(d)(1)(A) is amended by inserting "or domestic research or experimental expenditures under section 174A" after "section 174".

(B) Section 280C(c)(1) is amended to read as follows:

"(1) IN GENERAL.—The domestic research or experimental expenditures otherwise taken into account under section 174 or 174A (as the case may be) shall be reduced by the amount of the credit allowed under section 41(a).".

(2) AMT ADJUSTMENT.—Section 56(b)(2) is amended by striking "174(a)" each place it appears and inserting "174A(a)".

(3) OPTIONAL 10-YEAR WRITEOFF.—Section 59(e)(2)(B) is amended by striking "section 174(a) (relating to research and experimental expenditures)" and inserting "section 174A(a) (relating to temporary rules for domestic research and experimental expenditures)".

(4) QUALIFIED SMALL ISSUE BONDS.—Section 144(a)(4)(C)(iv) is amended by striking "174(a)" and inserting "174A(a)".

(5) START-UP EXPENDITURES.—Section 195(c)(1) is amended by striking "or 174" in the last sentence and inserting "174, or 174A".

(6) CAPITAL EXPENDITURES.—

(A) Section 263(a)(1)(B) is amended by inserting " or 174A" after "174".

(B) Section 263A(c)(2) is amended by inserting "or 174A" after "174".

(7) ACTIVE BUSINESS COMPUTER SOFTWARE ROYALTIES.—Section 543(d)(4)(A)(i) is amended by inserting "174A," after "174,".

(8) SOURCE RULES.—Section 864(g)(2) is amended in the last sentence—

(A) by striking "treated as deferred expenses under subsection (b) of section 174" and inserting "allowed as an amortization deduction under section 174(a) or section 174A(c),", and

(B) by striking "such subsection" and inserting "such section (as the case may be)".

(9) BASIS ADJUSTMENT.—Section 1016(a)(14) is amended by striking "deductions as deferred expenses under section 174(b)(1) (relating to research and experimental expenditures)" and inserting "deductions under section 174 or 174A".

(10) SMALL BUSINESS STOCK.—Section 1202(e)(2)(B) is amended by striking "research and experimental expenditures under section 174" and inserting "specified research or experimental expenditures under section 174 or domestic research or experimental expenditures under section 174A".

(d) CONFORMING AMENDMENTS.—

(1) Section 13206 of Public Law 115–97 is amended by striking subsection (b) (relating to change in method of accounting).

(2) The table of sections for part VI of subchapter B of chapter 1 is amended by inserting after the item relating to section 174 the following new item:

"Sec. 174A. Temporary rules for domestic research and experimental expenditures.".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 2021.

(2) COORDINATION WITH RESEARCH CREDIT.—The amendment made by subsection (c)(1)(B) shall apply to taxable years beginning after December 31, 2022.

(3) REPEAL OF SUPERCEDED CHANGE IN METHOD OF ACCOUNTING RULES.—The amendment made by subsection (d)(1) shall take effect as if included in Public Law 115–97.

(4) NO INFERENCE WITH RESPECT TO COORDINATION WITH RESEARCH CREDIT FOR PRIOR PERIODS.—The amendment made by subsection (c)(1)(B) shall not be construed to create any inference with respect to the proper application of section 280C(c) of the Internal Revenue Code of 1986 with respect to taxable years beginning before January 1, 2023.

(f) TRANSITION RULES.—

(1) IN GENERAL.—Except as otherwise provided by the Secretary, an election made under subsection (c) or (d) of section 174A of the Internal Revenue Code of 1986 (as added by this section) for the taxpayer's first taxable year beginning after December 31, 2021, shall not fail to be treated as timely made (or as made on the return) if made during the 1-year period beginning on the date of the enactment of this Act on an amended return for the taxpayer's first taxable year beginning after December 31, 2021, or in such other manner as the Secretary may provide.

(2) ELECTION REGARDING TREATMENT AS CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer which (as of the date of the enactment of this Act) had adopted a method of accounting provided by section 174 of the Internal Revenue Code of 1986 (as in effect prior to the amendments made by this section) for the taxpayer's first taxable year beginning after December 31, 2021, and elects the application of this paragraph—

(A) the amendments made by this section shall be treated as a change in method of accounting for purposes of section 481 of such Code,

(B) such change shall be treated as initiated by the taxpayer for the taxpayer's immediately succeeding taxable year,

(C) such change shall be treated as made with the consent of the Secretary,

(D) such change shall be applied on a modified cut-off basis, taking into account for purposes of section 481(a) of such Code only the domestic research or experimental expenditures (as defined in section 174A(b) of such Code (as added by this section) and determined by applying the rules of section 174A(e) of such Code) paid or incurred in the taxpayer's first taxable year beginning after December 31, 2021, and not allowed as a deduction in such taxable year, and

(E) in the case of a taxpayer which elects the application of this subparagraph, the amount of such change (as determined under subparagraph (D)) shall be taken into account ratably over the 2-taxable-year period beginning with the taxable year referred to in subparagraph (B).

(3) ELECTION REGARDING 10-YEAR WRITEOFF.—

(A) IN GENERAL.—Except as otherwise provided by the Secretary, an eligible taxpayer which files, during the 1-year period beginning on the date of the enactment of this Act, an amended income tax return for the taxable year described in subparagraph (B)(ii) may elect the application of section 59(e) of the Internal Revenue Code of 1986 with respect to qualified expenditures described in section 59(e)(2)(B) of such Code (as amended by subsection (c)(3)) with respect to such taxable year. Such election shall be filed with such amended income tax return and shall be effective only to the extent that such election would have been effective if filed with the original income tax return for such taxable year (determined after taking into account the amendment made by subsection (c)(3)).

(B) ELIGIBLE TAXPAYER.—For purposes of subparagraph (A), the term "eligible taxpayer" means any taxpayer which—

(i) does not elect the application of paragraph (2), and

(ii) filed an income tax return for such taxpayer's first taxable year beginning after December 31, 2021, before the earlier of—

(I) the due date for such return, and

(II) the date of the enactment of this Act.

(4) ELECTION REGARDING COORDINATION WITH RESEARCH CREDIT.—Except as otherwise provided by the Secretary, an eligible taxpayer (as defined in paragraph (3)(B) without regard to clause (i) thereof) which files, during the 1-year period beginning on the date of the enactment of this Act, an amended income tax return for the taxpayer's first taxable year beginning after December 31, 2021, may, notwithstanding subparagraph (C) of section 280C(c)(2) of the Internal Revenue Code of 1986 make, or revoke, on such amended return the election under such section for such taxable year.

SEC. 202. EXTENSION OF ALLOWANCE FOR DEPRECIATION, AMORTIZATION, OR DEPLETION IN DETERMINING THE LIMITATION ON BUSINESS INTEREST.

(a) IN GENERAL.—Section 163(j)(8)(A)(v) is amended by striking "January 1, 2022" and inserting "January 1, 2026".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendment made by this section shall apply to taxable years beginning after December 31, 2023.

(2) ELECTION TO APPLY EXTENSION RETROACTIVELY.—In the case of a taxpayer which elects (at such time and in such manner as the Secretary may provide)

the application of this paragraph, paragraph (1) shall be applied by substituting "December 31, 2021" for "December 31, 2023".

SEC. 203. EXTENSION OF 100 PERCENT BONUS DEPRECIATION.

(a) IN GENERAL.—Section 168(k)(6)(A) is amended—

(1) in clause (i)—

(A) by striking "2023" and inserting "2026", and

(B) by adding "and" at the end, and

(2) by striking clauses (ii), (iii), and (iv), and redesignating clause (v) as clause (ii).

(b) PROPERTY WITH LONGER PRODUCTION PERIODS.—Section 168(k)(6)(B) is amended—

(1) in clause (i)—

(A) by striking "2024" and inserting "2027", and

(B) by adding "and" at the end, and

(2) by striking clauses (ii), (iii), and (iv), and redesignating clause (v) as clause (ii).

(c) PLANTS BEARING FRUITS AND NUTS.—Section 168(k)(6)(C) is amended—

(1) in clause (i)—

(A) by striking "2023" and inserting "2026", and

(B) by adding "and" at the end, and

(2) by striking clauses (ii), (iii), and (iv), and redesignating clause (v) as clause (ii).

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to property placed in service after December 31, 2022.

(2) PLANTS BEARING FRUITS AND NUTS.—The amendments made by subsection (c) shall apply to specified plants planted or grafted after December 31, 2022.

SEC. 204. INCREASE IN LIMITATIONS ON EXPENSING OF DEPRECIABLE BUSINESS ASSETS.

(a) IN GENERAL.—Section 179(b) is amended—

(1) by striking "$1,000,000" in paragraph (1) and inserting "$1,290,000", and

(2) by striking "$2,500,000" in paragraph (2) and inserting "$3,220,000".

(b) INFLATION ADJUSTMENT.—Section 179(b)(6) is amended—

(1) by striking "2018" and inserting "2024 (2018 in the case of the dollar amount in paragraph (5)(A))", and

(2) by striking "'calendar year 2017" and inserting "'calendar year 2024' ('calendar year 2017' in the case of the dollar amount in paragraph (5)(A))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service in taxable years beginning after December 31, 2023.

TITLE III—INCREASING GLOBAL COMPETITIVENESS

Subtitle A—United States-Taiwan Expedited Double-Tax Relief Act

SEC. 301. SHORT TITLE.

This subtitle may be cited as the "United States-Taiwan Expedited Double-Tax Relief Act".

SEC. 302. SPECIAL RULES FOR TAXATION OF CERTAIN RESIDENTS OF TAIWAN.

(a) IN GENERAL.—Subpart D of part II of subchapter N of chapter 1 is amended by inserting after section 894 the following new section:

"SEC. 894A. SPECIAL RULES FOR QUALIFIED RESIDENTS OF TAIWAN.

"(a) CERTAIN INCOME FROM UNITED STATES SOURCES.—

"(1) INTEREST, DIVIDENDS, AND ROYALTIES, ETC.—

"(A) IN GENERAL.—In the case of interest (other than original issue discount), dividends, royalties, amounts described in section 871(a)(1)(C), and gains described in section 871(a)(1)(D) received by or paid to a qualified resident of Taiwan—

"(i) sections 871(a), 881(a), 1441(a), 1441(c)(5), and 1442(a) shall each be applied by substituting 'the applicable percentage (as defined in section 894A(a)(1)(C))' for '30 percent' each place it appears, and

"(ii) sections 871(a), 881(a), and 1441(c)(1) shall each be applied by substituting 'a United States permanent establishment of a qualified resident of Taiwan' for 'a trade or business within the United States' each place it appears.

"(B) EXCEPTIONS.—

"(i) IN GENERAL.—Subparagraph (A) shall not apply to—

"(I) any dividend received from or paid by a real estate investment trust which is not a qualified REIT dividend,

"(II) any amount subject to section 897,

"(III) any amount received from or paid by an expatriated entity (as defined in section 7874(a)(2)) to a foreign related person (as defined in section 7874(d)(3)), and

"(IV) any amount which is included in income under section 860C to the extent that such amount does not exceed an excess inclusion with respect to a REMIC.

"(ii) QUALIFIED REIT DIVIDEND.—For purposes of clause (i)(I), the term 'qualified REIT dividend' means any dividend received from or paid by a real estate investment trust if such dividend is paid with respect to a class of shares that is publicly traded and the recipient of the dividend is a person who holds an interest in any class of shares of the real estate investment trust of not more than 5 percent.

"(C) APPLICABLE PERCENTAGE.—For purposes of applying subparagraph (A)(i)—

"(i) IN GENERAL.—Except as provided in clause (ii), the term 'applicable percentage' means 10 percent.

"(ii) SPECIAL RULES FOR DIVIDENDS.— In the case of any dividend in respect of stock received by or paid to a qualified resident of Taiwan, the applicable percentage shall be 15 percent (10 percent in the case of a dividend which meets the requirements of subparagraph (D) and is received by or paid to an entity taxed as a corporation in Taiwan).

"(D) REQUIREMENTS FOR LOWER DIVIDEND RATE.—

"(i) IN GENERAL.—The requirements of this subparagraph are met with respect to any dividend in respect of stock in a corporation if, at all times during the 12-month period ending on the date such stock becomes ex-dividend with respect to such dividend—

"(I) the dividend is derived by a qualified resident of Taiwan, and

"(II) such qualified resident of Taiwan has held directly at least 10 percent (by vote and value) of the total outstanding shares of stock in such corporation.

For purposes of subclause (II), a person shall be treated as directly holding a share of stock during any period described in the preceding sentence if the share was held by a corporation from which such person later acquired that share and such corporation was, at the time the share was acquired, both a connected person to such person and a qualified resident of Taiwan.

"(ii) EXCEPTION FOR RICS AND REITS.—Notwithstanding clause (i), the requirements of this subparagraph shall not be treated as met with respect to any dividend paid by a regulated investment company or a real estate investment trust.

"(2) QUALIFIED WAGES.—

"(A) IN GENERAL.—No tax shall be imposed under this chapter (and no amount shall be withheld under section 1441(a) or chapter 24) with respect to qualified wages paid to a qualified resident of Taiwan who—

"(i) is not a resident of the United States (determined without regard to subsection (c)(3)(E)), or

"(ii) is employed as a member of the regular component of a ship or aircraft operated in international traffic.

"(B) QUALIFIED WAGES.—

"(i) IN GENERAL.—The term 'qualified wages' means wages, salaries, or similar remunerations with respect to employment involving the performance of personal services within the United States which—

"(I) are paid by (or on behalf of) any employer other than a United States person, and

"(II) are not borne by a United States permanent establishment of any person other than a United States person.

"(ii) EXCEPTIONS.—Such term shall not include directors' fees, income derived as an entertainer or athlete, income derived as a student or trainee, pensions, amounts paid with respect to employment with the United States, any State (or political subdivision thereof), or any pos-

session of the United States (or any political subdivision thereof), or other amounts specified in regulations or guidance under subsection (f)(1)(F).

"(3) INCOME DERIVED FROM ENTERTAINMENT OR ATHLETIC ACTIVITIES.—

"(A) IN GENERAL.—No tax shall be imposed under this chapter (and no amount shall be withheld under section 1441(a) or chapter 24) with respect to income derived by an entertainer or athlete who is a qualified resident of Taiwan from personal activities as such performed in the United States if the aggregate amount of gross receipts from such activities for the taxable year do not exceed $30,000.

"(B) EXCEPTION.—Subparagraph (A) shall not apply with respect to—

"(i) income which is qualified wages (as defined in paragraph (2)(B), determined without regard to clause (ii) thereof), or

"(ii) income which is effectively connected with a United States permanent establishment.

"(b) INCOME CONNECTED WITH A UNITED STATES PERMANENT ESTABLISHMENT OF A QUALIFIED RESIDENT OF TAIWAN.—

"(1) IN GENERAL.—

"(A) IN GENERAL.—In lieu of applying sections 871(b) and 882, a qualified resident of Taiwan that carries on a trade or business within the United States through a United States permanent establishment shall be taxable as provided in section 1, 11, 55, or 59A, on its taxable income which is effectively connected with such permanent establishment.

"(B) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the permanent establishment.

"(2) TREATMENT OF DISPOSITIONS OF UNITED STATES REAL PROPERTY.—In the case of a qualified resident of Taiwan, section 897(a) shall be applied—

"(A) by substituting 'carried on a trade or business within the United States through a United States permanent establishment' for 'were engaged in a trade or business within the United States', and

"(B) by substituting 'such United States permanent establishment' for 'such trade or business'.

"(3) TREATMENT OF BRANCH PROFITS TAXES.—In the case of any corporation which is a qualified resident of Taiwan, section 884 shall be applied—

"(A) by substituting '10 percent' for '30 percent ' in subsection (a) thereof, and

"(B) by substituting 'a United States permanent establishment of a qualified resident of Taiwan' for 'the conduct of a trade or business within the United States' in subsection (d)(1) thereof.

"(4) SPECIAL RULE WITH RESPECT TO INCOME DERIVED FROM CERTAIN ENTERTAINMENT OR ATHLETIC ACTIVITIES.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to the extent that the income is derived—

"(i) in respect of entertainment or athletic activities performed in the United States, and

"(ii) by a qualified resident of Taiwan who is not the entertainer or athlete performing such activities.

"(B) EXCEPTION.—Subparagraph (A) shall not apply if the person described in subparagraph (A)(ii) is contractually authorized to designate the individual who is to perform such activities.

"(5) SPECIAL RULE WITH RESPECT TO CERTAIN AMOUNTS.—Paragraph (1) shall not apply to any income which is wages, salaries, or similar remuneration with respect to employment or with respect to any amount which is described in subsection (a)(2)(B)(ii).

"(c) QUALIFIED RESIDENT OF TAIWAN.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified resident of Taiwan' means any person who—

"(A) is liable to tax under the laws of Taiwan by reason of such person's domicile, residence, place of management, place of incorporation, or any similar criterion,

"(B) is not a United States person (determined without regard to paragraph (3)(E)), and

"(C) in the case of an entity taxed as a corporation in Taiwan, meets the requirements of paragraph (2).

"(2) LIMITATION ON BENEFITS FOR CORPORATE ENTITIES OF TAIWAN.—

"(A) IN GENERAL.—Subject to subparagraphs (E) and (F), an entity meets the requirements of this paragraph only if it—

"(i) meets the ownership and income requirements of subparagraph (B),

"(ii) meets the publicly traded requirements of subparagraph (C), or

"(iii) meets the qualified subsidiary requirements of subparagraph (D).

"(B) OWNERSHIP AND INCOME REQUIREMENTS.—The requirements of this subparagraph are met for an entity if—

"(i) at least 50 percent (by vote and value) of the total outstanding shares of stock in such entity are owned directly or indirectly by qualified residents of Taiwan, and

"(ii) less than 50 percent of such entity's gross income (and in the case of an entity that is a member of a tested group, less than 50 percent of the tested group's gross income) is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the income taxes imposed by Taiwan, to persons who are not—

"(I) qualified residents of Taiwan, or

"(II) United States persons who meet such requirements with respect to the United States as determined by the Secretary to be equivalent to the requirements of this subsection (determined without regard to paragraph (1)(B)) with respect to residents of Taiwan.

"(C) PUBLICLY TRADED REQUIREMENTS.—An entity meets the requirements of this subparagraph if—

"(i) the principal class of its shares (and any disproportionate class of shares) of such entity are primarily and regularly traded on an established securities market in Taiwan, or

"(ii) the primary place of management and control of the entity is in Taiwan and all classes of its outstanding shares described in clause (i) are regularly traded on an established securities market in Taiwan.

"(D) QUALIFIED SUBSIDIARY REQUIREMENTS.—An entity meets the requirement of this subparagraph if—

"(i) at least 50 percent (by vote and value) of the total outstanding shares of the stock of such entity are owned directly or indirectly by 5 or fewer entities—

"(I) which meet the requirements of subparagraph (C), or

"(II) which are United States persons the principal class of the shares (and any disproportionate class of shares) of which are primarily and regularly traded on an established securities market in the United States, and

"(ii) the entity meets the requirements of clause (ii) of subparagraph (B).

"(E) ONLY INDIRECT OWNERSHIP THROUGH QUALIFYING INTERMEDIARIES COUNTED.—

"(i) IN GENERAL.—Stock in an entity owned by a person indirectly through 1 or more other persons shall not be treated as owned by such person in determining whether the person meets the requirements of subparagraph (B)(i) or (D)(i) unless all such other persons are qualifying intermediate owners.

"(ii) QUALIFYING INTERMEDIATE OWNERS.—The term 'qualifying intermediate owner' means a person that is—

"(I) a qualified resident of Taiwan, or

"(II) a resident of any other foreign country (other than a foreign country that is a foreign country of concern) that has in effect a comprehensive convention with the United States for the avoidance of double taxation.

"(iii) SPECIAL RULE FOR QUALIFIED SUBSIDIARIES.—For purposes of applying subparagraph (D)(i), the term 'qualifying intermediate owner' shall include any person who is a United States person who meets such requirements with respect to the United States as determined by the Secretary to be equivalent to the requirements of this subsection (determined without regard to paragraph (1)(B)) with respect to residents of Taiwan.

"(F) CERTAIN PAYMENTS NOT INCLUDED.—In determining whether the requirements of subparagraph (B)(ii) or (D)(ii) are met with respect to an entity, the following payments shall not be taken into account:

"(i) Arm's-length payments by the entity in the ordinary course of business for services or tangible property.

"(ii) In the case of a tested group, intra-group transactions.

"(3) DUAL RESIDENTS.—

"(A) RULES FOR DETERMINATION OF STATUS.—

"(i) IN GENERAL.—An individual who is an applicable dual resident and who is described in subparagraph (B), (C), or (D) shall be treated as a qualified resident of Taiwan.

"(ii) APPLICABLE DUAL RESIDENT.—For purposes of this paragraph, the term 'applicable dual resident' means an individual who—

"(I) is not a United States citizen,

"(II) is a resident of the United States (determined without regard to subparagraph (E)), and

"(III) would be a qualified resident of Taiwan but for paragraph (1)(B).

"(B) PERMANENT HOME.—An individual is described in this subparagraph if such individual—

"(i) has a permanent home available to such individual in Taiwan, and

"(ii) does not have a permanent home available to such individual in the United States.

"(C) CENTER OF VITAL INTERESTS.—An individual is described in this subparagraph if—

"(i) such individual has a permanent home available to such individual in both Taiwan and the United States, and

"(ii) such individual's personal and economic relations (center of vital interests) are closer to Taiwan than to the United States.

"(D) HABITUAL ABODE.—An individual is described in this subparagraph if—

"(i) such individual—

"(I) does not have a permanent home available to such individual in either Taiwan or the United States, or

"(II) has a permanent home available to such individual in both Taiwan and the United States but such individual's center of vital interests under subparagraph (C)(ii) cannot be determined, and

"(ii) such individual has a habitual abode in Taiwan and not the United States.

"(E) UNITED STATES TAX TREATMENT OF QUALIFIED RESIDENT OF TAIWAN.—Notwithstanding section 7701, an individual who is treated as a qualified resident of Taiwan by reason of this paragraph for all or any portion of a taxable year shall not be treated as a resident of the United States for purposes of computing such individual's United States income tax liability for such taxable year or portion thereof.

"(4) RULES OF SPECIAL APPLICATION.—

"(A) DIVIDENDS.—For purposes of applying this section to any dividend, paragraph (2)(D) shall be applied without regard to clause (ii) thereof.

"(B) ITEMS OF INCOME EMANATING FROM AN ACTIVE TRADE OR BUSINESS IN TAIWAN.—For purposes of this section—

"(i) IN GENERAL.—Notwithstanding the preceding paragraphs of this subsection, if an entity taxed as a corporation in Taiwan is not a qualified resident of Taiwan but meets the requirements of subparagraphs (A) and (B) of paragraph (1), any qualified item of income such entity derived from the United States shall be treated as income of a qualified resident of Taiwan.

"(ii) QUALIFIED ITEMS OF INCOME.—

"(I) IN GENERAL.—The term 'qualified item of income' means any item of income which emanates from, or is incidental to, the conduct of an active trade or business in Taiwan (other than operating as a holding company, providing overall supervision or administration of a group of companies, providing group financing, or making or managing investments (unless such making or managing investments is carried on by a bank, insurance company, or registered securities dealer in the ordinary course of its business as such)).

"(II) SUBSTANTIAL ACTIVITY REQUIREMENT.—An item of income which is derived from a trade or business conducted in the United States or from a connected person shall be a qualified item of income only if the trade or business activity conducted in Taiwan to which the item is related is substantial in relation to the same or a complementary trade or business activity carried on in the United States. For purposes of applying this subclause, activities conducted by persons that are connected to the entity described in clause (i) shall be deemed to be conducted by such entity.

"(iii) EXCEPTION.—This subparagraph shall not apply to any item of income derived by an entity if at least 50 percent (by vote or value) of

such entity is owned (directly or indirectly) or controlled by residents of a foreign country of concern.

"(d) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) UNITED STATES PERMANENT ESTABLISHMENT.—

"(A) IN GENERAL.—The term 'United States permanent establishment' means, with respect to a qualified resident of Taiwan, a permanent establishment of such resident which is within the United States.

"(B) SPECIAL RULE.—The determination of whether there is a permanent establishment of a qualified resident of Taiwan within the United States shall be made without regard to whether an entity which is taxed as a corporation in Taiwan and which is a qualified resident of Taiwan controls or is controlled by—

"(i) a domestic corporation, or

"(ii) any other person that carries on business in the United States (whether through a permanent establishment or otherwise).

"(2) PERMANENT ESTABLISHMENT.—

"(A) IN GENERAL.—The term 'permanent establishment' means a fixed place of business through which a trade or business is wholly or partly carried on. Such term shall include—

"(i) a place of management,

"(ii) a branch,

"(iii) an office,

"(iv) a factory,

"(v) a workshop, and

"(vi) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

"(B) SPECIAL RULES FOR CERTAIN TEMPORARY PROJECTS.—

"(i) IN GENERAL.—A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or exploitation of the sea bed and its subsoil and their natural resources, constitutes a permanent establishment only if it lasts, or the activities of the rig or ship lasts, for more than 12 months.

"(ii) DETERMINATION OF 12-MONTH PERIOD.—For purposes of clause (i), the period over which a building site or construction or installation project of a person lasts shall include any period of more than 30 days during which such person does not carry on activities at such building site or construction or installation project but connected activities are carried on at such building site or construction or installation project by one or more connected persons.

"(C) HABITUAL EXERCISE OF CONTRACT AUTHORITY TREATED AS PERMANENT ESTABLISHMENT.—Notwithstanding subparagraphs (A) and (B), where a person (other than an agent of an independent status to whom subparagraph (D)(ii) applies) is acting on behalf of a trade or business of a qualified resident of Taiwan and has and habitually exercises an authority to conclude contracts that are binding on the trade or business, that trade or business shall be deemed to have a permanent establishment in the country in which such authority is exercised in respect of any activities that the person undertakes for the trade or business, unless the activities of such person are limited to those described in subparagraph (D)(i) that, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that subparagraph.

"(D) EXCLUSIONS.—

"(i) IN GENERAL.—Notwithstanding subparagraphs (A) and (B), the term 'permanent establishment' shall not include—

"(I) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the trade or business,

"(II) the maintenance of a stock of goods or merchandise belonging to the trade or business solely for the purpose of storage, display, or delivery,

"(III) the maintenance of a stock of goods or merchandise belonging to the trade or business solely for the purpose of processing by another trade or business,

"(IV) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the trade or business,

"(V) the maintenance of a fixed place of business solely for the purpose of carrying on, for the trade or business, any other activity of a preparatory or auxiliary character, or

"(VI) the maintenance of a fixed place of business solely for any combination of the activities mentioned in subclauses (I) through (V), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

"(ii) BROKERS AND OTHER INDEPENDENT AGENTS.—A trade or business shall not be considered to have a permanent establishment in a country merely because it carries on business in such country through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business as independent agents.

"(3) TESTED GROUP.—The term 'tested group' includes, with respect to any entity taxed as a corporation in Taiwan, such entity and any other entity taxed as a corporation in Taiwan that—

"(A) participates as a member with such entity in a tax consolidation, fiscal unity, or similar regime that requires members of the group to share profits or losses, or

"(B) shares losses with such entity pursuant to a group relief or other loss sharing regime.

"(4) CONNECTED PERSON.—Two persons shall be 'connected persons' if one owns, directly or indirectly, at least 50 percent of the interests in the other (or, in the case of a corporation, at least 50 percent of the aggregate vote and value of the corporation's shares) or another person owns, directly or indirectly, at least 50 percent of the interests (or, in the case of a corporation, at least 50 percent of the aggregate vote and value of the corporation's shares) in each person. In any case, a person shall be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

"(5) FOREIGN COUNTRY OF CONCERN.—The term 'foreign country of concern' has the meaning given such term under paragraph (7) of section 9901 of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 (15 U.S.C. 4651(7)), as added by section 103(a)(4) of the CHIPS Act of 2022).

"(6) PARTNERSHIPS; BENEFICIARIES OF ESTATES AND TRUSTS.—For purposes of this section—

"(A) a qualified resident of Taiwan which is a partner of a partnership which carries on a trade or business within the United States through a United States permanent establishment shall be treated as carrying on such trade or business through such permanent establishment, and

"(B) a qualified resident of Taiwan which is a beneficiary of an estate or trust which carries on a trade or business within the United States through a United States permanent establishment shall be treated as carrying on such trade or business through such permanent establishment.

"(7) DENIAL OF BENEFITS FOR CERTAIN PAYMENTS THROUGH HYBRID ENTITIES.—For purposes of this section, rules similar to the rules of section 894(c) shall apply.

"(e) APPLICATION.—

"(1) IN GENERAL.—This section shall not apply to any period unless the Secretary has determined that Taiwan has provided benefits to United States persons for such period that are reciprocal to the benefits provided to qualified residents of Taiwan under this section.

"(2) PROVISION OF RECIPROCITY.—The President or his designee is authorized to exchange letters, enter into an agreement, or take other necessary and appropriate steps relative to Taiwan for the reciprocal provision of the benefits described in this section.

"(f) REGULATIONS OR OTHER GUIDANCE.—

"(1) IN GENERAL.—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including such regulations or guidance for—

"(A) determining—

"(i) what constitutes a United States permanent establishment of a qualified resident of Taiwan, and

"(ii) income that is effectively connected with such a permanent establishment,

"(B) preventing the abuse of the provisions of this section by persons who are not (or who should not be treated as) qualified residents of Taiwan,

"(C) requirements for record keeping and reporting,

"(D) rules to assist withholding agents or employers in determining whether a foreign person is a qualified resident of Taiwan for purposes of

determining whether withholding or reporting is required for a payment (and, if withholding is required, whether it should be applied at a reduced rate),

"(E) the application of subsection (a)(1)(D)(i) to stock held by predecessor owners,

"(F) determining what amounts are to be treated as qualified wages for purposes of subsection (a)(2),

"(G) determining the amounts to which subsection (a)(3) applies,

"(H) defining established securities market for purposes of subsection (c),

"(I) the application of the rules of subsection (c)(4)(B),

"(J) the application of subsection (d)(6) and section 1446,

"(K) determining ownership interests held by residents of a foreign country of concern, and

"(L) determining the starting and ending dates for periods with respect to the application of this section under subsection (e), which may be separate dates for taxes withheld at the source and other taxes.

"(2) REGULATIONS TO BE CONSISTENT WITH MODEL TREATY.—Any regulations or other guidance issued under this section shall, to the extent practical, be consistent with the provisions of the United States model income tax convention dated February 7, 2016.".

(b) CONFORMING AMENDMENT TO WITHHOLDING TAX.—Subchapter A of chapter 3 is amended by adding at the end the following new section:

"SEC. 1447. WITHHOLDING FOR QUALIFIED RESIDENTS OF TAIWAN.

"For reduced rates of withholding for certain residents of Taiwan, see section 894A.".

(c) CLERICAL AMENDMENTS.—

(1) The table of sections for subpart D of part II of subchapter N of chapter 1 is amended by inserting after the item relating to section 894 the following new item:

"Sec. 894A. Special rules for qualified residents of Taiwan.".

(2) The table of sections for subchapter A of chapter 3 is amended by adding at the end the following new item:

"Sec. 1447. Withholding for qualified residents of Taiwan.".

Subtitle B—United States-Taiwan Tax Agreement Authorization Act

SEC. 311. SHORT TITLE.

This subtitle may be cited as the "United States-Taiwan Tax Agreement Authorization Act".

SEC. 312. DEFINITIONS.

In this subtitle:

(1) AGREEMENT.—The term "Agreement" means the tax agreement authorized by section 313(a).

(2) APPROPRIATE CONGRESSIONAL COMMITTEES.—The term "appropriate congressional committees" means—

(A) the Committee on Foreign Relations and the Committee on Finance of the Senate; and

(B) the Committee on Ways and Means of the House of Representatives.

(3) APPROVAL LEGISLATION.—The term "approval legislation" means legislation that approves the Agreement.

(4) IMPLEMENTING LEGISLATION.—The term "implementing legislation" means legislation that makes any changes to the Internal Revenue Code of 1986 necessary to implement the Agreement.

SEC. 313. AUTHORIZATION TO NEGOTIATE AND ENTER INTO AGREEMENT.

(a) IN GENERAL.—Subsequent to a determination under section 894A(e)(1) of the Internal Revenue Code of 1986 (as added by the United States-Taiwan Expedited Double-Tax Relief Act), the President is authorized to negotiate and enter into a tax agreement relative to Taiwan.

(b) ELEMENTS OF AGREEMENT.—

(1) CONFORMITY WITH BILATERAL INCOME TAX CONVENTIONS.—The President shall ensure that—

(A) any provisions included in the Agreement conform with provisions customarily contained in United States bilateral income tax conventions, as exemplified by the 2016 United States Model Income Tax Convention; and

(B) the Agreement does not include elements outside the scope of the 2016 United States Model Income Tax Convention.

(2) INCORPORATION OF TAX AGREEMENTS AND LAWS.—Notwithstanding paragraph (1), the Agreement may incorporate and restate provisions of any agreement, or existing United States law, addressing double taxation for residents of the United States and Taiwan.

(3) AUTHORITY.—The Agreement shall include the following statement: "The Agreement is entered into pursuant to the United States-Taiwan Tax Agreement Authorization Act."

(4) ENTRY INTO FORCE.—The Agreement shall include a provision conditioning entry into force upon—

(A) enactment of approval legislation and implementing legislation pursuant to section 317; and

(B) confirmation by the Secretary of the Treasury that the relevant authority in Taiwan has approved and taken appropriate steps required to implement the Agreement.

SEC. 314. CONSULTATIONS WITH CONGRESS.

(a) NOTIFICATION UPON COMMENCEMENT OF NEGOTIATIONS.—The President shall provide written notification to the appropriate congressional committees of the commencement of negotiations between the United States and Taiwan on the Agreement at least 15 calendar days before commencing such negotiations.

(b) CONSULTATIONS DURING NEGOTIATIONS.—

(1) BRIEFINGS.—Not later than 90 days after commencement of negotiations with respect to the Agreement, and every 180 days thereafter until the President enters into the Agreement, the President shall provide a briefing to the appropriate congressional committees on the status of the negotiations, including a description of elements under negotiation.

(2) MEETINGS AND OTHER CONSULTATIONS.—

(A) IN GENERAL.—In the course of negotiations with respect to the Agreement, the Secretary of the Treasury, in coordination with the Secretary of State, shall—

(i) meet, upon request, with the chairman or ranking member of any of the appropriate congressional committees regarding negotiating objectives and the status of negotiations in progress; and

(ii) consult closely and on a timely basis with, and keep fully apprised of the negotiations, the appropriate congressional committees.

(B) ELEMENTS OF CONSULTATIONS.—The consultations described in subparagraph (A) shall include consultations with respect to—

(i) the nature of the contemplated Agreement;

(ii) how and to what extent the contemplated Agreement is consistent with the elements set forth in section 313(b); and

(iii) the implementation of the contemplated Agreement, including—

(I) the general effect of the contemplated Agreement on existing laws;

(II) proposed changes to any existing laws to implement the contemplated Agreement; and

(III) proposed administrative actions to implement the contemplated Agreement.

SEC. 315. APPROVAL AND IMPLEMENTATION OF AGREEMENT.

(a) IN GENERAL.—The Agreement may not enter into force unless—

(1) the President, at least 60 days before the day on which the President enters into the Agreement, publishes the text of the contemplated Agreement on a publicly available website of the Department of the Treasury; and

(2) there is enacted into law, with respect to the Agreement, approval legislation and implementing legislation pursuant to section 317.

(b) ENTRY INTO FORCE.—The President may provide for the Agreement to enter into force upon—

(1) enactment of approval legislation and implementing legislation pursuant to section 317; and

(2) confirmation by the Secretary of the Treasury that the relevant authority in Taiwan has approved and taken appropriate steps required to implement the Agreement.

SEC. 316. SUBMISSION TO CONGRESS OF AGREEMENT AND IMPLEMENTATION POLICY.

(a) SUBMISSION OF AGREEMENT.—Not later than 270 days after the President enters into the Agreement, the President or the President's designee shall submit to Congress—

(1) the final text of the Agreement; and

(2) a technical explanation of the Agreement.

(b) SUBMISSION OF IMPLEMENTATION POLICY.—Not later than 270 days after the President enters into the Agreement, the Secretary of the Treasury shall submit to Congress—

(1) a description of those changes to existing laws that the President considers would be required in order to ensure that the United States acts in a manner consistent with the Agreement; and

(2) a statement of anticipated administrative action proposed to implement the Agreement.

SEC. 317. CONSIDERATION OF APPROVAL LEGISLATION AND IMPLEMENTING LEGISLATION.

(a) IN GENERAL.—The approval legislation with respect to the Agreement shall include the following: "Congress approves the Agreement submitted to Congress pursuant to section 316 of the United States-Taiwan Tax Agreement Authorization Act on _____.", with the blank space being filled with the appropriate date.

(b) APPROVAL LEGISLATION COMMITTEE REFERRAL.—The approval legislation shall—

(1) in the Senate, be referred to the Committee on Foreign Relations; and

(2) in the House of Representaives, be referred to the Committee on Ways and Means.

(c) IMPLEMENTING LEGISLATION COMMITTEE REFERRAL.—The implementing legislation shall—

(1) in the Senate, be referred to the Committee on Finance; and

(2) in the House of Representatives, be referred to the Committee on Ways and Means.

SEC. 318. RELATIONSHIP OF AGREEMENT TO INTERNAL REVENUE CODE OF 1986.

(a) INTERNAL REVENUE CODE OF 1986 TO CONTROL.—No provision of the Agreement or approval legislation, nor the application of any such provision to any person or circumstance, which is inconsistent with any provision of the Internal Revenue Code of 1986, shall have effect.

(b) CONSTRUCTION.—Nothing in this subtitle shall be construed—

(1) to amend or modify any law of the United States; or

(2) to limit any authority conferred under any law of the United States,

unless specifically provided for in this subtitle.

SEC. 319. AUTHORIZATION OF SUBSEQUENT TAX AGREEMENTS RELATIVE TO TAIWAN.

(a) IN GENERAL.—Subsequent to the enactment of approval legislation and implementing legislation pursuant to section 317—

(1) the term "tax agreement" in section 313(a) shall be treated as including any tax agreement relative to Taiwan which supplements or supersedes the Agreement to which such approval legislation and implementing legislation relates, and

(2) the term "Agreement" shall be treated as including such tax agreement.

(b) REQUIREMENTS, ETC., TO APPLY SEPARATELY.—The provisions of this subtitle (including section 314) shall be applied separately with respect to each tax agreement referred to in subsection (a).

SEC. 320. UNITED STATES TREATMENT OF DOUBLE TAXATION MATTERS WITH RESPECT TO TAIWAN.

(a) FINDINGS.—Congress makes the following findings:

(1) The United States addresses issues with respect to double taxation with foreign countries by entering into bilateral income tax conventions (known as tax treaties) with such countries, subject to the advice and consent of the Senate to ratification pursuant to article II of the Constitution.

(2) The United States has entered into more than sixty such tax treaties, which facilitate economic activity, strengthen bilateral cooperation, and benefit United States workers, businesses, and other United States taxpayers.

(3) Due to Taiwan's unique status, the United States is unable to enter into an article II tax treaty with Taiwan, necessitating an agreement to address issues with respect to double taxation.

(b) STATEMENT OF POLICY.—It is the policy of the United States to—

(1) provide for additional bilateral tax relief with respect to Taiwan, beyond that provided for in section 894A of the Internal Revenue Code of 1986 (as added by the United States-Taiwan Expedited Double-Tax Relief Act), only after

entry into force of an Agreement, as provided for in section 315, and only in a manner consistent with such Agreement; and

(2) continue to provide for bilateral tax relief with sovereign states to address double taxation and other related matters through entering into bilateral income tax conventions, subject to the Senate's advice and consent to ratification pursuant to article II of the Constitution.

TITLE IV—ASSISTANCE FOR DISASTER-IMPACTED COMMUNITIES

SEC. 401. SHORT TITLE.

This title may be cited as the "Federal Disaster Tax Relief Act of 2024".

SEC. 402. EXTENSION OF RULES FOR TREATMENT OF CERTAIN DISASTER-RELATED PERSONAL CASUALTY LOSSES.

For purposes of applying section 304(b) of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, section 301 of such Act shall be applied by substituting "the Federal Disaster Tax Relief Act of 2024" for "this Act" each place it appears.

SEC. 403. EXCLUSION FROM GROSS INCOME FOR COMPENSATION FOR LOSSES OR DAMAGES RESULTING FROM CERTAIN WILDFIRES.

(a) IN GENERAL.—For purposes of the Internal Revenue Code of 1986, gross income shall not include any amount received by an individual as a qualified wildfire relief payment.

(b) QUALIFIED WILDFIRE RELIEF PAYMENT.—For purposes of this section—

(1) IN GENERAL.—The term "qualified wildfire relief payment" means any amount received by or on behalf of an individual as compensation for losses, expenses, or damages (including compensation for additional living expenses, lost wages (other than compensation for lost wages paid by the employer which would have otherwise paid such wages), personal injury, death, or emotional distress) incurred as a result of a qualified wildfire disaster, but only to the extent the losses, expenses, or damages compensated by such payment are not compensated for by insurance or otherwise.

(2) QUALIFIED WILDFIRE DISASTER.—The term "qualified wildfire disaster" means any federally declared disaster (as defined in section 165(i)(5)(A) of the Internal Revenue Code of 1986) declared, after December 31, 2014, as a result of any forest or range fire.

(c) DENIAL OF DOUBLE BENEFIT.—Notwithstanding any other provision of the Internal Revenue Code of 1986—

(1) no deduction or credit shall be allowed (to the person for whose benefit a qualified wildfire relief payment is made) for, or by reason of, any expenditure to the extent of the amount excluded under this section with respect to such expenditure, and

(2) no increase in the basis or adjusted basis of any property shall result from any amount excluded under this subsection with respect to such property.

(d) LIMITATION ON APPLICATION.—This section shall only apply to qualified wildfire relief payments received by the individual during taxable years beginning after December 31, 2019, and before January 1, 2026.

SEC. 404. EAST PALESTINE DISASTER RELIEF PAYMENTS.

(a) DISASTER RELIEF PAYMENTS TO VICTIMS OF EAST PALESTINE TRAIN DERAILMENT.—East Palestine train derailment payments shall be treated as qualified disaster relief payments for purposes of section 139(b) of the Internal Revenue Code of 1986.

(b) EAST PALESTINE TRAIN DERAILMENT PAYMENTS.—For purposes of this section, the term "East Palestine train derailment payment" means any amount received by or on behalf of an individual as compensation for loss, damages, expenses, loss in real property value, closing costs with respect to real property (including realtor commissions), or inconvenience (including access to real property) resulting from the East Palestine train derailment if such amount was provided by—

(1) a Federal, State, or local government agency,

(2) Norfolk Southern Railway, or

(3) any subsidiary, insurer, or agent of Norfolk Southern Railway or any related person.

(c) TRAIN DERAILMENT.—For purposes of this section, the term "East Palestine train derailment" means the derailment of a train in East Palestine, Ohio, on February 3, 2023.

(d) EFFECTIVE DATE.—This section shall apply to amounts received on or after February 3, 2023.

TITLE V—MORE AFFORDABLE HOUSING

SEC. 501. STATE HOUSING CREDIT CEILING INCREASE FOR LOW-INCOME HOUSING CREDIT.

(a) IN GENERAL.—Section 42(h)(3)(I) is amended—

(1) by striking "and 2021," and inserting "2021, 2023, 2024, and 2025,", and

(2) by striking "2018, 2019, 2020, AND 2021" in the heading and inserting "CERTAIN CALENDAR YEARS".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years after 2022.

SEC. 502. TAX-EXEMPT BOND FINANCING REQUIREMENT.

(a) IN GENERAL.—Section 42(h)(4) is amended by striking subparagraph (B) and inserting the following:

"(B) SPECIAL RULE WHERE MINIMUM PERCENT OF BUILDINGS IS FINANCED WITH TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP.—For purposes of subparagraph (A), paragraph (1) shall not apply to any portion of the credit allowable under subsection (a) with respect to a building if—

"(i) 50 percent or more of the aggregate basis of such building and the land on which the building is located is financed by 1 or more obligations described in subparagraph (A), or

"(ii)(I) 30 percent or more of the aggregate basis of such building and the land on which the building is located is financed by 1 or more qualified obligations, and

"(II) 1 or more of such qualified obligations—

"(aa) are part of an issue the issue date of which is after December 31, 2023, and

"(bb) provide the financing for not less than 5 percent of the aggregate basis of such building and the land on which the building is located.

"(C) QUALIFIED OBLIGATION.—For purposes of subparagraph (B)(ii), the term 'qualified obligation' means an obligation which is described in subparagraph (A) and which is part of an issue the issue date of which is before January 1, 2026.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to buildings placed in service in taxable years beginning after December 31, 2023.

(2) REHABILITATION EXPENDITURES TREATED AS SEPARATE NEW BUILDING.—In the case of any building with respect to which any expenditures are treated as a separate new building under section 42(e) of the Internal Revenue Code of 1986, for purposes of paragraph (1), both the existing building and the separate new building shall be treated as having been placed in service on the date such expenditures are treated as placed in service under section 42(e)(4) of such Code.

TITLE VI—TAX ADMINISTRATION AND ELIMINATING FRAUD

SEC. 601. INCREASE IN THRESHOLD FOR REQUIRING INFORMATION REPORTING WITH RESPECT TO CERTAIN PAYEES.

(a) IN GENERAL.—Sections 6041(a) is amended by striking "$600" and inserting "$1,000".

(b) INFLATION ADJUSTMENT.—Section 6041 is amended by adding at the end the following new subsection:

"(h) INFLATION ADJUSTMENT.—In the case of any calendar year after 2024, the dollar amount in subsection (a) shall be increased by an amount equal to—

"(1) such dollar amount, multiplied by

"(2) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting 'calendar year 2023' for 'calendar year 2016' in subparagraph (A)(ii) thereof.

If any increase under the preceding sentence is not a multiple of $100, such increase shall be rounded to the nearest multiple of $100.".

(c) APPLICATION TO REPORTING ON REMUNERATION FOR SERVICES AND DIRECT SALES.—Section 6041A is amended—

(1) in subsection (a)(2), by striking "is $600 or more" and inserting "equals or exceeds the dollar amount in effect for such calendar year under section 6041(a)", and

(2) in subsection (b)(1)(B), by striking "is $5,000 or more" and inserting "equals or exceeds the dollar amount in effect for such calendar year under section 6041(a)".

(d) APPLICATION TO BACKUP WITHHOLDING.—Section 3406(b)(6) is amended—

(1) by striking "$600" in subparagraph (A) and inserting "the dollar amount in effect for such calendar year under section 6041(a)", and

(2) by striking "ONLY WHERE AGGREGATE FOR CALENDAR YEAR IS $600 OR MORE" in the heading and inserting "ONLY IF IN EXCESS OF THRESHOLD".

(e) CONFORMING AMENDMENTS.—

(1) The heading of section 6041(a) is amended by striking "OF $600 OR MORE" and inserting "EXCEEDING THRESHOLD".

(2) Section 6041(a) is amended by striking "taxable year" and inserting "calendar year".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to payments made after December 31, 2023.

SEC. 602. ENFORCEMENT PROVISIONS WITH RESPECT TO COVID-RELATED EMPLOYEE RETENTION CREDITS.

(a) INCREASE IN ASSESSABLE PENALTY ON COVID–ERTC PROMOTERS FOR AIDING AND ABETTING UNDERSTATEMENTS OF TAX LIABILITY.—

(1) IN GENERAL.—If any COVID–ERTC promoter is subject to penalty under section 6701(a) of the Internal Revenue Code of 1986 with respect to any COVID–ERTC document, notwithstanding paragraphs (1) and (2) of section 6701(b) of such Code, the amount of the penalty imposed under such section 6701(a) shall be the greater of—

(A) $200,000 ($10,000, in the case of a natural person), or

(B) 75 percent of the gross income derived (or to be derived) by such promoter with respect to the aid, assistance, or advice referred to in section 6701(a)(1) of such Code with respect to such document.

(2) NO INFERENCE.—Paragraph (1) shall not be construed to create any inference with respect to the proper application of the knowledge requirement of section 6701(a)(3) of the Internal Revenue Code of 1986.

(b) FAILURE TO COMPLY WITH DUE DILIGENCE REQUIREMENTS TREATED AS KNOWLEDGE FOR PURPOSES OF ASSESSABLE PENALTY FOR AIDING AND ABETTING UNDERSTATEMENT OF TAX LIABILITY.—In the case of any COVID–ERTC promoter, the knowledge requirement of section 6701(a)(3) of the Internal Revenue Code of 1986 shall be treated as satisfied with respect to any COVID–ERTC document with respect to which such promoter provided aid, assistance, or advice, if such promoter fails to comply with the due diligence requirements referred to in subsection (c)(1).

(c) ASSESSABLE PENALTY FOR FAILURE TO COMPLY WITH DUE DILIGENCE REQUIREMENTS.—

(1) IN GENERAL.—Any COVID–ERTC promoter which provides aid, assistance, or advice with respect to any COVID–ERTC document and which fails to comply with due diligence requirements imposed by the Secretary with respect to determining eligibility for, or the amount of, any COVID-related employee retention tax credit, shall pay a penalty of $1,000 for each such failure.

(2) DUE DILIGENCE REQUIREMENTS.—Except as otherwise provided by the Secretary, the due diligence requirements referred to in paragraph (1) shall be similar to the due diligence requirements imposed under section 6695(g).

(3) RESTRICTION TO DOCUMENTS USED IN CONNECTION WITH RETURNS OR CLAIMS FOR REFUND.—Paragraph (1) shall not apply with respect to any COVID–ERTC document unless such document constitutes, or relates to, a return or claim for refund.

(4) TREATMENT AS ASSESSABLE PENALTY, ETC.—For purposes of the Internal Revenue Code of 1986, the penalty imposed under paragraph (1) shall be treated in the same manner as a penalty imposed under section 6695(g).

(5) SECRETARY.—For purposes of this subsection, the term "Secretary" means the Secretary of the Treasury or the Secretary's delegate.

(d) ASSESSABLE PENALTIES FOR FAILURE TO DISCLOSE INFORMATION, MAINTAIN CLIENT LISTS, ETC.—For purposes of sections 6111, 6112, 6707 and 6708 of the Internal Revenue Code of 1986—

(1) any COVID-related employee retention tax credit (whether or not the taxpayer claims such COVID-related employee retention tax credit) shall be treated as a listed transaction (and as a reportable transaction) with respect to any COVID–ERTC promoter if such promoter provides any aid, assistance, or advice with respect to any COVID–ERTC document relating to such COVID-related employee retention tax credit, and

(2) such COVID–ERTC promoter shall be treated as a material advisor with respect to such transaction.

(e) COVID–ERTC PROMOTER.—For purposes of this section—

(1) IN GENERAL.—The term "COVID–ERTC promoter" means, with respect to any COVID–ERTC document, any person which provides aid, assistance, or advice with respect to such document if—

(A) such person charges or receives a fee for such aid, assistance, or advice which is based on the amount of the refund or credit with respect to such document and, with respect to such person's taxable year in which such person provided such assistance or the preceding taxable year, the aggregate gross receipts of such person for aid, assistance, and advice with respect to all COVID-ERTC documents exceeds 20 percent of the gross receipts of such person for such taxable year, or

(B) with respect to such person's taxable year in which such person provided such assistance or the preceding taxable year—

(i) the aggregate gross receipts of such person for aid, assistance, and advice with respect to all COVID–ERTC documents exceeds 50 percent of the gross receipts of such person for such taxable year, or

(ii) both—

(I) such aggregate gross receipts exceeds 20 percent of the gross receipts of such person for such taxable year, and

(II) the aggregate gross receipts of such person for aid, assistance, and advice with respect to all COVID–ERTC documents (determined after application of paragraph (3)) exceeds $500,000.

(2) EXCEPTION FOR CERTIFIED PROFESSIONAL EMPLOYER ORGANIZATIONS.—The term "COVID–ERTC promoter" shall not include a certified professional employer organization (as defined in section 7705).

(3) AGGREGATION RULE.—For purposes of paragraph (1)(B)(ii)(II), all persons treated as a single employer under subsection (a) or (b) of section 52 of the Internal Revenue Code of 1986, or subsection (m) or (o) of section 414 of such Code, shall be treated as 1 person.

(4) SHORT TAXABLE YEARS.—In the case of any taxable year of less than 12 months, paragraph (1) shall be applied with respect to the calendar year in which such taxable year begins (in addition to applying to such taxable year).

(f) COVID–ERTC DOCUMENT.—For purposes of this section, the term "COVID–ERTC document" means any return, affidavit, claim, or other document related to any COVID-related employee retention tax credit, including any document related to eligibility for, or the calculation or determination of any amount directly related to any COVID-related employee retention tax credit.

(g) COVID-RELATED EMPLOYEE RETENTION TAX CREDIT.—For purposes of this section, the term "COVID-related employee retention tax credit" means—

(1) any credit, or advance payment, under section 3134 of the Internal Revenue Code of 1986, and

(2) any credit, or advance payment, under section 2301 of the CARES Act.

(h) LIMITATION ON CREDIT AND REFUND OF COVID-RELATED EMPLOYEE RETENTION TAX CREDITS.—Notwithstanding section 6511 of the Internal Revenue Code of 1986 or any other provision of law, no credit or refund of any COVID-related employee retention tax credit shall be allowed or made after January 31, 2024, unless a claim for such credit or refund is filed by the taxpayer on or before such date.

(i) AMENDMENTS TO EXTEND LIMITATION ON ASSESSMENT.—

(1) IN GENERAL.—Section 3134(l) of the Internal Revenue Code of 1986 is amended to read as follows:

"(l) EXTENSION OF LIMITATION ON ASSESSMENT.—

"(1) IN GENERAL.—Notwithstanding section 6501, the limitation on the time period for the assessment of any amount attributable to a credit claimed under this section shall not expire before the date that is 6 years after the latest of—

"(A) the date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed,

"(B) the date on which such return is treated as filed under section 6501(b)(2), or

"(C) the date on which the claim for credit or refund with respect to such credit is made.

"(2) DEDUCTION FOR WAGES TAKEN INTO ACCOUNT IN DETERMINING IMPROPERLY CLAIMED CREDIT.—

"(A) IN GENERAL.—Notwithstanding section 6511, in the case of an assessment attributable to a credit claimed under this section, the limitation on the time period for credit or refund of any amount attributable to a deduction for improperly claimed ERTC wages shall not expire before the time period for such assessment expires under paragraph (1).

"(B) IMPROPERLY CLAIMED ERTC WAGES.—For purposes of this paragraph, the term 'improperly claimed ERTC wages' means, with respect to an assessment attributable to a credit claimed under this section, the wages with respect to which a deduction would not have been allowed if the portion of the credit to which such assessment relates had been properly claimed.".

(2) APPLICATION TO CARES ACT CREDIT.—Section 2301 of the CARES Act is amended by adding at the end the following new subsection:

"(o) EXTENSION OF LIMITATION ON ASSESSMENT.—

"(1) IN GENERAL.—Notwithstanding section 6501 of the Internal Revenue Code of 1986, the limitation on the time period for the assessment of any amount attributable to a credit claimed under this section shall not expire before the date that is 6 years after the latest of—

"(A) the date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed,

"(B) the date on which such return is treated as filed under section 6501(b)(2) of such Code, or

"(C) the date on which the claim for credit or refund with respect to such credit is made.

"(2) DEDUCTION FOR WAGES TAKEN INTO ACCOUNT IN DETERMINING IMPROPERLY CLAIMED CREDIT.—

"(A) IN GENERAL.—Notwithstanding section 6511 of such Code, in the case of an assessment attributable to a credit claimed under this section, the limitation on the time period for credit or refund of any amount attributable to a deduction for improperly claimed ERTC wages shall not expire before the time period for such assessment expires under paragraph (1).

"(B) IMPROPERLY CLAIMED ERTC WAGES.—For purposes of this paragraph, the term 'improperly claimed ERTC wages' means, with respect to an assessment attributable to a credit claimed under this section, the wages with respect to which a deduction would not have been allowed if the portion of the credit to which such assessment relates had been properly claimed.".

(j) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the provisions of this section shall apply to aid, assistance, and advice provided after March 12, 2020.

(2) DUE DILIGENCE REQUIREMENTS.—Subsections (b) and (c) shall apply to aid, assistance, and advice provided after the date of the enactment of this Act.

(3) LIMITATION ON CREDIT AND REFUND OF COVID-RELATED EMPLOYEE RETENTION TAX CREDITS.—Subsection (h) shall apply to credits and refunds allowed or made after January 31, 2024.

(4) AMENDMENTS TO EXTEND LIMITATION ON ASSESSMENT.—The amendments made by subsection (i) shall apply to assessments made after the date of the enactment of this Act.

(k) TRANSITION RULE WITH RESPECT TO REQUIREMENTS TO DISCLOSE INFORMATION, MAINTAIN CLIENT LISTS, ETC.—Any return under section 6111 of the Internal Revenue Code of 1986, or list under section 6112 of such Code, required by reason of subsection (d) of this section to be filed or maintained, respectively, with respect to any aid, assistance, or advice provided by a COVID–ERTC promoter with respect to a COVID–ERTC document before the date of the enactment of this Act, shall not be required to be so filed or maintained (with respect to such aid, assistance or advice) before the date which is 90 days after such date.

(l) PROVISIONS NOT TO BE CONSTRUED TO CREATE NEGATIVE INFERENCES.—

(1) NO INFERENCE WITH RESPECT TO APPLICATION OF KNOWLEDGE REQUIREMENT TO PRE-ENACTMENT CONDUCT OF COVID-ERTC PROMOTERS, ETC.—Subsection (b) shall not be construed to create any inference with respect to the proper application of section 6701(a)(3) of the Internal Revenue Code of 1986 with respect to any aid, assistance, or advice provided by any COVID-ERTC promoter on or before the date of the enactment of this Act (or with respect to any other aid, assistance, or advice to which such subsection does not apply).

(2) REQUIREMENTS TO DISCLOSE INFORMATION, MAINTAIN CLIENT LISTS, ETC.—Subsections (d) and (k) shall not be construed to create any inference with respect to whether any COVID-related employee retention tax credit is (without regard to subsection (d)) a listed transaction (or reportable transaction) with respect to any COVID–ERTC promoter; and, for purposes of subsection (j), a return or list shall not be treated as required (with respect to such aid, assistance, or advice) by reason of subsection (d) if such return or list would be so required without regard to subsection (d).

(m) REGULATIONS.—The Secretary (as defined in subsection (c)(5)) shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section (and the amendments made by this section).

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

The bill, H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024," as ordered reported by the Committee on Ways and Means on January 19, 2024.

The Tax Relief for American Families and Workers Act of 2024 provides tax relief for working families, promotes American innovation and growth, increases global competitiveness, provides assistance for disaster-impacted communities, encourages more affordable housing, enhances tax administration, and eliminates fraud.

TAX RELIEF FOR WORKING FAMILIES

Calculation of Refundable Credit on a Per-Child Basis.—Under current law, the maximum refundable child tax credit for a taxpayer is computed by multiplying that taxpayer's earned income (in excess of $2,500) by 15 percent. This provision modifies the calculation of the maximum refundable credit amount by providing that taxpayers first multiply their earned income (in excess of $2,500) by 15 percent, and then multiply that amount by the number of qualifying children. This policy would be effective for tax years 2023, 2024, and 2025.

Modification in Overall Limit on Refundable Child Tax Credit.—Under current law, the maximum refundable child tax credit is limited to $1,600 per child for 2023, even if the earned income limitation described above is in excess of this amount. This provision increases the maximum refundable amount per child to $1,800 in tax year 2023, $1,900 in tax year 2024, and $2,000 in tax year 2025, along with the inflation adjustment described below.

Adjustment of Child Tax Credit for Inflation.—This provision would adjust the $2,000 value of the child tax credit for inflation in tax years 2024 and 2025, rounded down to the nearest $100.

Rule for Determination of Earned Income.—For tax years 2024 and 2025, taxpayers may, at their election, use their earned income from the prior taxable year in calculating their maximum child tax credit if the taxpayer's earned income in the current taxable year was less than the taxpayer's earned income in the prior taxable year.

Special Rule for Certain Early-Filed 2023 Returns.—This provision ensures that taxpayers filing their 2023 tax returns at the beginning of the 2024 tax filing season receive the correct child tax credit amount given the per-child and refundable amount changes made in this title. Additionally, to the extent that a taxpayer is eligible for an increased credit, the IRS is to execute such payment expeditiously.

AMERICAN INNOVATION AND GROWTH

Deduction for Research and Experimental Expenditures.—Current law provides that research or experimental costs paid or incurred in tax years beginning after December 31, 2021, are required to be deducted over a five-year period. Research or experimental costs that are attributable to research that is conducted outside of the United States are required to be deducted over a 15-year period.

The provision delays the date when taxpayers must begin deducting their domestic research or experimental costs over a five-year period until taxable years beginning after December 31, 2025. Therefore, taxpayers may deduct currently domestic research or experimental costs that are paid or incurred in tax years beginning after December 31, 2021, and before January 1, 2026.

Extension of Allowance for Depreciation, Amortization, or Depletion in Determining the Limitation on Business Interest.—For tax years beginning before January 1, 2022, the computation of adjusted taxable income (ATI) for purposes of the limitation on the deduction for business interest is determined without regard to any deduction allowable for depreciation, amortization, or depletion (i.e., earnings before interest, taxes, depreciation, and amortization (EBITDA)).

The provision extends the application of EBITDA to taxable years beginning after December 31, 2023 (and, if elected, for taxable years beginning after December 31, 2021), and before January 1, 2026. Therefore, for taxable years beginning after December 31, 2021, and before January 1, 2024, ATI is computed with regard to deductions allowable for depreciation, amortization, or depletion (i.e., earnings before interest and taxes (EBIT)). However, ATI may be computed as EBITDA, if elected, for such taxable years. For taxable years beginning after December 31, 2023, and before January 1, 2026, ATI is computed as EBITDA. For taxable years beginning after December 31, 2025, ATI is computed as EBIT.

Extension of 100 Percent Bonus Depreciation.—Qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as specified plants planted or grafted after September 27, 2017, and before January 1, 2023, are eligible for 100-percent bonus depreciation. The 100-percent allowance is phased down by 20 percent per calendar year for qualified property acquired after September 27, 2017, and placed in service after December 31, 2022 (after December 31, 2023, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after December 31, 2022.

The provision extends 100-percent bonus depreciation for qualified property placed in service after December 31, 2022, and before January 1, 2026 (January 1, 2027, for longer production period property and certain aircraft) and for specified plants planted or grafted after December 31, 2022, and before January 1, 2026. The provision retains 20-percent bonus depreciation for property placed in service after December 31, 2025, and before January 1, 2027 (after December 31, 2026, and before January 1, 2028, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after December 31, 2025, and before January 1, 2027.

Increase in Limitations on Expensing of Depreciable Business Assets.—Under Internal Revenue Code ("IRC") section 179, a taxpayer may elect to expense the cost of qualifying property, rather than to recover such costs through tax depreciation deductions, subject to limitation. Under current law, the maximum amount a taxpayer may expense is $1 million of the cost of qualifying property placed in service for the taxable year. The $1 million amount is reduced by the amount by which the cost of such property placed

in service during the taxable year exceeds $2.5 million. The $1 million and $2.5 million amounts are adjusted for inflation for taxable years beginning after 2018, and were $1.16 million and $2.89 million in 2023, respectively. In general, qualifying property is defined as depreciable tangible personal property, off-the shelf computer software, and qualified real property that is purchased for use in the active conduct of a trade or business.

The provision increases the maximum amount a taxpayer may expense to $1.29 million, reduced by the amount by which the cost of qualifying property exceeds $3.22 million. The $1.29 million and $3.22 million amounts are adjusted for inflation for taxable years beginning after 2024. The proposal applies to property placed in service in taxable years beginning after December 31, 2023.

INCREASING GLOBAL COMPETITIVENESS

Subtitle A—United States-Taiwan Expedited Double-Tax Relief Act

This subtitle provides targeted and expedited relief from double taxation on U.S.-Taiwan cross border investment through changes to the U.S. tax code.

Special Rules for Taxation of Certain Residents of Taiwan.—This section creates new section 894A of the IRC, providing substantial benefits to Taiwan residents ("qualified residents of Taiwan"), similar to those that are provided in the 2016 United States Model Income Tax Convention ("U.S. Model Tax Treaty"). The provisions fall into four primary categories:

1. Reduction of withholding taxes;
2. Application of permanent establishment ("PE") rules;
3. Treatment of income from employment; and
4. Determination of qualified residents of Taiwan, including rules for dual residents.

Since the application of these provisions requires full reciprocal benefits, the new tax code section does not come into effect until Taiwan provides the same set of benefits to U.S. persons with income subject to tax in Taiwan, similar to the reciprocal operation of a tax treaty.

Reduction of withholding taxes

A reduced rate of withholding tax would apply to certain income from U.S. sources received by qualified residents of Taiwan, such as interest, dividends, royalties, and certain other comparable payments, such as dividend equivalent amounts.

Instead of the 30 percent withholding tax presently imposed on U.S. source income received by nonresident aliens and foreign corporations, interest and royalties would be subject to a 10 percent withholding tax rate. Generally, dividends would be subject to a 15 percent withholding tax rate. Dividends would be subject to a lower 10 percent rate if paid to a recipient that owns at least ten percent of the shares of stock in the corporation, subject to limitations.

Lower withholding tax rates would not apply to certain amounts, such as those subject to the Foreign Investment in Real Property Tax Act ("FIRPTA"), received from or paid by an inverted company, and others.

Application of permanent establishment ("PE") rules

The threshold of whether a qualified resident of Taiwan's income from a U.S. trade or business is subject to U.S. income tax would be raised to the PE standard in treaties, rather than the U.S. trade or business standard applied in the IRC. If a qualified resident of Taiwan has a PE in the United States, income which is subject to U.S. income tax would be only the qualified resident of Taiwan's taxable income effectively connected to the United States PE.

Treatment of income from employment

No U.S. tax would be imposed on certain wages of qualified residents of Taiwan in connection with personal services performed in the U.S. Such wages cannot be paid by a U.S. person or borne by a U.S. PE of a foreign person. This treatment does not apply to certain types of wages, such as directors' fees, pensions, and other wages that are generally taxable under the U.S. Model Tax Treaty.

Determination of qualified residents of Taiwan, including rules for dual residents

A "qualified resident of Taiwan" generally is any person who is liable for tax to Taiwan because of such person's domicile, residence, place of management, place of incorporation, or any similar criterion, and is not a U.S. person. Additional rules are provided to determine whether certain dual resident individuals are treated as qualified residents of Taiwan. For corporations, a qualified resident of Taiwan must also meet one of the limitation on benefits tests to be a beneficiary of the provision.

Application and regulatory authority

The tax benefits provided to qualified residents of Taiwan only apply once the U.S. has determined that Taiwan has granted reciprocal benefits to U.S. persons. Specific regulatory authority is provided for a number of policies, and any regulations or other guidance should be consistent with the provisions of the U.S. Model Tax Treaty.

Subtitle B—United States-Taiwan Tax Agreement Authorization Act

Because the U.S. is unable to enter into a bilateral tax treaty with Taiwan due to Taiwan's unique status, subtitle B provides authorization to the President to negotiate and enter into a U.S.-Taiwan tax agreement that includes provisions generally conforming with those customarily contained in U.S. tax treaties.

Definitions.—This section provides definitions for terms used in subtitle B, including the terms "Agreement," "appropriate congressional committees," "approval legislation," and "implementing legislation."

Authorization to Negotiate and Enter Into Agreement.—This section states that the President is authorized to negotiate and enter into a U.S.-Taiwan tax agreement only after the U.S. tax code provisions described in subtitle A are enacted and effective. The tax agreement should include only provisions customarily contained in U.S. tax treaties. In addition, the tax agreement may incorporate and restate provisions of any agreement or existing law addressing double taxation for residents of the U.S. and Taiwan. Finally, the tax agreement should include a statement of authority and a provi-

sion conditioning the entry into force of the tax agreement upon (i) enactment of approval and implementing legislation and (ii) confirmation by the Treasury Secretary that Taiwan has approved and taken appropriate steps required to implement the tax agreement.

Consultations with Congress.—This section stipulates that the President provide written notification to the appropriate congressional committees at least 15 days before commencement of negotiations on a U.S.-Taiwan tax agreement. In addition, the section includes rules providing that these committees be regularly briefed by the President on the status of negotiations and that the Treasury Secretary, in coordination with the Secretary of State, meet and consult with these committees throughout the negotiations. Finally, the section provides rules regarding the elements of those consultations.

Approval and Implementation of Agreement.—This section states that a tax agreement does not enter into force unless (i) the President, at least 60 days before the tax agreement is entered into, publishes the text of the contemplated tax agreement on a publicly available website of the Treasury Department, and (ii) approval and implementing legislation with respect to the tax agreement is enacted into law. Further, this section provides that the President may provide for the tax agreement to enter into force upon (i) enactment of approval and implementing legislation, and (ii) confirmation by the Treasury Secretary that Taiwan has approved and taken appropriate steps required to implement the tax agreement.

Submission to Congress of Agreement and Implementation Policy.—This section stipulates that not later than 270 days after the President enters into the tax agreement, (i) the President or the President's designee should submit to Congress the final text and a technical explanation of the tax agreement, and (ii) the Treasury Secretary should submit to Congress a description of changes to existing laws that the President considers would be necessary to ensure the U.S. acts in a manner consistent with the tax agreement and a statement of anticipated administrative action proposed to implement the tax agreement.

Consideration of Approval Legislation and Implementing Legislation.—This section provides language that should be included in approval legislation and indicates the congressional committees to whom the approval and implementing legislation would be referred. Approval legislation would be referred to the Senate Foreign Relations Committee and House Ways & Means Committee, and implementing legislation would be referred to the Senate Finance Committee and House Ways & Means Committee.

Relationship of Agreement to Internal Revenue Code of 1986.—This section states that no provision of a tax agreement or approval legislation which is inconsistent with any provision of the IRC shall have effect. Further, this section provides that nothing in subtitle B should be construed to amend or modify any U.S. law or limit any authority conferred under any U.S. law unless specifically provided for in subtitle B.

Authorization of Subsequent Tax Agreements Relative to Taiwan.—This section modifies the treatment of the terms "Agreement" and "tax agreement" so that, subsequent to the enactment of approval and implementing legislation, the tax agreement authorization framework provided in subtitle B may be utilized for a

future U.S.-Taiwan tax agreement(s) that supplements or supersedes a previous tax agreement(s). The section also provides that the provisions of subtitle B, including the congressional consultation requirements in section 204, should be applied separately with respect to each tax agreement.

United States Treatment of Double Taxation Matters With Respect to Taiwan.—This section provides congressional findings and a statement of policy regarding double taxation matters with respect to Taiwan.

ASSISTANCE FOR DISASTER-IMPACTED COMMUNITIES

Extension of Rules for Treatment of Certain Disaster-Related Personal Casualty Losses.—The Taxpayer Certainty and Disaster Tax Relief Act of 2020 provided tax relief to certain individuals in qualified disaster areas. The relief included special rules for qualified disaster-related personal casualty losses, including eliminating the requirement that casualty losses must exceed 10 percent of adjusted gross income (AGI) to qualify for the deduction, requiring losses to exceed $500 per casualty in order to be deductible, and allowing taxpayers to claim the casualty loss deduction "above the line," i.e., without itemizing their deductions.

This section extends the rules for the treatment of certain disaster-related personal casualty losses as passed in the Taxpayer Certainty and Disaster Tax Relief Act of 2020, including any area with respect to which a major disaster was declared by the President during the period beginning on January 1, 2020, and ending 60 days after the date of enactment of the proposal if the incident period of the disaster (as specified by the Federal Emergency Management Agency as the period during which the disaster occurred) begins on or after December 28, 2019, and on or before the date of enactment of the proposal.

Exclusion From Gross Income for Compensation for Losses or Damages Resulting From Certain Wildfires.—In general, gross income is defined as income from whatever source derived. This section excludes from gross income any amount received by or on behalf of an individual as a qualified wildfire relief payment. It defines "qualified wildfire relief payment" as any amount received by or on behalf of an individual for expenses, damages, or losses incurred as a result of a qualified wildfire disaster, but only to the extent any expense, damage, or loss is not compensated for by insurance or otherwise. This section also includes provisions to deny double benefits.

This section applies only to qualified wildfire relief payments received by an individual during taxable years beginning after December 31, 2019, and before January 1, 2026.

East Palestine Disaster Relief Payments.—In general, gross income is defined as income from whatever source derived. This section treats East Palestine train derailment payments as qualified disaster relief payments as defined in IRC section 139(b). Thus, these payments are excluded from gross income and are subject to other present-law provisions applicable to qualified disaster relief payments.

East Palestine train derailment payments are any amount received by or on behalf of an individual as compensation for loss, damages, expenses, loss in real property value, closing costs with

respect to real property, or inconvenience resulting from the East Palestine train derailment paid by a Federal, State, or local government agency, Norfolk Southern Railway, or any subsidiary, insurer, or agent of Norfolk Southern Railway or any related person. "East Palestine train derailment" is defined as the derailment of a train in East Palestine, Ohio, on February 3, 2023. This section applies to amounts received on or after February 3, 2023.

MORE AFFORDABLE HOUSING

State Housing Credit Ceiling Increase for Low-Income Housing Credit.—In calendar years 2018 through 2021, the 9 percent LIHTC ceiling was increased by 12.5 percent, allowing states to allocate more credits for affordable housing projects. This provision restores the 12.5 percent increase for calendar years 2023 through 2025 and is effective for taxable years beginning after December 31, 2022.

Tax-Exempt Bond Financing Requirement.—Under current law, to receive LIHTC a building must either receive a credit allocation from the state housing finance authority or be bond-financed. To be bond-financed, 50 percent or more of the aggregate basis of the building and land must be financed with bonds that are subject to a state's private activity bond volume cap. This provision lowers the bond-financing threshold to 30 percent for projects financed by bonds with an issue date before 2026. This section provides a transition rule for buildings that already have bonds issued by requiring that a building must have 5 percent or more of its aggregate basis financed by bonds with an issue date in 2024 or 2025.

This provision is effective for buildings placed in service after December 31, 2023. In the case of rehabilitation expenditures, which are treated as a separate new building by the IRS, the building is considered placed in service at the end of the rehabilitation expenditures period. The 30 percent requirement is applied to the aggregate basis of both the existing building and the rehabilitation expenditures.

TAX ADMINISTRATION AND ELIMINATING FRAUD

Increase in Threshold for Information Reporting on Forms 1099–NEC and 1099–MISC.—Under current law, the reporting threshold for payments by a business for services performed by an independent contractor or subcontractor and for certain other payments is generally $600. This section generally increases the threshold to $1,000 and adjusts it for inflation after 2024. Under current law, the reporting threshold is, in some cases, based on payments during the taxable year. The new threshold is based on payments during the calendar year. This section applies to payments made after December 31, 2023.

Enforcement Provisions with Respect to COVID Related Employee Retention Tax Credit (ERTC).—Under current law, a $1,000 penalty may apply to a person who knows or has reason to know that an understatement of tax or excessive credit would result from the use of the person's aid, assistance, or advice and knows that the advice "could not be supported on any reasonable basis under the law." Nevertheless tax preparers are not subject to the penalty merely for suggesting "an aggressive but supportable filing position" that is later rejected by the courts. This section increases the

penalty for aiding and abetting the understatement of a tax liability by a COVID–ERTC promoter, separately defined, to the greater of $200,000 for a business promoter ($10,000 for an individual) or 75 percent of the gross income of the ERTC promoter derived (or to be derived) from providing aid, assistance, or advice with respect to a return or claim for ERTC refund or a document relating to the return or claim. The bill makes clear that the pre-enactment standard for applying the aiding & abetting penalty remains unchanged despite the targeted increase in the amount of the penalty that applies solely to ERTC promoters.

Under current law, a paid tax return preparer may be subject to a $500 penalty for each failure to comply with due diligence requirements relating to the filing status and amount of certain credits with respect to a taxpayer's return or claim for refund. This section requires a COVID–ERTC promoter to comply with similar due diligence requirements with respect to a taxpayer's eligibility for (or the amount of) an ERTC and applies a $1,000 penalty for each failure to comply. If the COVID–ERTC promoter does not comply with the due diligence requirements, the promoter is also treated as knowing that his aid, assistance, or advice, would (if used) result in an understatement of tax liability by another person, for purposes of imposing the penalty for aiding and abetting the understatement of tax liability.

Under current law, certain material advisors are required to disclose information to the IRS with respect to designated types of transactions (known as "listed transactions") and to make lists of advice recipients with respect to such transactions available to the IRS upon request. Under this section, a COVID–ERTC promoter is similarly required to file return disclosures and provide lists of clients to the IRS upon request.

This section defines a COVID–ERTC promoter as any person who provides aid, assistance, or advice with respect to an affidavit, refund, claim, or other document relating to an ERTC, if the person charges fees for ERTC-related aid, assistance, or advice based on the amount of the credit (contingency fees) and gross receipts from such advice exceed 20% of the person's total gross receipts or meets a separate gross-receipts test. The separate gross receipts test is met if (1) gross receipts from ERTC-related aid, assistance, or advice regardless of the manner in which fees are charged equal or exceed 50% of the person's gross receipts for the relevant year, or (2) both (i) the gross receipts for the relevant year from such advice exceeds 20 percent of the person's gross receipts for the relevant year and (ii) the person's aggregate gross receipts from all such advice exceeds $500,000 (after application of an aggregation rule that applies solely to this dollar-threshold test). For this purpose, certified professional employer organizations (PEOs) are not treated as COVID–ERTC promoters.

Under current law, the statute of limitations period on assessment for the COVID-related ERTC is generally five years from the date of the claim. This section extends the period to six years. As a correlative matter, it extends the period for taxpayers to claim valid deductions for wages attributable to invalid ERTC claims that are corrected after the normal period of limitations.

Under current law, taxpayers can claim COVID-related ERTC until April 15, 2025. This section bars additional claims after January 31, 2024.

This section is effective for aid, assistance, or advice provided after March 12, 2020. The due diligence requirement is effective for aid, assistance, or advice provided after the date of enactment. The requirement for a COVID–ERTC promoter to file disclosures or maintain lists with respect to aid, assistance, or advice provided before the date of enactment is effective 90 days after the date of enactment. The extension of the statute of limitations on assessment is effective for assessments made after the date of enactment.

B. Background and Need for Legislation

Background—Based on a framework released by Chairman Smith with Senate Finance Committee Chairman Wyden the Ways and Means Committee marked up the "Tax Relief for American Families and Workers Act" (H.R. 7024), as amended, on January 19, 2024, and ordered the bill favorably reported to the House of Representatives.

Need for legislation—A top priority of the Ways and Means Committee has been listening to the concerns of American workers and families and developing policy solutions to help. The Committee has heard extensively about the need to provide tax relief for working families, make adjustments to the tax code to promote American innovation and growth, increase Global Competitiveness, assist families have been harmed by recent disasters, build more affordable housing, and combat fraud.

This legislation provides tax cuts to working class families that are struggling to make ends meet in the current economy by helping them keep more of their hard-earned dollars and enhancing the child tax.

The legislation promotes American growth and innovation necessary to compete in a global economy, by allowing full expensing of U.S. research and development costs, more generous interest expense deductibility, and full capital expensing U.S. businesses will be better to compete on main street and across the globe, especially with China.

Broad bipartisan support exists for strengthening the United States' economic partnership with Taiwan. Taiwan is one of the largest trading partners with the U.S. and is an especially critical trading partner in the semiconductor industry and in enhancing our onshoring capabilities for advanced manufacturing. To further strengthen that economic partnership, there has been bipartisan interest in addressing double taxation to encourage cross-border investment between the U.S. and Taiwan. Taiwan is the United States' largest trading partner with whom it does not have an income tax treaty, but Taiwan's very unique status precludes the conclusion of a tax treaty. In order to address double taxation between the U.S. and Taiwan, a unique solution is necessary that provides both targeted and expedited relief and a path forward for a more comprehensive tax agreement.

Families and communities are left to put back the pieces after events such as hurricanes, droughts, wildfires, windstorms, winter storms, accidents, and flooding leave them devastated. This legisla-

tion builds on bipartisan bills to help families recover and rebuild stronger in the aftermath of a disaster.

Enacted as part of a package of relief measures to sustain economic growth in the midst of the Covid–19 pandemic, the ERTC was intended to help large and small businesses meet payroll obligations and avoid layoffs that would otherwise have occurred due to sharp declines in revenue caused by the pandemic. Consistent with this purpose, eligibility for the credit was based the existence of a governmental order impacting the business's revenue, or a percentage decline in revenue from a benchmark pre-pandemic calendar quarter. At the time it was enacted, the Joint Committee on Taxation estimated the ten year revenue cost of the ERTC would be under $55 billion.

The last calendar quarter for which most businesses can file claims is the third quarter of 2021, and businesses that file employment tax returns by the regular filing deadline would have filed their initial claims for a credit in 2021 or 2022. Nevertheless, the IRS saw the pace of amended claims pick up at the end of 2022 along with significant evidence of promoter activity by firms filing claims on a contingency fee basis. As of late 2023 amended claims alone reached $180 billion, more than three times the Joint Committee on Taxation's ten year estimate for the whole program. While it is important to recognize that many of these claims may be valid, the impact on improper claims for businesses participating in them as clients of a promoter firm can be severe.

In order to protect businesses from the consequences of improper claims and deter the aggressive promotion of amended ERTC return filing opportunities, the Committee believed it was necessary, twenty-eight months after the close of the last eligible calendar quarter, to bring an end to the period to file new claims, enhance the due diligence requirements for ERTC promoters, and require such ERTC promoters to keep records that would enable the IRS better to distinguish valid from invalid claims.

C. Legislative History

BACKGROUND

H.R. 7024 was introduced on January 17, 2024, and was referred to the Committee on Ways and Means.

COMMITTEE HEARINGS

On February 6, 2023, the Committee held a hearing entitled "Field Hearing on the State of the American Economy: Appalachia."

On March 7, 2023, the Committee held a hearing entitled "Field Hearing on the State of the American Economy: The Heartland."

On March 10, 2023, the Committee held a hearing entitled "President Biden's Fiscal Year 2024 Budget Request with Treasury Secretary Yellen."

On March 24, 2023, the Committee held a hearing entitled "The Biden Administration's 2023 Trade Policy Agenda with United States Trade Representative, Ambassador Tai."

On April 21, 2023, the Committee held a hearing entitled "Field Hearing on the State of the American Economy: The South."

On September 14, 2023, the Committee held a hearing entitled "Member Day."

COMMITTEE ACTION

The Committee on Ways and Means marked up H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024," on January 19, 2024, and ordered the bill, as amended, favorably reported (with a quorum being present) by a roll call vote of 40 ayes and 3 nays.

D. DESIGNATED HEARINGS

Pursuant to clause 3(c)(6) of rule XIII, the following hearings were used to develop and consider H.R. 7024:

On February 6, 2023, the Committee held a hearing entitled "Field Hearing on the State of the American Economy: Appalachia."

On March 7, 2023, the Committee held a hearing entitled "Field Hearing on the State of the American Economy: The Heartland."

On March 10, 2023, the Committee held a hearing entitled "President Biden's Fiscal Year 2024 Budget Request with Treasury Secretary Yellen."

On March 24, 2023, the Committee held a hearing entitled "The Biden Administration's 2023 Trade Policy Agenda with United States Trade Representative, Ambassador Tai."

On April 21, 2023, the Committee held a hearing entitled "Field Hearing on the State of the American Economy: The South."

On September 14, 2023, the Committee held a hearing entitled "Member Day."

E. COMMITTEE EXCHANGE OF LETTERS

January 23, 2024

The Honorable Jason Smith
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On January 19, 2024, the Committee on Ways and Means ordered H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024", reported to the House. As you know, the Committee on Rules was granted an additional referral upon the bill's introduction pursuant to the Committee's jurisdiction under rule X of the Rules of the House of Representatives over the rules of the House and special orders of business. The Committee has exclusive jurisdiction over several provisions related to expedited procedures for consideration of legislation in the House.

Because of your willingness to consult with my committee regarding this matter, I will waive consideration of the bill by the Committee on Rules. By agreeing to waive its consideration of the bill, the Committee on Rules does not waive its jurisdiction over H.R. 7024. In addition, the Committee reserves its authority to seek conferees on any provisions of the bill that are within its jurisdiction during any House-Senate conference that may be convened on this legislation. I ask your commitment to support any request by the Committee on Rules for conferees on H.R. 7024 or related legislation.

I also request that you include our exchange of letters on this matter in the committee report to accompany H.R. 7024 and in the *Congressional Record* during consideration of this legislation on the House floor. Thank you for your attention to these matters.

Sincerely,

Tom Cole
Chairman

cc: The Honorable Mike Johnson, Speaker, U.S. House of Representatives
The Honorable James P. McGovern, Ranking Member, Committee on Rules
The Honorable Richard Neal, Ranking Member, Committee on Ways and Means
The Honorable Jason Smith, Parliamentarian

JASON SMITH
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U.S. House of Representatives

COMMITTEE ON WAYS AND MEANS
1139 LONGWORTH HOUSE OFFICE BUILDING
Washington, DC 20515

January 23, 2024

The Honorable Tom Cole
Chairman
Committee on Rules
H-312, The Capitol
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter regarding the Rules Committee's jurisdictional interest in H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024", and your willingness to forego consideration by your committee.

I agree that the Committee on Rules has a valid jurisdictional interest in certain provisions of the bill and that the Committee's jurisdiction will not be adversely affected by your decision to forego consideration. As you have requested, I will support your request for an appropriate appointment of outside conferees from your committee in the event of a House-Senate conference on this or similar legislation should such a conference be convened.

Finally, I will include a copy of your letter and this response in the Congressional Record during the floor consideration of the bill. Thank you again for your cooperation.

Sincerely,

Jason Smith
Chairman

cc: The Honorable Mike Johnson, Speaker, U.S. House of Representatives

The Honorable Richard Neal, Ranking Minority Member
Committee on Ways and Means

The Honorable Jim McGovern, Ranking Minority Member
Committee on Rules

Mr. Jason Smith, Parliamentarian

II. EXPLANATION OF THE BILL

TITLE I—TAX RELIEF FOR WORKING FAMILIES

(secs. 101–105 of the bill and sec. 24 of the Code)

PRESENT LAW

In general

Present law provides taxpayers with a child tax credit of up to $2,000 for each qualifying child.[1] The aggregate amount of otherwise allowable child tax credit is phased out for taxpayers with income over a threshold amount of $400,000 for taxpayers filing jointly and $200,000 for all other taxpayers.[2] The otherwise allowable child tax credit amount is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("AGI") over the applicable threshold amount. For purposes of this limitation, modified AGI means AGI increased by any amount excluded from gross income under section 911 (foreign earned income exclusion), 931 (exclusion of income for a bona fide resident of American Samoa), or 933 (exclusion of income for a bona fide resident of Puerto Rico).[3]

Generally, for purposes of the child tax credit, a qualifying child is a qualifying child, as defined in section 152(c), who is under the age of 17.[4] Only a child who is a U.S. citizen, national, or resident may be a qualifying child; citizens of contiguous countries who are not U.S. citizens, nationals, or residents are ineligible under the child tax credit definition of qualifying child.[5]

The name and social security number ("SSN") of the qualifying child must appear on the return, and the SSN must be issued before the due date for filing the return.[6] The SSN must also be issued to a citizen or national of the United States or pursuant to a provision of the Social Security Act relating to the lawful admission for employment in the United States.[7] The TIN of the taxpayer must be issued on or before the due date for filing the return.[8]

Partial refundability and calculation of additional child tax credit

The child tax credit is generally a nonrefundable tax credit taken against income tax liability. The credit is allowable against both the regular tax and the alternative minimum tax.[9]

In some circumstances, all or a portion of the otherwise allowable credit is treated as a refundable credit (the "additional child tax

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[1] Sec. 24(a), (h)(2). For taxable years beginning after December 31, 2025, the amount of the credit is $1,000 for each qualifying child.

[2] Sec. 24(b), (h)(3). For taxable years beginning after December 31, 2025, the modified AGI threshold amounts at which the credit begins to phase out are $75,000 for individuals who are not married, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns.

[3] Sec. 24(b)(1).

[4] Sec. 24(c)(1).

[5] Sec. 24(c)(2).

[6] Sec. 24(h)(7). For taxable years beginning after December 31, 2025, the child tax credit may be claimed if the taxpayer identification number ("TIN") of the qualifying child, rather than the SSN of the child, appears on the return. Sec. 24(e)(1).

[7] See sec. 205(c)(2)(B)(i)(I) (or that portion of subclause (III) that relates to subclause (I)) of the Social Security Act.

[8] Sec. 24(e)(2).

[9] Sec. 26(a).

credit").[10] The credit is treated as refundable in an amount equal to 15 percent of earned income in excess of $2,500 (the "earned income formula").[11] Earned income generally has the same definition as for purposes of the earned income tax credit and is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings.[12] For purposes of the additional child tax credit, only items taken into account in computing taxable income are treated as earned income.[13] However, combat pay that is excluded from gross income under section 112 is also taken into account.

A taxpayer with three or more qualifying children may determine the additional child tax credit using the "alternative formula," if this formula results in a larger additional child tax credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's Social Security taxes exceed the taxpayer's earned income tax credit.[14]

Under current law, the maximum amount of the additional child tax credit per qualifying child ($1,600 for 2023 and $1,700 for 2024) [15] is indexed for inflation, although the amount may not exceed the $2,000 amount of the nonrefundable child tax credit.[16] Any adjustment for inflation is rounded down to the next lowest multiple of $100.

Withholding

Chapter 24 of the Code provides rules for employers to deduct and withhold amounts from employee wages for the payment of income tax. Under rules determined by the Secretary, an employee may be permitted one or more withholding allowances that reduces the amount of income tax withholding. A taxpayer's withholding allowances may take into account the number of children in respect of whom it is reasonably expected that the taxpayer is eligible for a child tax credit.[17]

Credit for other dependents

An individual is allowed a $500 nonrefundable credit for each dependent of the taxpayer as defined in section 152 other than a qualifying child as defined for purposes of the child tax credit.[18]

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[10] Sec. 24(d).

[11] Sec. 24(d)(1)(B)(i), (h)(6). For taxable years beginning after December 31, 2025, the earned income threshold for the refundable child tax credit is $3,000.

[12] Sec. 32(c)(2).

[13] Sec. 24(d)(1)(B)(i). For example, some ministers' parsonage allowances are considered self-employment income, see section 1402(a)(8), and thus are considered earned income for purposes of computing the EITC, but they are excluded from gross income for income tax purposes and thus are not considered earned income for purposes of the additional child tax credit.

[14] Sec. 24(d)(1)(B)(ii).

[15] Rev. Proc. 2022–38, 2022–45 I.R.B. 445. and Rev. Proc. 2023–34. 2023–48 I.R.B. 1287.

[16] Sec. 24(h)(5). The nonrefundable portion of the child tax credit is not adjusted for inflation. For taxable years beginning after December 31, 2025, there is no separately stated maximum amount of the additional child tax credit; however, the refundable credit may not exceed the total amount of the credit of $1,000 for taxable years beginning after December 31, 2025.

[17] Sec. 3402(f)(1)(C).

[18] An individual who is a qualifying child for purposes of the dependent rules under section 152, but not a qualifying child for purposes of the child tax credit (*e.g.*, a child who is age 17 or 18, a full-time student under age 24, or a child without a valid SSN) is eligible to be a qualifying dependent for purposes of the $500 nonrefundable credit for other dependents. For taxable years beginning after December 31, 2025, there is no tax credit for other dependents.

Application of the child tax credit in the territories of the United States

The three mirror Code territories (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) have, under their mirror Codes, a child tax credit identical to that in the Internal Revenue Code. A resident of one of these territories claims the child tax credit on the income tax return filed with the territory's revenue authority.

Mirror Code territories

The Secretary is directed to make payments to each of Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands in an amount equal to the loss in revenue by reason of the application of the child tax credit to the territory's mirror Code for the taxable year.[19] This amount is determined by the Secretary based on information provided by the government of the territory.

No child tax credit under the Internal Revenue Code is permitted for any resident of a mirror Code territory with respect to whom a child tax credit is allowed against income taxes of the territory.[20]

Puerto Rico

Bona fide residents of Puerto Rico may claim an additional child tax credit up to the maximum amount[21] from the U.S. Treasury under the alternative formula, but determined without regard to the three-child limitation, by filing a return with the Internal Revenue Service ("IRS").[22]

Residents of Puerto Rico claim the additional child tax credit under the alternative formula by filing a Form 1040–SS or Form 1040–PR with the IRS.

American Samoa

The Secretary is directed to make payments to American Samoa in an amount estimated by the Secretary as being equal to the aggregate benefits that would have been provided to residents of American Samoa if the U.S. child tax credit had been in effect in American Samoa (and had been applied as if American Samoa were the United States) in that taxable year.[23]

The provision prohibits the Secretary from making these payments unless American Samoa has a plan approved by the Secretary to promptly distribute the payments to its residents. For years with respect to which American Samoa has an approved plan, no child tax credit under the Internal Revenue Code is permitted for any person who is eligible for a payment under the plan. If American Samoa does not have a plan in place for a taxable year, a bona fide resident of American Samoa may claim a child tax credit by filing a return with the IRS under rules similar to those for Puerto Rico, described above.

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[19] Sec. 24(k)(1).
[20] Sec. 24(k)(2).
[21] This amount is $1,600 for taxable years beginning in 2023 and $1,700 for taxable years beginning in 2024. Rev. Proc. 2022–38, 2022–45 I.R.B. 445. and Rev. Proc. 2023–34. 2023–48 I.R.B. 1287.
[22] Sec. 24(k)(2)(B).
[23] Sec. 24(k)(3).

Temporary earned income lookback for certain disasters

Congress has at times enacted taxpayer favorable rules for determining earned income for purposes of calculating the additional child tax credit for taxpayers affected by specific natural disasters.[24]

Most recently, Division Q of Public Law 116–94, the Taxpayer Certainty and Disaster Tax Relief Act of 2019 (the "2019 Disaster Act"), allows qualified individuals to elect to use earned income for the preceding taxable year instead of earned income for the applicable taxable year to calculate the additional child tax credit, if earned income for the applicable taxable year is less than earned income for the preceding taxable year.[25]

A "qualified individual" is an individual whose principal place of abode at any time during the incident period of any qualified disaster was located in the qualified disaster area, and such individual was displaced from such principal place of abode because of such qualified disaster, or in the qualified disaster zone.[26]

A "qualified disaster area" refers to an area with respect to which a major disaster has been declared by the President during the period beginning on January 1, 2018, and ending on the date which is 60 days after the date of enactment of the 2019 Disaster Act,[27] under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, (the "Stafford Act"),[28] if the incident period of the disaster with respect to which the declaration is made begins on or before the date of enactment of the 2019 Disaster Act.[29] A "qualified disaster zone" refers to any portion of any qualified disaster area which was determined by the President, during the period beginning on January 1, 2018, and ending on the date which is 60 days after the date of enactment of the 2019 Disaster Act, to warrant individual or individual and public assistance under the Stafford Act.[30]

A "qualified disaster" is, with respect to the applicable qualified disaster area, the disaster by reason of which a major disaster was declared with respect to that area.[31]

The "incident period" is, with respect to the applicable qualified disaster, the period specified by the Federal Emergency Management Agency as the period during which the disaster occurred, except that the period is not treated as beginning before January 1, 2018, or ending after the date which is 30 days after the date of enactment of the 2019 Disaster Act.[32]

REASONS FOR CHANGE

The Committee believes that the child tax credit provides important support for families raising children and notes that the real value of this support has declined due to the rising cost of living.

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[24] *See, e.g.*, sec. 204(c) of Pub. L. No. 116–94 (Hurricanes Florence and Michael); sec. 20104(c) of Pub. L. No. 115–123 (certain California wildfires); sec. 504(c) of Pub. L. No. 115–63 (Hurricanes Harvey, Irma, and Maria); and former sec. 1400S(d) (Hurricanes Katrina, Rita, and Wilma).

[25] Sec. 204(c) of Div. Q of Pub. L. No. 116–94.

[26] Sec. 204(c)(2) of Div. Q of Pub. L. No. 116–94.

[27] The 2019 Disaster Act became law on December 20, 2019.

[28] Pub. L. No. 100–707.

[29] Sec. 201 of Div. Q of Pub. L. No. 116–94.

[30] *Ibid.*

[31] *Ibid.*

[32] *Ibid.*

The Committee also believes that large working families with multiple children should not be treated differently than working families with fewer children who receive the additional child tax credit and that these families with the highest need should not be required to file amended returns in order to receive the modified credit. Furthermore, the Committee believes that working families may face declines in earned income from one year to the next, and that it is important for families to have certainty when they face these earnings declines.

The provision temporarily increases the maximum amount of the additional credit and allows families with more than one child to receive that increased maximum as does a family with only one child. It also directs the Treasury Department to expeditiously calculate and issue refunds to taxpayers who have filed their tax returns without taking into account this change in law. The provision also temporarily indexes both the child tax credit and the additional child tax credit for inflation. Finally, the provision temporarily allows families whose earned income is less than it was in the prior year to elect to calculate their additional child tax credit based on the prior year's higher earned income.

EXPLANATION OF PROVISION

Per-child calculation of the additional child tax credit

Under the provision, the calculation of the additional child tax credit is temporarily made by multiplying each of the amounts determined under the earned income formula and the alternative formula by the number of qualifying children. The additional child tax credit continues to be limited to the maximum amount of the additional child tax credit per qualifying child.

For example, consider a taxpayer with two qualifying children and earned income of $9,000. With other simplifying assumptions, under present law, this taxpayer would calculate the additional child tax credit amount to be $975.[33] Under the provision, this taxpayer would calculate the additional child tax credit amount to be $1,950.[34]

The temporary modification of the calculation of the additional child tax credit expires for taxable years beginning after December 31, 2025.

Increase in the maximum amount of the additional child tax credit

The provision temporarily increases the maximum amount of the additional child tax credit per qualifying child to $1,800 in 2023, $1,900 in 2024, and $2,000 in 2025, along with the inflation adjustment described below.

The temporary increase of the maximum amount of the additional child tax credit expires for taxable years beginning after December 31, 2025.

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[33] Under present law, the additional child tax credit is calculated by multiplying the amount of earned income that exceeds $2,500 by 15 percent. ($9,000 − $2,500) × .15 = $975.

[34] Under the provision, the additional child tax credit is calculated by multiplying the amount of earned income that exceeds $2,500 by 15 percent and by the number of children. ($9,000 − $2,500) × .15 × 2 = $1,950.

Inflation adjustment of the child tax credit and of the 2025 additional child tax credit

The $2,000 amount of the child tax credit is temporarily indexed for inflation beginning in 2024.[35] The maximum amount of the additional child tax credit per qualifying child is also temporarily indexed for inflation, but only in 2025 and, as a result, matches the amount of the child tax credit for that year.[36] Any adjustment for inflation is rounded down to the next lowest multiple of $100.

The temporary indexing for inflation expires for taxable years beginning after December 31, 2025 when the amount of the child tax credit returns to $1,000 per qualifying child.

Rules for the determination of earned income to calculate the additional child tax credit

In calculating the additional child tax credit, the provision temporarily allows, for tax years 2024 and 2025, a taxpayer to elect to use earned income for the preceding taxable year instead of earned income for the current taxable year to calculate the additional child tax credit, if earned income for the current taxable year is less than earned income for the preceding taxable year. In the case of a joint return, the earned income of the taxpayer for the preceding taxable year is the sum of the earned incomes of each spouse for such preceding taxable year.

In the case of a taxpayer electing the application of this new temporary rule, the provision gives the IRS math error authority for an error involving an entry on a return of earned income for the preceding taxable year that is inconsistent with the amount of earned income determined by the Secretary for the preceding taxable year.

The temporary election to use prior year earned income expires for taxable years beginning after December 31, 2025.

Special rule for certain early-filed 2023 returns

If a taxpayer files a claim for the child tax credit on their tax return for 2023 and the amount of the additional child tax credit on the return is determined without regard to the sections of the provision described above that are effective for 2023 (i.e., the per-child calculation of the additional child tax credit and the increase in the additional child tax credit), the taxpayer may be entitled to an additional credit or refund amount. In such a case, the Treasury Department is directed (to the maximum extent practicable) to (1) redetermine the amount of such credit (after taking into account the relevant sections of the provision described above which are effective for 2023) on the basis of the information provided on the return, and (2) credit or refund any such additional credit or refund as expeditiously as possible.

EFFECTIVE DATES

The provision changing the calculation of the additional child tax credit to a per-child earned income formula and a per-child alter-

[35] The provision uses 2022 as the base year for this inflation calculation. Using 2022 as the base year results in one year of inflation adjustment for 2024, and two years of inflation adjustment for 2025.

[36] The provision uses 2022 as the base year for this inflation calculation. Using 2022 as the base year results in two years of inflation adjustment for 2025.

native formula is effective for taxable years beginning after December 31, 2022.

The provision increasing the maximum amount of the additional child tax credit is effective for taxable years beginning after December 31, 2022.

The provision indexing the amount of the child tax credit in 2024 and 2025 and the additional child tax credit in 2025 for inflation is effective for taxable years beginning after December 31, 2023.

The provision allowing the use of prior year earned income to calculate the additional child tax credit is effective for taxable years beginning after December 31, 2023.

The provision directing the Treasury Department to make redeterminations of the child tax credit and to credit or refund amounts is effective upon date of enactment.

TITLE II—AMERICAN INNOVATION AND GROWTH

1. DEDUCTION FOR RESEARCH AND EXPERIMENTAL EXPENDITURES (SEC. 201 OF THE BILL AND SECS. 174 AND 174A OF THE CODE)

PRESENT LAW

Public Law 115–97[37] modified the cost recovery rules for research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021 (with conforming changes made to sections 41 and 280C).[38] Section 174 as applicable to amounts paid or incurred in taxable years beginning before January 1, 2022, is described first below, followed by a description of section 174 as applicable to amounts paid or incurred in taxable years beginning after December 31, 2021.

Amounts paid or incurred in taxable years beginning before January 1, 2022

Business expenses associated with the development or creation of an asset having a useful life extending beyond the current year generally must be capitalized and depreciated over its useful life.[39] However, taxpayers may elect to deduct the amount of reasonable research or experimental expenditures paid or incurred in taxable years beginning before January 1, 2022, in connection with a trade or business.[40] Alternatively, taxpayers may elect to capitalize research or experimental expenditures and recover them ratably over the useful life of the research, but in no case over a period of less than 60 months,[41] or elect to capitalize and amortize those expenditures over 10 years.[42] Research and experimental expenditures under section 174 are not required to be capitalized under either

[37] December 22, 2017.
[38] Sec. 174.
[39] Secs. 167 and 263(a).
[40] Former secs. 174(a) and (e).
[41] Former sec. 174(b). Taxpayers that have a taxable loss or that would have a taxable loss after allowance of the deduction for research and experimental expenses, including taxpayers that incur research and experimental expenses before the start of an active trade or business, may elect to capitalize these expenses under this rule.
[42] Former secs. 174(f)(2) and 59(e). This special 10-year election is available to mitigate the effect of the individual alternative minimum taxable income adjustment for research expenditures set forth in section 56(b)(2). The election under section 59(e) to amortize research or experimental expenditures over 10 years does not apply to research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021. A technical correction may be necessary to reflect this intent.

section 263(a)[43] or section 263A[44] and are generally reduced by the amount of the taxpayer's research credit under section 41.[45]

Research or experimental expenditures generally include all costs incurred in the experimental or laboratory sense incident to the development or improvement of a product.[46] Qualifying costs are incurred for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product.[47] Uncertainty exists when information available to the taxpayer is not sufficient to ascertain the capability or method for developing, improving, or appropriately designing the product.[48]

Whether expenditures qualify as deductible research expenses depends on the nature of the activity to which the costs relate, not the nature of the product or improvement being developed or the level of technological advancement the product or improvement represents.[49] The ultimate success, failure, sale, or other use of research or property is irrelevant.[50] Examples of qualifying costs include salaries for those engaged in research or experimentation efforts, overhead incurred to operate and maintain research facilities (*e.g.*, utilities, depreciation, rent, *etc.*), and materials and supplies used and consumed in the course of research or experimentation (including amounts incurred in conducting trials).[51] The costs to develop computer software have been accorded treatment similar to the cost recovery treatment of research and experimental expenditures.[52]

Research or experimental expenditures do not include expenditures for quality control testing;[53] efficiency surveys; management studies; consumer surveys; advertising or promotions; the acquisition of another's patent, model, production, or process; or research in connection with literary, historical, or similar projects.[54]

Generally, no deduction under section 174 is allowable for expenditures incurred to acquire or improve land or for depreciable or depletable property used in connection with any research or experimentation.[55] In addition, no deduction is allowed for any expenditure incurred to ascertain the existence, location, extent, or

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[43] Sec. 263(a)(1)(B).

[44] Sec. 263A(c)(2).

[45] Former secs. 280C(c)(1) and (2). Taxpayers may instead elect to claim a reduced research credit amount under section 41 in lieu of reducing deductions otherwise allowed. Sec. 280C(c)(3), as effective for amounts paid or incurred in taxable years beginning before January 1, 2022.

[46] Treas. Reg. sec. 1.174–2(a)(1) and (2). Product is defined to include any pilot model, process, formula, invention, technique, patent, or similar property, and includes products to be used by the taxpayer in its trade or business as well as products to be held for sale, lease, or license. Treas. Reg. sec. 1.174–2(a)(11), Example 10, provides an example of new process development costs for which the cost recovery rules of section 174 apply.

[47] Treas. Reg. sec. 1.174–2(a)(1).

[48] *Ibid.*

[49] *Ibid.*

[50] *Ibid.*

[51] See Treas. Reg. sec. 1.174–4(c). The definition of research and experimental expenditures also includes the costs of obtaining a patent, such as attorneys' fees incurred in making and perfecting a patent application. Treas. Reg. sec. 1.174–2(a)(1).

[52] Rev. Proc. 2000–50, 2000–2 C.B. 601.

[53] Quality control testing means testing to determine whether units of materials or products conform to specified parameters but does not include testing to determine if the design of the product is appropriate. Treas. Reg. sec. 1.174–2(a)(7).

[54] Treas. Reg. sec. 1.174–2(a)(6).

[55] Former sec. 174(c). However, depreciation and depletion allowances may be considered section 174 expenditures. *Ibid.*

quality of any deposit of ore or other minerals (including oil and gas).[56]

Amounts paid or incurred in taxable years beginning after December 31, 2021

For taxable years beginning after December 31, 2021, specified research or experimental expenditures must be capitalized and amortized ratably over a five-year period (or, in the case of expenditures that are attributable to research that is conducted outside of the United States, over a 15-year period),[57] beginning with the midpoint of the taxable year in which such specified research or experimental expenditures are paid or incurred (referred to as a half-year convention).[58] Specified research or experimental expenditures that are required to be capitalized include expenditures for software development.[59] Specified research or experimental expenditures exclude expenditures incurred to acquire or improve land or for depreciable or depletable property used in connection with the research or experimentation.[60] Also excluded are exploration expenditures incurred for ore or other minerals (including oil and gas).[61]

In the case of retired, abandoned, or disposed property with respect to which specified research or experimental expenditures are paid or incurred, any remaining basis may not be recovered in the year of retirement, abandonment, or disposal, but instead must continue to be amortized over the remaining amortization period.[62]

If a taxpayer's research credit under section 41 for a taxable year beginning after December 31, 2021, exceeds the amount allowed as a deduction under section 174 for that taxable year, the amount chargeable to capital account under section 174 for such taxable year must be reduced by that excess amount.[63] A taxpayer instead may elect to claim a reduced research credit amount under section 41.[64] If this election is made, the research credit is reduced by an amount equal to the amount of the credit multiplied by the highest corporate tax rate.[65]

REASONS FOR CHANGE

The Committee recognizes that the full and immediate expensing of domestic research or experimental expenditures, including software development costs, improves cash flow for critical domestic research and development. Forcing businesses to capitalize and amortize these expenditures erodes their value, increases the cost of important research, and inhibits investment by a broad spectrum of industries in domestic products. The adverse treatment of do-

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[56] Former sec. 174(d). Special rules apply with respect to geological and geophysical costs (section 167(h)), qualified tertiary injectant expenses (section 193), intangible drilling costs (sections 263(c) and 291(b)), and mining exploration and development costs (sections 616 and 617).

[57] For this purpose, the term "United States" includes the United States, the Commonwealth of Puerto Rico, and any possession of the United States. Sec. 174(a)(2)(B), by reference to sec. 41(d)(4)(F).

[58] Sec. 174(a)(2)(B).

[59] Sec. 174(c)(3).

[60] Sec. 174(c)(3). However, depreciation and depletion allowances may be considered section 174 expenditures. *Ibid*.

[61] Sec. 174(c)(2).

[62] Sec. 174(d).

[63] Sec. 280C(c)(1).

[64] Sec. 280C(c)(2)(A).

[65] Sec. 280C(c)(2)(B).

mestic research and experimental expenditures under current law will force domestic businesses to cut jobs and curtail research to pay a higher tax bill.

The Committee believes that allowing businesses to immediately deduct wages, supplies, and equipment attributable to research performed in the United States, Puerto Rico, and U.S. territories will enable them to initiate or expand domestic research programs. Lowering the cost of domestic research will also incentivize multinationals to onshore research activities back to the United States.

EXPLANATION OF PROVISION

The proposal suspends the application of section 174 for domestic research or experimental expenditures[66] paid or incurred in taxable years beginning after December 31, 2021, and before January 1, 2026. Research or experimental expenditures attributable to research that is conducted outside the United States ("foreign research or experimental expenditures") must continue to be capitalized and amortized over 15 years under section 174.

The proposal provides temporary rules (in new section 174A) for domestic research or experimental expenditures.

The proposal provides that a taxpayer may:

1. deduct domestic research or experimental expenditures;
2. elect to capitalize certain domestic research or experimental expenditures and recover them ratably over the useful life of the research (but in no case over a period of less than 60 months);[67] or
3. elect to capitalize certain domestic research or experimental expenditures to a capital account.

Similar to section 174, domestic research or experimental expenditures include software development costs.[68]

The proposal requires a taxpayer to reduce the amount it takes into account as research or experimental expenditures (whether expensed or capitalized) by the amount of the research credit allowable under section 41 ("excess research or experimental expenditures") for taxable years beginning after December 31, 2022. Taxpayers instead may elect to claim a reduced research credit amount under section 41.

The proposal treats the requirement to capitalize and amortize research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2025, as a change in the taxpayer's method of accounting. This change is treated as initiated by the taxpayer, is treated as made with the consent of the Secretary, and is applied prospectively on a cut-off basis with no corresponding catch-up adjustment to taxable income under section 481(a).

The proposal coordinates the applicable rules with the following provisions:

1. Adds domestic research or experimental expenditures to the definition of qualified research under section 41(d)(1)(A).

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[66] The proposal defines "domestic research or experimental expenditures" as research or experimental expenditures paid or incurred by the taxpayer in connection with its trade or business that are not attributable to foreign research (as defined by section 41(d)(4)(F)).

[67] The proposal provides that the election does not apply to property subject to the depreciation allowance under section 167 or depletion under section 611.

[68] Under former section 174, taxpayers relied on Rev. Proc. 2000–50, *supra*, for the treatment of software development expenditures.

2. Modifies the individual adjustments to alternative minimum taxable income under section 56(b)(2) to include domestic research or experimental expenditures deducted under temporary section 174A(a).

3. Adds domestic research or experimental expenditures to the definition of qualified expenditures eligible for the election under section 59(e)(2)(B) to capitalize and amortize certain expenditures over 10 years.

4. Adds certain domestic research or experimental expenditures deducted under temporary section 174A(a) to the list of excludable capital expenditures from the qualified small issue bond limit under section 144(a)(4)(C)(iv).

5. Adds domestic research or experimental expenditures to the list of exclusions from the definition of start-up expenditures under section 195(c)(1).

6. Adds amounts deducted as domestic research or experimental expenditures to the exclusions from the capitalization rules under section 263(a)(1)(B) (for depreciable or amortizable property) and section 263A(c)(2) (for inventory).

7. Amends the rules for active business computer software royalties under section 543(d)(4)(A)(i) with respect to personal holding company income to account for domestic research or experimental expenditures.

8. Modifies the allocation rules for qualified research and experimental expenditures under section 864(g)(2) to take the amortization deductions under section 174 or section 174A(c) into account for purposes of section 864 in the taxable year for which such expenditures are allowed as a deduction.

9. Clarifies that the basis of property under section 1016(a)(14) is reduced by deductions allowed under section 174 or 174A.

10. Amends the active business requirement rules for qualified small business stock under section 1202(e)(2)(B) to account for both specified research or experimental expenditures under section 174 and domestic research or experimental expenditures under section 174A.

EFFECTIVE DATE

The proposal applies to excess research or experimental expenditures for taxable years beginning after December 31, 2022. No inference is intended with respect to application of section 280C(c)(1) for taxable years beginning before January 1, 2023.

Notwithstanding the modification to section 280C(c)(1) for excess research or experimental expenditures, the proposal is effective for amounts paid or incurred in taxable years beginning after December 31, 2021.

The proposal provides four elective transition rules. The first transition rule allows a taxpayer to make a late election under the temporary rules to (1) capitalize and amortize domestic research or experimental expenditures over a period not less than 60 months or (2) capitalize the expenditures to a capital account for the taxpayer's first taxable year beginning after December 31, 2021. Taxpayers may effectuate the late election by filing an amended income tax return within one year of the date of enactment or in another manner as the Secretary provides.

The second transition rule allows a taxpayer that adopted a method of accounting under section 174 before the date of the proposal's enactment for the taxpayer's first taxable year beginning after December 31, 2021, to treat the application of the temporary rules as a change in method of accounting for the taxpayer's immediately succeeding taxable year. Taxpayers are allowed a catch-up adjustment to taxable income under section 481(a) on a modified cut-off basis.[69] Taxpayers may elect to account for the catch-up adjustment ratably over two taxable years.

The third transition rule allows an eligible taxpayer to make a late election under section 59(e)(2)(B) to capitalize and amortize domestic research or experimental expenditures over 10 years for the taxpayer's first taxable year beginning after December 31, 2021. Eligible taxpayers may effectuate the late election by filing an amended income tax return within one year of the date of enactment.[70] The proposal defines an eligible taxpayer for purposes of the third transition rule as any taxpayer that does not elect the application of the second transition rule, and that filed an income tax return for the taxpayer's first taxable year beginning after December 31, 2021, before the earlier of the due date for that return and the date of enactment.

The fourth transition rule allows an eligible taxpayer to make or revoke an election under section 280C(c)(2) to claim a reduced research credit under section 41 for the taxpayer's first taxable year beginning after December 31, 2021. Eligible taxpayers may effectuate the late election or revocation by filing an amended income tax return within one year of the date of enactment.[71] The proposal defines an eligible taxpayer for purposes of the fourth transition rule as any taxpayer that filed an income tax return for the taxpayer's first taxable year beginning after December 31, 2021, before the earlier of the due date for that return and the date of enactment.

2. Extension of Allowance for Depreciation, Amortization, or Depletion in Determining the Limitation on Business Interest (Sec. 202 of the Bill and Sec. 163(J) of the Code)

PRESENT LAW

Limitation on deduction of business interest expense

Interest paid or accrued by a business generally is deductible against taxable income, subject to a number of limitations.[72] The

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[69] The section 481(a) adjustment only includes an adjustment for the capitalized expenditures which were not allowed as an amortization deduction by reason of section 174 prior to amendment by the proposal for the taxpayer's first taxable year beginning after December 31, 2021.

[70] Generally, an election under section 59(e)(2)(B) must be filed no later than the date prescribed by law for filing the taxpayer's original income tax return (including extensions) for the tax year in which the amortization of the qualified expenditures subject to the election begins. See Treas. Reg. sec. 1.59–1(b)(1).

[71] Generally, an election under section 280C(c)(2) must be filed no later than the date prescribed by law for filing the taxpayer's original income tax return (including extensions). See sec. 280C(c)(2)(C).

[72] Sec. 163(a). Interest deductions limitations that are not described in this document include: denial of the deduction for the disqualified portion of the original issue discount on an applicable high yield discount obligation (sec. 163(e)(5)), denial of deduction for interest on certain obligations not in registered form (sec. 163(f)), reduction of the deduction for interest on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 (sec. 163(g)), disallowance of deduction for interest on debt with respect to certain life insurance contracts (sec. 264(a)), and disallowance of deduction for interest relating to tax-exempt income (sec. 265(a)(2)). In some circumstances, interest expense is required to be capitalized. See, *e.g.*, secs.

deduction for business interest expense[73] is generally limited to the sum of (1) business interest income of the taxpayer for the taxable year,[74] (2) 30 percent of the adjusted taxable income of the taxpayer for the taxable year (not less than zero), and (3) the floor plan financing interest[75] of the taxpayer for the taxable year.[76] Thus, other than floor plan financing interest, business interest expense in excess of business interest income is generally deductible only to the extent of 30 percent of adjusted taxable income.[77]

The limitation generally applies at the taxpayer level (although special rules apply in the case of partnerships, described below). In the case of a group of affiliated corporations that file a consolidated return, the limitation applies at the consolidated tax return filing level.[78] The amount of any business interest expense not allowed as a deduction for any taxable year is generally treated as business interest expense paid or accrued by the taxpayer in the succeeding taxable year. This business interest expense may be carried forward indefinitely.[79]

Application to passthrough entities

In general

In the case of a partnership, the section 163(j) interest limitation is generally applied at the partnership level.[80] A partner generally must apply section 163(j) separately to any business interest expense it incurs. To prevent double counting, the business interest

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263A(f) (capitalization of interest incurred to produce certain tangible property) and 461(g) (prepaid interest). Section 385 also recharacterizes as equity some instruments that are purported to be indebtedness with the results that payments on the interest are treated as nondeductible dividends rather than deductible interest.

[73] Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business and does not include investment interest (within the meaning of section 163(d)). Sec. 163(j)(5). Section 163(j) applies only to business interest that would otherwise be deductible in the current taxable year, absent the application of section 163(j). Treas. Reg. sec. 1.163(j)–3(b)(1). Thus, section 163(j) applies after the application of provisions that subject interest to deferral, capitalization, or other limitation (e.g., sections 163(e)(3), 163(e)(5)(A)(ii), 246A, 263A, 263(g), 267, 1277, and 1282), but before application of sections 461(l), 465, and 469. See Treas. Reg. sec. 1.163(j)–3(b)(2)–(6).

[74] Business interest income means the amount of interest includible in the gross income of the taxpayer for the taxable year that is properly allocable to a trade or business and does not include investment income (within the meaning of section 163(d)). Sec. 163(j)(6).

[75] Floor plan financing interest means interest paid or accrued on floor plan financing indebtedness. Floor plan financing indebtedness means indebtedness used to finance the acquisition of motor vehicles held for sale or lease to retail customers and secured by the inventory so acquired. A motor vehicle means a motor vehicle that is: (1) any self-propelled vehicle designed for transporting person or property on a public street, highway, or road; (2) a boat; or (3) farm machinery or equipment. Sec. 163(j)(9).

[76] These rules were modified for taxable years beginning in 2019 or 2020 to permit certain taxpayers to deduct more business interest than would be allowed under the rules described herein. See sec. 163(j)(10).

[77] The business interest limitation does not apply in certain cases. The business interest limitation does not apply to any taxpayer (other than a tax shelter prohibited from using the cash method under section 448(a)(3)) that meets the $25 million gross receipts test of section 448(c). At a taxpayer's election, (1) any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business (referred to as an "electing real property trade or business") or (2) any farming business or any business engaged in the trade or business of a specified agricultural or horticultural cooperative (referred to as an "electing farming business") is not treated as a trade or business for purposes of the limitation. The limitation does not apply to certain regulated public utilities. See sec. 163(j)(7).

[78] See Treas. Reg. sec. 1.163(j)–4(d) (providing that a consolidated group has a single sec. 163(j) limitation and generally treating all members of the consolidated group as a single taxpayer for sec. 163(j) purposes).

[79] Sec. 163(j)(2). With respect to corporations, any carryforward of disallowed business interest of a corporation is an item taken into account in the case of certain corporate acquisitions described in section 381 and is subject to limitation under section 382. Secs. 381(c)(20) and 382(d)(3).

[80] Sec. 163(j)(4)(A)(i).

income and adjusted taxable income of each partner are generally determined without regard to the partner's distributive share of any items of income, gain, deduction, or loss of the partnership.[81] However, in cases in which the partnership has an excess amount of business interest income, an excess amount of adjusted taxable income, or both, section 163(j) partnership items generally may support additional business interest expense deductions by the partnership's partners. Specifically, a partner's business interest deduction limitation is increased by the sum of the partner's distributive share of the partnership's excess business interest income and 30 percent of the partner's distributive share of the partnership's excess taxable income.[82]

Similar rules apply to an S corporation and its shareholders.[83]

Carryforward rules for partnerships

Special rules for the carryforward of disallowed business interest expense apply only to partnerships and their partners.[84] In the case of a partnership, the general taxpayer-level carryforward rule does not apply. Instead, any business interest expense that is not allowed as a deduction to the partnership for the taxable year (referred to as "excess business interest expense") is allocated to the partners.[85] A partner may not deduct excess business interest expense in the year in which it is allocated to a partner. A partner may deduct its share of the partnership's excess business interest expense in any future year, but only in an amount that is based on the partner's distributive share of excess business interest income and excess taxable income of the partnership the activities of which gave rise to the disallowed business interest expense carryforward.[86] Any amount that is not allowed as a deduction generally continues to be carried forward.[87]

When excess business interest expense is allocated to a partner, the partner's basis in its partnership interest is reduced (but not below zero) by the amount of the allocation, even though the excess business interest expense does not give rise to a deduction in the year of the basis reduction.[88] The partner's deduction in a subsequent year for excess business interest expense does not reduce the partner's basis in its partnership interest. If the partner disposes of a partnership interest the basis of which has been reduced by an allocation of excess business interest expense, the partner's basis in the interest is increased immediately before the disposition by the amount by which the basis reduction exceeds any amount of excess business interest expense that has been treated as business interest expense paid or accrued by the partner as a result of an allocation of excess business interest income or excess taxable income by the same partnership.[89] This rule applies to both total

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[81] Sec. 163(j)(4)(A)(ii)(I); Treas. Reg. sec. 1.163(j)–6(e)(1).
[82] Sec. 163(j)(4)(A)(ii)(II); Treas. Reg. sec. 1.163(j)–6(e)(1).
[83] Sec. 163(j)(4)(D).
[84] Sec. 163(j)(4)(B).
[85] Sec. 163(j)(4)(B)(i)(II).
[86] Sec. 163(j)(4)(B)(ii)(I); Treas. Reg. sec. 1.163(j)–6(g)(2). See also Joint Committee on Taxation, *General Explanation of Public Law 115–97* (JCS–1–18), December 2018, pp. 175–178 (describing section 163(j)(4) as it was intended to work).
[87] Sec. 163(j)(4)(B)(ii)(II).
[88] Sec. 163(j)(4)(B)(iii)(I); Treas. Reg. sec. 1.163(j)–6(h)(2).
[89] Sec. 163(j)(4)(B)(iii)(II); Treas. Reg. sec. 1.163(j)–6(h)(3). The special rule for dispositions also applies to transfers of a partnership interest (including by reason of death) in transactions in which gain is not recognized in whole or in part. *Id.* No deduction is allowed to the transferor

and (on a proportionate basis) partial dispositions of a partnership interest.[90]

The special carryforward rules do not apply to S corporations or their shareholders.[91] Rather, any disallowed business interest expense is carried forward by the S corporation (as opposed to the shareholder) to the succeeding taxable year.[92]

Adjusted taxable income

For purposes of the section 163(j) interest limitation, adjusted taxable income means the taxable income of the taxpayer computed without regard to: (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction; or (4) the amount of any deduction allowed under section 199A.

For taxable years beginning before January 1, 2022, adjusted taxable income also is computed without regard to any deduction allowable for depreciation, amortization, or depletion.[93] This definition of adjusted taxable income generally corresponds with the financial accounting concept of earnings before interest, taxes, depreciation, and amortization, or "EBITDA" (hereinafter referred to as the "EBITDA limitation").

For taxable years beginning after December 31, 2021, adjusted taxable income is computed to include deductions allowable for depreciation, amortization, or depletion. This definition of adjusted taxable income generally corresponds with the financial accounting concept of earnings before interest and taxes, or "EBIT."

REASON FOR CHANGE

The Committee understands that a combination of rising interest rates and restrictions on interest deductions under current law curtails business investment and growth. The EBIT limitation may be viewed as imposing a cost on investment that impairs the ability of businesses to finance new equipment and expand operations. Increasing the cost of critical machinery and equipment for businesses discourages domestic investment, reduces wages, and costs jobs. The Committee believes that reinstating the EBITDA limitation will alleviate this burden on businesses and reduce barriers to domestic investment.

EXPLANATION OF PROVISION

The proposal temporarily extends the EBITDA limitation under section 163(j) to apply to taxable years beginning before January 1, 2026. For purposes of the section 163(j) interest deduction limitation, adjusted taxable income is computed without regard to the de-

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or transferee for any disallowed business interest resulting in a basis increase under this rule. *Id.*

[90] *Ibid.*

[91] Sec. 163(j)(4)(D).

[92] Treas. Reg. sec. 1.163(j)–6(l)(5).

[93] Sec. 163(j)(8)(A). Treasury regulations provide other adjustments to the definition of adjusted taxable income. Sec. 163(j)(8)(B); Treas. Reg. sec. 1.163(j)–1(b)(1).

duction for depreciation, amortization, or depletion for taxable years beginning before January 1, 2026.[94]

EFFECTIVE DATE

While the proposal generally is effective for taxable years beginning after December 31, 2023, an elective transition rule allows a taxpayer to elect to apply the EBITDA limitation under section 163(j) to taxable years beginning after December 31, 2021.

3. EXTENSION OF 100 PERCENT BONUS DEPRECIATION (SEC. 203 OF THE BILL AND SEC. 168(K) OF THE CODE)

PRESENT LAW

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover the cost over time through annual deductions for depreciation or amortization.[95] The period for depreciation or amortization generally begins when the asset is placed in service by the taxpayer.[96] Tangible property generally is depreciated using the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention.[97]

Bonus depreciation

An additional first-year depreciation deduction equal to 100 percent of the adjusted basis of qualified property is allowed for property acquired after September 27, 2017,[98] and placed in service before January 1, 2023 (January 1, 2024 for certain property with a recovery period of at least 10 years, or certain transportation prop-

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[94] A partnership that has already filed Form 1065, *U.S. Return of Partnership Income*, for a taxable year beginning in 2022 may have to either supersede or amend its return or file an administrative adjustment request ("AAR") if it is subject to the Bipartisan Budget Act ("BBA") centralized partnership audit regime of sections 6221 through 6241. In general, only partnerships that are not subject to the BBA centralized partnership audit regime are able to file a superseding or amended Form 1065. Partnerships subject to those rules must instead file an AAR. See secs. 6221 and 6227. However, at times the IRS has exercised its authority under section 6031(b) and allowed BBA partnerships to instead file superseding or amended returns (while still being subject to the BBA centralized partnership audit regime). See, e.g., Rev. Proc. 2021–50, 2021–49 I.R.B. 844; Rev. Proc. 2021–29, 2021–27 I.R.B. 12; Rev. Proc. 2020–23, 2020–18 I.R.B. 749; and Rev. Proc. 2019–32, 2019–33 I.R.B. 659.

[95] See secs. 263(a) and 167. In general, only the tax owner of property (*i.e.,* the taxpayer with the benefits and burdens of ownership) is entitled to claim cost recovery deductions for the property. Where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.,* sec. 280A.

[96] See Treas. Reg. secs. 1.167(a)–10(b), –3, –14, and 1.197–2(f). See also Treas. Reg. sec. 1.167(a)–11(e)(1)(i).

[97] Sec. 168.

[98] For a description of section 168(k) as it applies to qualified property acquired before September 28, 2017, as well as a transition rule that permits a taxpayer to elect to apply a 50-percent allowance instead of the 100-percent allowance for a taxable year that includes September 28, 2017, see Joint Committee on Taxation, *General Explanation of Public Law No. 115–97* (JCS–1–18), December 2018, pp. 115–128. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

erty[99] and aircraft[100]).[101] The 100-percent allowance is phased down by 20 percentage points per calendar year for property acquired after September 27, 2017, and placed in service after December 31, 2022 (after December 31, 2023, for longer production period property and certain aircraft).[102] This additional first-year depreciation is commonly referred to as "bonus depreciation." The bonus depreciation applicable percentages for qualified property acquired and placed in service after September 27, 2017 (as well as for specified plants which are planted or grafted after September 27, 2017 (described below)) are as follows.

Placed in Service Year[103]	Bonus Depreciation Applicable Percentage	
	Qualified Property in General/ Specified Plants (%)	Longer Production Period Property and Certain Aircraft (%)
Sept. 28, 2017–Dec. 31, 2022	100	100
2023	80	100
2024	60	800
2025	40	60
2026	20	40
2027	None	20[104]
2028 and thereafter	None	None

The bonus depreciation deduction is allowed for both regular tax and alternative minimum tax purposes, but is not allowed in computing earnings and profits.[105] The basis of the property and the depreciation allowances in the placed in service year and later years are adjusted to reflect the bonus depreciation deduction.[106] The amount of the bonus depreciation deduction is not affected by a short taxable year.[107] A taxpayer may elect out of bonus depreciation for any class of property for any taxable year.[108] An election

[99] Property qualifying for the extended placed-in-service date must have a recovery period of at least 10 years or constitute transportation property, have an estimated production period exceeding one year, and have a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Sec. 168(k)(2)(B). Property defined in section 168(k)(2)(B) is hereinafter collectively referred to as "longer production period property."

[100] Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000. Sec. 168(k)(2)(C).

[101] Sec. 168(k). The bonus depreciation deduction is generally subject to the rules regarding whether a cost must be capitalized under section 263A. For a description of section 263A, see Joint Committee on Taxation, *Present Law and Background Regarding the Federal Income Taxation of Small Businesses* (JCX–10–23), June 5, 2023, pp. 15–17. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[102] Sec. 168(k)(6)(A) and (B).

[103] In the case of specified plants, this is the year of planting or grafting, as discussed below.

[104] 20 percent applies to the adjusted basis attributable to its manufacture, construction, or production before January 1, 2027. The remaining adjusted basis does not qualify for bonus depreciation. 20 percent applies to the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2027.

[105] Secs. 56A(c)(13), 168(k)(2)(G), and 312(k)(3).

[106] Sec. 168(k)(1).

[107] Treas. Reg. sec. 1.168(k)–2(e)(1)(ii).

[108] For the definition of a class of property, see Treas. Reg. sec. 1.168(k)–2(f)(1)(ii). Treas. Reg. sec. 1.168(k)–2(f)(1) provides the procedures for making an election not to deduct bonus depreciation.

out of bonus depreciation may be revoked only with the consent of the Secretary.[109]

Qualified property

Property qualifying for the bonus depreciation deduction must meet the following requirements:

- The property must be:

1. property to which MACRS applies with an applicable recovery period of 20 years or less,

2. computer software other than computer software required to be amortized under section 197,

3. water utility property,[110] or

4. a qualified film, television, or live theatrical production,[111] for which a deduction otherwise would have been allowable under section 181 without regard to the dollar limitation or termination of that section,[112]

- Either (i) the original use of the property must commence with the taxpayer,[113] or (ii) the property must not have been used by the taxpayer at any time before acquisition and the acquisition must meet the requirements of section 179(d)(2)(A)–(C) and (3),[114] and

- The property must be placed in service before January 1, 2027.[115]

The bonus depreciation deduction is not allowed for any property that is required to be depreciated under the alternative depreciation system ("ADS"),[116] or for listed property in respect of which

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[109] Sec. 168(k)(7). See also Treas. Reg. sec. 1.168(k)–2(f)(5).

[110] As defined in section 168(e)(5).

[111] As defined in section 181(d) and (e).

[112] Under section 181, a taxpayer may generally elect to deduct up to $15 million of the aggregate production costs ($20 million in the case of productions in certain areas) of any qualified film, television or live theatrical production, commencing prior to January 1, 2026, in the year the costs are paid or incurred by the taxpayer, in lieu of capitalizing the costs and recovering them through depreciation allowances once the production is placed in service. The costs of the production in excess of the applicable dollar limitation are capitalized and recovered under the taxpayer's method of accounting for the recovery of such property once placed in service (*e.g.*, under section 168(k) if eligible). For a description of section 181, see Joint Committee on Taxation, *General Explanation of Certain Tax Legislation Enacted in the 116th Congress* (JCS-1-22), February 2022, pp. 480-482. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[113] See Treas. Reg. sec. 1.168(k)–2(b)(3)(ii).

[114] Thus, used property must be purchased in an arm's length transaction. The property must not be acquired (i) from a member of the taxpayer's family, including a spouse, ancestors, and lineal descendants, or from another related entity as defined in section 267; (ii) from a person who controls, is controlled by, or is under common control with, the taxpayer; nor (iii) in a nontaxable exchange such as a reorganization. The property must not be received as a gift or from a decedent. In the case of trade-ins, like-kind exchanges, or involuntary conversions, bonus depreciation applies only to any money paid in addition to the traded-in property or in excess of the adjusted basis of the replaced property. See sec. 179(d)(2)(A)–(C) and (3); Treas. Reg. secs. 1.168(k)–2(b)(3)(iii) and 1.179–4(c) and (d). A special rule applies in the case of a syndication transaction. See sec. 168(k)(2)(E)(iii); Treas. Reg. sec. 1.168(k)–2(b)(3)(vi).

[115] A qualified production is considered placed in service, and thus eligible for the bonus depreciation allowance, at the time of initial release, broadcast, or live staged performance. Sec. 168(k)(2)(H); Treas. Reg. sec. 1.168(k)–2(b)(4)(iii).

[116] See sec. 168(g) (determined without regard to an election to use ADS under section 168(g)(7)). See also Treas. Reg. sec. 1.168(k)–2(b)(2)(ii)(B). ADS is required to be used for tangible property used predominantly outside the United States, certain tax-exempt use property, tax-exempt bond financed property, certain imported property covered by an Executive order, and certain property held by either a real property trade or business or a farming business electing out of the business interest limitation under section 163(j). In addition, an election to use ADS is available to taxpayers for any class of property for any taxable year. Under ADS, all property is depreciated using the straight-line method and applicable convention over recovery periods which generally are equal to the class life of the property.

the business use is not greater than 50 percent (as determined under section 280F(b)).[117]

In the case of longer production period property and certain aircraft, the property must also be acquired (or acquired pursuant to a written binding contract entered into) before January 1, 2027, and placed in service before January 1, 2028.[118] With respect to such property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property before January 1, 2027.[119] Additionally, a special rule limits the amount of costs of longer production period property eligible for bonus depreciation. With respect to this property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2027 ("progress expenditures") is eligible for the bonus depreciation deduction.[120]

Exception for certain businesses not subject to the limitation on interest expense

Qualified property eligible for the bonus depreciation deduction does not include any property which is primarily used in the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.[121]

Qualified property also does not include any property used in a trade or business that has had floor plan financing indebtedness[122] if the interest related to the indebtedness is taken into account to increase the taxpayer's section 163(j) interest limitation under section 163(j)(1)(C).[123]

Special rules

Passenger automobiles

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify for (and for which the taxpayer does not elect out of) bonus depreciation.[124] While the underlying section 280F limitation is indexed

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[117] Sec. 168(k)(2)(D). For a description of section 280F, see Joint Committee on Taxation, *General Explanation of Public Law No. 115–97* (JCS–1–18), December 2018, pp. 128–130. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[118] Sec. 168(k)(2)(B)(i)(II) and (III).

[119] Sec. 168(k)(2)(E)(i).

[120] Sec. 168(k)(2)(B)(ii). See also Treas. Reg. sec. 1.168(k)–2(e)(1)(iii).

[121] Secs. 168(k)(9)(A) and 163(j)(7)(A)(iv). See also Treas. Reg. sec. 1.168(k)–2(b)(2)(ii)(F).

[122] As defined in section 163(j)(9).

[123] Sec. 168(k)(9)(B). See also Treas. Reg. sec. 1.168(k)–2(b)(2)(ii)(G).

[124] Sec. 168(k)(2)(F). See Rev. Proc. 2019–13, 2019–09 I.R.B. 744, for a safe harbor method of accounting for determining depreciation deductions for passenger automobiles that qualify for bonus depreciation and are subject to the section 280F depreciation limitations.

for inflation,[125] the section 280F increase amount is not indexed for inflation.

Certain plants bearing fruits and nuts

A farming business[126] is allowed a special election in respect of certain costs of planting or grafting certain plants bearing fruits and nuts.[127] Under the election, the applicable percentage of the adjusted basis of a specified plant which is planted or grafted after September 27, 2017, and before January 1, 2027, is deductible for regular tax and alternative minimum tax purposes in the year planted or grafted by the taxpayer in the ordinary course of the taxpayer's farming business (rather than in the year the specified plant is placed in service by the taxpayer[128]), and the adjusted basis is reduced by the amount of the deduction.[129] The applicable percentage is 100 percent for specified plants planted or grafted after September 27, 2017, and before January 1, 2023, and then is phased down by 20 percentage points per calendar year beginning in 2023.[130] Thus, the applicable percentage is 80 percent for 2023, 60 percent for 2024, 40 percent for 2025, and 20 percent for 2026.

A specified plant is (i) any tree or vine that bears fruits or nuts, and (ii) any other plant that will have more than one crop or yield of fruits or nuts and which generally has a pre-productive period of more than two years from the time of planting or grafting to the time it begins bearing a marketable crop or yield of fruits or nuts.[131] A specified plant does not include any property that is planted or grafted outside of the United States. If the election is made with respect to any specified plant, the plant is not treated as qualified property eligible for bonus depreciation in the subsequent taxable year in which it is placed in service.[132] Once made, the election is revocable only with the consent of the Secretary.[133]

Long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[134] Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service be-

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[125] Sec. 280F(d)(7). See Rev. Proc. 2023–14, 2023–6 I.R.B. 466, for the section 280F limitations that apply to passenger automobiles placed in service during calendar year 2023.

[126] For this purpose, the term "farming business" means the trade or business of farming, including the trade or business of operating a nursery or sod farm, the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots). Sec. 263A(e)(4).

[127] Sec. 168(k)(5). Treas. Reg. sec. 1.168(k)–2(f)(2) provides the procedures for making a section 168(k)(5) election.

[128] In the case of any tree or vine bearing fruits or nuts, the placed in service date generally does not occur until the tree or vine first reaches an income-producing stage. See Treas. Reg. sec. 1.46–3(d)(2). See also Rev. Rul. 80–25, 1980–1 C.B. 65; and Rev. Rul. 69–249, 1969–1 C.B. 31.

[129] Any amount deducted under this election is not subject to capitalization under section 263A. Sec. 263A(c)(7).

[130] Sec. 168(k)(6)(C).

[131] Sec. 168(k)(5)(B).

[132] Sec. 168(k)(5)(D). However, when placed in service, the remaining adjusted basis of the specified plant may be eligible for expensing under section 179.

[133] Sec. 168(k)(5)(C). See also Treas. Reg. sec. 1.168(k)–2(f)(5).

[134] Sec. 460.

fore January 1, 2027 (January 1, 2028, in the case of longer production period property).[135]

REASONS FOR CHANGE

The Committee believes that providing full expensing for certain business assets will accelerate equipment and other asset purchases, and promote capital investment, modernization, and growth. The Committee also believes that bonus depreciation is important for small businesses that qualify for the section 179 deduction because the deduction is limited to taxable income. Combining bonus depreciation with the section 179 deduction provides flexibility and accelerated cost recovery for most businesses.

The Committee also believes that providing full expensing for certain production costs of qualified film, television, and live theatrical products (as defined in section 181) will encourage investment in and financing of domestic productions and will help to prevent the production of American projects abroad. These productions create broader economic effects in cities and towns across the United States, with revenues and jobs generated in a variety of other local businesses including hotels, restaurants, catering companies, equipment rental facilities, transportation vendors, and many others.

The Committee further believes that allowing growers of certain plants bearing fruit or nuts to elect to claim full expensing in the year of planting or grafting, rather than having to wait until the year in which the plant produces a commercially viable or harvestable crop of fruits or nuts, encourages farmers to invest in long-term crops.

EXPLANATION OF PROVISION

The proposal extends the allowance of a 100-percent bonus depreciation deduction for property placed in service after December 31, 2022, and before January 1, 2026 (January 1, 2027, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after December 31, 2022, and before January 1, 2026. The proposal retains the present law 20-percent bonus depreciation deduction that is allowed for property placed in service after December 31, 2025, and before January 1, 2027 (after December 31, 2026, and before January 1, 2028, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after December 31, 2025, and before January 1, 2027.

Under the proposal, the bonus depreciation percentage rates are as follows.

Placed in Service Calendar Year[136]	Bonus Depreciation Applicable Percentage	
	Qualified Property in General/ Specified Plants (%)	Longer Production Period Property and Certain Aircraft (%)
2023–2025	100	100

[135] Sec. 460(c)(6).

Placed in Service Calendar Year [136]	Bonus Depreciation Applicable Percentage	
	Qualified Property in General/ Specified Plants (%)	Longer Production Period Property and Certain Aircraft (%)
2026	20	100
2027	None	20 [137]
2028 and thereafter	None	None

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2022, and to specified plants planted or grafted after that date.

4. INCREASE IN LIMITATIONS ON EXPENSING OF DEPRECIABLE BUSINESS ASSETS (SEC. 204 OF THE BILL AND SEC. 179 OF THE CODE)

PRESENT LAW

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[138] The period for depreciation or amortization generally begins when the asset is placed in service by the taxpayer.[139] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention.[140]

Election to expense certain depreciable business assets

Subject to certain limitations, a taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.[141] The maximum amount a taxpayer may expense is $1,000,000 of the cost of qualifying property placed in service for the taxable year.[142] The $1,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,500,000.[143]

The $1,000,000 and $2,500,000 amounts are indexed for inflation for taxable years beginning after 2018.[144] For taxable years begin-

[136] In the case of specified plants, this is the year of planting or grafting.

[137] 20 percent applies to progress expenditures incurred before January 1, 2027, and the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2027.

[138] See secs. 263(a) and 167. In general, only the tax owner of property (*i.e.*, the taxpayer with the benefits and burdens of ownership) is entitled to claim cost recovery deductions with respect to the property. In addition, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, sec. 280A.

[139] See Treas. Reg. secs. 1.167(a)–10(b), –3, –14, and 1.197–2(f). See also Treas. Reg. sec. 1.167(a)–11(e)(1)(i).

[140] Sec. 168.

[141] In the case of property purchased and placed in service by a partnership (or S corporation), the determination of whether the property is section 179 property is made at the partnership (or corporate) level, and the election to expense is made by the partnership (or S corporation). Treas. Reg. sec. 1.179–1(h).

[142] Sec. 179(b)(1).

[143] Sec. 179(b)(2).

[144] Sec. 179(b)(6).

ning in 2023, the total amount that may be expensed is $1,160,000, and the phaseout threshold amount is $2,890,000.[145] For example, assume that during 2023 a calendar year taxpayer purchased and placed in service $4,000,000 of section 179 property. The $1,160,000 section 179(b)(1) dollar amount for 2023 is reduced by the excess section 179 property cost amount of $1,110,000 ($4,000,000 − $2,890,000). The taxpayer's 2023 section 179 expensing limitation is $50,000 ($1,160,000 − $1,110,000).[146]

In general, qualifying property is defined as depreciable tangible personal property, off-the-shelf computer software, and qualified real property[147] that is purchased for use in the active conduct of a trade or business.[148] Qualifying property excludes any property described in section 50(b) (other than paragraph (2) thereof[149]).[150]

Qualified real property includes (1) qualified improvement property[151] and (2) any of the following improvements to nonresidential real property that are placed in service by the taxpayer after the date such nonresidential real property was first placed in service: roofs; heating, ventilation, and air-conditioning ("HVAC") property;[152] fire protection and alarm systems; and security systems.[153]

Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F.[154] For sport utility vehicles above the 6,000 pound weight rating and not more than the 14,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for any taxable year under section 179 is $25,000 (the "sport utility vehicle limitation").[155] The $25,000 amount is indexed for inflation for taxable years beginning after 2018. For taxable years beginning in 2023, the sport utility vehicle limitation is $28,900.[156]

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[145] Section 3.25 of Rev. Proc. 2022–38, 2022–45 I.R.B. 445.

[146] The taxpayer's remaining basis in the property may be eligible for bonus depreciation under section 168(k). See Treas. Reg. sec. 1.168(k)–1(a)(2)(iii).

[147] At the election of the taxpayer. Sec. 179(d)(1)(B)(ii). See sec. 3.02 of Rev. Proc. 2019–08, 2019–03 I.R.B. 347, for guidance regarding the election to treat qualified real property as section 179 property.

[148] Sec. 179(d)(1). If section 179 property is not used predominantly in a trade or business of the taxpayer at any time before the end of its recovery period, recapture rules apply. See sec. 179(d)(10) and Treas. Reg. sec. 1.179–1(e).

[149] Thus, section 179 property includes certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging (*e.g.*, beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided and let). See Treas. Reg. sec. 1.48–1(h).

[150] Sec. 179(d)(1) flush language. Property described in section 50(b) (other than paragraph (2) thereof) is generally property used outside the United States, property used by certain tax-exempt organizations, and property used by governmental units and foreign persons or entities (*i.e.*, certain property not eligible for the investment tax credit).

[151] As defined in sec. 168(e)(6).

[152] HVAC property includes all components (whether in, on, or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes, and ducts. Treas. Reg. sec. 1.48–1(e)(2). See also sec. 3.01(1)(b)(iii)(B) of Rev. Proc. 2019–08, 2019–03 I.R.B. 347.

[153] Sec. 179(e).

[154] For a description of section 280F, see Joint Committee on Taxation, *General Explanation of Public Law 115–97* (JCS–1–18), December 2018, pp. 128–130. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[155] Sec. 179(b)(5). For this purpose, a sport utility vehicle is defined to exclude any vehicle that: (1) is designed for more than nine individuals in seating rearward of the driver's seat; (2) is equipped with an open cargo area, or a covered box not readily accessible from the passenger compartment, of at least six feet in interior length; or (3) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

[156] Section 3.25 of Rev. Proc. 2022–38, 2022–45 I.R.B. 445.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to section 179).[157] Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations). In the case of a partnership (or S corporation), the section 179 limitations are applied at the partnership (or corporate) and partner (or shareholder) levels.[158]

Amounts expensed under section 179 are allowed for both regular tax and alternative minimum tax purposes.[159] However, no general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.[160] In addition, if a corporation makes an election under section 179 to deduct expenditures, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted under section 179 reduce corporate earnings and profits ratably over a five-year period.[161]

An expensing election is made under rules prescribed by the Secretary.[162] In general, any election made under section 179, and any specification contained therein, may be revoked by the taxpayer with respect to any property without the consent of the Commissioner.[163] Such revocation, once made, is irrevocable.

REASONS FOR CHANGE

The Committee believes that section 179 expensing provides two important benefits for small businesses. First, it lowers the cost of capital for certain property used in a trade or business. With a lower cost of capital, the Committee believes that small businesses will invest in more equipment, expand their businesses, and employ more workers. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. To increase the value of these benefits and the number of eligible taxpayers that may receive these benefits, the provision increases both the amount allowed to be expensed under section 179 and the amount of the phase-out threshold. The provision indexes these amounts for inflation to counteract the negative effect of inflation on the limit and phase-out threshold of this provision for small businesses.

EXPLANATION OF PROVISION

The proposal increases the maximum amount a taxpayer may expense under section 179 to $1,290,000 and increases the phaseout threshold amount to $3,220,000. The proposal provides that the maximum amount a taxpayer may expense for taxable years begin-

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[157] Sec. 179(b)(3). See also Treas. Reg. sec. 1.179–2(c)(6)(iv) (wages, salaries, tips, and other compensation received by a taxpayer as an employee are included in the taxpayer's aggregate amount of taxable income derived from the active conduct of a trade or business).

[158] Sec. 179(d)(8).

[159] See the Senate Finance Committee Report to Accompany H.R. 3838, Tax Reform Act of 1986, S. Rep. No. 99–313, May 29, 1985, p. 522. See also the Instructions for Form 6251, *Alternative Minimum Tax—Individuals (2022)*, p. 5.

[160] Sec. 179(d)(9).

[161] Sec. 312(k)(3)(B).

[162] Sec. 179(c)(1). Such election may be made on an amended return. See sec. 3.02 of Rev. Proc. 2017–33, 2017–19 I.R.B. 1236; and sec. 3.02 of Rev. Proc. 2019–08, 2019–03 I.R.B. 347.

[163] Sec. 179(c)(2).

ning after 2023 is $1,290,000 of the cost of section 179 property placed in service for the taxable year. The $1,290,000 amount is reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during the taxable year exceeds $3,220,000. The $1,290,000 and $3,220,000 amounts are indexed for inflation for taxable years beginning after 2024.

For example, assume that during 2024 a calendar year taxpayer purchases and places in service $4,000,000 of section 179 property. The $1,290,000 section 179(b)(1) dollar amount for 2024 will be reduced by the excess section 179 property cost amount of $780,000 ($4,000,000 − $3,220,000 limitation). Thus, the taxpayer's 2024 section 179 limitation will be $510,000 ($1,290,000 dollar limitation − $780,000 excess). The remaining $3,490,000 ($4,000,000 − $510,000 section 179 expense) may be eligible for bonus depreciation under section 168(k).

EFFECTIVE DATE

The proposal applies to property placed in service in taxable years beginning after December 31, 2023.

TITLE III—INCREASING GLOBAL COMPETITIVENESS

A. THE UNITED STATES-TAIWAN EXPEDITED DOUBLE-TAX RELIEF ACT (SECS. 301 AND 302 OF THE BILL AND CODE SECTIONS 860C, 871, 881, 882, 884, 894, 897 1441, 1442, AND 7874; NEW CODE SECTIONS 894A AND 1447)

PRESENT LAW

The following discussion summarizes U.S. taxation of income from cross-border business activity, with emphasis on how the rules determine whether the income is subject to tax by the United States or another jurisdiction in either the Internal Revenue Code [164] or in bilateral agreements in which the United States agrees to relieve double taxation when its jurisdiction to tax overlaps or is in conflict with that of another jurisdiction.

International law generally recognizes the right of each sovereign nation to prescribe rules to regulate conduct and persons (whether natural or juridical) with a sufficient nexus to the sovereign nation. The nexus may be based on nationality (*i.e.*, a nexus based on a connection between the relevant person and the sovereign nation) or may be territorial (*i.e.*, a nexus based on a connection between the relevant conduct and the sovereign nation). These concepts have been refined and adapted to form the principles for determining whether sufficient nexus with a jurisdiction exists to conclude that the jurisdiction may enforce its right to tax.

1. U.S. Tax Principles Common to Inbound and Outbound Taxation

Taxes based on where activities occur, or where property is located, are source-based taxes. The United States generally taxes the U.S. trades or businesses of foreign persons and sales or other dispositions of interests in U.S. real property by foreign persons. In addition, the United States generally taxes items of income that

[164] Unless otherwise stated, section references are to the Internal Revenue Code of 1986, as amended (the "Code").

are paid by U.S. persons to foreign persons. Most jurisdictions, including the United States, have rules for determining the source of items of income and expense in a broad range of categories, such as compensation for services, dividends, interest, royalties, and gains.

Income taxes based on a person's citizenship, nationality, or residence are residence-based taxes. The United States generally imposes residence-based taxation on U.S. persons in the year in which income is earned. For individuals and domestic entities, this results in taxing them on their worldwide income, whether derived in the United States or abroad, with limited opportunity for deferral of taxation of income earned by foreign corporations owned by U.S. shareholders. As explained below, income earned by a resident of the United States from foreign activities conducted through a foreign entity generally is subject to U.S. tax in the year earned or not at all. The United States generally taxes foreign persons on only U.S.-source income.

The United States imposes source-based taxation on U.S.-source income of nonresident alien individuals and other foreign persons. Under this system, the application of the Code differs depending on whether income arises from outbound investment (*i.e.*, foreign investments by U.S. persons) or inbound investment (*i.e.*, U.S. investment by foreign persons). While the United States taxes inbound and outbound investments differently, certain rules are common to the taxation of both, including rules relating to residency, entity classification, source determination, and transfer pricing.

Residence

The Code defines a U.S. person to include all U.S. citizens and residents as well as domestic entities such as partnerships, corporations, trusts and estates.[165] Partnerships and corporations are domestic if organized or created under the laws of the United States, any State, or the District of Columbia, unless, in the case of a partnership, the Secretary prescribes otherwise by regulation.[166] All other partnerships and corporations (*i.e.*, those organized under the laws of foreign countries) are foreign.[167] Other jurisdictions may use factors such as situs or management and control to determine residence. As a result, legal entities may have more than one tax residence, or, in some cases, no residence. In such cases, bilateral treaties may resolve conflicting claims of residence.

Exception for corporate inversions

In certain cases, a foreign corporation that acquires a domestic corporation or partnership may be treated as a domestic corporation for Federal tax purposes.[168] This result generally applies following a transaction in which, pursuant to a plan or a series of related transactions:

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[165] Sec. 7701(a)(30).

[166] Sec. 7701(a)(4) and (10).

[167] Sec. 7701(a)(5) and (9). Entities organized in a possession or territory of the United States are not considered to have been organized under the laws of the United States.

[168] Sec. 7874. The Treasury Department and the IRS have promulgated detailed guidance, through both regulations and several notices, addressing these requirements under section 7874 since its enactment in 2004, and have sought to expand the reach of the section or reduce the tax benefits of inversion transactions.

1. A domestic corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity;

2. The former shareholders of the domestic corporation hold (by reason of the stock they had held in the domestic corporation) at least 80 percent (by vote or value) of the stock of the foreign-incorporated entity after the transaction (often referred to as "stock held by reason of"); and

3. The foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50-percent ownership (the "expanded affiliated group"), does not have substantial business activities in the entity's country of organization, compared to the total worldwide business activities of the expanded affiliated group.

If the "stock held by reason of" the acquisition is less than 80 percent, but at least 60 percent of the stock of the foreign corporation, and the other requirements above are satisfied, then the foreign corporation is not treated as a domestic corporation. Instead, the foreign corporation is considered a surrogate foreign corporation for the acquired domestic company, which is an expatriated entity that must recognize certain "inversion gain" post-acquisition restructuring [169] and may be subject to other consequences under the provisions enacted in 2017.[170]

Source of income rules

Various factors determine the source of income for U.S. tax purposes, including the status or nationality of the payor or recipient and the location of the activities or assets that generate the income. Extensive rules determine whether income is considered to be from U.S. sources or foreign sources.[171] Special rules are provided for certain industries, (*e.g.*, transportation, shipping, and certain space and ocean activities) as well as for income partly from within and partly from without the United States.[172]

Gains, profits, and income from the sale or exchange of inventory property that is either (1) produced (in whole or in part) inside the United States and then sold or exchanged outside the United States or (2) produced (in whole or part) outside the United States and then sold or exchanged inside the United States is allocated and apportioned solely on the basis of the location of the production activities.[173] For example, income derived from the sale of inventory produced entirely in the United States is wholly from U.S. sources, even if title passage occurs elsewhere. Likewise, income derived from the sale of inventory produced entirely in another country is wholly from foreign sources, even if title passage occurs

[169] An excise tax may be imposed on certain stock compensation of executives of companies that undertake inversion transactions. Sec. 4985. In addition, dividends from certain surrogate foreign corporations are excluded from qualified dividend income within the meaning of section 1(h)(11)(B) and are ineligible to be taxed as net capital gains. Sec. 1(h)(11)(C)(iii). As a result, individual shareholders in such corporations cannot claim the reduced rate on dividends otherwise available under section 1(h)(11).

[170] See secs. 59A(d)(4) (providing that payments made to expatriated entities that reduce gross receipts are base erosion payments) and 965(l) (disallowing the partial participation exemption deduction for computing the transition tax and assessing the additional transition tax in the year of inversion if an entity inverts within the 10-year period beginning on December 22, 2017).

[171] Sections 861 through 865, generally.

[172] Sec. 863.

[173] Sec. 863(b). Prior to Public Law 115–97, enacted on December 22, 2017, the source of income from sale of inventory was determined by passage of title.

in the United States. If inventory is produced only partly in the United States, the income derived from its sale is sourced partly in the United States regardless of where title to the property passes.

2. U.S. Tax Rules Applicable to Foreign Activities of U.S. Persons

In general, income earned directly by a U.S. person from the conduct of a foreign trade or business is taxed currently,[174] while income earned indirectly through certain related foreign entities (*i.e.*, controlled foreign corporations ("CFCs"))[175] is taxed in the year earned or not at all. Earnings and profits of CFCs are generally taxable in one of two ways. First, the earnings may constitute income to U.S. shareholders under the traditional anti-deferral regime of subpart F, which applies to certain passive income and income that is readily movable from one jurisdiction to another.[176] Subpart F was designed as an anti-abuse regime to prevent U.S. taxpayers from shifting passive and mobile income to low-tax jurisdictions.[177] Second, the earnings may be subject to section 951A, which applies to some foreign-source income of a CFC that is not subpart F income (referred to as global intangible low-taxed income ("GILTI")). GILTI was enacted as a base protection measure to counter the participation exemption system, established by the dividends-received-deduction, under which the income could potentially be distributed back to the U.S. corporation with no U.S. tax imposed.[178] Subpart F income is taxed at full rates with related foreign taxes generally eligible for the foreign tax credit; GILTI is taxed at reduced rates with additional limitations on the use of related foreign tax credits. Both subpart F income and GILTI are included by the U.S. shareholder without regard to whether the earnings are distributed by the CFC.

In addition to the taxation of GILTI at reduced rates, U.S. corporations generally are taxed at reduced rates on their foreign-derived intangible income ("FDII").[179] Foreign earnings not subject to tax as subpart F income or GILTI generally are exempt from U.S. tax. To exempt those earnings, dividends received by corporate U.S. shareholders from specified 10-percent owned foreign corporations (including CFCs) generally are eligible for a 100-percent dividends-received deduction ("DRD").[180] Special rules apply in situations in which a U.S. person transfers property to a foreign corporation or certain partnerships in certain nonrecognition transactions.[181]

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[174] Such income is called foreign branch income.

[175] A CFC generally is defined as any foreign corporation in which U.S. persons own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value), taking into account only "U.S. shareholders," that is, U.S. persons who own at least 10 percent of the stock (measured by vote or value). See secs. 951(b), 957, and 958. Special rules apply with respect to U.S. persons that are shareholders (regardless of their percentage ownership) in any foreign corporation that is not a CFC but is a passive foreign investment company ("PFIC"). See secs. 1291 through 1298. The PFIC rules generally seek to prevent the deferral of passive income through the use of foreign corporations.

[176] Subpart F comprises sections 951 through 965.

[177] See JCS–5–61, "Tax Effects of Conducting Foreign Business through Foreign Corporations" (July 21, 1961), Part V. See also Rev. Act. of 1962, Pub. L. 87–834.

[178] See Reconciliation Recommendations Pursuant to H. Con. Res. 71 (December 2017).

[179] Sec. 250(a)(1)(A).

[180] Sec. 245A. The DRD is not limited to dividends from CFCs, but rather may be available with respect to any dividend received from a specified 10-percent owned foreign corporation by a domestic corporation which is a U.S. shareholder with respect to such foreign corporation.

[181] Secs. 367 and 721(c); Treas. Reg. sec. 1.721(c)–1.

3. U.S. Tax Rules Applicable to Foreign Persons

Nonresident aliens and foreign corporations generally are subject to U.S. tax only on their U.S.-source income. There are two broad types of taxation of U.S.-source income of foreign taxpayers: (1) gross-basis tax on income that is "fixed or determinable annual or periodical gains, profits, and income" (*i.e.*, FDAP income), and (2) net-basis tax on income that is "effectively connected with the conduct of a trade or business within the United States" (*i.e.*, ECI). FDAP income, although nominally subject to a statutory 30-percent gross-basis tax withheld at its source, in many cases is subject to a reduced rate of, or entirely exempt from, U.S. tax under the Code or a bilateral income tax treaty. ECI generally is subject to the same U.S. tax rules and rates that apply to business income earned by U.S. persons.

Finally, certain corporations are subject to a base erosion and anti-abuse tax ("BEAT") that is in the nature of a minimum tax and payable in addition to all other tax liabilities.[182]

Gross-basis taxation of U.S.-source income

FDAP income received by foreign persons from U.S. sources is subject to a 30-percent gross-basis tax (*i.e.*, a tax on gross income without reduction for related expenses), which is collected by withholding at the source of the payment. FDAP income includes interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments.[183] The items enumerated in defining FDAP income are illustrative, and the words "annual or periodical" are "merely generally descriptive" of the payments within the purview of the statute.[184] The categories of income subject to the 30-percent tax and the categories for which withholding is required generally are coextensive.[185]

Exclusions from FDAP income

FDAP income encompasses a broad range of gross income but has important exceptions. Capital gains of nonresident aliens generally are foreign source; however, capital gains of nonresident aliens present in the United States for 183 days or more[186] during the year are income from U.S. sources subject to gross-basis taxation.[187] In addition, U.S.-source gains from the sale or exchange of intangibles are subject to tax and withholding if they are contingent on the productivity, use, or disposition of the property sold.[188]

Interest on bank deposits may qualify for exemption from treatment as FDAP income on two grounds. First, interest on deposits with domestic banks and savings and loan associations, and certain amounts held by insurance companies, is U.S.-source income but is exempt from the 30-percent tax when paid to a foreign person.[189]

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[182] Sec. 59A.
[183] Secs. 871(a) and 881. FDAP income that is ECI is taxed as ECI.
[184] *Commissioner v. Wodehouse*, 337 U.S. 369, 393 (1949).
[185] See secs. 1441 and 1442.
[186] For purposes of this rule, whether a person is considered a resident in the United States is determined by application of the rules under section 7701(b).
[187] Sec. 871(a)(2). In addition, certain capital gains from sales of U.S. real property interests are subject to tax as ECI under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"). See sec. 897(a)(1).
[188] Secs. 871(a)(1)(D) and 881(a)(4).
[189] Secs. 871(i)(2)(A) and 881(d); Treas. Reg. sec. 1.1441–1(b)(4)(ii).

Second, interest on deposits with foreign branches of domestic banks and domestic savings and loan associations is not U.S.-source income and, thus, is not subject to U.S. tax.[190] Interest and original issue discount on certain short-term obligations also is exempt from U.S. tax when paid to a foreign person.[191] In addition, an exception to information reporting requirements may apply with respect to payments of such exempt amounts.[192]

Although FDAP income includes U.S.-source portfolio interest, such interest is specifically exempt from the 30-percent gross-basis tax. Portfolio interest is any interest (including original issue discount) that is paid on an obligation that is in registered form and for which the beneficial owner has provided to the U.S. withholding agent a statement certifying that the beneficial owner is not a U.S. person.[193] Portfolio interest, however, does not include interest received by a 10-percent shareholder,[194] certain contingent interest,[195] interest received by a CFC from a related person,[196] or interest received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business.[197]

Withholding of 30-percent gross-basis tax

The 30-percent tax on FDAP income is generally collected by means of withholding.[198] Withholding on FDAP payments to foreign payees is required unless the withholding agent (i.e., the person making the payment to the foreign person) can establish that the beneficial owner of the amount is eligible for an exemption from withholding or a reduced rate of withholding under an income tax treaty.[199]

Often, the income subject to withholding is the only income of the foreign person subject to any U.S. tax. If the foreign person has no ECI and the withholding is sufficient to satisfy the tax liability with respect to FDAP income, the foreign person generally is not required to file a U.S. Federal income tax return. Accordingly, the withholding of the 30-percent gross-basis tax generally represents the collection of the foreign person's final U.S. tax liability.

To the extent that a withholding agent withholds an amount, the withheld tax is credited to the foreign recipient of the income.[200] If the agent withholds more than is required, and that results in

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[190] Sec. 861(a)(1); Treas. Reg. sec. 1.1441–1(b)(4)(iii).

[191] Secs. 871(g)(1)(B) and 881(a)(3); Treas. Reg. sec. 1.1441–1(b)(4)(iv).

[192] Treas. Reg. sec. 1.1461–1(c)(2)(ii)(A) and (B). A bank must report interest if the recipient is a nonresident alien who resides in a country with which the United States has a satisfactory exchange of information program under a bilateral agreement and the deposit is maintained at an office in the United States. Treas. Reg. secs. 1.6049–4(b)(5) and –8. The IRS publishes lists of the countries whose residents are subject to the reporting requirements, and those countries with respect to which the reported information is automatically exchanged. See Rev. Proc. 2022–35, 2022–40 I.R.B. 270.

[193] Sec. 871(h)(2).

[194] Sec. 871(h)(3). The exemption does not apply to interest payments made to a foreign lender that owns 10 percent or more of the voting power (but not value) of the stock of the borrower.

[195] Sec. 871(h)(4).

[196] Sec. 881(c)(3)(C).

[197] Sec. 881(c)(3)(A).

[198] Secs. 1441 and 1442.

[199] A withholding agent includes any U.S. or foreign person that has the control, receipt, custody, disposal, or payment of an item of income of a foreign person subject to withholding. Treas. Reg. sec. 1.1441–7(a). See also Treas. Reg. sec. 1.1441–6 (providing, in part, the requirements (including documentary evidence) that must be satisfied for purposes of claiming the benefits of an exemption from or reduced rate of withholding under a treaty).

[200] Sec. 1462.

an overpayment of tax, the foreign recipient may file a claim for refund.

Net-basis taxation of income from conduct of a trade or business within the United States

Income that is effectively connected with the conduct of a trade or business within the United States ("ECI") generally is subject to tax on a net basis under the same U.S. tax rules and rates that apply to business income earned by U.S. persons.[201]

U.S. trade or business

A foreign person is subject to U.S. tax on a net basis if the person is engaged in a U.S. trade or business. Partners in a partnership and beneficiaries of an estate or trust are treated as engaged in a U.S. trade or business if the partnership, estate, or trust is so engaged.[202]

Whether a foreign person is engaged in a U.S. trade or business is a factual question that has generated a significant amount of case law. Basic issues include whether the activity rises to the level of a trade or business, whether a trade or business has sufficient connections to the United States, and whether the relationship between the foreign person and persons performing activities in the United States for the foreign person is sufficient to attribute those activities to the foreign person.

The trade or business rules differ from one activity to another. The term "trade or business within the United States" expressly includes the performance of personal services within the United States.[203] Detailed rules govern whether trading in stock or securities, or in commodities, constitutes the conduct of a U.S. trade or business.[204] A foreign person who trades in stock or securities, or in commodities, in the United States through an independent agent generally is not treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which trades are carried out. A foreign person who trades stock or securities, or commodities, for the person's own account also generally is not considered to be engaged in a U.S. trade or business so long as the foreign person is not a dealer in stock or securities, or in commodities. This may be the case even in the presence of an office or fixed place of business in the United States through which trades for the person's own account are carried out.

For eligible foreign persons, U.S. bilateral income tax treaties restrict the application of net-basis U.S. taxation. Under each treaty, the United States is permitted to tax business profits only to the extent those profits are attributable to a U.S. permanent establishment of the foreign person. The threshold level of activities that constitute a permanent establishment is generally higher than the threshold level of activities that constitute a U.S. trade or business. For example, a permanent establishment typically requires the maintenance of a fixed place of business over a significant period of time.

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[201] Secs. 871(b) and 882.
[202] Sec. 875.
[203] Sec. 864(b).
[204] Sec. 864(b)(2) and Treas. Reg. sec. 1.864–2(c) and (d).

Effectively connected income

A foreign person that is engaged in the conduct of a trade or business within the United States is subject to U.S. net-basis taxation on ECI from that trade or business. Specific statutory rules govern whether income is ECI.[205]

In general, for a foreign person engaged in the conduct of a U.S. trade or business, all income, gain, or loss from sources within the United States is treated as ECI.[206]

In the case of U.S.-source capital gain and U.S.-source income of a type that would be subject to gross-basis U.S. taxation, the factors taken into account in determining whether the income is ECI include whether the income is derived from assets used in or held for use in the conduct of the U.S. trade or business, and whether the activities of the U.S. trade or business were a material factor in the realization of the amount (the "asset use" and "business activities" tests).[207] Under the asset use and business activities tests, due regard is given to whether such asset or such income, gain, deduction, or loss was accounted for through the trade or business.

A foreign person that is engaged in a U.S. trade or business may have limited categories of foreign-source income that are considered to be ECI.[208] A foreign tax credit may be allowed with respect to foreign income tax imposed on such income.[209] Foreign-source income not included in one of those categories generally is exempt from U.S. tax.

In determining whether a foreign person has a U.S. office or other fixed place of business, the office or other fixed place of business of an independent agent generally is disregarded. The place of business of an agent other than an independent agent acting in the ordinary course of business is not disregarded, however, if the agent either has the authority (regularly exercised) to negotiate and conclude contracts in the name of the foreign person or has a stock of merchandise from which the agent regularly fills orders on behalf of the foreign person.[210] If a foreign person has a U.S. office or fixed place of business, income, gain, deduction, or loss is not considered attributable to the office unless the office is a material factor in the production of the income, gain, deduction, or loss and the office regularly carries on activities of the type from which the income, gain, deduction, or loss is derived.[211]

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[205] Sec. 864(c).
[206] Sec. 864(c)(3).
[207] Sec. 864(c)(2).
[208] A foreign person's income from foreign sources generally is considered to be ECI only if the person has an office or other fixed place of business within the United States to which the income is attributable and the income is in one of the following categories: (1) rents or royalties for the use of patents, copyrights, secret processes or formulas, goodwill, trademarks, trade brands, franchises, or other like intangible properties derived in the active conduct of the trade or business; (2) interest or dividends derived in the active conduct of a banking, financing, or similar business within the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; or (3) income derived from the sale or exchange (outside the United States), through the U.S. office or fixed place of business, of inventory or property held by the foreign person primarily for sale to customers in the ordinary course of the trade or business, unless the sale or exchange is for use, consumption, or disposition outside the United States and an office or other fixed place of business of the foreign person in a foreign country participated materially in the sale or exchange. Foreign-source dividends, interest, and royalties are not treated as ECI if the items are paid by a foreign corporation more than 50 percent (by vote) of which is owned directly, indirectly, or constructively by the recipient of the income. Sec. 864(c)(4)(B) and (D)(i).
[209] See sec. 906.
[210] Sec. 864(c)(5)(A).
[211] Sec. 864(c)(5)(B).

Certain sales and other dispositions

Income, gain, deduction, or loss for a particular year generally is not treated as ECI if the foreign person is not engaged in a U.S. trade or business in that year.[212] If, however, income or gain taken into account for a taxable year is attributable to activity in a prior taxable year (i.e., such as the sale or exchange of property, the performance of services, or any other transaction), the income or gain is ECI if the income or gain would have been ECI in the prior year.[213] If any property ceases to be used or held for use in connection with the conduct of a U.S. trade or business and the property is disposed of within 10 years after the cessation, the income or gain attributable to the disposition of the property is ECI if the income or gain would have been ECI had the disposition occurred immediately before the property ceased to be used or held for use in connection with the conduct of a U.S. trade or business.[214]

Allowance of deductions

Taxable ECI is computed by taking into account deductions associated with gross ECI. Regulations address the allocation and apportionment of deductions between ECI and other income. Certain deductions may be allocated and apportioned on the basis of units sold, gross sales or receipts, costs of goods sold, profits contributed, expenses incurred, assets used, salaries paid, space used, time spent, or gross income received. Specific rules provide for the allocation and apportionment of research and experimental expenditures, legal and accounting fees, income taxes, losses on dispositions of property, and net operating losses. In general, interest is allocated and apportioned based on assets rather than income.

Sales of partnership interests

Gain or loss from the sale or exchange of a partnership interest is treated as effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange.[215] Any gain or loss from such hypothetical asset sale by the partnership must be allocated to interests in the partnership in the same manner as nonseparately stated income and loss.

The transferee of a partnership interest must withhold 10 percent of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the sale qualifies for an exception from withholding, e.g., that the transferor is not a nonresident alien individual or foreign corporation or that there is no realized gain from the sale.[216] If the transferee fails to withhold the correct amount, the partnership is required to deduct and withhold from distributions to the transferee partner an amount equal to the amount the transferee failed to withhold.[217]

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[212] Sec. 864(c)(1)(B).
[213] Sec. 864(c)(6).
[214] Sec. 864(c)(7).
[215] Sec. 864(c)(8)(B).
[216] Sec. 1446(f)(1).
[217] Sec. 1446(f)(4); Treas. Reg. sec. 1.1446(f)–2(b).

Foreign Investment in Real Property Act ("FIRPTA")

A foreign person's gain or loss from the disposition of a U.S. real property interest ("USRPI") is treated as ECI.[218] Thus, a foreign person subject to tax on such a disposition is required to file a U.S. tax return. In the case of a foreign corporation, the gain from the disposition of a USRPI may also be subject to the branch profits tax at a 30-percent rate (or lower treaty rate). Certain sales of USRPI are exempt from this tax. For example, qualified foreign pension funds ("QFPF") are not treated as a nonresident alien individual or foreign corporation subject to tax under FIRPTA,[219] foreign governments are exempt from FIRPTA tax on gain from certain sales of stock of U.S. real property holding corporations,[220] and equity interests in "domestically controlled" REITs are not USRPIs.[221]

The payor of income that FIRPTA treats as ECI is generally required to withhold U.S. tax from the payment.[222] The foreign person can request a refund with its U.S. tax return, if appropriate, based on that person's overall tax liability for the taxable year.

4. Special Measures to Address Potential Tax Avoidance

Base erosion and anti-abuse tax

The base erosion and anti-abuse tax (the "BEAT") is an additional tax imposed on certain multinational corporations with respect to payments to foreign affiliates.[223]

The BEAT applies only to corporate taxpayers with average annual gross receipts for the three-taxable-year period ending with the preceding taxable year in excess of $500 million, and is determined, in part, by the extent to which a taxpayer has made payments to foreign related parties.[224] The BEAT generally does not apply to taxpayers for which reductions to taxable income ("base erosion tax benefits") arising from payments to foreign related parties ("base erosion payments") are less than three percent of total deductions (*i.e.*, a "base erosion percentage" of less than three percent).[225]

For a taxpayer subject to the BEAT (an "applicable taxpayer"), the additional tax (the "base erosion minimum tax amount" or "BEAT liability") for the year generally equals the excess, if any, of 10 percent of its modified taxable income over an amount equal to its regular tax liability reduced (but not below zero) by the sum of certain tax credits.[226]

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[218] Sec. 897(a).
[219] Sec. 897(l)(1).
[220] Treas. Reg. sec. 1.892–3T(a).
[221] Sec. 897(h)(2).
[222] Sec. 1445 and regulations thereunder.
[223] Sec. 59A.
[224] For this purpose, a related party is, with respect to the taxpayer, any 25-percent owner of the taxpayer; any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or any 25-percent owner of the taxpayer; and any other person who is related (within the meaning of section 482) to the taxpayer. Sec. 59A(g). The 25-percent ownership threshold is determined by vote or value.
[225] Sec. 59A.
[226] Sec. 59A(e). For taxable years beginning after December 31, 2025, the 10-percent rate on modified taxable income is increased to 12.5 percent, and regular tax liability is reduced (and the base erosion minimum tax amount is therefore increased) by the sum of all the taxpayer's income tax credits for the taxable year. Sec. 59A(b)(2). In addition, special rules with respect to banks and securities dealers provide that for purposes of determining whether they are subject to the BEAT, banks and securities dealers are subject to a base erosion percentage threshold of two percent (rather than three percent), and if that threshold is met, such persons are

Branch profits taxes

The branch profits tax generally seeks to equalize the tax treatment of a dividend to a foreign person paid from a domestic branch with that paid from a domestic corporation. A domestic corporation is subject to U.S. income tax on its net income. The earnings of the domestic corporation may be subject to a second tax, this time at the shareholder level, when dividends are paid. When the shareholders are foreign, the second-level tax may be collected by withholding. Unless the portfolio interest exemption or another exemption applies, interest payments made by a domestic corporation to foreign creditors are likewise subject to withholding tax. To approximate those second-level withholding taxes imposed on payments made by domestic subsidiaries to their foreign shareholders, the United States taxes a foreign corporation that is engaged in a U.S. trade or business through a U.S. branch on amounts of U.S. earnings and profits that are shifted (to the head office) out of, or amounts of interest that are deducted by, the U.S. branch of the foreign corporation.[227] Those branch taxes may be reduced or eliminated under an applicable income tax treaty.[228]

Hybrid arrangements

Hybrid arrangements exploit differences in the tax treatment of a transaction or entity under the laws of two or more tax jurisdictions to achieve tax benefits, including double nontaxation and deferral. Special rules seek to combat the use of such arrangements. These rules include denying deductions relating to certain interest and royalty payments.[229] Specifically, no deduction is allowed for any "disqualified related party amount"[230] that is paid or accrued pursuant to a hybrid transaction[231] or that is paid or accrued by, or to, a hybrid entity.[232]

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subject to a tax rate on its modified taxable income that is one-percentage point higher than the generally applicable tax rate. Secs. 59A(b)(3) and 59A(e)(1)(C).

[227] Under the branch profits tax, the United States imposes a tax of 30 percent on a foreign corporation's "dividend equivalent amount." Sec. 884(a). The dividend equivalent amount generally is the earnings and profits of a U.S. branch of a foreign corporation attributable to its ECI. Sec. 884(b).

Interest paid by a U.S. trade or business of a foreign corporation generally is treated as if paid by a domestic corporation and therefore generally is subject to 30-percent withholding tax if paid to a foreign person. Sec. 884(f)(1)(A). Certain "excess interest" of a U.S. trade or business of a foreign corporation is treated as if paid by a U.S. corporation to a foreign parent and, therefore, also may be subject to 30-percent withholding tax. Sec. 884(f)(1)(B). For this purpose, excess interest is the excess of the interest expense of the foreign corporation apportioned to the U.S. trade or business over the amount of interest paid by the trade or business.

[228] See Treas. Reg. secs. 1.884–1(g) and –4(b)(8).

[229] Sec. 267A; see also sec. 245A(e) (addressing hybrid dividends).

[230] A disqualified related party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes or in which such related party is subject to tax, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. Sec. 267A(b)(1). A disqualified related party amount does not include any payment to the extent such payment is included in the gross income of a U.S. shareholder under subpart F. In general, a related party is any person that controls, or is controlled by, the taxpayer, with control being direct or indirect ownership of more than 50 percent of the vote, value, or beneficial interests of the relevant person. Sec. 267A(b)(2).

[231] A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for Federal income tax purposes and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or in which the recipient is subject to tax. Sec. 267A(c).

[232] A hybrid entity is any entity which is either: (1) treated as fiscally transparent for Federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or in which the entity is subject to tax or (2) treated as fiscally transparent for purposes of the tax law of the foreign country of which the entity

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5. Resolving Overlapping or Conflicting Jurisdiction to Tax

Multinational enterprises operating in multiple countries may find that the same item of income is subject to tax under the rules of two or more jurisdictions. Such double taxation may be mitigated by domestic laws permitting credit or deduction for income taxes paid to another jurisdiction or by bilateral tax treaties. Another related objective of such treaties is the removal of barriers to trade, capital flows, and commercial travel that may be caused by overlapping tax jurisdictions and by the burdens of complying with the tax laws of a jurisdiction when a person's contacts with, and income derived from, that jurisdiction are minimal.

Relief from double taxation by statute

Subject to certain limitations, U.S. citizens, resident individuals, and domestic corporations are allowed a credit for foreign income taxes they pay. In addition, a domestic corporation is allowed a credit for foreign income taxes paid by a CFC with respect to income included by the corporation as subpart F income and GILTI; such taxes are deemed to have been paid by the domestic corporation for purposes of calculating the foreign tax credit.

The foreign tax credit generally is limited to a taxpayer's U.S. tax liability on its foreign- source taxable income. The limit is intended to ensure that the credit mitigates double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income. The limit is computed by multiplying a taxpayer's total precredit U.S. tax liability for the year by the ratio of the taxpayer's foreign-source taxable income for the year to the taxpayer's total taxable income for the year. If the total amount of foreign income taxes paid and deemed paid for the year exceeds the taxpayer's foreign tax credit limitation for the year, the taxpayer may (in certain cases) carry back the excess foreign taxes to the previous year and then carry forward any remaining excess to one of the 10 succeeding taxable years. No carryback or carryover of excess foreign tax credits are allowed in the GILTI foreign tax credit limitation category.

Bilateral treaties to relieve double taxation

The United States is a partner in numerous bilateral treaties that aim to avoid international double taxation and to prevent tax avoidance and evasion. The United States Model Income Tax Convention of 2016 ("Model Treaty") was published in 2016 and reflects the most recent comprehensive statement of U.S. policy with respect to tax treaties.[233] As explained in the Preamble published contemporaneously with the Model Treaty, the provisions therein included both refinements of provisions that have been included in U.S. tax treaties, as well as new provisions, not yet incorporated in a bilateral treaty, that deny treaty benefits on deductible payments of highly mobile income that are made to related persons that enjoy low or no taxation with respect to that income under a

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is resident for tax purposes or in which the entity is subject to tax but not so treated for Federal income tax purposes. Sec. 267A(d).

[233] The Model Treaty has been updated periodically. The Model Treaty and its Preamble, as well as text of earlier Model Treaties, are available at https://home.treasury.gov/policy-issues/tax-policy/treaties.

special tax regime.[234] To a large extent, the treaty provisions designed to carry out these objectives supplement U.S. tax law provisions having the same objectives; treaty provisions may modify the generally applicable statutory rules with provisions that take into account the particular tax system of the treaty partner.

The objective of limiting double taxation generally is accomplished in treaties through the agreement of each country to allocate taxing authority by limiting, in specified situations, its right to tax income earned within its territory by residents of the other country. For the most part, the various rate reductions and exemptions agreed to by the country in which income is derived (the "source country") in treaties are premised on the assumption that the country of residence of the taxpayer deriving the income (the "residence country") may tax the income at levels comparable to those imposed by the source country on its residents. Treaties also provide for the elimination of double taxation by requiring the residence country to allow a credit for taxes that the source country retains the right to impose under the treaty. In addition, in the case of certain types of income, treaties may provide for exemption by the residence country of income taxed by the source country.

Treaties define the term "resident" so that an individual or corporation generally will not be subject to tax as a resident by both countries. A "limitation on benefits" provision in treaties further determines whether a treaty resident is a qualified person permitted to receive treaty benefits. This provision limits the ability of third country residents to engage in treaty shopping by establishing conduit legal entities in either the United States or the treaty partner jurisdiction. The provision sets forth objective tests that commonly include a publicly traded company test, an ownership and base erosion test, and an active trade or business test.

Treaties generally provide that neither country may tax business income derived by residents of the other country unless the business activities in the taxing jurisdiction are substantial enough to constitute a permanent establishment or fixed base in that jurisdiction, and the business income is attributable to that permanent establishment. As explained above, U.S. bilateral income tax treaties restrict the application of net-basis U.S. taxation by requiring a threshold for permanent establishment status that is higher than that required to constitute a U.S. trade or business under the Code. As a result, a foreign corporation engaged in a U.S. trade or business but not through a permanent establishment generally would not be taxable in the United States under an applicable treaty. The term "attributable to" is generally analogous to the "effectively connected" concept in section 864(c). Treaties also contain commercial visitation exemptions under which individual residents of one country performing personal services in the other are not required to pay tax in that other country unless their contacts exceed certain specified minimums (for example, presence for a set number of days or earnings in excess of a specified amount).

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[234] For example, the Model Treaty denies treaty benefits when U.S. source payments are made to a beneficial owner that benefits from a special tax regime, as defined in Article 3 (General Definitions), subparagraph (l) of paragraph 1; the benefits that may be denied include the reduced withholding rates on dividends, interest and royalties that are paid to persons that fail to satisfy the limitation on benefits requirements in Article 22 (Limitation on Benefits).

Treaties address the taxation of passive income such as dividends, interest, and royalties from sources within one country derived by residents of the other country either by providing that the income is taxed only in the recipient's country of residence or by reducing the rate of the source country's withholding tax imposed on the income. In this regard, the United States agrees in its tax treaties to reduce its 30-percent withholding tax (or, in the case of some income, to eliminate it entirely)[235] in return for reciprocal treatment by its treaty partner. In particular, under the Model Treaty and many U.S. tax treaties, source-country taxation of most payments of interest and royalties is eliminated, and some recent U.S. treaties forbid the source country from imposing withholding tax on dividends paid by an 80-percent owned subsidiary to a parent corporation organized in the other treaty country.

In its treaties, the United States, as a matter of policy, generally retains the right to tax its citizens and residents on their worldwide income as if the treaty had not come into effect. The United States also provides in its treaties that it allows a credit against U.S. tax for income taxes paid to the treaty partners, subject to the various limitations of U.S. law.

REASONS FOR CHANGE

There is broad bipartisan support for strengthening our economic partnership with Taiwan. Taiwan is one of the largest trading partners of the United States and is an especially critical trading partner in the semiconductor industry and in enhancing our onshoring capabilities for advanced manufacturing. The Committee believes that the absence of a bilateral income tax treaty with Taiwan results in an unacceptable inability to relieve double taxation and is a hindrance to the ability of the United States to achieve the full potential of U.S.-Taiwan cross border investment. In the absence of a tax treaty, legislative efforts are necessary to approximate the relief from double taxation that a treaty would ordinarily allow. Title III of the bill does so in Subtitle A by providing changes to the Code that are comparable to specific benefits described in articles in the Model Treaty, including reduction in withholding tax rates on certain categories of income.

The benefits conferred by Subtitle A of Title III are effective only when the Secretary confirms that Taiwan provides reciprocal benefits to U.S. persons. While developing this legislation, the Committee has become aware of an existing asymmetry in how Taiwan and the United States treat amounts received by residents of one jurisdiction for services performed for residents of the other jurisdiction (the "taxing jurisdiction"). For services performed outside the taxing jurisdiction, Taiwan and the United States diverge. The United States imposes a gross basis tax on outbound payments for services provided by foreign persons only if those amounts are from sources in the United States. Because our sourcing rules generally do not treat amounts paid for services performed outside the United States as from U.S. sources, such amounts generally are not subject to our gross basis tax. It is our understanding, however,

[235] The rates agreed upon in U.S. bilateral tax treaties for income other than personal services income are found in "Table 1. Tax Rates on Income Other Than Personal Service Income Under Chapter 3, Internal Revenue Code, and Income Tax Treaties (Rev. May 2023)" at https://www.irs.gov/individuals/international-taxpayers/tax-treaty-tables.

that Taiwan imposes a gross basis tax on all outbound payments for services provided by foreign persons, even if the services in question are performed outside Taiwan. The Committee believes that the reciprocity contemplated in the legislation cannot be confirmed if this disparity in treatment of business income remains.

In addition, Subtitle B of Title III of the bill ensures that additional measures may be enacted as needed to enforce and expand such relief with respect to Taiwan after further executive negotiation, in consultation with appropriate committees of both chambers of Congress, followed by approving and implementing legislation.

EXPLANATION OF PROVISION

Under the provision, income from U.S. sources earned or received by qualified residents of Taiwan is entitled to certain benefits. These benefits include reduced tax rates for income otherwise subject to the 30-percent gross-basis tax; with respect to income effectively connected with a U.S. trade or business, taxation of only that income effectively connected with a U.S. permanent establishment; and preferential treatment of wages and related income earned by such qualified residents. The new rules are analogous to provisions typical in bilateral treaties to which the United States is a party and are based on relevant language found in the Model Treaty. The provision requires general anti-abuse standards similar to those in section 894(c) to deny benefits when payments are made through hybrid entities. The proposed rules are applicable only if reciprocal provisions apply to U.S. persons with respect to income sourced in Taiwan.

Treatment of certain income from U.S. sources

Special rules address the treatment of several forms of income received by qualified residents of Taiwan from U.S. sources are described below. Interest, royalties, certain gains and dividends that would otherwise be subject to a 30-percent gross-basis tax (i.e., a tax on gross income without reduction for related expenses) withheld at the source are eligible for reduced rates. Other types of income received by individuals that are subject to net-basis tax are also eligible identified for relief under provisions that address qualified wages and income of athletes and entertainers.

Interest, royalties and gains

Tax on U.S.-source interest (other than original issue discount), royalties, amounts described in section 871(a)(1)(C), and gains described in section 871(a)(1)(D) that are paid to or received by a qualified resident of Taiwan is reduced to 10 percent. The treatment of these types of income is consistent with that provided under Model Treaty Articles 11 (Interest), 12 (Royalties), and 13 (Gains).

Dividends

Tax on U.S.-source dividends that are paid to or received by a qualified resident of Taiwan is reduced to 15 percent. The reduction in rates follows the treaty benefits provided under Model Treaty Article 10 (Dividends).

The reduced rates do not apply to amounts subject to FIRPTA; payments between an expatriated entity and a related party; any

amount which is included in income under section 860C to the extent that such amount does not exceed an excess inclusion with respect to a REMIC; and dividends paid by a REIT other than qualified REIT dividends. A dividend paid by a REIT is a qualified REIT dividend if the dividend is paid with respect to a class of shares that is publicly traded and the owner of the dividend holds not more than five percent of any class of shares in the REIT.

Certain qualified residents of Taiwan that are taxable as corporations in Taiwan may be eligible for a further reduction in the tax rate (*i.e.*, from 15 percent to 10 percent) with respect to dividends, provided that certain holding period and ownership thresholds are met. To qualify for the 10-percent tax rate on dividends, at all times during the 12-month period ending on the date on which the stock in a corporation becomes ex-dividend with respect to such dividend, the dividend recipient must be a qualified resident of Taiwan and directly own at least 10 percent of the vote and value of the total outstanding shares of stock in such corporation. For purposes of the 12-month period, a dividend recipient shall be permitted to tack the holding period of an entity taxed as a corporation in Taiwan from whom the dividend recipient acquired such stock, if that entity was a qualified resident of Taiwan and a "connected person" with respect to the dividend recipient at the time the share was acquired. Persons are "connected persons" if one person owns, directly or indirectly, at least 50 percent of the beneficial interest in the other (or, if a corporation, at least 50 percent of the vote and value of its shares); a third person owns, directly or indirectly, at least 50 percent of the beneficial interest in each person (or, if a corporation, at least 50 percent of the vote and value of its shares). In addition, a person may be a connected person if, based on all the relevant facts and circumstances, one has control of the other, or both are under the control of the same persons. In no event is a dividend paid by a RIC or a REIT eligible for this further reduction in tax rate.

Income from employment

Qualified wages for personal services performed within the United States generally are not subject to U.S. income tax if paid by an employer to a qualified resident of Taiwan who is either not a U.S. resident or is employed as a member of the regular component of a ship or aircraft operated in international traffic. The definition of qualified wages follows the definition in Model Treaty Article 14 (Income from Employment) to include amounts paid by or on behalf of a non-U.S. person (and not borne by a U.S. permanent establishment) in the form of wages, salaries, or similar remunerations with respect to personal services performed in the United States. Directors' fees, income derived as a student or trainee, pensions, or amounts paid with respect to employment with the United States, any State, or any U.S. possession, or other amounts specified in regulations or guidance are not included within the scope of qualified wages.

Income from services as an entertainer or athlete

Income derived by a qualified resident of Taiwan for services performed as an entertainer or athlete in the United States generally is subject to income tax in the United States but may avoid U.S.

taxation if gross receipts from such services do not exceed in total (including amounts received as reimbursement of expenses) $30,000. If total receipts from the performance of services as an entertainer or athlete exceeds $30,000, then the entire amount is subject to taxation in the United States. Income from such services accruing to a person other than the entertainer or athlete performing such services also may qualify for the exemption from U.S. taxation, but only if the person receiving the income is contractually authorized to designate another person or persons to provide the services.

This provision is intended to be consistent with the rules in Model Treaty Article 16 (Entertainers and Sportsmen), which generally provides that income derived from services performed by entertainers and athletes resident in one treaty partner jurisdiction may be subject to tax based on the source of income rather than the residence of the performer or athlete, notwithstanding the provisions of Model Treaty Article 14 (Income from Employment).

Income effectively connected with a U.S. permanent establishment

Income of a qualified resident of Taiwan that is effectively connected with a U.S. permanent establishment is subject to tax on a net basis (under section 1 for noncorporate persons and section 11 for corporations). In addition, such ECI continues to be subject to the alternative minimum tax and BEAT, if applicable. In determining taxable income for these purposes, gross income includes only gross income which is effectively connected with the permanent establishment.

Various rules of special application are provided for determining whether rules regarding ECI are modified. First, under FIRPTA, to ensure that the ultimate substantive tax treatment of FIRPTA income is unchanged, references to "trade or business within the United States" are changed to refer to carrying on a trade or business through a U.S. permanent establishment. The branch profits tax applicable to ECI (including the branch profits tax on interest) is reduced to 10 percent, thus matching the reduced rate for dividends and interest that would otherwise apply. The provision adopts the anti-abuse standards of section 894(c) to deny benefits when payments are made through hybrid entities.

In addition, wages, salaries, or similar remunerations with respect to employment as well as directors' fees, income from services as an entertainer or athlete, income derived as a student or trainee, pensions, and amounts paid with respect to employment with the United States are outside the scope of income considered to be effectively connected with a permanent establishment. This limitation is in accordance with language in Model Treaty Article 7 (Business Profits), paragraph 4, which provides that "[w]here profits include items of income that are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article."

Definition of U.S. permanent establishment

A U.S. permanent establishment is a fixed place of business through which a qualified resident of Taiwan conducts an active trade or business within the United States. A U.S. permanent establishment need not be subject to corporate tax in Taiwan to qual-

ify. The fixed place may include a place from which a trade or business is managed, as well as an office, factory, workshop, branch, site in which minerals are extracted, or other sites. Such a fixed place generally does not include sites maintained for a limited purpose such as storage, display, or auxiliary or preparatory work; further, such a fixed place generally does not include a fixed place of business of an independent agent even if such agent habitually contracts on behalf of the foreign entity. Following Model Treaty Article 5 (Permanent Establishment), special rules on the extent to which a temporary project may constitute a fixed place of business are provided.

Qualified resident of Taiwan

Following Model Treaty Article 4 (Resident), the provision defines residence for both individuals and entities. In general, a "qualified resident of Taiwan" is entitled to the benefits of the new provision. The term generally includes any person that is not a U.S. person who is liable for tax in Taiwan and establishes domicile, residence, management or control, or place of incorporation in Taiwan. Rules specific to individuals, as well as specific limitations on eligibility of corporations, are provided.

Individuals

In general, the Code provides that the residence of an individual other than a U.S. citizen be determined by application of section 7701(b). If such a person also has met the foregoing criteria for status as a qualified resident of Taiwan, such individual may be a dual resident, whose residence must be resolved after further inquiry.

Resolving residence of a dual resident

The residence of a dual resident is resolved by applying a hierarchy of three tests based on the individual's permanent home, center of vital interests, or habitual abode. The first inquiry is where the individual has a permanent home. If the individual has a permanent home in Taiwan but not the United States, the permanent home is determinative of residence. If a person has permanent homes in both jurisdictions, the second inquiry is whether the individual has a center of vital interests in Taiwan. If the person has a permanent home in both jurisdictions and the center of vital interests cannot be determined, or has no permanent home in either jurisdiction, then the individual's residence is based on the individual's habitual abode. If an individual's residence cannot be determined by habitual abode, that person is not a qualified resident of Taiwan for purposes of claiming benefits under this provision.

Rules for determining residence of an entity

Entities taxed as corporations in Taiwan are treated as qualified residents of Taiwan if they meet an ownership and income test, a publicly traded in Taiwan test, or a qualified subsidiary test. In addition, qualified items of income are treated as income of a qualified resident of Taiwan.

Ownership and income thresholds for non-publicly traded entities

The ownership and income tests require that at least 50 percent by vote and value of the entity is owned (directly or indirectly) by qualified residents of Taiwan and that less than 50 percent of gross income of the entity (and, in the case of an entity that is a member of a tested group, less than 50 percent of the tested group's gross income) is in the form of payments deductible for purposes of income taxes imposed by Taiwan to persons who are neither qualified residents of Taiwan nor certain U.S. persons whose connection to the United States meets comparable tests, as determined by the Secretary. Indirect ownership for purposes of the ownership threshold requires that all intermediate owners are qualifying intermediate owners; that is, a qualified resident of Taiwan or resident of a foreign country with which the United States has a comprehensive tax treaty for the relief of double taxation, provided that the foreign country is not a country of concern within the meaning of that term as included in the CHIPS Act of 2022.[236]

Certain deductible payments are not included in gross income for purposes of the income test. Such deductible payments do not include arm's-length payments by an entity in the ordinary course of an active trade or business for services or tangible property and do not include certain intragroup transactions within a tested group. A tested group is defined as a group of two or more corporations that participate in a group for tax consolidation, fiscal unity or other plan that requires the corporations to share profits and losses, or that share losses through group relief or other loss sharing regimes.

Publicly traded test

Alternatively, an entity may establish itself as a qualified resident of Taiwan under the publicly traded test. An entity is considered to be publicly traded in Taiwan if its principal class of shares (and any disproportionate class of shares) is primarily and regularly traded on an established securities market in Taiwan. If such shares of an entity are not primarily traded in Taiwan but the entity has its primary place of management and control in Taiwan and its principal class of shares (and any disproportionate class of shares) is regularly traded there on an established securities market, the entity meets the publicly traded test.

Qualified subsidiary test

An entity that does not meet the above ownership and income test or publicly traded test may nonetheless be eligible for the benefits described herein if that entity meets the qualified subsidiary test. Entities that meet the income requirements of the ownership and income tests may qualify if they are owned at least 50 percent by five or fewer corporations that themselves satisfy the publicly traded test or are U.S. persons, the shares of which are primarily and regularly traded in the United States on an established securities market. For this purpose, the indirect ownership of the qualified subsidiary is met only if all intermediate owners are themselves qualifying intermediate owners, which, for purposes of the

[236] Section 103(a)(4) of the CHIPS Act of 2022.

qualified subsidiary test only, may include U.S. persons that satisfy tests comparable to the test for a qualified resident of Taiwan, as determined by the Secretary. In addition, qualifying intermediate owners also include a qualified resident of Taiwan or a resident of a foreign country with which the United States has a comprehensive tax treaty for the relief of double taxation and is not a country of concern.

Active trade or business test

Even if an entity is not otherwise a qualified resident of Taiwan, a qualified item of income from the United States that is derived by a person subject to income tax under Taiwan law (and that is not a U.S. person) shall be treated as income of a qualified resident of Taiwan. A qualified item of income includes any item of income which emanates from, or is incidental to, the conduct of an active trade or business in Taiwan and, if such person derives an item of income from a trade or business activity conducted in the United States, or derives an item of income arising in the United States from a connected person, the trade or business activity in Taiwan to which the item relates is required to be substantial in relation to the same or complementary trade or business activity in the United States. The trade or business activity in the United States may be carried on by such person or any connected person. The active trade or business test is not available for any item of income derived by an entity if at least 50 percent (by vote or value) of such entity is owned (directly or indirectly) or controlled by residents of a foreign country of concern.

Reciprocity requirements

Before any of the foregoing rules are applicable in any taxable period, the Secretary must determine that certain reciprocity requirements are met, ensuring that U.S. persons subject to income tax in Taiwan are afforded reciprocal benefits. Reciprocity may be determined in any appropriate manner.

Regulations

The provision grants the Secretary authority to promulgate regulations on a variety of enumerated issues. These issues include regulations or guidance for determining what constitutes a U.S. permanent establishment of a qualified resident of Taiwan and income that is effectively connected to such a permanent establishment; preventing the abuse of the provisions of this section by persons who are not (or who should not be treated as) qualified residents of Taiwan; requirements for record keeping and reporting; rules to assist withholding agents or employers in determining whether a foreign person is a qualified resident of Taiwan or whether reporting is required for a payment; the application of the provision to ownership thresholds attributable to stock held by predecessor owners; determining what amounts are to be treated as qualified wages; defining established securities markets for the limitation on benefits provisions; the application of the legislation to qualified residents of Taiwan that are partners of a partnership or beneficiaries of an estate or trust; determining ownership interests held by residents of foreign countries of concern; determining what items are to be treated as qualified items of income under the ac-

tive trade or business provisions of the limitation of benefits to prevent abuse of the purposes of this section; and determining the starting and ending dates for periods with respect to the reciprocity requirements. To the extent practical, the regulations shall be consistent with the relevant Model Treaty provisions.

EFFECTIVE DATE

The provisions of Subtitle A are effective on date of enactment, subject to satisfaction of the contingent reciprocity standards being met.

B. THE UNITED STATES-TAIWAN TAX AGREEMENT AUTHORIZATION ACT (SECS. 301 THROUGH 320 OF THE BILL)

PRESENT LAW

The applicable present law is described above under section A of this Part.

EXPLANATION OF PROVISION

The United States-Taiwan Tax Agreement Authorization Act authorizes the President to negotiate and enter into one or more non-self-executing tax agreements (in each case, the "Agreement") to provide for bilateral tax relief with Taiwan beyond that provided for in section 894A (as added by United States-Taiwan Expedited Double-Tax Relief Act) and prescribes the process for approving and implementing such an agreement, as described below.[237]

Authorization to negotiate and enter into Agreement

After a determination by the Secretary of the Treasury that Taiwan has provided benefits to U.S. persons that are reciprocal to the benefits provided to qualified residents of Taiwan under section 894A, the President is authorized to negotiate and enter into the Agreement. Any provisions in the Agreement must conform with provisions customarily contained in U.S. bilateral income tax conventions, as exemplified by the 2016 U.S. Model Income Tax Convention, and the Agreement may not include elements outside the scope of the 2016 U.S. Model Income Tax Convention.

Notwithstanding such conformity, the Agreement may incorporate and restate provisions of any agreement, as well as existing U.S. law, addressing double taxation for residents of the United States and Taiwan. The Agreement shall include the following statement: "The Agreement is entered into pursuant to the United States-Taiwan Tax Agreement Authorization Act." The Agreement is required to include a provision conditioning entry into force upon enactment of approval legislation and implementing legislation (as described below) and confirmation by the Secretary of the Treasury that the relevant authority in Taiwan has approved and taken appropriate steps required to implement the Agreement.

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[237] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Amendment in the Nature of a Substitute to H.R. 5988."* (JCX–55–23), November 29, 2023. This document can also be found on the Joint Committee on Taxation website at www.jct.gov. All section references in the document are to the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise stated.

Consultations with Congress

The provision requires the President to provide written notification to certain appropriate congressional committees of the commencement of negotiations with Taiwan at least 15 calendar days prior to commencing negotiations. In addition, no later than 90 days after commencing negotiations and every 180 days thereafter until the President enters into the Agreement, the President is required to provide a briefing to the appropriate congressional committees on the status of the negotiations, including a description of elements under negotiation.

The appropriate congressional committees include the Committee on Foreign Relations and the Committee on Finance of the Senate, as well as the Committee on Ways and Means of the House of Representatives.

During the course of negotiations with respect to the Agreement, the Secretary of the Treasury, in coordination with the Secretary of State, upon request, is required to meet with the chairman or ranking member of any of the appropriate congressional committees regarding negotiating objectives and the status of negotiations in progress. In addition, the Secretaries must closely and timely consult with the appropriate congressional committees, as well as keep such committees fully apprised of the negotiations. Such consultations are required to include the nature of the contemplated Agreement, how and to what extent the contemplated Agreement is consistent with the scope of the 2016 U.S. Model Income Tax Convention, and the implementation of the contemplated Agreement, including (i) the general effect of the contemplated Agreement on existing laws, (ii) proposed changes to any existing laws to implement the contemplated Agreement, and (iii) proposed administrative actions to implement the contemplated Agreement.

Approval and implementation of Agreement

The Agreement may not enter into force unless:

- the President publishes the text of the contemplated Agreement on a publicly available website of the Department of the Treasury at least 60 days before the day on which the President enters into the Agreement, and
- there is enacted into law, with respect to the Agreement, approval legislation and implementing legislation.

The President may provide for the Agreement to enter into force upon enactment of approval legislation and implementing legislation and confirmation by the Secretary of the Treasury that the relevant authority in Taiwan has approved and taken appropriate steps required to implement the Agreement. Approval legislation means legislation that approves the Agreement and implementing legislation means legislation that makes any changes to the Code necessary to implement the Agreement.

Submission of Agreement

The provision requires that no later than 270 days after the President enters into the Agreement, the President or the President's designee shall submit to Congress the final text of the Agreement and a technical explanation of the Agreement. In addition, no later than 270 days after the President enters into the Agreement, the Secretary of the Treasury shall submit to Congress a descrip-

tion of those changes to existing laws that the President considers would be required in order to ensure that the United States acts in a manner consistent with the Agreement, and a statement of anticipated administrative action proposed to implement the Agreement.

Consideration of approval legislation and implementing legislation

The provision requires that the approval legislation relating to the Agreement include the following text, "Congress approves the Agreement submitted to Congress pursuant to section 206 of the United States-Taiwan Tax Agreement Authorization Act on_____" with the blank space being filled with the appropriate date. The approval legislation is required to be referred to the Committee on Foreign Relations in the Senate and to the Committee on Ways and Means in the House of Representatives.

The implementing legislation is required to be referred to the Committee on Finance in the Senate and the Committee on Ways and Means in the House of Representatives.

Relationship of Agreement to Internal Revenue Code of 1986

The provision states that the provisions of the Agreement or approval legislation, or the application of any such provision, that are inconsistent with the Code do not have effect. Nothing in the provision is intended to be construed to amend or modify any law of the United States or to limit any authority conferred under any law of the United States, unless specifically provided for in the provision.

Authorization of subsequent tax agreements relative to Taiwan

After enactment of approval legislation and implementing legislation, the tax agreement that is authorized by this provision is required to be treated as including any tax agreement relative to Taiwan which supplements or supersedes the Agreement to which such approval legislation and implementing legislation relates. The term "Agreement" shall be treated as including such tax agreement. The provision is required to be applied separately with respect to each such tax agreement.

Congressional findings and statement of policy

The provision makes the following findings: the United States addresses issues with respect to double taxation with foreign countries by entering into bilateral income tax conventions (known as tax treaties) with such countries negotiated by the President pursuant to Article II of the Constitution, and subject to the advice and consent of the Senate; the United States has entered into more than sixty such tax treaties, which facilitate economic activity, strengthen bilateral cooperation, and benefit U.S. workers, businesses, and other U.S. taxpayers; and because of Taiwan's unique status, the United States is unable to enter into an Article II tax treaty with Taiwan, necessitating an alternative means to address issues with respect to double taxation.

The provision states that it is the policy of the United States to provide for additional bilateral tax relief with respect to Taiwan, beyond that provided for in section 894A (as added by the United States-Taiwan Expedited Double-Tax Relief Act), only after entry into force of an Agreement and only in a manner consistent with

such Agreement. It further states that it is the policy of the United States to continue to provide for relief from double taxation and other related matters through entering into bilateral income tax conventions, negotiated by the President pursuant to Article II of the Constitution, and subject to the advice and consent of the Senate.

EFFECTIVE DATE

Subtitle B is effective upon date of enactment.

TITLE IV—ASSISTANCE FOR DISASTER-IMPACTED COMMUNITIES

(secs. 401 404 of the bill)

PRESENT LAW

Exclusion from income for qualified disaster relief payments

Present law provides an exclusion from income for qualified disaster relief payments.[238] Qualified disaster relief payments include amounts paid to an individual: (1) to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; (2) to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster; (3) by a person engaged in the furnishing or sale of transportation (*i.e.*, common carriers) by reason of death or personal injuries as a result of a qualified disaster; or (4) by a Federal, State, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare.[239] These amounts do not include payments for any expenses compensated for by insurance or otherwise.[240]

Qualified disaster relief payments also are excludable for purposes of self-employment taxes and employment taxes.[241]

A qualified disaster is a disaster which results from a terroristic or military action (as defined in section 692(c)(2)); a Federally declared disaster (as defined in section 165(i)(5)(A)); a disaster which results from an accident involving a common carrier or from any other event which would be determined by the Secretary of the Treasury (the "Secretary") to be of a catastrophic nature; or, for purposes of payments made by a Federal, State or local government, or an agency or instrumentality of a government, a disaster designated by an applicable Federal, State, or local authority (as determined by the Secretary) to warrant assistance.[242]

The exclusion from income does not apply to any individual identified by the Attorney General to have been a participant or conspirator in any terrorist attack, or to a representative of such individual.[243] No deduction or credit is allowed for, or by reason of, any

[238] Sec. 139.
[239] Sec. 139(b).
[240] *Ibid.*
[241] Sec. 139(d).
[242] Sec. 139(c).
[243] Sec. 139(e).

expenditure to the extent of the amount excluded from income with respect to such expenditure.[244]

Personal casualty losses

In general

An individual taxpayer may claim an itemized deduction for a personal casualty loss.[245] If the loss is attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, (the "Stafford Act")[246] then the loss is deductible only to the extent of the sum of the individual's personal casualty gains plus the amount by which aggregate net disaster-related losses exceed 10 percent of the individual taxpayer's adjusted gross income.[247] In any taxable year beginning after December 31, 2017, and before January 1, 2026, all other personal casualty losses are deductible only to the extent that the losses do not exceed the individual's personal casualty gains.

For individual taxpayers, personal casualty losses are losses of property not connected with a trade or business or a transaction entered into for profit that arise from fire, storm, shipwreck, or other casualty, or from theft.[248] Personal casualty gains are recognized gains from any involuntary conversion of property not connected with a trade or business or a transaction entered into for profit that arise from fire, storm, shipwreck, or other casualty, or from theft.[249] Personal casualty losses are deductible to the extent they exceed $100 per casualty.[250]

Additional relief for certain disasters

Congress has at times enacted taxpayer favorable casualty loss provisions in response to specific natural disasters.[251]

Most recently, Division EE of Public Law 116–260, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (the "2020 Disaster Act"), provides special rules for "qualified disaster-related personal casualty losses," personal casualty losses arising in a qualified disaster area on or after the first day of the incident period of the applicable qualified disaster which are attributable to that qualified disaster.[252] These losses are deductible without regard to whether aggregate net losses exceed 10 percent of a taxpayer's adjusted gross income. These losses are deductible to the extent they exceed $500 per casualty. These losses are allowed as a deduction in addition to the standard deduction and are allowed against alternative minimum taxable income.

A "qualified disaster area" refers to an area with respect to which a major disaster has been declared by the President during the period beginning on January 1, 2020, and ending on the date

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[244] Sec. 139(h).
[245] Sec. 165(h).
[246] Sec. 165(h)(5) and Pub. L. No. 100–707.
[247] Sec. 165(h)(2). Personal casualty gains are reduced for this purpose by any gain used to offset any personal casualty loss which is not attributable to a disaster.
[248] Sec. 165(c)(3)(B).
[249] Sec. 165(c)(3)(A).
[250] Sec. 165(h)(1).
[251] See, *e.g.*, sec. 204(b) of Pub. L. No. 116–94 (Hurricanes Florence and Michael); sec. 20104(b) of Pub. L. No. 115–123 (certain California wildfires); sec. 504(b) of Pub. L. No. 115–63 (Hurricanes Harvey, Irma, and Maria); and former sec. 1400S(b) (Hurricanes Katrina, Rita, and Wilma).
[252] Sec. 304(b) of Div. EE. of Pub. L. No. 116–260.

which is 60 days after the date of enactment of the 2020 Disaster Act,[253] under section 401 of the Stafford Act, if the incident period of the disaster with respect to which the declaration is made begins on or after December 28, 2019 and on or before the date of enactment of the 2020 Disaster Act. A qualified disaster area does not include any area with respect to which a major disaster had been declared only by reason of COVID–19.[254]

A "qualified disaster" is, with respect to the applicable qualified disaster area, the disaster by reason of which a major disaster was declared with respect to that area.[255]

The "incident period" is, with respect to the applicable qualified disaster, the period specified by the Federal Emergency Management Agency as the period during which the disaster occurred, except that the period is not treated as ending after the date which is 30 days after the date of enactment of the 2020 Disaster Act.[256]

REASONS FOR CHANGE

The Committee wishes to provide tax relief for taxpayers affected by certain disasters and events. The Committee believes that the expansion of the personal casualty loss deduction under section 165 under the Taxpayer Certainty and Disaster Relief Act of 2020 provided necessary tax relief to taxpayers who suffered losses in the wake of that year's major disasters, and that such relief should be extended to provide similar relief for major disasters in 2021, 2022, and 2023. The Committee also believes that taxpayers affected by certain wildfires and the East Palestine train derailment should not be subject to Federal income tax on payments that compensate for losses, expenses, or damages incurred as a result of those events.

EXPLANATION OF PROVISIONS

Certain disaster-related personal casualty losses

For purposes of personal casualty losses arising in a qualified disaster area, the provision broadens the 2020 Disaster Act's definition of qualified disaster area to include any area with respect to which a major disaster was declared by the President during the period beginning on January 1, 2020, and ending on the date which is 60 days after the date of enactment of the provision, under section 401 of Stafford Act if the incident period of the disaster begins on or after December 28, 2019, and on or before the date of enactment of the provision. The incident period will be treated as ending no later than the date which is 30 days after the date of enactment of the provision.

Thus, under the provision, certain disaster-related personal casualty losses attributable to major disasters beginning any time after the date of enactment of the 2020 Disaster Act and through the date of enactment of the provision are provided the same treatment as qualified disaster-related personal casualty losses under the 2020 Disaster Act.

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[253] The 2020 Disaster Act became law on December 27, 2020.
[254] Sec. 301 of Div. EE. of Pub. L. No, 116–260.
[255] *Ibid.*
[256] *Ibid.*

Exclusion of certain wildfire relief payments

The provision provides an exclusion from gross income for amounts received as qualified wildfire relief payments. Qualified wildfire relief payments are amounts received by or on behalf of an individual as compensation for losses, expenses, or damages (including compensation for additional living expenses, lost wages (other than compensation for lost wages paid by the employer which would have otherwise paid such wages), personal injury, death, or emotional distress) incurred as a result of a qualified wildfire disaster, but only to the extent the losses, expenses, or damages compensated by such payment are not compensated for by insurance or otherwise.

A qualified wildfire disaster is any Federally declared disaster (as defined in section 165(i)(5)(A)) declared, after December 31, 2014, as a result of any forest or range fire.

No deduction or credit is allowed with respect to any expenditure to the extent of the amount excluded under the provision with respect to the expenditure. The basis of any property is not increased by amounts excluded from gross income under the provision.

East Palestine disaster relief payments

The provision treats East Palestine train derailment payments as qualified disaster relief payments for purposes of section 139(b). As a consequence, the payments are excluded from gross income and are subject to other present-law provisions, such as the employment tax exclusions from wages and net earnings from self-employment (section 139(d)) and the prohibition on double benefits (section 139(h)), applicable to qualified disaster relief payments.

The provision defines East Palestine train derailment payment as any amount received by or on behalf of an individual as compensation for loss, damages, expenses, loss in real property value, closing costs with respect to real property (including realtor commissions), or inconvenience (including access to real property) resulting from the East Palestine train derailment if the amount was provided by a Federal, State, or local government agency, Norfolk Southern Railway, or a subsidiary, insurer, or agent of Norfolk Southern Railway or any related person. For this purpose, East Palestine train derailment means the derailment of a train in East Palestine, Ohio on February 3, 2023.

EFFECTIVE DATES

The provision relating to certain disaster-related personal casualty losses is effective on date of enactment.

The provision relating to the exclusion of certain wildfire relief payments applies to qualified wildfire relief payments received during taxable years beginning after December 31, 2019, and before January 1, 2026.

The provision relating to the East Palestine train derailment applies to amounts received on or after February 3, 2023.

TITLE V—LOW INCOME HOUSING TAX CREDIT IMPROVEMENTS

1. State Housing Credit Ceiling Increase for Low-Income Housing Credit (sec. 501 of the bill and sec. 42 of the Code)

PRESENT LAW

A taxpayer may claim the low-income housing credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.[257]

Generally, the low-income housing credit is allowable only if the taxpayer receives a credit allocation from a State or local housing credit agency. For calendar year 2024, after application of a cost-of-living adjustment, the aggregate credit authority provided annually to each State (the "State housing credit ceiling") is $2.90 multiplied by the State population, with a minimum annual credit amount of $3,360,000 for certain small population States.[258] For calendar years 2018, 2019, 2020, and 2021, the State housing credit ceiling was increased by multiplying the State housing credit ceiling dollar amount by 1.125.[259]

REASONS FOR CHANGE

The low-income housing credit has played a key role in the building or rehabilitation of millions of affordable rental units. However, the Committee believes that the annual allocations are currently insufficient to meet the increasing need for affordable housing in many areas of the country. In calendar years 2018 through 2021, State low-income housing credits were increased by 12.5 percent, allowing States to allocate more credits for affordable housing projects. Therefore, the provision restores the 12.5 percent increase in State housing credits for 2023, 2024, and 2025.

The low-income housing credit has played a key role in the building or rehabilitation of millions of affordable rental units. However, the Committee believes that the annual credit allocations that are provided to States are currently insufficient to meet the increasing need for affordable housing in many areas of the country. Therefore, the provision provides for a 12.5 percent increase in State housing credits for 2023, 2024, and 2025 to increase the production of affordable housing.

EXPLANATION OF PROVISION

The provision provides an increase in the State housing credit ceiling for calendar years 2023, 2024, and 2025. In each of those calendar years, the dollar amount in effect for determining the current-year credit ceiling (after any increase due to the applicable

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[257] Sec. 42(a).

[258] Rev. Proc. 2023–34, 2023–48 I.R.B. 1287, November 9, 2023. For calendar year 2023, the small population States were Alaska, Delaware, the District of Columbia, Montana, North Dakota, Rhode Island, South Dakota, Vermont, and Wyoming. See Notice 2023–22, 2023–12 I.R.B. 569, March 17, 2023.

[259] Sec. 42(h)(3)(I).

cost-of-living adjustment) is increased by multiplying the dollar amount for that year by 1.125.

EFFECTIVE DATE

The provision applies to calendar years after 2022.

2. TAX-EXEMPT BOND FINANCING REQUIREMENT (SEC. 502 OF THE BILL AND SEC. 42 OF THE CODE)

PRESENT LAW

A taxpayer may claim the low-income housing credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.[260]

Credit calculations

The applicable percentage for non-Federally subsidized newly constructed housing and non-Federally subsidized substantial rehabilitation is calculated such that the present value of the 10 annual credit amounts equals 70 percent of a building's qualified basis.[261] The applicable percentage is adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the annual applicable Federal rate ("AFR") for mid-term and long-term obligations for the month the building is placed in service. However, under the Housing and Economic Recovery Act of 2008,[262] the minimum applicable percentage for such credits was temporarily set at nine percent. The Consolidated Appropriations Act, 2016[263] made the nine-percent minimum applicable rate permanent. These credits are sometimes referred to as "nine-percent credits."

The applicable percentage for Federally subsidized newly constructed housing, Federally subsidized substantial rehabilitation, and certain housing acquisition costs is calculated such that the present value of the 10 annual credit amounts equals 30 percent of a building's qualified basis. The applicable percentage is adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the annual AFR for mid-term and long- term obligations for the month the building is placed in service. However, under the Consolidated Appropriations Act, 2021,[264] the minimum applicable percentage for such credits was permanently set at four percent. These credits are sometimes referred to as "four-percent credits."

Rehabilitation expenditures

Certain rehabilitation expenditures paid or incurred by the taxpayer are treated for purposes of the low-income housing credit as a separate new building. Rehabilitation expenditures are amounts chargeable to the capital account and incurred for depreciable prop-

[260] Sec. 42(a).
[261] See sec. 42(b)(1)(B) and (e).
[262] Pub. L. No. 110–289, July 30, 2008.
[263] Pub. L. No. 114–113, December 18, 2015.
[264] Pub. L. No. 116–260, December 27, 2020.

erty (or additions or improvements to depreciable property) in connection with the rehabilitation of a building. However, rehabilitation expenditures do not include, for example, the cost of acquiring an existing building.[265]

Generally, the rule treating rehabilitation expenditures as a separate new building applies only if, as of the close of the first tax year in the credit period, two conditions are met with respect to such expenditures. First, the expenditures must be allocable to one or more low- income units or substantially benefit such units. Second, the amount of the expenditures during any 24-month period must meet one of the following requirements (whichever requires the greater amount of expenditures): (1) the amount must be at least 20 percent of the adjusted basis of the building (determined as of the first day of the 24-month period),[266] or (2) the qualified basis attributable to the expenditures, when divided by the number of low-income units in the building, must be at least $6,000 (subject to an inflation adjustment).[267]

For purposes of treating rehabilitation expenditures as a separate building, such expenditures are treated as placed in service at the close of the 24-month period described above.[268]

Tax-exempt bond-financed buildings

Generally, the low-income housing credit is allowable only if the taxpayer receives a credit allocation from a State or local housing credit agency. However, a building may be allowed four-percent credits without receiving a credit allocation if at least 50 percent of the aggregate basis of the building and the land on which the building is located is financed with tax-exempt obligations that are subject to the State private activity bond volume limit ("tax-exempt bonds"). If less than 50 percent of the aggregate basis of the building and the land on which the building is located is financed with tax-exempt bonds, only the portion of credits attributable to the bond-financed portion of the building is allowed without a credit allocation.[269]

REASONS FOR CHANGE

Many areas of the country struggle with a lack of affordable housing, a problem that has been exacerbated in recent years by rising building costs and interest rates. The Committee believes that reducing the amount of tax-exempt bond financing that is required for four-percent credits will help to boost the production of affordable housing. Therefore, for certain buildings, the provision temporarily lowers the bond financing threshold that buildings must meet to receive four-percent credits without a credit allocation.

EXPLANATION OF PROVISION

The provision temporarily lowers the 50-percent bond-financing threshold for purposes of the exception to the credit allocation requirement under certain conditions. Under the provision, a build-

[265] Sec. 42(e)(1) and (2).
[266] Without regard to sec. 1016(a)(2) and (3).
[267] Sec. 42(e)(3).
[268] Sec. 42(e)(4).
[269] Sec 42(h)(4).

ing may be allowed four-percent credits without receiving a credit allocation if two requirements are met. First, at least 30 percent of the aggregate basis of the building and the land on which the building is located must be financed with one or more qualified obligations. A qualified obligation is a tax-exempt bond that is part of an issue the issue date of which is before January 1, 2026. Second, at least five percent of the aggregate basis of the building and the land on which the building is located must be financed with one or more qualified obligations that are part of an issue the issue date of which is after December 31, 2023. Therefore, for purposes of satisfying the second condition, the obligations must be part of an issue the issue date of which is after December 31, 2023, and before January 1, 2026.

EFFECTIVE DATE

The provision applies to buildings placed in service in taxable years beginning after December 31, 2023. For this purpose, in the case of any building with respect to which any expenditures are treated as a separate new building under section 42(e), both the existing building and the separate new building are treated as having been placed in service on the date the expenditures are treated as placed in service under section 42(e)(4).

TITLE VI—TAX ADMINISTRATION AND ELIMINATING FRAUD

1. INCREASE IN THRESHOLD FOR REQUIRING INFORMATION REPORTING WITH RESPECT TO CERTAIN PAYEES (SEC. 601 OF THE BILL AND SECS. 6041 AND 6041A OF THE CODE)

PRESENT LAW

Information reporting requirements

Present law requires persons to file an information return concerning certain transactions with other persons.[270] The person filing an information return (the "payor") is also required to provide the person for whom the information return is being filed (the "payee") with a written statement showing the information that was reported to the Internal Revenue Service ("IRS"), which generally includes aggregate payments made, and the contact information for the payor.[271] These returns are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether such income tax returns are correct and complete.

For example, every person engaged in a trade or business who makes certain payments aggregating $600 or more in any taxable year to a single payee in the course of such trade or business must report those payments to the IRS.[272] This requirement applies to fixed or determinable payments of income as well as nonemployee compensation, generally reported on either Form 1099–MISC, *Miscellaneous Information*, or Form 1099–NEC, *Nonemployee Compensation*. In addition, any service recipient engaged in a trade or

[270] Secs. 6041 through 6050Y.
[271] See, *e.g.,* sec. 6041(d).
[272] Sec. 6041.

business and paying for services is required to make a return according to regulations when aggregate payments equal $600 or more.[273] Governmental entities are specifically required to make an information return,[274] and in the case of payments by Federal executive agencies that extends to reporting payments to corporations as well as individuals.[275]

However, these provisions discussed above do not cover payments for goods or certain enumerated types of payments that are subject to other specific reporting requirements, such as provisions covering dividends, interest, and royalties.[276] Treasury regulations generally provide further exceptions from the reporting of payments to corporations, exempt organizations, governmental entities, international organizations, and retirement plans.[277]

A person who is required to file information returns but who fails to do so by the due date for the returns, includes on the returns incorrect information, or files incomplete returns generally is subject to a penalty of $250 for each return with respect to which such a failure occurs, up to a maximum of $3,000,000 in any calendar year, adjusted for inflation.[278] Similar penalties apply to failures to furnish correct written statements to recipients of payments for which information reporting is required.[279] The failure to file and failure to furnish penalties are reduced for small businesses[280] and increased for failures due to intentional disregard.[281]

Backup withholding

Generally, a payor is not required to withhold taxes from payments to the payee. However, a payor may be required to deduct and withhold income tax on certain "reportable payments" at a rate equal to 24 percent[282] if: (1) the payee fails to furnish his or her taxpayer identification number ("TIN") to the payor; (2) the IRS notifies the payor that the payee's TIN is incorrect; (3) a notified payee underreporting of reportable payments has occurred; or (4)

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[273] Sec. 6041A. For direct sales, any person engaged in a trade or business who, in the course of that trade or business, sells consumer products during any calendar year on a buy-sell or deposit-commission basis (or any other similar basis), for resale in a home or elsewhere (other than a permanent retail establishment), and the aggregate amount of sales to such buyer during the calendar year is $5,000 or more, such person is required to file an information return setting forth the name and address of the buyer to whom such sales are made. Sec. 6041A(b).

[274] Sec. 6041(A)(d)(2).

[275] Sec. 6041A(d)(3)(A).

[276] Section 6041(a) generally excepts from its scope most interest, royalties, and dividends, which are instead covered by sections 6049, 6050N, and 6042, respectively.

[277] Treas. Reg. sec. 1.6041–3. Certain for-profit health care provider corporations are not covered by this general exception, including those organizations providing billing services for such companies.

[278] Sec. 6721. These amounts are adjusted annually for inflation. For information returns required to be filed in calendar year 2023, the penalty amount is $290, up to a maximum of $3,532,500 per calendar year. For information returns required to be filed in calendar year 2024, the penalty amount is $310, up to a maximum of $3,783,000 per calendar year. The penalties are reduced if the failure is corrected within a specified amount of time. Sec. 6721(b). The penalties are waived if a person establishes that any failure was due to reasonable cause and not willful neglect. Sec. 6724(a).

[279] Sec. 6722. These amounts are also adjusted annually for inflation. For information statements required to be filed in calendar year 2023, the penalty amount is $290, up to a maximum of $3,532,500 per calendar year. For information statements required to be filed in calendar year 2024, the penalty amount is $310, up to a maximum of $3,783,000 per calendar year. The penalties are reduced if the failure is corrected within a specified amount of time. Sec. 6722(b). The penalties are waived if a person establishes that any failure was due to reasonable cause and not willful neglect. Sec. 6724(a).

[280] Secs. 6721(d) and 6722(d).

[281] Secs. 6721(e) and 6722(e).

[282] Sec. 3406(a)(1)(D). The backup withholding rate is the fourth lowest rate of tax applicable under section 1(c). In 2023, this rate is 24 percent.

a payee certification failure with respect to reportable payments has occurred.[283] The requirement to deduct and withhold in the case of a notified payee underreporting or a payee certification failure applies solely to reportable interest or dividend payments. These deduction and withholding requirements[284] are referred to as backup withholding.

Reportable payments are defined as any reportable interest or dividend payment and any other reportable payment.[285] A reportable interest or dividend payment means any payment of a kind, and to a payee, required to be shown on an information return required under any of the following sections: (i) 6049(a), relating to payments of interest, (ii) 6042(a), relating to payments of dividends, or (iii) 6044, relating to payments of patronage dividends, but only to the extent such payment is in money and only if 50 percent or more of such payment is in money. Any other reportable payment means any payment of a kind, and to a payee, required to be shown on a return required under any of the following sections: (i) 6041, relating to certain information at source, (ii) 6041A(a), relating to payments of remuneration for services, (iii) 6045, relating to returns of brokers, (iv) 6050A, relating to reporting requirements of certain fishing boat operators, but only to the extent such payment is in money and represents a share of the proceeds of the catch, (v) 6050N, relating to payments of royalties, or (vi) 6050W, relating to payments made in settlement of payment card and third party settlement transactions. Examples of payments that may be subject to backup withholding include interest, dividends, rents, royalties, commissions, non-employee compensation, and broker payments.

In general, a payment is determined to be a reportable payment, and therefore subject to backup withholding, without regard to any minimum amount which must be paid before an information return is required under the applicable information reporting statute.[286]

For payments required to be shown on a return under section 6041(a) or 6041A(a), relating to certain information at the source and payments of remuneration for services, a minimum amount generally must be paid before the payment is subject to backup withholding.[287] Such payments are treated as reportable payments, and therefore subject to backup withholding, only if (i) the aggregate amount of such payment and all previous payments described in section 6041(a) or 6041A(a) by the payor to the payee during such calendar year equals or exceeds $600, (ii) the payor was required under section 6041(a) or 6041A(a) to file an information return for the preceding calendar year with respect to payments to the payee, or (iii) during the preceding calendar year, the payor made reportable payments to the payee with respect to which amounts were required to be deducted and withheld under the backup withholding requirements. Backup withholding generally applies only to payments made to U.S. persons who have failed to provide the payor with a valid IRS Form W–9, *Request for Taxpayer Identification Number and Certification*; however, it may also

[283] Sec. 3406(a)(1).
[284] Sec. 3406.
[285] Sec. 3406(b).
[286] Sec. 3406(b)(4).
[287] Sec. 3406(b)(6).

apply to certain payments made to persons in the absence of valid documentation of foreign status. Backup withholding does not apply to payments made to exempt recipients, including tax-exempt organizations, government entities, and certain other entities.[288] Thus, a payor of reportable payments generally must request that a U.S. payee (other than certain exempt recipients) furnish a Form W–9 providing that person's name and TIN.[289]

REASONS FOR CHANGE

The Committee notes that the thresholds for third party information reporting have not been fundamentally reviewed or adjusted for inflation since 1954. The Committee also notes that the penalties for failure to properly report are adjusted for inflation. The Committee believes that the compliance objectives of third party information reporting must be balanced with the resulting additional administrative burden, specifically that placed on small businesses. Thus, the Committee believes it is necessary to modernize the information reporting regime by updating the reporting thresholds to keep up with inflation and provide relief for small businesses and individuals subject to these rules.

EXPLANATION OF PROVISION

The provision changes the information reporting threshold for certain payments to persons engaged in a trade or business [290] and payments of remuneration for services and direct sales [291] to $1,000 in a calendar year,[292] with the threshold amount to be indexed annually for inflation in calendar years after 2024.

The provision also makes a conforming change to the backup withholding dollar threshold [293] to align with the new $1,000 reporting threshold. Under the provision, both the information reporting thresholds and the backup withholding thresholds are for transactions that equal or exceed $1,000 (indexed for inflation for calendar years after 2024).

EFFECTIVE DATE

The provision applies with respect to payments made after December 31, 2023.

2. ENFORCEMENT PROVISIONS WITH RESPECT TO COVID-RELATED EMPLOYEE RETENTION CREDITS (SEC. 602 OF THE BILL, SEC. 2301 OF THE CARES ACT,[294] AND SEC. 3134 OF THE CODE)

PRESENT LAW

Present law permits an eligible employer to claim a refundable employee retention tax credit ("ERTC") against applicable employment taxes for calendar quarters in 2020 and 2021 in an amount

[288] Sec. 3406(g); Treas. Reg. sec. 31.3406(g)–1.
[289] Treas. Reg. sec. 31.3406(h)–3.
[290] Sec. 6041(a).
[291] Sec. 6041A(a), (b).
[292] The reporting threshold for certain payments to persons engaged in a trade or business under section 6041(a) and payments of remuneration for services under section 6041A(a) is increased from $600 to $1,000 and the reporting threshold for direct sales under section 6041A(b) is decreased from $5,000 to $1,000.
[293] Sec. 3406(b)(6).
[294] Coronavirus Aid, Relief, and Economic Security (CARES) Act sec. 2301 (Pub. L. No. 116–136).

equal to a percentage of the qualified wages with respect to each employee of such employer for such calendar quarter. The percentage is 50 percent of qualified wages paid after March 12, 2020, and before January 1, 2021, and 70 percent of qualified wages for calendar quarters beginning after December 31, 2020, and before January 1, 2022, subject to a maximum amount of wages per employee.[295] The statute of limitations for assessment of any amount attributable to an ERTC is extended from three years to five years for calendar quarters beginning after June 30, 2021, and before January 1, 2022.

If for any calendar quarter the amount of the credit exceeds the applicable employment taxes imposed on the eligible employer, reduced by certain other credits, the excess is treated as a refundable overpayment. Claiming the ERTC on an employment tax return as originally filed can either reduce the eligible employer's employment tax due, or if it exceeds the amount of such tax, give rise to a refund. An eligible employer may claim the employee retention credit on an amended employment tax return (Form 941–X) if the employer did not claim (or seeks to correct) the credit on its original employment tax return. For tax year 2020, an amended employment tax return must be filed by April 15, 2024, and for tax year 2021, by April 15, 2025.

Following a significant increase in ERTC claims, on July 26, 2023, the IRS announced new procedures to address ERTC fraud risk.[296] On September 14, 2023, the IRS announced a moratorium on processing ERTC claims.[297] On October 19, 2023, the IRS announced a process for withdrawing ERTC claims.[298] On December 21, 2023, the IRS announced a voluntary disclosure program for taxpayers that claimed and received the credit, but that are ineligible and seek to pay back the credit.[299]

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[295] The amount of qualified wages per employee that may be taken into account in calculating the credit is increased from $10,000 per employee for all calendar quarters beginning in 2020 to $10,000 per employee per calendar quarter for calendar quarters beginning after December 31, 2020. Legislation enacted in 2020, 2021, and 2022 further modified ERTC rules and definitions, and terminated the credit for wages paid on or after October 31, 2021 (except in the case of a recovery startup business, for which the credit terminated for wages paid on or after January 1, 2022). See Coronavirus Aid, Relief, and Economic Security (CARES) Act sec. 2301 (Pub. L. No. 116–136); Taxpayer Certainty and Disaster Relief Act of 2020 secs. 206 and 207 (Pub. L. No. 116–260); American Rescue Plan Act secs. 9651 (codifying the credit in Code sec. 3134) and 80604 (Pub. L. No. 117–2); and Infrastructure and Jobs Act sec. 80604 (Pub. L. No. 117–58).

[296] See IRS July 26, 2023, announcement at https://www.irs.gov/newsroom/irs-commissioner-signals-new-phase-of-employee-retention-credit-work-with-backlog-eliminated-additional-procedures-will-be-put-in-place-to-deal-with-growing-fraud-risk. There have been many reports of aggressive claim filing practies by so-called ERTC "mills." See, e.g., https://www.abipcpa.com/employee-retention-tax-credit-ertc-scams-and-fraud; https://www.jec-llc.com/blog/ertc-mills-what-should-you-look-out-for; and https://www.irs.gov/newsroom/red-flags-for-employee-retention-credit-claims-irs-reminds-businesses-to-watch-out-for-warning-signs-of-aggressive-promotion-that-can-mislead-people-into-making-improper-erc-claims.

[297] See https://www.irs.gov/newsroom/to-protect-taxpayers-from-scams-irs-orders-immediate-stop-to-new-employee-retention-credit-processing-amid-surge-of-questionable-claims-concerns-from-tax-pros.

[298] See https://www.irs.gov/newsroom/irs-announces-withdrawal-process-for-employee-retention-credit-claims-special-initiative-aimed-at-helping-businesses-concerned-about-an-ineligible-claim-amid-aggressive-marketing-scams.

[299] Expressing concerns about "misleading public advertisements and scams taking advantage of taxpayers," on December 21, 2023, the IRS announced a voluntary disclosure program permitting taxpayers to voluntarily repay the ERTC minus 20 percent through March 22, 2024. See IRS Announcement 2024–3, https://www.irs.gov/pub/irs-drop/a-24-03.pdf, and https://www.irs.gov/coronavirus/employee-retention-credit-voluntary-disclosure-program.

Present law imposes assessable penalties on promoters of tax shelter or abusive transactions.[300] One such penalty is based on aiding and abetting the understatement of tax liability, if the person knows that an understatement of the tax liability of another person would result.[301]

Separately, paid tax return preparers are subject to a penalty of $500 for each failure to comply with due diligence requirements relating to the filing status and amount of certain credits with respect to a taxpayer's return or claim for refund.[302]

Other promoter penalties are related to failure to disclose particular information with respect to a reportable transaction (generally, a transaction that the Treasury Secretary determines has the potential for tax avoidance or evasion),[303] and require material advisors of reportable transactions to keep lists of advisees, subject to a penalty for failure.

REASONS FOR CHANGE

A significant increase in ERTC claims has raised concerns about fraud and about wasteful governmental payments or credits, as well as concerns that claimants are being misled by promoters. Not only can taxpayers become victims of promoters, and face unjust tax penalties in some cases, but the IRS has become so overburdened with thousands of such claims that it is struggling to process valid claims. The cost of improperly and erroneously claimed ERTC refunds or credits is a burden to the fisc and other taxpayers with valid claims.

Determining whether each claimed refund or credit is erroneously or fraudulently claimed and recovering any erroneously paid refunds or erroneously allowed tax credits is likely to be a costly and a lengthy process. Allowing erroneous ERTC refunds or credits claimed, paid, or allowed to increase unchecked would be wasteful and inefficient. The Committee believes that disallowing new and amended claims for refund or credit of the ERTC after the end of January, 2024, serves to limit waste, fraud, and abuse in the tax system. In addition, the Committee believes that an increased penalty on promoters for aiding and abetting understatements of tax liability, a new penalty on promoters for failure to comply with due diligence requirements, and a penalty on promoters for failure to disclose information and maintain client lists are each warranted. Finally, the Committee believes extending the statute of limitations for resolving such cases is necessary to allow more time to address potentially erroneous and fraudulent claims.

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[300] Secs. 6700 through 6708. Sec. 6671 provides rules for application of assessable penalties, including that assessable penalties are payable on notice and demand (sec. 6671(a)).

[301] Sec. 6701. See also IRM, 20.1.6.14.1 (10–13–2021), Activities Subject to the Penalty: "A tax advisor would not be subject to this penalty for suggesting to a client an aggressive but supportable filing position even though that position was later rejected by the courts and even though the client was subjected to the substantial understatement penalty. However, if the advisor suggested a position which the advisor knew could not be supported on any reasonable basis under the law, the penalty would apply."

[302] Sec. 6695(g). This is treated as an assessable penalty.

[303] Secs. 6111 and 6112.

EXPLANATION OF PROVISION

Penalties and definition of ERTC promoter

The provision makes penalties applicable to an ERTC promoter, as defined by the provision. The penalties applicable to ERTC promoters are assessable without regard to the restrictions on assessment found in section 6213(a).[304] References in the provision to the ERTC include the ERTC under both section 3134 of the Code and section 2301 of the CARES Act.

For an ERTC promoter, the assessable penalty for aiding and abetting understatement of a tax liability is increased to the greater of $200,000 ($10,000 in the case of an ERTC promoter that is a natural person) or 75 percent of the gross income of the ERTC promoter from providing aid, assistance, or advice with respect to a return or claim for ERTC refund or a document relating to the return or claim. No-inference language provides that the amount of the penalty under section 6701 relating to ERTC promoters is not to be construed to create any inference regarding the proper application of the knowledge requirement of section 6701(a)(3).

The provision specifically requires an ERTC promoter to comply with due diligence requirements[305] with respect to a taxpayer's eligibility for (or the amount of) an employee retention tax credit and applies a $1,000 penalty for each failure to comply. This amount is treated as an assessable penalty. In addition, for aid, assistance, or advice provided after the date of enactment, if the ERTC promoter does not comply with these due diligence requirements, the provision treats the knowledge requirement[306] as satisfied for purposes of imposing the penalty for aiding and abetting understatement of a tax liability.[307] No-inference language provides that the prospective due diligence requirement is not to be construed to create any inference with respect to any aid, assistance, or advice provided by any ERTC promoter on or before the date of the enactment of the Act (or with respect to any other aid, assistance, or advice to which section 602(b) of the provision does not apply).

For purposes of present-law disclosure and other requirements as well as penalties relating to reportable and listed transactions,[308] an employee retention tax credit (whether or not the taxpayer claims the credit) is treated as a listed transaction as well as a reportable transaction with respect to an ERTC promoter that provides any aid, assistance or advice with respect to the credit, and the ERTC promoter is treated as a material advisor.

No-inference language provides that the requirement to file such disclosures or maintain such lists shall not be construed to create any inference with respect to whether an ERTC is (absent the rule of this provision that treats it as such) treated as a reportable or listed transaction with respect to an ERTC promoter; and a return or list is not treated as required (with respect to such aid, assistance, or advice) by reason of the rule of this provision that treats

[304] Assessable penalties are payable on notice and demand. Sec. 6671(a).

[305] The due diligence requirements for ERTC promoters are required to be similar to the due diligence requirements of section 6695(g), and apply with respect to documents that constitute, or relate to, a return or claim for refund.

[306] Sec. 6701(a)(3). See the present-law description of the knowledge requirement, above.

[307] Section 602(b) of the provision.

[308] Secs. 6111, 6112, 6707, and 6708.

it as required, if the return or list would be required without regard to the rule of this provision that does treat it as required.

Under the provision, an ERTC promoter is any person that provides aid, assistance, or advice with respect to an affidavit, refund, claim or other document relating to an ERTC or to eligibility or to the calculation of the amount of the credit, if the person (1) charges or receives a fee based on the amount of the ERTC refund or credit and meets a materiality standard, or (2) meets a gross receipts test.

Under the materiality standard, a person is treated as an ERTC promoter if the person charges or receives a fee which is based on the amount of the refund or credit only if the aggregate gross receipts of such person for aid, assistance, and advice with respect to the person's taxable year in which the person provided the assistance or the preceding taxable year with respect to all ERTC documents[309] exceeds 20 percent of such person's gross receipts for such taxable year.

Alternatively, the gross receipts test is met if (1) the aggregate gross receipts for the relevant year from such aid, assistance, and advice exceeds half of the person's gross receipts for the relevant year, or (2) both (i) the aggregate gross receipts for the relevant year from such aid exceeds 20 percent of the person's gross receipts for the relevant year and (ii) the person's aggregate gross receipts[310] from such aid exceeds $500,000. An ERTC promoter does not include a certified professional employer organization (PEO).

Statute of limitations extension

The provision extends the statute of limitations on assessment for the ERTC to six years after the latest of: (1) the date on which the original return for the relevant calendar quarter is filed, (2) the date on which the return is treated as filed under present-law statute of limitations rules,[311] or (3) the date on which the credit or refund with respect to the ERTC is made.

Time for filing claims

The provision also provides that no credit or refund of the ERTC shall be allowed or made after January 31, 2024, unless such claim for such refund or credit is filed on or before that date. For this purpose, the term "such claim for such refund or credit" means the claim as filed on or before January 31, 2024, including the amount, taxpayer, calendar quarter or time period, employees, wages, and any other characteristic with respect to such claim as filed on or before January 31, 2024. The provision has the effect of ending the period for filing ERTC claims. No new claims and no new amendments to ERTC claims are allowed after January 31, 2024. The filing of a protective claim on or before January 31, 2024, does not preserve a right to claim a refund or credit of the ERTC after January 31, 2024.

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[309] An ERTC document is any return, affidavit, claim, or other document related to the ERTC, including any document related to eligibility for, or the calculation or determination of any amount directly related to the ERTC.

[310] For purposes of determining aggregate gross receipts, an aggregation rule provides that all persons treated as a single employer under section 52(a) or (b) are treated as one person. A rule for short taxable years applies.

[311] Sec. 6501.

For example, if a claim for credit or refund of the ERTC is made in the amount of $100 on January 25, 2024, no amendment of such claim, including the amount of such claim or any other aspect of such claim, can be made or allowed after January 31, 2024. That is, an amended claim for $5,000, or alternatively for $1, made on February 15, 2024 (or any other date after January 31, 2024), cannot be made or allowed.

EFFECTIVE DATE

The provision is generally effective for aid, assistance, or advice provided after March 12, 2020. The part of the provision relating to verification and due diligence is effective for aid, assistance, or advice provided after the date of enactment. The limitation on credit or refund of the ERTC applies to credits or refunds allowed or made after January 31, 2024. The extension of the statute of limitations on assessment is effective for assessments made after the date of enactment.

Under a transition rule, the requirement for an ERTC promoter to file disclosures or maintain lists with respect to aid, assistance, or advice provided before the date of enactment does not require filing before 90 days after the date of enactment.

In addition, regulatory authority is provided.

III. VOTES OF THE COMMITTEE

Purpose to clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means in its consideration of H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024," on January 19, 2024.

The vote on the amendment offered by Ms. DelBene to the amendment in the nature of a substitute to H.R. 7024, which strikes the provisions in the underlying bill that would index the child tax credit to inflation and provide for the income lookback and inserts the ARPA CTC was not agreed to by a roll call vote of 18 yeas to 25 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (MO)		X		Mr. Neal	X		
Mr. Buchanan		X		Mr. Doggett	X		
Mr. Smith (NE)		X		Mr. Thompson	X		
Mr. Kelly		X		Mr. Larson	X		
Mr. Schweikert		X		Mr. Blumenauer	X		
Mr. LaHood		X		Mr. Pascrell	X		
Dr. Wenstrup		X		Mr. Davis	X		
Mr. Arrington		X		Ms. Sánchez	X		
Dr. Ferguson		X		Mr. Higgins	X		
Mr. Estes		X		Ms. Sewell	X		
Mr. Smucker		X		Ms. DelBene	X		
Mr. Hern		X		Ms. Chu	X		
Ms. Miller		X		Ms. Moore	X		
Dr. Murphy		X		Mr. Kildee	X		
Mr. Kustoff		X		Mr. Beyer	X		
Mr. Fitzpatrick		X		Mr. Evans	X		
Mr. Steube		X		Mr. Schneider	X		
Ms. Tenney		X		Mr. Panetta	X		
Mrs. Fischbach		X					
Mr. Moore		X					
Mrs. Steel		X					

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Ms. Van Duyne		X					
Mr. Feenstra		X					
Ms. Malliotakis		X					
Mr. Carey		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024," on January 19, 2024.

The vote on the amendment offered by Ms. Sanchez to the amendment in the nature of a substitute to H.R. 7024, which strikes the provisions that would provide the Child Tax Credit on a per-child basis, increases the refundable credit amount, indexes the credit for inflation, and provides for the income lookback, and instead makes current law Child Tax Credit fully refundable was not agreed to by a roll call vote of 18 yeas to 25 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (MO)		X		Mr. Neal	X		
Mr. Buchanan		X		Mr. Doggett	X		
Mr. Smith (NE)		X		Mr. Thompson	X		
Mr. Kelly		X		Mr. Larson	X		
Mr. Schweikert		X		Mr. Blumenauer	X		
Mr. LaHood		X		Mr. Pascrell	X		
Dr. Wenstrup		X		Mr. Davis	X		
Mr. Arrington		X		Ms. Sánchez	X		
Dr. Ferguson		X		Mr. Higgins	X		
Mr. Estes		X		Ms. Sewell	X		
Mr. Smucker		X		Ms. DelBene	X		
Mr. Hern		X		Ms. Chu	X		
Ms. Miller		X		Ms. Moore	X		
Dr. Murphy		X		Mr. Kildee	X		
Mr. Kustoff		X		Mr. Beyer	X		
Mr. Fitzpatrick		X		Mr. Evans	X		
Mr. Steube		X		Mr. Schneider	X		
Ms. Tenney		X		Mr. Panetta	X		
Mrs. Fischbach		X					
Mr. Moore		X					
Mrs. Steel		X					
Ms. Van Duyne		X					
Mr. Feenstra		X					
Ms. Malliotakis		X					
Mr. Carey		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024," on January 19, 2024.

The vote on the amendment offered by Ms. Sewell to the amendment in the nature of a substitute to H.R. 7024, which provides for monthly Child Tax Credit payments was not agreed to by a roll call vote of 18 yeas to 25 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (MO)		X		Mr. Neal	X		
Mr. Buchanan		X		Mr. Doggett	X		

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (NE)		X		Mr. Thompson	X		
Mr. Kelly		X		Mr. Larson	X		
Mr. Schweikert		X		Mr. Blumenauer	X		
Mr. LaHood		X		Mr. Pascrell	X		
Dr. Wenstrup		X		Mr. Davis	X		
Mr. Arrington		X		Ms. Sánchez	X		
Dr. Ferguson		X		Mr. Higgins	X		
Mr. Estes		X		Ms. Sewell	X		
Mr. Smucker		X		Ms. DelBene	X		
Mr. Hern		X		Ms. Chu	X		
Ms. Miller		X		Ms. Moore	X		
Dr. Murphy		X		Mr. Kildee	X		
Mr. Kustoff		X		Mr. Beyer	X		
Mr. Fitzpatrick		X		Mr. Evans	X		
Mr. Steube		X		Mr. Schneider	X		
Ms. Tenney		X		Mr. Panetta	X		
Mrs. Fischbach		X					
Mr. Moore		X					
Mrs. Steel		X					
Ms. Van Duyne		X					
Mr. Feenstra		X					
Ms. Malliotakis		X					
Mr. Carey		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024," on January 19, 2024.

The vote on the amendment offered by Mr. Pascrell to the amendment in the nature of a substitute to H.R. 7024, which increases the state and local tax deduction from $10,000 to $60,000 for single filers (and $120,000 for joint filers) was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (MO)		X		Mr. Neal	X		
Mr. Buchanan		X		Mr. Doggett			
Mr. Smith (NE)		X		Mr. Thompson	X		
Mr. Kelly		X		Mr. Larson	X		
Mr. Schweikert		X		Mr. Blumenauer	X		
Mr. LaHood		X		Mr. Pascrell	X		
Dr. Wenstrup		X		Mr. Davis	X		
Mr. Arrington		X		Ms. Sánchez	X		
Dr. Ferguson		X		Mr. Higgins	X		
Mr. Estes		X		Ms. Sewell	X		
Mr. Smucker		X		Ms. DelBene	X		
Mr. Hern		X		Ms. Chu	X		
Ms. Miller		X		Ms. Moore			
Dr. Murphy		X		Mr. Kildee	X		
Mr. Kustoff		X		Mr. Beyer	X		
Mr. Fitzpatrick		X		Mr. Evans	X		
Mr. Steube		X		Mr. Schneider	X		
Ms. Tenney		X		Mr. Panetta	X		
Mrs. Fischbach		X					
Mr. Moore		X					
Mrs. Steel		X					
Ms. Van Duyne		X					
Mr. Feenstra		X					
Ms. Malliotakis							
Mr. Carey		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 7024, the "Tax Relief for American Families and Workers Act of 2024," on January 19, 2024.

H.R. 7024 was oredered favorably reported to the House of Representatives as amended by a roll call vote of 40 yeas to 3 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (MO)	X			Mr. Neal	X		
Mr. Buchanan	X			Mr. Doggett		X	
Mr. Smith (NE)	X			Mr. Thompson	X		
Mr. Kelly	X			Mr. Larson	X		
Mr. Schweikert	X			Mr. Blumenauer	X		
Mr. LaHood	X			Mr. Pascrell	X		
Dr. Wenstrup	X			Mr. Davis	X		
Mr. Arrington	X			Ms. Sánchez		X	
Dr. Ferguson	X			Mr. Higgins	X		
Mr. Estes	X			Ms. Sewell	X		
Mr. Smucker	X			Ms. DelBene	X		
Mr. Hern	X			Ms. Chu	X		
Ms. Miller	X			Ms. Moore		X	
Dr. Murphy	X			Mr. Kildee	X		
Mr. Kustoff	X			Mr. Beyer	X		
Mr. Fitzpatrick	X			Mr. Evans	X		
Mr. Steube	X			Mr. Schneider	X		
Ms. Tenney	X			Mr. Panetta	X		
Mrs. Fischbach	X						
Mr. Moore	X						
Mrs. Steel	X						
Ms. Van Duyne	X						
Mr. Feenstra	X						
Ms. Malliotakis	X						
Mr. Carey	X						

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 7024, as reported. The estimate prepared by the Congressional Budget Office was not provided at the time of the filing.

The bill is estimated to decrease Federal fiscal year budget receipts by $399 million for the period 2024 through 2033.

ESTIMATED BUDGET EFFECTS OF
H.R. 7024, THE "TAX RELIEF FOR AMERICAN FAMILIES AND WORKERS ACT OF 2024,"
AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS

Fiscal Years 2024 - 2033

[Millions of Dollars]

Provision	Effective	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2024-28	2024-33
I. TAX RELIEF FOR WORKING FAMILIES - Index credit starting in 2024 and refundable maximum starting in 2025, rounding down to the nearest $100 increment and 1(f)(3) base year 2022; per-child credit phase in; allow use of prior-year earnings in 2024 and 2025; increase refundable maximum to $1,800 in 2023, $1,900 in 2024, and $2,000 in 2025 before indexing (all provisions sunset 12/31/25) [1]	**tyba 12/31/22**	**-8,215**	**-10,723**	**-14,555**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**-33,493**	**-33,493**
II. AMERICAN INNOVATION AND GROWTH													
1. Deduction for domestic research and experimental expenditures	tyba 12/31/21	-82,732	-19,843	15,143	30,312	23,882	15,833	7,400	1,540	---	---	-33,238	-8,465
2. Extension of allowance for depreciation, amortization, or depletion in determining the limitation on business interest	tyba12/31/23 through tyba 12/31/25 [2]	-8,996	-4,618	-2,768	-492	-430	-342	-277	-251	-301	-340	-17,305	-18,815
3. Extension of 100-percent bonus depreciation	ppisa 12/31/22	-32,793	-35,465	-4,439	26,031	16,693	11,773	7,922	4,267	2,024	942	-29,973	-3,046
4. Increase in limitations on expensing of depreciable business assets [3]	ppisi tyba 12/31/23	-236	-389	-323	-325	-275	-219	-190	-178	-177	-183	-1,548	-2,495
TOTAL OF AMERICAN INNOVATION AND GROWTH		**-124,757**	**-60,315**	**7,613**	**55,526**	**39,870**	**27,045**	**14,855**	**5,378**	**1,546**	**419**	**-82,064**	**-32,821**
III. INCREASING GLOBAL COMPETITIVENESS - United States-Taiwan Expedited Double-Tax Relief Act	**---**	*No Revenue Effect*											
IV. ASSISTANCE FOR DISASTER-IMPACTED COMMUNITIES													
1. Extension of rules for treatment of certain disaster-related personal casualty losses	DOE	-2,883	-876	-415	-201	-33	-1	-1	-1	-1	-1	-4,408	-4,414
2. Exclusion from gross income for compensation for losses or damages resulting from certain wildfires	[4]	-384	-85	-43	---	---	---	---	---	---	---	-512	-512
3. East Palestine disaster relief payments	arooa 2/3/23	-1	[5]	[5]	---	---	---	---	---	---	---	-1	-1
TOTAL OF ASSISTANCE FOR DISASTER-IMPACTED COMMUNITIES		**-3,268**	**-961**	**-458**	**-201**	**-33**	**-1**	**-1**	**-1**	**-1**	**-1**	**-4,921**	**-4,927**

Provision	Effective	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2024-28	2024-33
V. MORE AFFORDABLE HOUSING													
1. State housing credit ceiling increase for low-income housing credit	cyba 12/31/22	-20	-98	-215	-300	-332	-338	-339	-339	-339	-339	-965	-2,661
2. Tax-exempt bond financing requirement	bpisi tyba 12/31/23	-22	-118	-278	-404	-453	-464	-465	-464	-464	-464	-1,275	-3,597
TOTAL OF MORE AFFORDABLE HOUSING		**-42**	**-216**	**-493**	**-704**	**-785**	**-802**	**-805**	**-804**	**-804**	**-804**	**-2,240**	**-6,258**
VI. TAX ADMINISTRATION AND ELIMINATING FRAUD													
1. Increase in threshold for requiring information reporting with respect to certain payees	pma 12/31/23	-46	-128	-120	-139	-159	-163	-168	-173	-196	-220	-592	-1,513
2. Enforcement provisions with respect to COVID-related employee retention credits	[6]	18,812	34,580	21,028	3,306	888	---	---	---	---	---	78,613	78,613
TOTAL OF TAX ADMINISTRATION AND ELIMINATING FRAUD		**18,766**	**34,452**	**20,908**	**3,167**	**729**	**-163**	**-168**	**-173**	**-196**	**-220**	**78,021**	**77,100**
NET TOTAL		**-117,516**	**-37,763**	**13,015**	**57,788**	**39,781**	**26,079**	**13,881**	**4,400**	**545**	**-606**	**-44,697**	**-399**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is assumed to be January 31, 2024.

Legend for "Effective" column:

arooa = amounts received on or after
bpisi = buildings placed in service in
DOE = date of enactment
pma = payments made after
ppisa = property placed in service after
ppisi = property placed in service in
tyba = taxable years beginning after

	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2024-28	2024-33
[1] Estimate contains the following outlay effects:												
Tax Relief for Working Families	8,215	9,296	13,128	---	---	---	---	---	---	---	30,640	30,640

[2] A retroactive election is allowed for taxable years beginning after December 31, 2021.

[3] The limit is reduced (but not below zero) by the cost of qualifying property placed in service during the taxable year in excess of $3.22 million.

[4] Applies to qualified wildfire relief payments received during taxable years beginning after December 31, 2019, and before January 1, 2026.

[5] Loss of less than $500,000.

[6] Effective for aid, assistance and advice after March 12, 2020, except effective for aid, assistance and advice after the date of enactment with respect to the due diligence requirement, and the limitation on credits and refunds allowed or made after January 31, 2024

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

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

C. Cost Estimate Prepared by the Congressional Budget Office

With respect to the requirements of clause 3(c)(2) of rule XIII of the Rules of the House of Representatives and section 308(a) of the *Congressional Budget Act of 1974* and with respect to requirements of clause (3)(c)(3) of rule XIII of the Rules of the House of Representatives and section 402 of the *Congressional Budget Act of 1974*, the Committee has requested but not received a cost estimate for this bill from the Director of Congressional Budget Office. The Chairman of the Committee shall cause such estimate and statement to be printed in the Congressional Record upon its receipt by the Committee.

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

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee made findings and recommendations that are reflected in this report.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill does not authorize funding, so no statement of general performance goals and objectives is required.

C. Applicability of House Rule XXI, Clause 5(b)

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

D. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indi-

rectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, for each such provision identified by the staff of the Joint Committee on Taxation, a summary description of each provision is provided below along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and Treasury regarding each provision included in the complexity analysis.

LIST OF PROVISIONS IN THE COMPLEXITY ANALYSIS

1. Tax Relief for Working Families (sec. 101 through 105 of the bill)

Summary description of provisions

Per-child calculation of the additional child tax credit

Under the proposal, the calculation of the additional child tax credit is temporarily made after multiplying each of the amounts determined under the earned income formula and the alternative formula by the number of qualifying children. The additional child tax credit continues to be limited to the maximum amount of the additional child tax credit per qualifying child.

For example, consider a taxpayer with two qualifying children and earned income of $9,000. With other simplifying assumptions, under present law, this taxpayer would calculate the additional child tax credit amount to be $975.[312] Under the proposal, this taxpayer would calculate the additional child tax credit amount to be $1,950.[313]

The temporary modification of the calculation of the additional child tax credit is effective for taxable years beginning after December 31, 2022, and expires for taxable years beginning after December 31, 2025.

Increase in the maximum amount of the additional child tax credit

The proposal temporarily increases the maximum amount of the additional child tax credit per qualifying child to $1,800 in 2023, $1,900 in 2024, and the full amount of the child tax credit for qualifying children ($2,000, adjusted for inflation as described below) in 2025.

The temporary increase of the maximum amount of the additional child tax credit is effective for taxable years beginning after December 31, 2022, and expires for taxable years beginning after December 31, 2025.

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[312] Under present law, the additional child tax credit is calculated by multiplying the amount of earned income that exceeds $2,500 by 15 percent. ($9,000 – $2,500) x .15 = $975.

[313] Under the proposal, the additional child tax credit is calculated by multiplying the amount of earned income that exceeds $2,500 by 15 percent and by the number of children. ($9,000 – $2,500) x .15 x 2 = $1,950.

Inflation adjustment of the child tax credit and of the 2025 additional child tax credit

The $2,000 amount of the child tax credit is temporarily indexed for inflation beginning in 2024.[314] The maximum amount of the additional child tax credit per qualifying child is also temporarily indexed for inflation, but only in 2025 and, as a result, matches the amount of the child tax credit for that year.[315] Any adjustment for inflation is rounded down to the next lowest multiple of $100.

The temporary indexing for inflation is effective for taxable years beginning after December 31, 2023, and expires for taxable years beginning after December 31, 2025, when the amount of the child tax credit returns to $1,000 per qualifying child.

Rules for the determination of earned income to calculate the additional child tax credit

In calculating the additional child tax credit, the proposal temporarily allows a taxpayer to elect to use earned income for the preceding taxable year instead of earned income for the current taxable year to calculate the additional child tax credit, if earned income for the current taxable year is less than earned income for the preceding taxable year. In the case of a joint return, the earned income of the taxpayer for the preceding taxable year is the sum of the earned incomes of each spouse for such preceding taxable year.

In the case of a taxpayer electing the application of this new temporary rule, the proposal gives the IRS math error authority for an error involving an entry on a return of earned income for the preceding taxable year that is inconsistent with the amount of earned income determined by the Secretary for the preceding taxable year.

The temporary election to use prior year earned income is effective for taxable years beginning after December 31, 2023, and expires for taxable years beginning after December 31, 2025.

Special rule for certain early-filed 2023 returns

If a taxpayer files a claim on the tax return for 2023 for a child tax credit and the amount of the additional child tax credit on the return is determined without regard to the proposals described above that are effective for 2023 (i.e., the per-child calculation of the additional child tax credit and the increase in the additional child tax credit), the taxpayer may be entitled to an additional credit or refund amount. In such a case, the Treasury Department is directed (to the maximum extent practicable) to (1) redetermine the amount of such credit (after taking into account the relevant proposals described above which are effective for 2023) on the basis of the information provided on the return, and (2) credit or refund any such additional credit or refund as expeditiously as possible.

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[314] The proposal uses 2022 as the base year for this inflation calculation. Using 2022 as the base year results in one year of inflation adjustment for 2024, and two years of inflation adjustment for 2025.

[315] The proposal uses 2022 as the base year for this inflation calculation. Using 2022 as the base year results in two years of inflation adjustment for 2025.

NUMBER OF AFFECTED TAXPAYERS

It is estimated that the child tax credit provisions will affect approximately 9 million tax returns in 2023 and 2024 and 37 million tax returns in 2025.

DISCUSSION

The IRS will need to modify forms, instructions, and publications to reflect the changes to the child tax credit. For 2023, the IRS will need to recalculate the amount of the additional child tax credit for taxpayers subject to the maximum amount or with more than one child. The IRS will need to establish a program to expeditiously provide taxpayers that have already filed a 2023 tax return with any additional credit or refund. The changes to the child tax credit may result in an increase in disputes with the IRS.

2. Increase in threshold for requiring information reporting with respect to certain payees (sec. 601 of the bill)

Summary description of provision

The provision changes the information reporting threshold for certain payments to persons engaged in a trade or business [316] and payments of remuneration for services and direct sales [317] to $1,000 in a calendar year,[318] with the threshold amount to be indexed annually for inflation in calendar years after 2024.

The provision also makes a conforming change to the backup withholding dollar threshold [319] to align with the new $1,000 reporting threshold. Under the provision, both the information reporting thresholds and the backup withholding thresholds are for transactions that equal or exceed $1,000 (indexed for inflation for calendar years after 2024).

Number of affected taxpayers

It is estimated that the provision will affect more than 10 percent of individual or small business tax returns.

Discussion

If greater reporting from unrelated third parties were available, it is possible that the IRS could more readily identify areas of underreported income of the payees. In general, the more payments to which information reporting and/or withholding applies, the greater the improvement in compliance. However, numerous critics have pointed to the fact that not raising the reporting thresholds for inflation since 1954 poses a disproportionate administrative burden on those required to comply with the reporting obligations, including small businesses. For a small business without sufficient personnel or an automated payroll system, meeting these reporting requirements may be time consuming and complicated. The payer must collect tax identification and other personal information from the payee and must remit a Form 1099 to both the payee and the

[316] Sec. 6041(a).
[317] Sec. 6041A(a), (b).
[318] The reporting threshold for certain payments to persons engaged in a trade or business under section 6041(a) and payments of remuneration for services under section 6041A(a) is increased from $600 to $1,000 and the reporting threshold for direct sales under section 6041A(b) is decreased from $5,000 to $1,000.
[319] Sec. 3406(b)(6).

IRS. Even for businesses with sufficient systems in place, the administrative costs (e.g., printing and mailing) of gathering tax information from a single payee might not justify the compliance gain, especially for low dollar, non-recurring transactions.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

COMMISSIONER

January 23, 2024

Mr. Thomas A. Barthold
Chief of Staff
Joint Committee on Taxation
Washington, D.C. 20515

Dear Mr. Barthold:

I am responding to your letter dated January 19, 2024, in which you requested a complexity analysis related to the Committee Report for "H.R. 7024, Tax Relief for American Families and Workers Act of 2024."

Enclosed are the combined comments of the Internal Revenue Service (IRS) and the Department of the Treasury for inclusion in the complexity analysis in the Committee Report for "H.R. 7024, Tax Relief for American Families and Workers Act of 2024."

Our analysis covers the provisions that you preliminarily identified in your letter: Sec. 101 through 105. Tax Relief for Working Families and Sec. 601. Increase in threshold for requiring information reporting with respect to certain payees. Please note that for purposes of this complexity analysis, IRS staff assumed timely enactment of this legislation. If legislation is not enacted before the end of the year, there would be complexity for IRS and for taxpayers that is not addressed in this response.

Our comments are based on the description of the provision provided in your letter. This analysis does not include the administrative cost estimates for the changes that would be required. Due to the short turnaround time, our comments are provisional and subject to change upon a more complete and in-depth analysis of the provisions.

I hope this information is helpful. If you have any questions, please feel free to contact me, or your staff may contact Scott Landes, Chief, Legislation and Reports Branch, Office of Legislative Affairs, at 202-317-6985.

Sincerely,

Daniel I. Werfel

Digitally signed by Daniel I. Werfel
Date: 2024.01.23 12:05:48 -05'00'

Daniel I. Werfel

Enclosure

COMPLEXITY ANALYSIS OF H.R. 7024, TAX RELIEF FOR AMERICAN FAMILIES AND WORKERS ACT OF 2024

1. Sec. 101 through 105. Tax Relief for Working Families

Per-child calculation of the additional child tax credit

Under the proposal, the calculation of the additional child tax credit is temporarily made after multiplying each of the amounts determined under the earned income formula and the alternative formula by the number of qualifying children. The additional child tax credit continues to be limited to the maximum amount of the additional child tax credit per qualifying child.

For example, consider a taxpayer with two qualifying children and earned income of $9,000. With other simplifying assumptions, under present law, this taxpayer would calculate the additional child tax credit amount to be $975. Under the proposal, this taxpayer would calculate the additional child tax credit amount to be $1,950.

The temporary modification of the calculation of the additional child tax credit expires for taxable years beginning after December 31, 2025.

Increase in the maximum amount of the additional child tax credit

The proposal temporarily increases the maximum amount of the additional child tax credit per qualifying child to $1,800 in 2023, $1,900 in 2024, and the full amount of the child tax credit for qualifying children ($2,000, adjusted for inflation as described below) in 2025.

The temporary increase of the maximum amount of the additional child tax credit expires for taxable years beginning after December 31, 2025.

Inflation adjustment of the child tax credit and of the 2025 additional child tax credit

The $2,000 amount of the child tax credit is temporarily indexed for inflation beginning in 2024. The maximum amount of the additional child tax credit per qualifying child is also temporarily indexed for inflation, but only in 2025 and, as a result, matches the amount of the child tax credit for that year. Any adjustment for inflation is rounded down to the next lowest multiple of $100.

The temporary indexing for inflation expires for taxable years beginning after December 31, 2025 when the amount of the child tax credit returns to $1,000 per qualifying child.

Rules for the determination of earned income to calculate the additional child tax credit

In calculating the additional child tax credit, the proposal temporarily allows a taxpayer to elect to use earned income for the preceding taxable year instead of earned income for the current taxable year to calculate the additional child tax credit, if earned income for the current taxable year is less than earned income for the preceding taxable year. In the case of a joint return, the earned income of the taxpayer for the preceding taxable year is the sum of the earned incomes of each spouse for such preceding taxable year.

In the case of a taxpayer electing the application of this new temporary rule, the proposal gives the IRS math error authority for an error involving an entry on a return of earned income for the preceding taxable year that is inconsistent with the amount of earned income determined by the Secretary for the preceding taxable year.

The temporary election to use prior year earned income expires for taxable years beginning after December 31, 2025.

Special rule for certain early-filed 2023 returns

If a taxpayer files a claim on the tax return for 2023 for a child tax credit and the amount of the additional child tax credit on the return is determined without regard to the proposals described above that are effective for 2023 (i.e., the per-child calculation of the additional child tax credit and the increase in the additional child tax credit), the taxpayer may be entitled to an additional credit or refund amount. In such a case, the Treasury Department is directed (to the maximum extent practicable) to (1) redetermine the amount of such credit (after taking into account the relevant proposals described above which are effective for 2023) on the basis of the information provided on the return, and (2) credit or refund any such additional credit or refund as expeditiously as possible.

Effective Date

The proposal changing the calculation of the additional child tax credit to a per-child earned income formula and a per-child alternative formula is effective for taxable years beginning after December 31, 2022.

The proposal increasing the maximum amount of the additional child tax credit is effective for taxable years beginning after December 31, 2022.

The proposal indexing the amount of the child tax credit in 2024 and 2025 and the additional child tax credit in 2025 for inflation is effective for taxable years beginning after December 31, 2023.

The proposal allowing the use of prior year earned income to calculate the additional child tax credit is effective for taxable years beginning after December 31, 2023.

The proposal directing the Treasury Department to make redeterminations of the child tax credit and to credit or refund amounts is effective upon date of enactment.

IRS and Treasury Comments:

- Forms would be revised for 2023 through 2025.
- Programming changes would be needed for external IRS online tools to educate and inform taxpayers about the changes and Internal tools used by IRS customer service employees will also require changes.
- Significantly increased call volumes would result in the need to add or enhance phone lines, develop or enhance chat and voice bot capabilities, and monitoring of phones and bot volumes.
    - Provide customer service support to taxpayers with issues at filing, Math Errors, Amended Returns/Adjustments, etc.
    - Provide customer service support for taxpayer responses to new notices, letters, and general correspondence.
- Internal Revenue Manuals and employee training would be updated.
- Internal communications would be shared with all employees and external communications with the public would need updating and sharing.
- IRS would need to update webpages and other publicly available information.
- The statutory language with regard to the determination of the CTC allows the taxpayer to elect the benefit. The joint return provision allowing the preceding year's earned income to be the sum for each spouse presents difficulties. Without substantial programming, the IRS is unable to systemically calculate the amount of prior year earned income. For example, IRS does not systemically capture all information needed to independently calculate a taxpayer's individual earned

income – and changes in filing status or family composition couldn't be systemically determined.
- Programming changes would be required to incorporate the changes into the appropriate processing and compliance systems.

2. Sec. 601. Increase in threshold for requiring information reporting with respect to certain payees

Summary description of provision

The proposal increases the information reporting threshold for certain payments to persons engaged in a trade or business and payments of remuneration for services and direct sales to $1,000 in a calendar year, with the threshold amount to be indexed annually for inflation in calendar years after 2024.

The proposal also makes a conforming change to the backup withholding dollar threshold to align with the new $1,000 reporting threshold. Under the proposal, both the information reporting thresholds and the backup withholding thresholds are for transactions that equal or exceed $1,000 (indexed for inflation for calendar years after 2024).

Number of affected taxpayers

It is estimated that the provision will affect more than 10 percent of individual or small business tax returns.

Discussion

If greater reporting from unrelated third parties were available, it is possible that the IRS could more readily identify areas of underreported income of the payees. In general, the more payments to which information reporting and/or withholding applies, the greater the improvement in compliance. However, numerous critics have pointed to the fact that not raising the reporting thresholds for inflation since 1954 poses a disproportionate administrative burden on those required to comply with the reporting obligations, including small businesses. For a small business without sufficient personnel or an automated payroll system, meeting these reporting requirements may be time consuming and complicated. The payor must collect tax identification and other personal information from the payee and must remit a Form 1099 to both the payee and the IRS. Even for businesses with sufficient systems in place, the administrative costs of gathering tax information from a single payee might not justify the compliance gain, especially for low dollar, non-recurring transactions.

IRS and Treasury Comments:

- Potential for reducing payor recordkeeping and filing burden (for some payors, the reduction in burden could be significant).
- Forms, instructions and publications would need to be updated.
- IT programming would need to be reviewed and updated to reflect the new reporting requirements.
- Internal Revenue Manuals and employee training would need to be updated.
- Training materials for new employees would need to be updated.
- Internal communications would be shared with all employees.
- External communications would be necessary to communicate changes. Communication would need to be considerable (due to significance of changes) and as early as possible for stakeholder planning purposes. Communication also would need to address inaccurate perceptions that the change to the reporting requirements changes the tax consequences of any taxable amounts no longer reported to IRS.
- IRS.gov updates would need to be provided.
- IRS efforts to identify nonfilers could be affected, as IRS would receive less payor

information reports.

E. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4). The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

F. Congressional Earmarks, Limited Tax Benefits, and Limited Tariff Benefits

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

G. Duplication of Federal Programs

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

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

A. Text of Existing Law Amended or Repealed by the Bill, as Reported

With respect to the requirement of clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows.

Changes in Existing Law Made by the Bill, as Reported

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

INTERNAL REVENUE CODE OF 1986

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter A—DETERMINATION OF TAX LIABILITY

* * * * * * *

PART IV—CREDITS AGAINST TAX

* * * * * * *

Subpart A—NONREFUNDABLE PERSONAL CREDITS

* * * * * * *

SEC. 24. CHILD TAX CREDIT.

(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year with respect to each qualifying child of the taxpayer for which the taxpayer is allowed a deduction under section 151 an amount equal to $1,000.

(b) LIMITATIONS.—

(1) LIMITATION BASED ON ADJUSTED GROSS INCOME.—The amount of the credit allowable under subsection (a) shall be reduced (but not below zero) by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the threshold amount. For purposes of the preceding sentence, the term "modified adjusted gross income" means adjusted gross income increased by any amount excluded from gross income under section 911, 931, or 933.

(2) THRESHOLD AMOUNT.—For purposes of paragraph (1), the term "threshold amount" means—

(A) $110,000 in the case of a joint return,

(B) $75,000 in the case of an individual who is not married, and

(C) $55,000 in the case of a married individual filing a separate return.

For purposes of this paragraph, marital status shall be determined under section 7703.

(c) QUALIFYING CHILD.—For purposes of this section—

(1) IN GENERAL.—The term "qualifying child" means a qualifying child of the taxpayer (as defined in section 152(c)) who has not attained age 17.

(2) EXCEPTION FOR CERTAIN NONCITIZENS.—The term "qualifying child" shall not include any individual who would not be a dependent if subparagraph (A) of section 152(b)(3) were applied without regard to all that follows "resident of the United States".

(d) PORTION OF CREDIT REFUNDABLE.—

(1) IN GENERAL.—The aggregate credits allowed to a taxpayer under subpart C shall be increased by the lesser of—

(A) the credit which would be allowed under this section without regard to this subsection and the limitation under section 26(a) or

(B) the amount by which the aggregate amount of credits allowed by this subpart (determined without regard to this subsection) would increase if the limitation imposed by section 26(a) were increased by the greater of—

(i) 15 percent of so much of the taxpayer's earned income (within the meaning of section 32) which is taken into account in computing taxable income for the taxable year as exceeds $3,000, or

(ii) in the case of a taxpayer with 3 or more qualifying children, the excess (if any) of—

(I) the taxpayer's social security taxes for the taxable year, over

(II) the credit allowed under section 32 for the taxable year.

The amount of the credit allowed under this subsection shall not be treated as a credit allowed under this subpart and shall reduce the amount of credit otherwise allowable under subsection (a) without regard to section 26(a). For purposes of subparagraph (B), any amount excluded from gross income by reason of section 112 shall be treated as earned income which is taken into account in computing taxable income for the taxable year.

(2) SOCIAL SECURITY TAXES.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "social security taxes" means, with respect to any taxpayer for any taxable year—

(i) the amount of the taxes imposed by sections 3101 and 3201(a) on amounts received by the taxpayer during the calendar year in which the taxable year begins,

(ii) 50 percent of the taxes imposed by section 1401 on the self-employment income of the taxpayer for the taxable year, and

(iii) 50 percent of the taxes imposed by section 3211(a) on amounts received by the taxpayer during the calendar year in which the taxable year begins.

(B) COORDINATION WITH SPECIAL REFUND OF SOCIAL SECURITY TAXES.—The term "social security taxes" shall not include any taxes to the extent the taxpayer is entitled to a special refund of such taxes under section 6413(c).

(C) SPECIAL RULE.—Any amounts paid pursuant to an agreement under section 3121(*l*) (relating to agreements entered into by American employers with respect to foreign affiliates) which are equivalent to the taxes referred to in subparagraph (A)(i) shall be treated as taxes referred to in such subparagraph.

(3) EXCEPTION FOR TAXPAYERS EXCLUDING FOREIGN EARNED INCOME.—Paragraph (1) shall not apply to any taxpayer for any taxable year if such taxpayer elects to exclude any amount from gross income under section 911 for such taxable year.

(e) IDENTIFICATION REQUIREMENTS.—

(1) QUALIFYING CHILD IDENTIFICATION REQUIREMENT.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the name and taxpayer identification number of such qualifying child on the return of tax for the taxable year and such tax-

payer identification number was issued on or before the due date for filing such return.

(2) TAXPAYER IDENTIFICATION REQUIREMENT.—No credit shall be allowed under this section if the taxpayer identification number of the taxpayer was issued after the due date for filing the return for the taxable year.

(f) TAXABLE YEAR MUST BE FULL TAXABLE YEAR.—Except in the case of a taxable year closed by reason of the death of the taxpayer, no credit shall be allowable under this section in the case of a taxable year covering a period of less than 12 months.

(g) RESTRICTIONS ON TAXPAYERS WHO IMPROPERLY CLAIMED CREDIT IN PRIOR YEAR.—

(1) TAXPAYERS MAKING PRIOR FRAUDULENT OR RECKLESS CLAIMS.—

(A) IN GENERAL.—No credit shall be allowed under this section for any taxable year in the disallowance period.

(B) DISALLOWANCE PERIOD.—For purposes of subparagraph (A), the disallowance period is—

(i) the period of 10 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to fraud, and

(ii) the period of 2 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to reckless or intentional disregard of rules and regulations (but not due to fraud).

(2) TAXPAYERS MAKING IMPROPER PRIOR CLAIMS.—In the case of a taxpayer who is denied credit under this section for any taxable year as a result of the deficiency procedures under subchapter B of chapter 63, no credit shall be allowed under this section for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate eligibility for such credit.

(h) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—

(1) IN GENERAL.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, this section shall be applied as provided in paragraphs (2) through (7).

(2) CREDIT AMOUNT.—

(A) IN GENERAL.—Subsection (a) shall be applied by substituting "$2,000" for "$1,000".

(B) ADJUSTMENT FOR INFLATION.—In the case of a taxable year beginning after 2023, the $2,000 amounts in subparagraph (A) and paragraph (5)(B)(iii) shall each be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "2022" for "2016" in subparagraph (A)(ii) thereof.

If any increase under this clause is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.

(3) LIMITATION.—In lieu of the amount determined under subsection (b)(2), the threshold amount shall be $400,000 in the case of a joint return ($200,000 in any other case).

(4) PARTIAL CREDIT ALLOWED FOR CERTAIN OTHER DEPENDENTS.—

(A) IN GENERAL.—The credit determined under subsection (a) (after the application of paragraph (2)) shall be increased by $500 for each dependent of the taxpayer (as defined in section 152) other than a qualifying child described in subsection (c).

(B) EXCEPTION FOR CERTAIN NONCITIZENS.—Subparagraph (A) shall not apply with respect to any individual who would not be a dependent if subparagraph (A) of section 152(b)(3) were applied without regard to all that follows "resident of the United States".

(C) CERTAIN QUALIFYING CHILDREN.—In the case of any qualifying child with respect to whom a credit is not allowed under this section by reason of paragraph (7), such child shall be treated as a dependent to whom subparagraph (A) applies.

(5) [MAXIMUM AMOUNT OF] *SPECIAL RULES FOR* REFUNDABLE CREDIT.—

[(A) IN GENERAL.—The amount determined under subsection (d)(1)(A) with respect to any qualifying child shall not exceed $1,400, and such subsection shall be applied without regard to paragraph (4) of this subsection.]

(A) IN GENERAL.—In applying subsection (d)—

(i) the amount determined under paragraph (1)(A) of such subsection with respect to any qualifying child shall not exceed $1,400, and such paragraph shall be applied without regard to paragraph (4) of this subsection, and

(ii) paragraph (1)(B) of such subsection shall be applied by multiplying each of—

(I) the amount determined under clause (i) thereof, and

(II) the excess determined under clause (ii) thereof,

by the number of qualifying children of the taxpayer.

(B) AMOUNTS FOR 2023, 2024, AND 2025.—In the case of a taxable year beginning after 2022, subparagraph (A) shall be applied by substituting for "$1,400"—

(i) in the case of taxable year 2023, "$1,800",

(ii) in the case of taxable year 2024, "$1,900", and

(iii) in the case of taxable year 2025, "$2,000".

[(B)] *(C)* ADJUSTMENT FOR INFLATION.—In the case of a taxable year beginning after 2018 *and before 2023*, the $1,400 amount in subparagraph (A) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "2017" for "2016" in subparagraph (A)(ii) thereof.

If any increase under this clause is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.

(6) EARNED INCOME THRESHOLD FOR REFUNDABLE [CREDIT.—] [Subsection] *CREDIT.*—

(A) IN GENERAL.—Subsection (d)(1)(B)(i) shall be applied by substituting "$2,500" for "$3,000".

(B) RULE FOR DETERMINATION OF EARNED INCOME.—

(i) IN GENERAL.—In the case of a taxable year beginning after 2023, if the earned income of the taxpayer for such taxable year is less than the earned income of the taxpayer for the preceding taxable year, subsection (d)(1)(B)(i) may, at the election of the taxpayer, be applied by substituting—

(I) the earned income for such preceding taxable year, for

(II) the earned income for the current taxable year.

(ii) APPLICATION TO JOINT RETURNS.—For purposes of clause (i), in the case of a joint return, the earned income of the taxpayer for the preceding taxable year shall be the sum of the earned income of each spouse for such preceding taxable year.

(7) SOCIAL SECURITY NUMBER REQUIRED.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the social security number of such child on the return of tax for the taxable year. For purposes of the preceding sentence, the term "social security number" means a social security number issued to an individual by the Social Security Administration, but only if the social security number is issued—

(A) to a citizen of the United States or pursuant to subclause (I) (or that portion of subclause (III) that relates to subclause (I)) of section 205(c)(2)(B)(i) of the Social Security Act, and

(B) before the due date for such return.

(i) SPECIAL RULES FOR 2021.—In the case of any taxable year beginning after December 31, 2020, and before January 1, 2022—

(1) REFUNDABLE CREDIT.—If the taxpayer (in the case of a joint return, either spouse) has a principal place of abode in the United States (determined as provided in section 32) for more than one-half of the taxable year or is a bona fide resident of Puerto Rico (within the meaning of section 937(a)) for such taxable year—

(A) subsection (d) shall not apply, and

(B) so much of the credit determined under subsection (a) (after application of subparagraph (A)) as does not exceed the amount of such credit which would be so determined without regard to subsection (h)(4) shall be allowed under subpart C (and not allowed under this subpart).

(2) 17-YEAR-OLDS ELIGIBLE FOR TREATMENT AS QUALIFYING CHILDREN.—This section shall be applied—

(A) by substituting "age 18" for "age 17" in subsection (c)(1), and

(B) by substituting "described in subsection (c) (determined after the application of subsection (i)(2)(A))" for "described in subsection (c)" in subsection (h)(4)(A).

(3) CREDIT AMOUNT.—Subsection (h)(2) shall not apply and subsection (a) shall be applied by substituting "$3,000 ($3,600 in the case of a qualifying child who has not attained age 6 as of the close of the calendar year in which the taxable year of the taxpayer begins)" for "$1,000".

(4) REDUCTION OF INCREASED CREDIT AMOUNT BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(A) IN GENERAL.—The amount of the credit allowable under subsection (a) (determined without regard to subsection (b)) shall be reduced by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income (as defined in subsection (b)) exceeds the applicable threshold amount.

(B) APPLICABLE THRESHOLD AMOUNT.—For purposes of this paragraph, the term "applicable threshold amount" means—

(i) $150,000, in the case of a joint return or surviving spouse (as defined in section 2(a)),

(ii) $112,500, in the case of a head of household (as defined in section 2(b)), and

(iii) $75,000, in any other case.

(C) LIMITATION ON REDUCTION.—

(i) IN GENERAL.—The amount of the reduction under subparagraph (A) shall not exceed the lesser of—

(I) the applicable credit increase amount, or

(II) 5 percent of the applicable phaseout threshold range.

(ii) APPLICABLE CREDIT INCREASE AMOUNT.—For purposes of this subparagraph, the term "applicable credit increase amount" means the excess (if any) of—

(I) the amount of the credit allowable under this section for the taxable year determined without regard to this paragraph and subsection (b), over

(II) the amount of such credit as so determined and without regard to paragraph (3).

(iii) APPLICABLE PHASEOUT THRESHOLD RANGE.—For purposes of this subparagraph, the term "applicable phaseout threshold range" means the excess of—

(I) the threshold amount applicable to the taxpayer under subsection (b) (determined after the application of subsection (h)(3)), over

(II) the applicable threshold amount applicable to the taxpayer under this paragraph.

(D) COORDINATION WITH LIMITATION ON OVERALL CREDIT.—Subsection (b) shall be applied by substituting "the credit allowable under subsection (a) (determined after the application of subsection (i)(4)(A)" for "the credit allowable under subsection (a)".

(j) RECONCILIATION OF CREDIT AND ADVANCE CREDIT.—

(1) IN GENERAL.—The amount of the credit allowed under this section to any taxpayer for any taxable year shall be reduced (but not below zero) by the aggregate amount of pay-

ments made under section 7527A to such taxpayer during such taxable year. Any failure to so reduce the credit shall be treated as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1).

(2) EXCESS ADVANCE PAYMENTS.—

(A) IN GENERAL.—If the aggregate amount of payments under section 7527A to the taxpayer during the taxable year exceeds the amount of the credit allowed under this section to such taxpayer for such taxable year (determined without regard to paragraph (1)), the tax imposed by this chapter for such taxable year shall be increased by the amount of such excess. Any failure to so increase the tax shall be treated as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1).

(B) SAFE HARBOR BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(i) IN GENERAL.—In the case of a taxpayer whose modified adjusted gross income (as defined in subsection (b)) for the taxable year does not exceed 200 percent of the applicable income threshold, the amount of the increase determined under subparagraph (A) with respect to such taxpayer for such taxable year shall be reduced (but not below zero) by the safe harbor amount.

(ii) PHASE OUT OF SAFE HARBOR AMOUNT.—In the case of a taxpayer whose modified adjusted gross income (as defined in subsection (b)) for the taxable year exceeds the applicable income threshold, the safe harbor amount otherwise in effect under clause (i) shall be reduced by the amount which bears the same ratio to such amount as such excess bears to the applicable income threshold.

(iii) APPLICABLE INCOME THRESHOLD.—For purposes of this subparagraph, the term "applicable income threshold" means—

(I) $60,000 in the case of a joint return or surviving spouse (as defined in section 2(a)),

(II) $50,000 in the case of a head of household, and

(III) $40,000 in any other case.

(iv) SAFE HARBOR AMOUNT.—For purposes of this subparagraph, the term "safe harbor amount" means, with respect to any taxable year, the product of—

(I) $2,000, multiplied by

(II) the excess (if any) of the number of qualified children taken into account in determining the annual advance amount with respect to the taxpayer under section 7527A with respect to months beginning in such taxable year, over the number of qualified children taken into account in determining the credit allowed under this section for such taxable year.

(k) APPLICATION OF CREDIT IN POSSESSIONS.—

(1) MIRROR CODE POSSESSIONS.—

(A) IN GENERAL.—The Secretary shall pay to each possession of the United States with a mirror code tax system amounts equal to the loss (if any) to that possession by reason of the application of this section (determined without regard to this subsection) with respect to taxable years beginning after 2020. Such amounts shall be determined by the Secretary based on information provided by the government of the respective possession.

(B) COORDINATION WITH CREDIT ALLOWED AGAINST UNITED STATES INCOME TAXES.—No credit shall be allowed under this section for any taxable year to any individual to whom a credit is allowable against taxes imposed by a possession of the United States with a mirror code tax system by reason of the application of this section in such possession for such taxable year.

(C) MIRROR CODE TAX SYSTEM.—For purposes of this paragraph, the term "mirror code tax system" means, with respect to any possession of the United States, the income tax system of such possession if the income tax liability of the residents of such possession under such system is determined by reference to the income tax laws of the United States as if such possession were the United States.

(2) PUERTO RICO.—

(A) APPLICATION TO TAXABLE YEARS IN 2021.—(i) For application of refundable credit to residents of Puerto Rico, see subsection (i)(1).

(ii) For nonapplication of advance payment to residents of Puerto Rico, see section 7527A(e)(4)(A).

(B) APPLICATION TO TAXABLE YEARS AFTER 2021.—In the case of any bona fide resident of Puerto Rico (within the meaning of section 937(a)) for any taxable year beginning after December 31, 2021—

(i) the credit determined under this section shall be allowable to such resident, and

(ii) subsection (d)(1)(B)(ii) shall be applied without regard to the phrase "in the case of a taxpayer with 3 or more qualifying children".

(3) AMERICAN SAMOA.—

(A) IN GENERAL.—The Secretary shall pay to American Samoa amounts estimated by the Secretary as being equal to the aggregate benefits that would have been provided to residents of American Samoa by reason of the application of this section for taxable years beginning after 2020 if the provisions of this section had been in effect in American Samoa (applied as if American Samoa were the United States and without regard to the application of this section to bona fide residents of Puerto Rico under subsection (i)(1)).

(B) DISTRIBUTION REQUIREMENT.—Subparagraph (A) shall not apply unless American Samoa has a plan, which has been approved by the Secretary, under which American Samoa will promptly distribute such payments to its residents.

(C) COORDINATION WITH CREDIT ALLOWED AGAINST UNITED STATES INCOME TAXES.—

(i) IN GENERAL.—In the case of a taxable year with respect to which a plan is approved under subparagraph (B), this section (other than this subsection) shall not apply to any individual eligible for a distribution under such plan.

(ii) APPLICATION OF SECTION IN EVENT OF ABSENCE OF APPROVED PLAN.—In the case of a taxable year with respect to which a plan is not approved under subparagraph (B)—

(I) if such taxable year begins in 2021, subsection (i)(1) shall be applied by substituting "bona fide resident of Puerto Rico or American Samoa" for "bona fide resident of Puerto Rico", and

(II) if such taxable year begins after December 31, 2021, rules similar to the rules of paragraph (2)(B) shall apply with respect to bona fide residents of American Samoa (within the meaning of section 937(a)).

(4) TREATMENT OF PAYMENTS.—For purposes of section 1324 of title 31, United States Code, the payments under this subsection shall be treated in the same manner as a refund due from a credit provision referred to in subsection (b)(2) of such section.

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Subpart D—BUSINESS RELATED CREDITS

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SEC. 41. CREDIT FOR INCREASING RESEARCH ACTIVITIES.

(a) GENERAL RULE.—For purposes of section 38, the research credit determined under this section for the taxable year shall be an amount equal to the sum of—

(1) 20 percent of the excess (if any) of—

(A) the qualified research expenses for the taxable year, over

(B) the base amount,

(2) 20 percent of the basic research payments determined under subsection (e)(1)(A), and

(3) 20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.

(b) QUALIFIED RESEARCH EXPENSES.—For purposes of this section—

(1) QUALIFIED RESEARCH EXPENSES.—The term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer—

(A) in-house research expenses, and

(B) contract research expenses.

(2) IN-HOUSE RESEARCH EXPENSES.—

(A) IN GENERAL.—The term "in-house research expenses" means—

(i) any wages paid or incurred to an employee for qualified services performed by such employee,

(ii) any amount paid or incurred for supplies used in the conduct of qualified research, and

(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

Clause (iii) shall not apply to any amount to the extent that the taxpayer (or any person with whom the taxpayer must aggregate expenditures under subsection (f)(1)) receives or accrues any amount from any other person for the right to use substantially identical personal property.

(B) QUALIFIED SERVICES.—The term "qualified services" means services consisting of—

(i) engaging in qualified research, or

(ii) engaging in the direct supervision or direct support of research activities which constitute qualified research.

If substantially all of the services performed by an individual for the taxpayer during the taxable year consists of services meeting the requirements of clause (i) or (ii), the term "qualified services" means all of the services performed by such individual for the taxpayer during the taxable year.

(C) SUPPLIES.—The term "supplies" means any tangible property other than—

(i) land or improvements to land, and

(ii) property of a character subject to the allowance for depreciation.

(D) WAGES.—

(i) IN GENERAL.—The term "wages" has the meaning given such term by section 3401(a).

(ii) SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—In the case of an employee (within the meaning of section 401(c)(1)), the term "wages" includes the earned income (as defined in section 401(c)(2)) of such employee.

(iii) EXCLUSION FOR WAGES TO WHICH WORK OPPORTUNITY CREDIT APPLIES.—The term "wages" shall not include any amount taken into account in determining the work opportunity credit under section 51(a).

(3) CONTRACT RESEARCH EXPENSES.—

(A) IN GENERAL.—The term "contract research expenses" means 65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

(B) PREPAID AMOUNTS.—If any contract research expenses paid or incurred during any taxable year are attributable to qualified research to be conducted after the close of such taxable year, such amount shall be treated as paid or incurred during the period during which the qualified research is conducted.

(C) AMOUNTS PAID TO CERTAIN RESEARCH CONSORTIA.—

(i) IN GENERAL.—Subparagraph (A) shall be applied by substituting "75 percent" for "65 percent" with respect to amounts paid or incurred by the taxpayer to a qualified research consortium for qualified research on behalf of the taxpayer and 1 or more unrelated taxpayers. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related taxpayers.

(ii) QUALIFIED RESEARCH CONSORTIUM.—The term "qualified research consortium" means any organization which—

(I) is described in section 501(c)(3) or 501(c)(6) and is exempt from tax under section 501(a),

(II) is organized and operated primarily to conduct scientific research, and

(III) is not a private foundation.

(D) AMOUNTS PAID TO ELIGIBLE SMALL BUSINESSES, UNIVERSITIES, AND FEDERAL LABORATORIES.—

(i) IN GENERAL.—In the case of amounts paid by the taxpayer to—

(I) an eligible small business,

(II) an institution of higher education (as defined in section 3304(f)), or

(III) an organization which is a Federal laboratory,

for qualified research which is energy research, subparagraph (A) shall be applied by substituting "100 percent" for "65 percent".

(ii) ELIGIBLE SMALL BUSINESS.—For purposes of this subparagraph, the term "eligible small business" means a small business with respect to which the taxpayer does not own (within the meaning of section 318) 50 percent or more of—

(I) in the case of a corporation, the outstanding stock of the corporation (either by vote or value), and

(II) in the case of a small business which is not a corporation, the capital and profits interests of the small business.

(iii) SMALL BUSINESS.—For purposes of this subparagraph—

(I) IN GENERAL.—The term "small business" means, with respect to any calendar year, any person if the annual average number of employees employed by such person during either of the 2 preceding calendar years was 500 or fewer. For purposes of the preceding sentence, a preceding calendar year may be taken into account only if the person was in existence throughout the year.

(II) STARTUPS, CONTROLLED GROUPS, AND PREDECESSORS.—Rules similar to the rules of subparagraphs (B) and (D) of section 220(c)(4) shall apply for purposes of this clause.

(iv) FEDERAL LABORATORY.—For purposes of this subparagraph, the term "Federal laboratory" has the meaning given such term by section 4(6) of the Stevenson-Wydler Technology Innovation Act of 1980 (15 U.S.C. 3703(6)), as in effect on the date of the enactment of the Energy Tax Incentives Act of 2005.

(4) TRADE OR BUSINESS REQUIREMENT DISREGARDED FOR IN-HOUSE RESEARCH EXPENSES OF CERTAIN STARTUP VENTURES.—In the case of in-house research expenses, a taxpayer shall be treated as meeting the trade or business requirement of paragraph (1) if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business—

(A) of the taxpayer, or

(B) of 1 or more other persons who with the taxpayer are treated as a single taxpayer under subsection (f)(1).

(c) BASE AMOUNT.—

(1) IN GENERAL.—The term "base amount" means the product of—

(A) the fixed-base percentage, and

(B) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined (hereinafter in this subsection referred to as the "credit year").

(2) MINIMUM BASE AMOUNT.—In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

(3) FIXED-BASE PERCENTAGE.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the fixed-base percentage is the percentage which the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 1989, is of the aggregate gross receipts of the taxpayer for such taxable years.

(B) START-UP COMPANIES.—

(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The fixed-base percentage shall be determined under this subparagraph if—

(I) the first taxable year in which a taxpayer had both gross receipts and qualified research expenses begins after December 31, 1983, or

(II) there are fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses.

(ii) FIXED-BASE PERCENTAGE.—In a case to which this subparagraph applies, the fixed-base percentage is—

(I) 3 percent for each of the taxpayer's 1st 5 taxable years beginning after December 31, 1993, for which the taxpayer has qualified research expenses,

(II) in the case of the taxpayer's 6th such taxable year, 1/6 of the percentage which the aggre-

gate qualified research expenses of the taxpayer for the 4th and 5th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(III) in the case of the taxpayer's 7th such taxable year, 1/3 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th and 6th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(IV) in the case of the taxpayer's 8th such taxable year, 1/2 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, and 7th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(V) in the case of the taxpayer's 9th such taxable year, 2/3 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, and 8th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(VI) in the case of the taxpayer's 10th such taxable year, 5/6 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, 8th, and 9th such taxable years is of the aggregate gross receipts of the taxpayer for such years, and

(VII) for taxable years thereafter, the percentage which the aggregate qualified research expenses for any 5 taxable years selected by the taxpayer from among the 5th through the 10th such taxable years is of the aggregate gross receipts of the taxpayer for such selected years.

(iii) TREATMENT OF DE MINIMIS AMOUNTS OF GROSS RECEIPTS AND QUALIFIED RESEARCH EXPENSES.—The Secretary may prescribe regulations providing that de minimis amounts of gross receipts and qualified research expenses shall be disregarded under clauses (i) and (ii).

(C) MAXIMUM FIXED-BASE PERCENTAGE.—In no event shall the fixed-base percentage exceed 16 percent.

(D) ROUNDING.—The percentages determined under subparagraphs (A) and (B)(ii) shall be rounded to the nearest 1/100th of 1 percent.

(4) ELECTION OF ALTERNATIVE SIMPLIFIED CREDIT.—

(A) IN GENERAL.—At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to 14 percent of so much of the qualified research expenses for the taxable year as exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

(B) SPECIAL RULE IN CASE OF NO QUALIFIED RESEARCH EXPENSES IN ANY OF 3 PRECEDING TAXABLE YEARS.—

(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The credit under this paragraph shall be determined under this subparagraph if the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined.

(ii) CREDIT RATE.—The credit determined under this subparagraph shall be equal to 6 percent of the qualified research expenses for the taxable year.

(C) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

(5) CONSISTENT TREATMENT OF EXPENSES REQUIRED.—

(A) IN GENERAL.—Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expenses for the credit year.

(B) PREVENTION OF DISTORTIONS.—The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in computing such taxpayer's fixed-base percentage.

(6) GROSS RECEIPTS.—For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(d) QUALIFIED RESEARCH DEFINED.—For purposes of this section—

(1) IN GENERAL.—The term "qualified research" means research—

(A) with respect to which expenditures may be treated as specified research or experimental expenditures under section 174 *or domestic research or experimental expenditures under section 174A*,

(B) which is undertaken for the purpose of discovering information—

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

(2) TESTS TO BE APPLIED SEPARATELY TO EACH BUSINESS COMPONENT.—For purposes of this subsection—

(A) IN GENERAL.—Paragraph (1) shall be applied separately with respect to each business component of the taxpayer.

(B) BUSINESS COMPONENT DEFINED.—The term "business component" means any product, process, computer software, technique, formula, or invention which is to be—

(i) held for sale, lease, or license, or

(ii) used by the taxpayer in a trade or business of the taxpayer.

(C) SPECIAL RULE FOR PRODUCTION PROCESSES.—Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).

(3) PURPOSES FOR WHICH RESEARCH MAY QUALIFY FOR CREDIT.—For purposes of paragraph (1)(C)—

(A) IN GENERAL.—Research shall be treated as conducted for a purpose described in this paragraph if it relates to—

(i) a new or improved function,

(ii) performance, or

(iii) reliability or quality.

(B) CERTAIN PURPOSES NOT QUALIFIED.—Research shall in no event be treated as conducted for a purpose described in this paragraph if it relates to style, taste, cosmetic, or seasonal design factors.

(4) ACTIVITIES FOR WHICH CREDIT NOT ALLOWED.—The term "qualified research" shall not include any of the following:

(A) RESEARCH AFTER COMMERCIAL PRODUCTION.—Any research conducted after the beginning of commercial production of the business component.

(B) ADAPTATION OF EXISTING BUSINESS COMPONENTS.—Any research related to the adaptation of an existing business component to a particular customer's requirement or need.

(C) DUPLICATION OF EXISTING BUSINESS COMPONENT.—Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

(D) SURVEYS, STUDIES, ETC..—Any—

(i) efficiency survey,

(ii) activity relating to management function or technique,

(iii) market research, testing, or development (including advertising or promotions),

(iv) routine data collection, or

(v) routine or ordinary testing or inspection for quality control.

(E) COMPUTER SOFTWARE.—Except to the extent provided in regulations, any research with respect to computer software which is developed by (or for the benefit of)

the taxpayer primarily for internal use by the taxpayer, other than for use in—

(i) an activity which constitutes qualified research (determined with regard to this subparagraph), or

(ii) a production process with respect to which the requirements of paragraph (1) are met.

(F) FOREIGN RESEARCH.—Any research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(G) SOCIAL SCIENCES, ETC..—Any research in the social sciences, arts, or humanities.

(H) FUNDED RESEARCH.—Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

(e) CREDIT ALLOWABLE WITH RESPECT TO CERTAIN PAYMENTS TO QUALIFIED ORGANIZATIONS FOR BASIC RESEARCH.—For purposes of this section—

(1) IN GENERAL.—In the case of any taxpayer who makes basic research payments for any taxable year—

(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal to the excess of—

(i) such basic research payments, over

(ii) the qualified organization base period amount, and

(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1).

(2) BASIC RESEARCH PAYMENTS DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

(ii) such basic research is to be performed by such qualified organization.

(B) EXCEPTION TO REQUIREMENT THAT RESEARCH BE PERFORMED BY THE ORGANIZATION.—In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (6), clause (ii) of subparagraph (A) shall not apply.

(3) QUALIFIED ORGANIZATION BASE PERIOD AMOUNT.—For purposes of this subsection, the term "qualified organization base period amount" means an amount equal to the sum of—

(A) the minimum basic research amount, plus

(B) the maintenance-of-effort amount.

(4) MINIMUM BASIC RESEARCH AMOUNT.—For purposes of this subsection—

(A) IN GENERAL.—The term "minimum basic research amount" means an amount equal to the greater of—

(i) 1 percent of the average of the sum of amounts paid or incurred during the base period for—

(I) any in-house research expenses, and

(II) any contract research expenses, or

(ii) the amounts treated as contract research expenses during the base period by reason of this subsection (as in effect during the base period).

(B) FLOOR AMOUNT.—Except in the case of a taxpayer which was in existence during a taxable year (other than a short taxable year) in the base period, the minimum basic research amount for any base period shall not be less than 50 percent of the basic research payments for the taxable year for which a determination is being made under this subsection.

(5) MAINTENANCE-OF-EFFORT AMOUNT.—For purposes of this subsection—

(A) IN GENERAL.—The term "maintenance-of-effort amount" means, with respect to any taxable year, an amount equal to the excess (if any) of—

(i) an amount equal to—

(I) the average of the nondesignated university contributions paid by the taxpayer during the base period, multiplied by

(II) the cost-of-living adjustment for the calendar year in which such taxable year begins, over

(ii) the amount of nondesignated university contributions paid by the taxpayer during such taxable year.

(B) NONDESIGNATED UNIVERSITY CONTRIBUTIONS.—For purposes of this paragraph, the term "nondesignated university contribution" means any amount paid by a taxpayer to any qualified organization described in paragraph (6)(A)—

(i) for which a deduction was allowable under section 170, and

(ii) which was not taken into account—

(I) in computing the amount of the credit under this section (as in effect during the base period) during any taxable year in the base period, or

(II) as a basic research payment for purposes of this section.

(C) COST-OF-LIVING ADJUSTMENT DEFINED.—

(i) IN GENERAL.—The cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(f)(3), by substituting "calendar year 1987" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(ii) SPECIAL RULE WHERE BASE PERIOD ENDS IN A CALENDAR YEAR OTHER THAN 1983 OR 1984.—If the base period of any taxpayer does not end in 1983 or 1984, section 1(f)(3)(A)(ii) shall, for purposes of this paragraph, be applied by substituting the calendar year in which such base period ends for 2016. Such substitution shall be in lieu of the substitution under clause (i).

(6) QUALIFIED ORGANIZATION.—For purposes of this subsection, the term "qualified organization" means any of the following organizations:

(A) EDUCATIONAL INSTITUTIONS.—Any educational organization which—

(i) is an institution of higher education (within the meaning of section 3304(f)), and

(ii) is described in section 170(b)(1)(A)(ii).

(B) CERTAIN SCIENTIFIC RESEARCH ORGANIZATIONS.—Any organization not described in subparagraph (A) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a),

(ii) is organized and operated primarily to conduct scientific research, and

(iii) is not a private foundation.

(C) SCIENTIFIC TAX-EXEMPT ORGANIZATIONS.—Any organization which—

(i) is described in—

(I) section 501(c)(3) (other than a private foundation), or

(II) section 501(c)(6),

(ii) is exempt from tax under section 501(a),

(iii) is organized and operated primarily to promote scientific research by qualified organizations described in subparagraph (A) pursuant to written research agreements, and

(iv) currently expends—

(I) substantially all of its funds, or

(II) substantially all of the basic research payments received by it,

for grants to, or contracts for basic research with, an organization described in subparagraph (A).

(D) CERTAIN GRANT ORGANIZATIONS.—Any organization not described in subparagraph (B) or (C) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) (other than a private foundation),

(ii) is established and maintained by an organization established before July 10, 1981, which meets the requirements of clause (i),

(iii) is organized and operated exclusively for the purpose of making grants to organizations described in subparagraph (A) pursuant to written research agreements for purposes of basic research, and

(iv) makes an election, revocable only with the consent of the Secretary, to be treated as a private foundation for purposes of this title (other than section 4940, relating to excise tax based on investment income).

(7) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) BASIC RESEARCH.—The term "basic research" means any original investigation for the advancement of scientific knowledge not having a specific commercial objective, except that such term shall not include—

(i) basic research conducted outside of the United States, and

(ii) basic research in the social sciences, arts, or humanities.

(B) BASE PERIOD.—The term "base period" means the 3-taxable-year period ending with the taxable year immediately preceding the 1st taxable year of the taxpayer beginning after December 31, 1983.

(C) EXCLUSION FROM INCREMENTAL CREDIT CALCULATION.—For purposes of determining the amount of credit allowable under subsection (a)(1) for any taxable year, the amount of the basic research payments taken into account under subsection (a)(2)—

(i) shall not be treated as qualified research expenses under subsection (a)(1)(A), and

(ii) shall not be included in the computation of base amount under subsection (a)(1)(B).

(D) TRADE OR BUSINESS QUALIFICATION.—For purposes of applying subsection (b)(1) to this subsection, any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of subsection (b)(3)(B)).

(E) CERTAIN CORPORATIONS NOT ELIGIBLE.—The term "corporation" shall not include—

(i) an S corporation,

(ii) a personal holding company (as defined in section 542), or

(iii) a service organization (as defined in section 414(m)(3)).

(f) SPECIAL RULES.—For purposes of this section—

(1) AGGREGATION OF EXPENDITURES.—

(A) CONTROLLED GROUP OF CORPORATIONS.—In determining the amount of the credit under this section—

(i) all members of the same controlled group of corporations shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such member shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by such controlled group for purposes of this section.

(B) COMMON CONTROL.—Under regulations prescribed by the Secretary, in determining the amount of the credit under this section—

(i) all trades or businesses (whether or not incorporated) which are under common control shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such person shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consor-

tiums, taken into account by all such persons under common control for purposes of this section.

The regulations prescribed under this subparagraph shall be based on principles similar to the principles which apply in the case of subparagraph (A).

(2) ALLOCATIONS.—

(A) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

(B) ALLOCATION IN THE CASE OF PARTNERSHIPS.—In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

(3) ADJUSTMENTS FOR CERTAIN ACQUISITIONS, ETC..—Under regulations prescribed by the Secretary—

(A) ACQUISITIONS.—

(i) IN GENERAL.—If a person acquires the major portion of either a trade or business or a separate unit of a trade or business (hereinafter in this paragraph referred to as the "acquired business") of another person (hereinafter in this paragraph referred to as the "predecessor"), then the amount of qualified research expenses paid or incurred by the acquiring person during the measurement period shall be increased by the amount determined under clause (ii), and the gross receipts of the acquiring person for such period shall be increased by the amount determined under clause (iii).

(ii) AMOUNT DETERMINED WITH RESPECT TO QUALIFIED RESEARCH EXPENSES.—The amount determined under this clause is—

(I) for purposes of applying this section for the taxable year in which such acquisition is made, the acquisition year amount, and

(II) for purposes of applying this section for any taxable year after the taxable year in which such acquisition is made, the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period.

(iii) AMOUNT DETERMINED WITH RESPECT TO GROSS RECEIPTS.—The amount determined under this clause is the amount which would be determined under clause (ii) if "the gross receipts of" were substituted for "the qualified research expenses paid or incurred by" each place it appears in clauses (ii) and (iv).

(iv) ACQUISITION YEAR AMOUNT.—For purposes of clause (ii), the acquisition year amount is the amount equal to the product of—

(I) the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period, and

(II) the number of days in the period beginning on the date of the acquisition and ending on the last day of the taxable year in which the acquisition is made,

divided by the number of days in the acquiring person's taxable year.

(v) SPECIAL RULES FOR COORDINATING TAXABLE YEARS.—In the case of an acquiring person and a predecessor whose taxable years do not begin on the same date—

(I) each reference to a taxable year in clauses (ii) and (iv) shall refer to the appropriate taxable year of the acquiring person,

(II) the qualified research expenses paid or incurred by the predecessor, and the gross receipts of the predecessor, during each taxable year of the predecessor any portion of which is part of the measurement period shall be allocated equally among the days of such taxable year,

(III) the amount of such qualified research expenses taken into account under clauses (ii) and (iv) with respect to a taxable year of the acquiring person shall be equal to the total of the expenses attributable under subclause (II) to the days occurring during such taxable year, and

(IV) the amount of such gross receipts taken into account under clause (iii) with respect to a taxable year of the acquiring person shall be equal to the total of the gross receipts attributable under subclause (II) to the days occurring during such taxable year.

(vi) MEASUREMENT PERIOD.—For purposes of this subparagraph, the term "measurement period" means, with respect to the taxable year of the acquiring person for which the credit is determined, any period of the acquiring person preceding such taxable year which is taken into account for purposes of determining the credit for such year.

(B) DISPOSITIONS.—If the predecessor furnished to the acquiring person such information as is necessary for the application of subparagraph (A), then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by, and the gross receipts of, the predecessor during the measurement period (as defined in subparagraph (A)(vi), determined by substituting "predecessor" for "acquiring person" each place it appears) shall be reduced by—

(i) in the case of the taxable year in which such disposition is made, an amount equal to the product of—

(I) the qualified research expenses paid or incurred by, or gross receipts of, the predecessor with respect to the acquired business during the measurement period (as so defined and so determined), and

(II) the number of days in the period beginning on the date of acquisition (as determined for purposes of subparagraph (A)(iv)(II)) and ending on

the last day of the taxable year of the predecessor in which the disposition is made,

divided by the number of days in the taxable year of the predecessor, and

(ii) in the case of any taxable year ending after the taxable year in which such disposition is made, the amount described in clause (i)(I).

(C) CERTAIN REIMBURSEMENTS TAKEN INTO ACCOUNT IN DETERMINING FIXED-BASE PERCENTAGE.—If during any of the 3 taxable years following the taxable year in which a disposition to which subparagraph (B) applies occurs, the disposing taxpayer (or a person with whom the taxpayer is required to aggregate expenditures under paragraph (1)) reimburses the acquiring person (or a person required to so aggregate expenditures with such person) for research on behalf of the taxpayer, then the amount of qualified research expenses of the taxpayer for the taxable years taken into account in computing the fixed-base percentage shall be increased by the lesser of—

(i) the amount of the decrease under subparagraph (B) which is allocable to taxable years so taken into account, or

(ii) the product of the number of taxable years so taken into account, multiplied by the amount of the reimbursement described in this subparagraph.

(4) SHORT TAXABLE YEARS.—In the case of any short taxable year, qualified research expenses and gross receipts shall be annualized in such circumstances and under such methods as the Secretary may prescribe by regulation.

(5) CONTROLLED GROUP OF CORPORATIONS.—The term "controlled group of corporations" has the same meaning given to such term by section 1563(a), except that—

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and

(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

(6) ENERGY RESEARCH CONSORTIUM.—

(A) IN GENERAL.—The term "energy research consortium" means any organization—

(i) which is—

(I) described in section 501(c)(3) and is exempt from tax under section 501(a) and is organized and operated primarily to conduct energy research, or

(II) organized and operated primarily to conduct energy research in the public interest (within the meaning of section 501(c)(3)),

(ii) which is not a private foundation,

(iii) to which at least 5 unrelated persons paid or incurred during the calendar year in which the taxable year of the organization begins amounts (including as contributions) to such organization for energy research, and

(iv) to which no single person paid or incurred (including as contributions) during such calendar year an amount equal to more than 50 percent of the total amounts received by such organization during such calendar year for energy research.

(B) TREATMENT OF PERSONS.—All persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related persons for purposes of subparagraph (A)(iii) and as a single person for purposes of subparagraph (A)(iv).

(C) FOREIGN RESEARCH.—For purposes of subsection (a)(3), amounts paid or incurred for any energy research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States shall not be taken into account.

(D) DENIAL OF DOUBLE BENEFIT.—Any amount taken into account under subsection (a)(3) shall not be taken into account under paragraph (1) or (2) of subsection (a).

(E) ENERGY RESEARCH.—The term "energy research" does not include any research which is not qualified research.

(g) SPECIAL RULE FOR PASS-THRU OF CREDIT.—In the case of an individual who—

(1) owns an interest in an unincorporated trade or business,

(2) is a partner in a partnership,

(3) is a beneficiary of an estate or trust, or

(4) is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity. If the amount determined under subsection (a) for any taxable year exceeds the limitation of the preceding sentence, such amount may be carried to other taxable years under the rules of section 39; except that the limitation of the preceding sentence shall be taken into account in lieu of the limitation of section 38(c) in applying section 39.

(h) TREATMENT OF CREDIT FOR QUALIFIED SMALL BUSINESSES.—

(1) IN GENERAL.—At the election of a qualified small business for any taxable year, section 3111(f) shall apply to the payroll tax credit portion of the credit otherwise determined under subsection (a) for the taxable year and such portion shall not be treated (other than for purposes of section 280C) as a credit determined under subsection (a).

(2) PAYROLL TAX CREDIT PORTION.—For purposes of this subsection, the payroll tax credit portion of the credit determined under subsection (a) with respect to any qualified small business for any taxable year is the least of—

(A) the amount specified in the election made under this subsection,

(B) the credit determined under subsection (a) for the taxable year (determined before the application of this subsection), or

(C) in the case of a qualified small business other than a partnership or S corporation, the amount of the business credit carryforward under section 39 carried from the taxable year (determined before the application of this subsection to the taxable year).

(3) QUALIFIED SMALL BUSINESS.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified small business" means, with respect to any taxable year—

(i) a corporation or partnership, if—

(I) the gross receipts (as determined under the rules of section 448(c)(3), without regard to subparagraph (A) thereof) of such entity for the taxable year is less than $5,000,000, and

(II) such entity did not have gross receipts (as so determined) for any taxable year preceding the 5-taxable-year period ending with such taxable year, and

(ii) any person (other than a corporation or partnership) who meets the requirements of subclauses (I) and (II) of clause (i), determined—

(I) by substituting "person" for "entity" each place it appears, and

(II) by only taking into account the aggregate gross receipts received by such person in carrying on all trades or businesses of such person.

(B) LIMITATION.—Such term shall not include an organization which is exempt from taxation under section 501.

(4) ELECTION.—

(A) IN GENERAL.—Any election under this subsection for any taxable year—

(i) shall specify the amount of the credit to which such election applies,

(ii) shall be made on or before the due date (including extensions) of—

(I) in the case of a qualified small business which is a partnership, the return required to be filed under section 6031,

(II) in the case of a qualified small business which is an S corporation, the return required to be filed under section 6037, and

(III) in the case of any other qualified small business, the return of tax for the taxable year, and

(iii) may be revoked only with the consent of the Secretary.

(B) LIMITATIONS.—

(i) AMOUNT.—

(I) IN GENERAL.—The amount specified in any election made under this subsection shall not exceed $250,000.

(II) INCREASE.—In the case of taxable years beginning after December 31, 2022, the amount in subclause (I) shall be increased by $250,000.

(ii) NUMBER OF TAXABLE YEARS.—A person may not make an election under this subsection if such person (or any other person treated as a single taxpayer with such person under paragraph (5)(A)) has made an election under this subsection for 5 or more preceding taxable years.

(C) SPECIAL RULE FOR PARTNERSHIPS AND S CORPORATIONS.—In the case of a qualified small business which is a partnership or S corporation, the election made under this subsection shall be made at the entity level.

(5) AGGREGATION RULES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), all persons or entities treated as a single taxpayer under subsection (f)(1) shall be treated as a single taxpayer for purposes of this subsection.

(B) SPECIAL RULES.—For purposes of this subsection and section 3111(f)—

(i) each of the persons treated as a single taxpayer under subparagraph (A) may separately make the election under paragraph (1) for any taxable year, and

(ii) each of the $250,000 amounts under paragraph (4)(B)(i) shall be allocated among all persons treated as a single taxpayer under subparagraph (A) in the same manner as under subparagraph (A)(ii) or (B)(ii) of subsection (f)(1), whichever is applicable.

(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

(A) regulations to prevent the avoidance of the purposes of the limitations and aggregation rules under this subsection through the use of successor companies or other means,

(B) regulations to minimize compliance and record-keeping burdens under this subsection, and

(C) regulations for recapturing the benefit of credits determined under section 3111(f) in cases where there is a subsequent adjustment to the payroll tax credit portion of the credit determined under subsection (a), including requiring amended income tax returns in the cases where there is such an adjustment.

SEC. 42. LOW-INCOME HOUSING CREDIT.

(a) IN GENERAL.—For purposes of section 38, the amount of the low-income housing credit determined under this section for any taxable year in the credit period shall be an amount equal to—

(1) the applicable percentage of

(2) the qualified basis of each qualified low-income building.

(b) APPLICABLE PERCENTAGE: 70 PERCENT PRESENT VALUE CREDIT FOR CERTAIN NEW BUILDINGS; 30 PERCENT PRESENT VALUE CREDIT FOR CERTAIN OTHER BUILDINGS.—

(1) DETERMINATION OF APPLICABLE PERCENTAGE.—For purposes of this section—

(A) IN GENERAL.—The term "applicable percentage" means, with respect to any building, the appropriate percentage prescribed by the Secretary for the earlier of—

(i) the month in which such building is placed in service, or

(ii) at the election of the taxpayer—

(I) the month in which the taxpayer and the housing credit agency enter into an agreement with respect to such building (which is binding on such agency, the taxpayer, and all successors in interest) as to the housing credit dollar amount to be allocated to such building, or

(II) in the case of any building to which subsection (h)(4)(B) applies, the month in which the tax-exempt obligations are issued.

A month may be elected under clause (ii) only if the election is made not later than the 5th day after the close of such month. Such an election, once made, shall be irrevocable.

(B) METHOD OF PRESCRIBING PERCENTAGES.—The percentages prescribed by the Secretary for any month shall be percentages which will yield over a 10-year period amounts of credit under subsection (a) which have a present value equal to—

(i) 70 percent of the qualified basis of a new building which is not federally subsidized for the taxable year, and

(ii) 30 percent of the qualified basis of a building not described in clause (i).

(C) METHOD OF DISCOUNTING.—The present value under subparagraph (B) shall be determined—

(i) as of the last day of the 1st year of the 10-year period referred to in subparagraph (B),

(ii) by using a discount rate equal to 72 percent of the average of the annual Federal mid-term rate and the annual Federal long-term rate applicable under section 1274(d)(1) to the month applicable under clause (i) or (ii) of subparagraph (A) and compounded annually, and

(iii) by assuming that the credit allowable under this section for any year is received on the last day of such year.

(2) MINIMUM CREDIT RATE FOR NON-FEDERALLY SUBSIDIZED NEW BUILDINGS.—In the case of any new building—

(A) which is placed in service by the taxpayer after the date of the enactment of this paragraph, and

(B) which is not federally subsidized for the taxable year,

the applicable percentage shall not be less than 9 percent.

(3) MINIMUM CREDIT RATE.—In the case of any new or existing building to which paragraph (2) does not apply and which is placed in service by the taxpayer after December 31, 2020, the applicable percentage shall not be less than 4 percent.

(4) CROSS REFERENCES.—

(A) For treatment of certain rehabilitation expenditures as separate new buildings, see subsection (e).

(B) For determination of applicable percentage for increases in qualified basis after the 1st year of the credit period, see subsection (f)(3).

(C) For authority of housing credit agency to limit applicable percentage and qualified basis which may be taken into account under this section with respect to any building, see subsection (h)(7).

(c) QUALIFIED BASIS; QUALIFIED LOW-INCOME BUILDING.—For purposes of this section—

(1) QUALIFIED BASIS.—

(A) DETERMINATION.—The qualified basis of any qualified low-income building for any taxable year is an amount equal to—

(i) the applicable fraction (determined as of the close of such taxable year) of

(ii) the eligible basis of such building (determined under subsection (d)(5)).

(B) APPLICABLE FRACTION.—For purposes of subparagraph (A), the term "applicable fraction" means the smaller of the unit fraction or the floor space fraction.

(C) UNIT FRACTION.—For purposes of subparagraph (B), the term "unit fraction" means the fraction—

(i) the numerator of which is the number of low-income units in the building, and

(ii) the denominator of which is the number of residential rental units (whether or not occupied) in such building.

(D) FLOOR SPACE FRACTION.—For purposes of subparagraph (B), the term "floor space fraction" means the fraction—

(i) the numerator of which is the total floor space of the low-income units in such building, and

(ii) the denominator of which is the total floor space of the residential rental units (whether or not occupied) in such building.

(E) QUALIFIED BASIS TO INCLUDE PORTION OF BUILDING USED TO PROVIDE SUPPORTIVE SERVICES FOR HOMELESS.—In the case of a qualified low-income building described in subsection (i)(3)(B)(iii), the qualified basis of such building for any taxable year shall be increased by the lesser of—

(i) so much of the eligible basis of such building as is used throughout the year to provide supportive services designed to assist tenants in locating and retaining permanent housing, or

(ii) 20 percent of the qualified basis of such building (determined without regard to this subparagraph).

(2) QUALIFIED LOW-INCOME BUILDING.—The term "qualified low-income building" means any building—

(A) which is part of a qualified low-income housing project at all times during the period—

(i) beginning on the 1st day in the compliance period on which such building is part of such a project, and

(ii) ending on the last day of the compliance period with respect to such building, and

(B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.

(d) ELIGIBLE BASIS.—For purposes of this section—

(1) NEW BUILDINGS.—The eligible basis of a new building is its adjusted basis as of the close of the 1st taxable year of the credit period.

(2) EXISTING BUILDINGS.—

(A) IN GENERAL.—The eligible basis of an existing building is—

(i) in the case of a building which meets the requirements of subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and

(ii) zero in any other case.

(B) REQUIREMENTS.—A building meets the requirements of this subparagraph if—

(i) the building is acquired by purchase (as defined in section 179(d)(2)),

(ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service,

(iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service, and

(iv) except as provided in subsection (f)(5), a credit is allowable under subsection (a) by reason of subsection (e) with respect to the building.

(C) ADJUSTED BASIS.—For purposes of subparagraph (A), the adjusted basis of any building shall not include so much of the basis of such building as is determined by reference to the basis of other property held at any time by the person acquiring the building.

(D) SPECIAL RULES FOR SUBPARAGRAPH (B).—

(i) SPECIAL RULES FOR CERTAIN TRANSFERS.—For purposes of determining under subparagraph (B)(ii) when a building was last placed in service, there shall not be taken into account any placement in service—

(I) in connection with the acquisition of the building in a transaction in which the basis of the building in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such building in the hands of the person from whom acquired,

(II) by a person whose basis in such building is determined under section 1014(a) (relating to property acquired from a decedent),

(III) by any governmental unit or qualified nonprofit organization (as defined in subsection (h)(5)) if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such unit or organization and all the income from such property is exempt from Federal income taxation,

(IV) by any person who acquired such building by foreclosure (or by instrument in lieu of fore-

closure) of any purchase-money security interest held by such person if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such person and such building is resold within 12 months after the date such building is placed in service by such person after such foreclosure, or

(V) of a single-family residence by any individual who owned and used such residence for no other purpose than as his principal residence.

(ii) RELATED PERSON.—For purposes of subparagraph (B)(iii), a person (hereinafter in this subclause referred to as the "related person") is related to any person if the related person bears a relationship to such person specified in section 267(b) or 707(b)(1), or the related person and such person are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52).

(3) ELIGIBLE BASIS REDUCED WHERE DISPROPORTIONATE STANDARDS FOR UNITS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the eligible basis of any building shall be reduced by an amount equal to the portion of the adjusted basis of the building which is attributable to residential rental units in the building which are not low-income units and which are above the average quality standard of the low-income units in the building.

(B) EXCEPTION WHERE TAXPAYER ELECTS TO EXCLUDE EXCESS COSTS.—

(i) IN GENERAL.—Subparagraph (A) shall not apply with respect to a residential rental unit in a building which is not a low-income unit if—

(I) the excess described in clause (ii) with respect to such unit is not greater than 15 percent of the cost described in clause (ii)(II), and

(II) the taxpayer elects to exclude from the eligible basis of such building the excess described in clause (ii) with respect to such unit.

(ii) EXCESS.—The excess described in this clause with respect to any unit is the excess of—

(I) the cost of such unit, over

(II) the amount which would be the cost of such unit if the average cost per square foot of low-income units in the building were substituted for the cost per square foot of such unit.

The Secretary may by regulation provide for the determination of the excess under this clause on a basis other than square foot costs.

(4) SPECIAL RULES RELATING TO DETERMINATION OF ADJUSTED BASIS.—For purposes of this subsection—

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the adjusted basis of any building shall be determined without regard to the adjusted basis of any property which is not residential rental property.

(B) BASIS OF PROPERTY IN COMMON AREAS, ETC., INCLUDED.—The adjusted basis of any building shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation) used in common areas or provided as comparable amenities to all residential rental units in such building.

(C) INCLUSION OF BASIS OF PROPERTY USED TO PROVIDE SERVICES FOR CERTAIN NONTENANTS.—

(i) IN GENERAL.—The adjusted basis of any building located in a qualified census tract (as defined in paragraph (5)(B)(ii)) shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation and not otherwise taken into account) used throughout the taxable year in providing any community service facility.

(ii) LIMITATION.—The increase in the adjusted basis of any building which is taken into account by reason of clause (i) shall not exceed the sum of—

(I) 25 percent of so much of the eligible basis of the qualified low-income housing project of which it is a part as does not exceed $15,000,000, plus

(II) 10 percent of so much of the eligible basis of such project as is not taken into account under subclause (I).

For purposes of the preceding sentence, all community service facilities which are part of the same qualified low-income housing project shall be treated as one facility.

(iii) COMMUNITY SERVICE FACILITY.—For purposes of this subparagraph, the term "community service facility" means any facility designed to serve primarily individuals whose income is 60 percent or less of area median income (within the meaning of subsection (g)(1)(B)).

(D) NO REDUCTION FOR DEPRECIATION.—The adjusted basis of any building shall be determined without regard to paragraphs (2) and (3) of section 1016(a).

(5) SPECIAL RULES FOR DETERMINING ELIGIBLE BASIS.—

(A) FEDERAL GRANTS NOT TAKEN INTO ACCOUNT IN DETERMINING ELIGIBLE BASIS.—The eligible basis of a building shall not include any costs financed with the proceeds of a federally funded grant.

(B) INCREASE IN CREDIT FOR BUILDINGS IN HIGH COST AREAS.—

(i) IN GENERAL.—In the case of any building located in a qualified census tract or difficult development area which is designated for purposes of this subparagraph—

(I) in the case of a new building, the eligible basis of such building shall be 130 percent of such basis determined without regard to this subparagraph, and

(II) in the case of an existing building, the rehabilitation expenditures taken into account under subsection (e) shall be 130 percent of such expend-

itures determined without regard to this subparagraph.

(ii) QUALIFIED CENSUS TRACT.—

(I) IN GENERAL.—The term "qualified census tract" means any census tract which is designated by the Secretary of Housing and Urban Development and, for the most recent year for which census data are available on household income in such tract, either in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income for such year or which has a poverty rate of at least 25 percent. If the Secretary of Housing and Urban Development determines that sufficient data for any period are not available to apply this clause on the basis of census tracts, such Secretary shall apply this clause for such period on the basis of enumeration districts.

(II) LIMIT ON MSA'S DESIGNATED.—The portion of a metropolitan statistical area which may be designated for purposes of this subparagraph shall not exceed an area having 20 percent of the population of such metropolitan statistical area.

(III) DETERMINATION OF AREAS.—For purposes of this clause, each metropolitan statistical area shall be treated as a separate area and all nonmetropolitan areas in a State shall be treated as 1 area.

(iii) DIFFICULT DEVELOPMENT AREAS.—

(I) IN GENERAL.—The term "difficult development areas" means any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.

(II) LIMIT ON AREAS DESIGNATED.—The portions of metropolitan statistical areas which may be designated for purposes of this subparagraph shall not exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule shall apply to nonmetropolitan areas.

(iv) SPECIAL RULES AND DEFINITIONS.—For purposes of this subparagraph—

(I) population shall be determined on the basis of the most recent decennial census for which data are available,

(II) area median gross income shall be determined in accordance with subsection (g)(4),

(III) the term "metropolitan statistical area" has the same meaning as when used in section 143(k)(2)(B), and

(IV) the term "nonmetropolitan area" means any county (or portion thereof) which is not within a metropolitan statistical area.

(v) BUILDINGS DESIGNATED BY STATE HOUSING CREDIT AGENCY.—Any building which is designated by the State housing credit agency as requiring the increase in credit under this subparagraph in order for such building to be financially feasible as part of a qualified low-income housing project shall be treated for purposes of this subparagraph as located in a difficult development area which is designated for purposes of this subparagraph. The preceding sentence shall not apply to any building if paragraph (1) of subsection (h) does not apply to any portion of the eligible basis of such building by reason of paragraph (4) of such subsection.

(6) CREDIT ALLOWABLE FOR CERTAIN BUILDINGS ACQUIRED DURING 10-YEAR PERIOD DESCRIBED IN PARAGRAPH (2)(B)(II).—

(A) IN GENERAL.—Paragraph (2)(B)(ii) shall not apply to any federally- or State-assisted building.

(B) BUILDINGS ACQUIRED FROM INSURED DEPOSITORY INSTITUTIONS IN DEFAULT.—On application by the taxpayer, the Secretary may waive paragraph (2)(B)(ii) with respect to any building acquired from an insured depository institution in default (as defined in section 3 of the Federal Deposit Insurance Act) or from a receiver or conservator of such an institution.

(C) FEDERALLY- OR STATE-ASSISTED BUILDING.—For purposes of this paragraph—

(i) FEDERALLY-ASSISTED BUILDING.—The term "federally-assisted building" means any building which is substantially assisted, financed, or operated under section 8 of the United States Housing Act of 1937, section 221(d)(3), 221(d)(4), or 236 of the National Housing Act, section 515 of the Housing Act of 1949, or any other housing program administered by the Department of Housing and Urban Development or by the Rural Housing Service of the Department of Agriculture.

(ii) STATE-ASSISTED BUILDING.—The term "State-assisted building" means any building which is substantially assisted, financed, or operated under any State law similar in purposes to any of the laws referred to in clause (i).

(7) ACQUISITION OF BUILDING BEFORE END OF PRIOR COMPLIANCE PERIOD.—

(A) IN GENERAL.—Under regulations prescribed by the Secretary, in the case of a building described in subparagraph (B) (or interest therein) which is acquired by the taxpayer—

(i) paragraph (2)(B) shall not apply, but

(ii) the credit allowable by reason of subsection (a) to the taxpayer for any period after such acquisition shall be equal to the amount of credit which would have been allowable under subsection (a) for such period to the prior owner referred to in subparagraph (B) had such owner not disposed of the building.

(B) DESCRIPTION OF BUILDING.—A building is described in this subparagraph if—

(i) a credit was allowed by reason of subsection (a) to any prior owner of such building, and

(ii) the taxpayer acquired such building before the end of the compliance period for such building with respect to such prior owner (determined without regard to any disposition by such prior owner).

(e) REHABILITATION EXPENDITURES TREATED AS SEPARATE NEW BUILDING.—

(1) IN GENERAL.—Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of this section as a separate new building.

(2) REHABILITATION EXPENDITURES.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "rehabilitation expenditures" means amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building.

(B) COST OF ACQUISITION, ETC., NOT INCLUDED.—Such term does not include the cost of acquiring any building (or interest therein) or any amount not permitted to be taken into account under paragraph (3) or (4) of subsection (d).

(3) MINIMUM EXPENDITURES TO QUALIFY.—

(A) IN GENERAL.—Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if—

(i) the expenditures are allocable to 1 or more low-income units or substantially benefit such units, and

(ii) the amount of such expenditures during any 24-month period meets the requirements of whichever of the following subclauses requires the greater amount of such expenditures:

(I) The requirement of this subclause is met if such amount is not less than 20 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).

(II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is $6,000 or more.

(B) EXCEPTION FROM 10 PERCENT REHABILITATION.—In the case of a building acquired by the taxpayer from a governmental unit, at the election of the taxpayer, subparagraph (A)(ii)(I) shall not apply and the credit under this section for such rehabilitation expenditures shall be determined using the percentage applicable under subsection (b)(2)(B)(ii).

(C) DATE OF DETERMINATION.—The determination under subparagraph (A) shall be made as of the close of the 1st taxable year in the credit period with respect to such expenditures.

(D) INFLATION ADJUSTMENT.—In the case of any expenditures which are treated under paragraph (4) as placed in

service during any calendar year after 2009, the $6,000 amount in subparagraph (A)(ii)(II) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 2008" for "calendar year 2016" in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence which is not a multiple of $100 shall be rounded to the nearest multiple of $100.

(4) SPECIAL RULES.—For purposes of applying this section with respect to expenditures which are treated as a separate building by reason of this subsection—

(A) such expenditures shall be treated as placed in service at the close of the 24-month period referred to in paragraph (3)(A), and

(B) the applicable fraction under subsection (c)(1) shall be the applicable fraction for the building (without regard to paragraph (1)) with respect to which the expenditures were incurred.

Nothing in subsection (d)(2) shall prevent a credit from being allowed by reason of this subsection.

(5) NO DOUBLE COUNTING.—Rehabilitation expenditures may, at the election of the taxpayer, be taken into account under this subsection or subsection (d)(2)(A)(i) but not under both such subsections.

(6) REGULATIONS TO APPLY SUBSECTION WITH RESPECT TO GROUP OF UNITS IN BUILDING.—The Secretary may prescribe regulations, consistent with the purposes of this subsection, treating a group of units with respect to which rehabilitation expenditures are incurred as a separate new building.

(f) DEFINITION AND SPECIAL RULES RELATING TO CREDIT PERIOD.—

(1) CREDIT PERIOD DEFINED.—For purposes of this section, the term "credit period" means, with respect to any building, the period of 10 taxable years beginning with—

(A) the taxable year in which the building is placed in service, or

(B) at the election of the taxpayer, the succeeding taxable year,

but only if the building is a qualified low-income building as of the close of the 1st year of such period. The election under subparagraph (B), once made, shall be irrevocable.

(2) SPECIAL RULE FOR 1ST YEAR OF CREDIT PERIOD.—

(A) IN GENERAL.—The credit allowable under subsection (a) with respect to any building for the 1st taxable year of the credit period shall be determined by substituting for the applicable fraction under subsection (c)(1) the fraction—

(i) the numerator of which is the sum of the applicable fractions determined under subsection (c)(1) as of the close of each full month of such year during which such building was in service, and

(ii) the denominator of which is 12.

(B) DISALLOWED 1ST YEAR CREDIT ALLOWED IN 11TH YEAR.—Any reduction by reason of subparagraph (A) in the credit allowable (without regard to subparagraph (A)) for the 1st taxable year of the credit period shall be allowable under subsection (a) for the 1st taxable year following the credit period.

(3) DETERMINATION OF APPLICABLE PERCENTAGE WITH RESPECT TO INCREASES IN QUALIFIED BASIS AFTER 1ST YEAR OF CREDIT PERIOD.—

(A) IN GENERAL.—In the case of any building which was a qualified low-income building as of the close of the 1st year of the credit period, if—

(i) as of the close of any taxable year in the compliance period (after the 1st year of the credit period) the qualified basis of such building exceeds

(ii) the qualified basis of such building as of the close of the 1st year of the credit period,

the applicable percentage which shall apply under subsection (a) for the taxable year to such excess shall be the percentage equal to 2/3 of the applicable percentage which (after the application of subsection (h)) would but for this paragraph apply to such basis.

(B) 1ST YEAR COMPUTATION APPLIES.—A rule similar to the rule of paragraph (2)(A) shall apply to any increase in qualified basis to which subparagraph (A) applies for the 1st year of such increase.

(4) DISPOSITIONS OF PROPERTY.—If a building (or an interest therein) is disposed of during any year for which credit is allowable under subsection (a), such credit shall be allocated between the parties on the basis of the number of days during such year the building (or interest) was held by each. In any such case, proper adjustments shall be made in the application of subsection (j).

(5) CREDIT PERIOD FOR EXISTING BUILDINGS NOT TO BEGIN BEFORE REHABILITATION CREDIT ALLOWED.—

(A) IN GENERAL.—The credit period for an existing building shall not begin before the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building.

(B) ACQUISITION CREDIT ALLOWED FOR CERTAIN BUILDINGS NOT ALLOWED A REHABILITATION CREDIT.—

(i) IN GENERAL.—In the case of a building described in clause (ii)—

(I) subsection (d)(2)(B)(iv) shall not apply, and

(II) the credit period for such building shall not begin before the taxable year which would be the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building under the modifications described in clause (ii)(II).

(ii) BUILDING DESCRIBED.—A building is described in this clause if—

(I) a waiver is granted under subsection (d)(6)(B) with respect to the acquisition of the building, and

(II) a credit would be allowed for rehabilitation expenditures with respect to such building if subsection (e)(3)(A)(ii)(I) did not apply and if the dollar amount in effect under subsection (e)(3)(A)(ii)(II) were two-thirds of such amount.

(g) QUALIFIED LOW-INCOME HOUSING PROJECT.—For purposes of this section—

(1) IN GENERAL.—The term "qualified low-income housing project" means any project for residential rental property if the project meets the requirements of subparagraph (A), (B), or (C) whichever is elected by the taxpayer:

(A) 20–50 TEST.—The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income.

(B) 40–60 TEST.—The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

(C) AVERAGE INCOME TEST.—

(i) IN GENERAL.—The project meets the minimum requirements of this subparagraph if 40 percent or more (25 percent or more in the case of a project described in section 142(d)(6)) of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer with respect to the respective unit.

(ii) SPECIAL RULES RELATING TO INCOME LIMITATION.—For purposes of clause (i)—

(I) DESIGNATION.—The taxpayer shall designate the imputed income limitation of each unit taken into account under such clause.

(II) AVERAGE TEST.—The average of the imputed income limitations designated under subclause (I) shall not exceed 60 percent of area median gross income.

(III) 10-PERCENT INCREMENTS.—The designated imputed income limitation of any unit under subclause (I) shall be 20 percent, 30 percent, 40 percent, 50 percent, 60 percent, 70 percent, or 80 percent of area median gross income.

Any election under this paragraph, once made, shall be irrevocable. For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

(2) RENT-RESTRICTED UNITS.—

(A) IN GENERAL.—For purposes of paragraph (1), a residential unit is rent-restricted if the gross rent with respect to such unit does not exceed 30 percent of the imputed income limitation applicable to such unit. For purposes of the preceding sentence, the amount of the income limita-

tion under paragraph (1) applicable for any period shall not be less than such limitation applicable for the earliest period the building (which contains the unit) was included in the determination of whether the project is a qualified low-income housing project.

(B) GROSS RENT.—For purposes of subparagraph (A), gross rent—

(i) does not include any payment under section 8 of the United States Housing Act of 1937 or any comparable rental assistance program (with respect to such unit or occupants thereof),

(ii) includes any utility allowance determined by the Secretary after taking into account such determinations under section 8 of the United States Housing Act of 1937,

(iii) does not include any fee for a supportive service which is paid to the owner of the unit (on the basis of the low-income status of the tenant of the unit) by any governmental program of assistance (or by an organization described in section 501(c)(3) and exempt from tax under section 501(a)) if such program (or organization) provides assistance for rent and the amount of assistance provided for rent is not separable from the amount of assistance provided for supportive services, and

(iv) does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the Farmers' Home Administration under section 515 of the Housing Act of 1949.

For purposes of clause (iii), the term "supportive service" means any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent and avoid placement in a hospital, nursing home, or intermediate care facility for the mentally or physically handicapped. In the case of a single-room occupancy unit or a building described in subsection (i)(3)(B)(iii), such term includes any service provided to assist tenants in locating and retaining permanent housing.

(C) IMPUTED INCOME LIMITATION APPLICABLE TO UNIT.—For purposes of this paragraph, the imputed income limitation applicable to a unit is the income limitation which would apply under paragraph (1) to individuals occupying the unit if the number of individuals occupying the unit were as follows:

(i) In the case of a unit which does not have a separate bedroom, 1 individual.

(ii) In the case of a unit which has 1 or more separate bedrooms, 1.5 individuals for each separate bedroom.

In the case of a project with respect to which a credit is allowable by reason of this section and for which financing is provided by a bond described in section 142(a)(7), the imputed income limitation shall apply in lieu of the other-

wise applicable income limitation for purposes of applying section 142(d)(4)(B)(ii).

(D) TREATMENT OF UNITS OCCUPIED BY INDIVIDUALS WHOSE INCOMES RISE ABOVE LIMIT.—

(i) IN GENERAL.—Except as provided in clauses (ii), (iii), and (iv), notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under paragraph (1), such unit shall continue to be treated as a low-income unit if the income of such occupants initially met such income limitation and such unit continues to be rent-restricted.

(ii) RENTAL OF NEXT AVAILABLE UNIT IN CASE OF 20–50 OR 40–60 TEST.—In the case of a project with respect to which the taxpayer elects the requirements of subparagraph (A) or (B) of paragraph (1), if the income of the occupants of the unit increases above 140 percent of the income limitation applicable under paragraph (1), clause (i) shall cease to apply to such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation.

(iii) RENTAL OF NEXT AVAILABLE UNIT IN CASE OF AVERAGE INCOME TEST.—In the case of a project with respect to which the taxpayer elects the requirements of subparagraph (C) of paragraph (1), if the income of the occupants of the unit increases above 140 percent of the greater of—

(I) 60 percent of area median gross income, or

(II) the imputed income limitation designated with respect to the unit under paragraph (1)(C)(ii)(I),

clause (i) shall cease to apply to any such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds the limitation described in clause (v).

(iv) DEEP RENT SKEWED PROJECTS.—In the case of a project described in section 142(d)(4)(B), clause (ii) or (iii), whichever is applicable, shall be applied by substituting "170 percent" for "140 percent", and—

(I) in the case of clause (ii), by substituting "any low-income unit in the building is occupied by a new resident whose income exceeds 40 percent of area median gross income" for "any residential rental unit" and all that follows in such clause, and

(II) in the case of clause (iii), by substituting "any low-income unit in the building is occupied by a new resident whose income exceeds the lesser of 40 percent of area median gross income or the imputed income limitation designated with respect to such unit under paragraph (1)(C)(ii)(I)" for "any

residential rental unit" and all that follows in such clause.

(v) LIMITATION DESCRIBED.—For purposes of clause (iii), the limitation described in this clause with respect to any unit is—

(I) the imputed income limitation designated with respect to such unit under paragraph (1)(C)(ii)(I), in the case of a unit which was taken into account as a low-income unit prior to becoming vacant, and

(II) the imputed income limitation which would have to be designated with respect to such unit under such paragraph in order for the project to continue to meet the requirements of paragraph (1)(C)(ii)(II), in the case of any other unit.

(E) UNITS WHERE FEDERAL RENTAL ASSISTANCE IS REDUCED AS TENANT'S INCOME INCREASES.—If the gross rent with respect to a residential unit exceeds the limitation under subparagraph (A) by reason of the fact that the income of the occupants thereof exceeds the income limitation applicable under paragraph (1), such unit shall, nevertheless, be treated as a rent-restricted unit for purposes of paragraph (1) if—

(i) a Federal rental assistance payment described in subparagraph (B)(i) is made with respect to such unit or its occupants, and

(ii) the sum of such payment and the gross rent with respect to such unit does not exceed the sum of the amount of such payment which would be made and the gross rent which would be payable with respect to such unit if—

(I) the income of the occupants thereof did not exceed the income limitation applicable under paragraph (1), and

(II) such units were rent-restricted within the meaning of subparagraph (A).

The preceding sentence shall apply to any unit only if the result described in clause (ii) is required by Federal statute as of the date of the enactment of this subparagraph and as of the date the Federal rental assistance payment is made.

(3) DATE FOR MEETING REQUIREMENTS.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, a building shall be treated as a qualified low-income building only if the project (of which such building is a part) meets the requirements of paragraph (1) not later than the close of the 1st year of the credit period for such building.

(B) BUILDINGS WHICH RELY ON LATER BUILDINGS FOR QUALIFICATION.—

(i) IN GENERAL.—In determining whether a building (hereinafter in this subparagraph referred to as the "prior building") is a qualified low-income building, the taxpayer may take into account 1 or more additional buildings placed in service during the 12-month period

described in subparagraph (A) with respect to the prior building only if the taxpayer elects to apply clause (ii) with respect to each additional building taken into account.

(ii) TREATMENT OF ELECTED BUILDINGS.—In the case of a building which the taxpayer elects to take into account under clause (i), the period under subparagraph (A) for such building shall end at the close of the 12-month period applicable to the prior building.

(iii) DATE PRIOR BUILDING IS TREATED AS PLACED IN SERVICE.—For purposes of determining the credit period and the compliance period for the prior building, the prior building shall be treated for purposes of this section as placed in service on the most recent date any additional building elected by the taxpayer (with respect to such prior building) was placed in service.

(C) SPECIAL RULE.—A building—

(i) other than the 1st building placed in service as part of a project, and

(ii) other than a building which is placed in service during the 12-month period described in subparagraph (A) with respect to a prior building which becomes a qualified low-income building,

shall in no event be treated as a qualified low-income building unless the project is a qualified low-income housing project (without regard to such building) on the date such building is placed in service.

(D) PROJECTS WITH MORE THAN 1 BUILDING MUST BE IDENTIFIED.—For purposes of this section, a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii)), each building which is (or will be) part of such project is identified in such form and manner as the Secretary may provide.

(4) CERTAIN RULES MADE APPLICABLE.—Paragraphs (2) (other than subparagraph (A) thereof), (3), (4), (5), (6), and (7) of section 142(d), and section 6652(j), shall apply for purposes of determining whether any project is a qualified low-income housing project and whether any unit is a low-income unit; except that, in applying such provisions for such purposes, the term "gross rent" shall have the meaning given such term by paragraph (2)(B) of this subsection.

(5) ELECTION TO TREAT BUILDING AFTER COMPLIANCE PERIOD AS NOT PART OF A PROJECT.—For purposes of this section, the taxpayer may elect to treat any building as not part of a qualified low-income housing project for any period beginning after the compliance period for such building.

(6) SPECIAL RULE WHERE DE MINIMIS EQUITY CONTRIBUTION.—Property shall not be treated as failing to be residential rental property for purposes of this section merely because the occupant of a residential unit in the project pays (on a voluntary basis) to the lessor a de minimis amount to be held toward the purchase by such occupant of a residential unit in such project if—

(A) all amounts so paid are refunded to the occupant on the cessation of his occupancy of a unit in the project, and

(B) the purchase of the unit is not permitted until after the close of the compliance period with respect to the building in which the unit is located.

Any amount paid to the lessor as described in the preceding sentence shall be included in gross rent under paragraph (2) for purposes of determining whether the unit is rent-restricted.

(7) SCATTERED SITE PROJECTS.—Buildings which would (but for their lack of proximity) be treated as a project for purposes of this section shall be so treated if all of the dwelling units in each of the buildings are rent-restricted (within the meaning of paragraph (2)) residential rental units.

(8) WAIVER OF CERTAIN DE MINIMIS ERRORS AND RECERTIFICATIONS.—On application by the taxpayer, the Secretary may waive—

(A) any recapture under subsection (j) in the case of any de minimis error in complying with paragraph (1), or

(B) any annual recertification of tenant income for purposes of this subsection, if the entire building is occupied by low-income tenants.

(9) CLARIFICATION OF GENERAL PUBLIC USE REQUIREMENT.—A project does not fail to meet the general public use requirement solely because of occupancy restrictions or preferences that favor tenants—

(A) with special needs,

(B) who are members of a specified group under a Federal program or State program or policy that supports housing for such a specified group, or

(C) who are involved in artistic or literary activities.

(h) LIMITATION ON AGGREGATE CREDIT ALLOWABLE WITH RESPECT TO PROJECTS LOCATED IN A STATE.—

(1) CREDIT MAY NOT EXCEED CREDIT AMOUNT ALLOCATED TO BUILDING.—

(A) IN GENERAL.—The amount of the credit determined under this section for any taxable year with respect to any building shall not exceed the housing credit dollar amount allocated to such building under this subsection.

(B) TIME FOR MAKING ALLOCATION.—Except in the case of an allocation which meets the requirements of subparagraph (C), (D), (E), or (F), an allocation shall be taken into account under subparagraph (A) only if it is made not later than the close of the calendar year in which the building is placed in service.

(C) EXCEPTION WHERE BINDING COMMITMENT.—An allocation meets the requirements of this subparagraph if there is a binding commitment (not later than the close of the calendar year in which the building is placed in service) by the housing credit agency to allocate a specified housing credit dollar amount to such building beginning in a specified later taxable year.

(D) EXCEPTION WHERE INCREASE IN QUALIFIED BASIS.—

(i) IN GENERAL.—An allocation meets the requirements of this subparagraph if such allocation is made not later than the close of the calendar year in which

ends the taxable year to which it will 1st apply but only to the extent the amount of such allocation does not exceed the limitation under clause (ii).

(ii) LIMITATION.—The limitation under this clause is the amount of credit allowable under this section (without regard to this subsection) for a taxable year with respect to an increase in the qualified basis of the building equal to the excess of—

(I) the qualified basis of such building as of the close of the 1st taxable year to which such allocation will apply, over

(II) the qualified basis of such building as of the close of the 1st taxable year to which the most recent prior housing credit allocation with respect to such building applied.

(iii) HOUSING CREDIT DOLLAR AMOUNT REDUCED BY FULL ALLOCATION.—Notwithstanding clause (i), the full amount of the allocation shall be taken into account under paragraph (2).

(E) EXCEPTION WHERE 10 PERCENT OF COST INCURRED.—

(i) IN GENERAL.—An allocation meets the requirements of this subparagraph if such allocation is made with respect to a qualified building which is placed in service not later than the close of the second calendar year following the calendar year in which the allocation is made.

(ii) QUALIFIED BUILDING.—For purposes of clause (i), the term "qualified building" means any building which is part of a project if the taxpayer's basis in such project (as of the date which is 1 year after the date that the allocation was made) is more than 10 percent of the taxpayer's reasonably expected basis in such project (as of the close of the second calendar year referred to in clause (i)). Such term does not include any existing building unless a credit is allowable under subsection (e) for rehabilitation expenditures paid or incurred by the taxpayer with respect to such building for a taxable year ending during the second calendar year referred to in clause (i) or the prior taxable year.

(F) ALLOCATION OF CREDIT ON A PROJECT BASIS.—

(i) IN GENERAL.—In the case of a project which includes (or will include) more than 1 building, an allocation meets the requirements of this subparagraph if—

(I) the allocation is made to the project for a calendar year during the project period,

(II) the allocation only applies to buildings placed in service during or after the calendar year for which the allocation is made, and

(III) the portion of such allocation which is allocated to any building in such project is specified not later than the close of the calendar year in which the building is placed in service.

(ii) PROJECT PERIOD.—For purposes of clause (i), the term "project period" means the period—

(I) beginning with the 1st calendar year for which an allocation may be made for the 1st building placed in service as part of such project, and

(II) ending with the calendar year the last building is placed in service as part of such project.

(2) ALLOCATED CREDIT AMOUNT TO APPLY TO ALL TAXABLE YEARS ENDING DURING OR AFTER CREDIT ALLOCATION YEAR.—Any housing credit dollar amount allocated to any building for any calendar year—

(A) shall apply to such building for all taxable years in the compliance period ending during or after such calendar year, and

(B) shall reduce the aggregate housing credit dollar amount of the allocating agency only for such calendar year.

(3) HOUSING CREDIT DOLLAR AMOUNT FOR AGENCIES.—

(A) IN GENERAL.—The aggregate housing credit dollar amount which a housing credit agency may allocate for any calendar year is the portion of the State housing credit ceiling allocated under this paragraph for such calendar year to such agency.

(B) STATE CEILING INITIALLY ALLOCATED TO STATE HOUSING CREDIT AGENCIES.—Except as provided in subparagraphs (D) and (E), the State housing credit ceiling for each calendar year shall be allocated to the housing credit agency of such State. If there is more than 1 housing credit agency of a State, all such agencies shall be treated as a single agency.

(C) STATE HOUSING CREDIT CEILING.—The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to the sum of—

(i) the unused State housing credit ceiling (if any) of such State for the preceding calendar year,

(ii) the greater of—

(I) $1.75 multiplied by the State population, or

(II) $2,000,000,

(iii) the amount of State housing credit ceiling returned in the calendar year, plus

(iv) the amount (if any) allocated under subparagraph (D) to such State by the Secretary.

For purposes of clause (i), the unused State housing credit ceiling for any calendar year is the excess (if any) of the sum of the amounts described in clauses (ii) through (iv) over the aggregate housing credit dollar amount allocated for such year. For purposes of clause (iii), the amount of State housing credit ceiling returned in the calendar year equals the housing credit dollar amount previously allocated within the State to any project which fails to meet the 10 percent test under paragraph (1)(E)(ii) on a date after the close of the calendar year in which the allocation was made or which does not become a qualified low-income

housing project within the period required by this section or the terms of the allocation or to any project with respect to which an allocation is cancelled by mutual consent of the housing credit agency and the allocation recipient.

(D) UNUSED HOUSING CREDIT CARRYOVERS ALLOCATED AMONG CERTAIN STATES.—

(i) IN GENERAL.—The unused housing credit carryover of a State for any calendar year shall be assigned to the Secretary for allocation among qualified States for the succeeding calendar year.

(ii) UNUSED HOUSING CREDIT CARRYOVER.—For purposes of this subparagraph, the unused housing credit carryover of a State for any calendar year is the excess (if any) of—

(I) the unused State housing credit ceiling for the year preceding such year, over

(II) the aggregate housing credit dollar amount allocated for such year.

(iii) FORMULA FOR ALLOCATION OF UNUSED HOUSING CREDIT CARRYOVERS AMONG QUALIFIED STATES.—The amount allocated under this subparagraph to a qualified State for any calendar year shall be the amount determined by the Secretary to bear the same ratio to the aggregate unused housing credit carryovers of all States for the preceding calendar year as such State's population for the calendar year bears to the population of all qualified States for the calendar year. For purposes of the preceding sentence, population shall be determined in accordance with section 146(j).

(iv) QUALIFIED STATE.—For purposes of this subparagraph, the term "qualified State" means, with respect to a calendar year, any State—

(I) which allocated its entire State housing credit ceiling for the preceding calendar year, and

(II) for which a request is made (not later than May 1 of the calendar year) to receive an allocation under clause (iii).

(E) SPECIAL RULE FOR STATES WITH CONSTITUTIONAL HOME RULE CITIES.—For purposes of this subsection—

(i) IN GENERAL.—The aggregate housing credit dollar amount for any constitutional home rule city for any calendar year shall be an amount which bears the same ratio to the State housing credit ceiling for such calendar year as—

(I) the population of such city, bears to

(II) the population of the entire State.

(ii) COORDINATION WITH OTHER ALLOCATIONS.—In the case of any State which contains 1 or more constitutional home rule cities, for purposes of applying this paragraph with respect to housing credit agencies in such State other than constitutional home rule cities, the State housing credit ceiling for any calendar year shall be reduced by the aggregate housing credit dollar amounts determined for such year for all constitutional home rule cities in such State.

(iii) CONSTITUTIONAL HOME RULE CITY.—For purposes of this paragraph, the term "constitutional home rule city" has the meaning given such term by section 146(d)(3)(C).

(F) STATE MAY PROVIDE FOR DIFFERENT ALLOCATION.—Rules similar to the rules of section 146(e) (other than paragraph (2)(B) thereof) shall apply for purposes of this paragraph.

(G) POPULATION.—For purposes of this paragraph, population shall be determined in accordance with section 146(j).

(H) COST-OF-LIVING ADJUSTMENT.—

(i) IN GENERAL.—In the case of a calendar year after 2002, the $2,000,000 and $1.75 amounts in subparagraph (C) shall each be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 2001" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(ii) ROUNDING.—(I) In the case of the $2,000,000 amount, any increase under clause (i) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

(II) In the case of the $1.75 amount, any increase under clause (i) which is not a multiple of 5 cents shall be rounded to the next lowest multiple of 5 cents.

(I) INCREASE IN STATE HOUSING CREDIT CEILING FOR [2018, 2019, 2020, AND 2021] *CERTAIN CALENDAR YEARS*.—In the case of calendar years 2018, 2019, 2020, [and 2021,] *2021, 2023, 2024, and 2025,* each of the dollar amounts in effect under clauses (I) and (II) of subparagraph (C)(ii) for any calendar year (after any increase under subparagraph (H)) shall be increased by multiplying such dollar amount by 1.125.

(4) CREDIT FOR BUILDINGS FINANCED BY TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP NOT TAKEN INTO ACCOUNT.—

(A) IN GENERAL.—Paragraph (1) shall not apply to the portion of any credit allowable under subsection (a) which is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under section 103 if—

(i) such obligation is taken into account under section 146, and

(ii) principal payments on such financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide such financing or such financing is refunded as described in section 146(i)(6).

[(B) SPECIAL RULE WHERE 50 PERCENT OR MORE OF BUILDING IS FINANCED WITH TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP.—For purposes of subparagraph (A), if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed by

any obligation described in subparagraph (A), paragraph (1) shall not apply to any portion of the credit allowable under subsection (a) with respect to such building.]

(B) SPECIAL RULE WHERE MINIMUM PERCENT OF BUILDINGS IS FINANCED WITH TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP.—For purposes of subparagraph (A), paragraph (1) shall not apply to any portion of the credit allowable under subsection (a) with respect to a building if—

(i) 50 percent or more of the aggregate basis of such building and the land on which the building is located is financed by 1 or more obligations described in subparagraph (A), or

(ii)(I) 30 percent or more of the aggregate basis of such building and the land on which the building is located is financed by 1 or more qualified obligations, and

(II) 1 or more of such qualified obligations—

(aa) are part of an issue the issue date of which is after December 31, 2023, and

(bb) provide the financing for not less than 5 percent of the aggregate basis of such building and the land on which the building is located.

(C) QUALIFIED OBLIGATION.—For purposes of subparagraph (B)(ii), the term "qualified obligation" means an obligation which is described in subparagraph (A) and which is part of an issue the issue date of which is before January 1, 2026.

(5) PORTION OF STATE CEILING SET-ASIDE FOR CERTAIN PROJECTS INVOLVING QUALIFIED NONPROFIT ORGANIZATIONS.—

(A) IN GENERAL.—Not more than 90 percent of the State housing credit ceiling for any State for any calendar year shall be allocated to projects other than qualified low-income housing projects described in subparagraph (B).

(B) PROJECTS INVOLVING QUALIFIED NONPROFIT ORGANIZATIONS.—For purposes of subparagraph (A), a qualified low-income housing project is described in this subparagraph if a qualified nonprofit organization is to own an interest in the project (directly or through a partnership) and materially participate (within the meaning of section 469(h)) in the development and operation of the project throughout the compliance period.

(C) QUALIFIED NONPROFIT ORGANIZATION.—For purposes of this paragraph, the term "qualified nonprofit organization" means any organization if—

(i) such organization is described in paragraph (3) or (4) of section 501(c) and is exempt from tax under section 501(a),

(ii) such organization is determined by the State housing credit agency not to be affiliated with or controlled by a for-profit organization, and

(iii) 1 of the exempt purposes of such organization includes the fostering of low-income housing.

(D) TREATMENT OF CERTAIN SUBSIDIARIES.—

(i) IN GENERAL.—For purposes of this paragraph, a qualified nonprofit organization shall be treated as

satisfying the ownership and material participation test of subparagraph (B) if any qualified corporation in which such organization holds stock satisfies such test.

(ii) QUALIFIED CORPORATION.—For purposes of clause (i), the term "qualified corporation" means any corporation if 100 percent of the stock of such corporation is held by 1 or more qualified nonprofit organizations at all times during the period such corporation is in existence.

(E) STATE MAY NOT OVERRIDE SET-ASIDE.—Nothing in subparagraph (F) of paragraph (3) shall be construed to permit a State not to comply with subparagraph (A) of this paragraph.

(6) BUILDINGS ELIGIBLE FOR CREDIT ONLY IF MINIMUM LONG-TERM COMMITMENT TO LOW-INCOME HOUSING.—

(A) IN GENERAL.—No credit shall be allowed by reason of this section with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year.

(B) EXTENDED LOW-INCOME HOUSING COMMITMENT.—For purposes of this paragraph, the term "extended low-income housing commitment" means any agreement between the taxpayer and the housing credit agency—

(i) which requires that the applicable fraction (as defined in subsection (c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in such agreement and which prohibits the actions described in subclauses (I) and (II) of subparagraph (E)(ii),

(ii) which allows individuals who meet the income limitation applicable to the building under subsection (g) (whether prospective, present, or former occupants of the building) the right to enforce in any State court the requirement and prohibitions of clause (i),

(iii) which prohibits the disposition to any person of any portion of the building to which such agreement applies unless all of the building to which such agreement applies is disposed of to such person,

(iv) which prohibits the refusal to lease to a holder of a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937 because of the status of the prospective tenant as such a holder,

(v) which is binding on all successors of the taxpayer, and

(vi) which, with respect to the property, is recorded pursuant to State law as a restrictive covenant.

(C) ALLOCATION OF CREDIT MAY NOT EXCEED AMOUNT NECESSARY TO SUPPORT COMMITMENT.—

(i) IN GENERAL.—The housing credit dollar amount allocated to any building may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building, including any increase in such fraction pursuant to the application of subsection (f)(3) if such

increase is reflected in an amended low-income housing commitment.

(ii) BUILDINGS FINANCED BY TAX-EXEMPT BONDS.—If paragraph (4) applies to any building the amount of credit allowed in any taxable year may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building. Such commitment may be amended to increase such fraction.

(D) EXTENDED USE PERIOD.—For purposes of this paragraph, the term "extended use period" means the period—

(i) beginning on the 1st day in the compliance period on which such building is part of a qualified low-income housing project, and

(ii) ending on the later of—

(I) the date specified by such agency in such agreement, or

(II) the date which is 15 years after the close of the compliance period.

(E) EXCEPTIONS IF FORECLOSURE OR IF NO BUYER WILLING TO MAINTAIN LOW-INCOME STATUS.—

(i) IN GENERAL.—The extended use period for any building shall terminate—

(I) on the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period, or

(II) on the last day of the period specified in subparagraph (I) if the housing credit agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building.

Subclause (II) shall not apply to the extent more stringent requirements are provided in the agreement or in State law.

(ii) EVICTION, ETC. OF EXISTING LOW-INCOME TENANTS NOT PERMITTED.—The termination of an extended use period under clause (i) shall not be construed to permit before the close of the 3-year period following such termination—

(I) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or

(II) any increase in the gross rent with respect to such unit not otherwise permitted under this section.

(F) QUALIFIED CONTRACT.—For purposes of subparagraph (E), the term "qualified contract" means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the nonlow-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable

fraction (specified in the extended low-income housing commitment) of—

(i) the sum of—

(I) the outstanding indebtedness secured by, or with respect to, the building,

(II) the adjusted investor equity in the building, plus

(III) other capital contributions not reflected in the amounts described in subclause (I) or (II), reduced by

(ii) cash distributions from (or available for distribution from) the project.

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including regulations to prevent the manipulation of the amount determined under the preceding sentence.

(G) ADJUSTED INVESTOR EQUITY.—

(i) IN GENERAL.—For purposes of subparagraph (E), the term "adjusted investor equity" means, with respect to any calendar year, the aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to—

(I) such amount, multiplied by

(II) the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting the base calendar year for "calendar year 2016" in subparagraph (A)(ii) thereof.

An amount shall be taken into account as an investment in the project only to the extent there was an obligation to invest such amount as of the beginning of the credit period and to the extent such amount is reflected in the adjusted basis of the project.

(ii) COST-OF-LIVING INCREASES IN EXCESS OF 5 PERCENT NOT TAKEN INTO ACCOUNT.—Under regulations prescribed by the Secretary, if the C-CPI-U for any calendar year (as defined in section 1(f)(6)) exceeds the C-CPI-U for the preceding calendar year by more than 5 percent, the C-CPI-U for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i). In the case of a base calendar year before 2017, the C-CPI-U for such year shall be determined by multiplying the CPI for such year by the amount determined under section 1(f)(3)(B).

(iii) BASE CALENDAR YEAR.—For purposes of this subparagraph, the term "base calendar year" means the calendar year with or within which the 1st taxable year of the credit period ends.

(H) LOW-INCOME PORTION.—For purposes of this paragraph, the low-income portion of a building is the portion of such building equal to the applicable fraction specified in the extended low-income housing commitment for the building.

(I) PERIOD FOR FINDING BUYER.—The period referred to in this subparagraph is the 1-year period beginning on the

date (after the 14th year of the compliance period) the taxpayer submits a written request to the housing credit agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.

(J) EFFECT OF NONCOMPLIANCE.—If, during a taxable year, there is a determination that an extended low-income housing agreement was not in effect as of the beginning of such year, such determination shall not apply to any period before such year and subparagraph (A) shall be applied without regard to such determination if the failure is corrected within 1 year from the date of the determination.

(K) PROJECTS WHICH CONSIST OF MORE THAN 1 BUILDING.—The application of this paragraph to projects which consist of more than 1 building shall be made under regulations prescribed by the Secretary.

(7) SPECIAL RULES.—

(A) BUILDING MUST BE LOCATED WITHIN JURISDICTION OF CREDIT AGENCY.—A housing credit agency may allocate its aggregate housing credit dollar amount only to buildings located in the jurisdiction of the governmental unit of which such agency is a part.

(B) AGENCY ALLOCATIONS IN EXCESS OF LIMIT.—If the aggregate housing credit dollar amounts allocated by a housing credit agency for any calendar year exceed the portion of the State housing credit ceiling allocated to such agency for such calendar year, the housing credit dollar amounts so allocated shall be reduced (to the extent of such excess) for buildings in the reverse of the order in which the allocations of such amounts were made.

(C) CREDIT REDUCED IF ALLOCATED CREDIT DOLLAR AMOUNT IS LESS THAN CREDIT WHICH WOULD BE ALLOWABLE WITHOUT REGARD TO PLACED IN SERVICE CONVENTION, ETC..—

(i) IN GENERAL.—The amount of the credit determined under this section with respect to any building shall not exceed the clause (ii) percentage of the amount of the credit which would (but for this subparagraph) be determined under this section with respect to such building.

(ii) DETERMINATION OF PERCENTAGE.—For purposes of clause (i), the clause (ii) percentage with respect to any building is the percentage which—

(I) the housing credit dollar amount allocated to such building bears to

(II) the credit amount determined in accordance with clause (iii).

(iii) DETERMINATION OF CREDIT AMOUNT.—The credit amount determined in accordance with this clause is the amount of the credit which would (but for this subparagraph) be determined under this section with respect to the building if—

(I) this section were applied without regard to paragraphs (2)(A) and (3)(B) of subsection (f), and

(II) subsection (f)(3)(A) were applied without regard to "the percentage equal to 2/3 of".

(D) HOUSING CREDIT AGENCY TO SPECIFY APPLICABLE PERCENTAGE AND MAXIMUM QUALIFIED BASIS.—In allocating a housing credit dollar amount to any building, the housing credit agency shall specify the applicable percentage and the maximum qualified basis which may be taken into account under this section with respect to such building. The applicable percentage and maximum qualified basis so specified shall not exceed the applicable percentage and qualified basis determined under this section without regard to this subsection.

(8) OTHER DEFINITIONS.—For purposes of this subsection—

(A) HOUSING CREDIT AGENCY.—The term "housing credit agency" means any agency authorized to carry out this subsection.

(B) POSSESSIONS TREATED AS STATES.—The term "State" includes a possession of the United States.

(i) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) COMPLIANCE PERIOD.—The term "compliance period" means, with respect to any building, the period of 15 taxable years beginning with the 1st taxable year of the credit period with respect thereto.

(2) DETERMINATION OF WHETHER BUILDING IS FEDERALLY SUBSIDIZED.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, for purposes of subsection (b)(1), a new building shall be treated as federally subsidized for any taxable year if, at any time during such taxable year or any prior taxable year, there is or was outstanding any obligation the interest on which is exempt from tax under section 103 the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof.

(B) ELECTION TO REDUCE ELIGIBLE BASIS BY PROCEEDS OF OBLIGATIONS.—A tax-exempt obligation shall not be taken into account under subparagraph (A) if the taxpayer elects to exclude from the eligible basis of the building for purposes of subsection (d) the proceeds of such obligation.

(C) SPECIAL RULE FOR SUBSIDIZED CONSTRUCTION FINANCING.—Subparagraph (A) shall not apply to any tax-exempt obligation used to provide construction financing for any building if—

(i) such obligation (when issued) identified the building for which the proceeds of such obligation would be used, and

(ii) such obligation is redeemed before such building is placed in service.

(3) LOW-INCOME UNIT.—

(A) IN GENERAL.—The term "low-income unit" means any unit in a building if—

(i) such unit is rent-restricted (as defined in subsection (g)(2)), and

(ii) the individuals occupying such unit meet the income limitation applicable under subsection (g)(1) to the project of which such building is a part.

(B) EXCEPTIONS.—

(i) IN GENERAL.—A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.

(ii) SUITABILITY FOR OCCUPANCY.—For purposes of clause (i), the suitability of a unit for occupancy shall be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes.

(iii) TRANSITIONAL HOUSING FOR HOMELESS.—For purposes of clause (i), a unit shall be considered to be used other than on a transient basis if the unit contains sleeping accommodations and kitchen and bathroom facilities and is located in a building—

(I) which is used exclusively to facilitate the transition of homeless individuals (within the meaning of section 103 of the McKinney-Vento Homeless Assistance Act (42 U.S.C. 11302), as in effect on the date of the enactment of this clause) to independent living within 24 months, and

(II) in which a governmental entity or qualified nonprofit organization (as defined in subsection (h)(5)) provides such individuals with temporary housing and supportive services designed to assist such individuals in locating and retaining permanent housing.

(iv) SINGLE-ROOM OCCUPANCY UNITS.—For purposes of clause (i), a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.

(C) SPECIAL RULE FOR BUILDINGS HAVING 4 OR FEWER UNITS.—In the case of any building which has 4 or fewer residential rental units, no unit in such building shall be treated as a low-income unit if the units in such building are owned by—

(i) any individual who occupies a residential unit in such building, or

(ii) any person who is related (as defined in subsection (d)(2)(D)(iii)) to such individual.

(D) CERTAIN STUDENTS NOT TO DISQUALIFY UNIT.—A unit shall not fail to be treated as a low-income unit merely because it is occupied—

(i) by an individual who is—

(I) a student and receiving assistance under title IV of the Social Security Act,

(II) a student who was previously under the care and placement responsibility of the State agency responsible for administering a plan under part B or part E of title IV of the Social Security Act, or

(III) enrolled in a job training program receiving assistance under the Job Training Partnership Act

or under other similar Federal, State, or local laws, or

(ii) entirely by full-time students if such students are—

(I) single parents and their children and such parents are not dependents (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof) of another individual and such children are not dependents (as so defined) of another individual other than a parent of such children, or

(II) married and file a joint return.

(E) OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS ELIGIBLE FOR CREDIT WHERE DEVELOPMENT PLAN.—

(i) IN GENERAL.—Subparagraph (C) shall not apply to the acquisition or rehabilitation of a building pursuant to a development plan of action sponsored by a State or local government or a qualified nonprofit organization (as defined in subsection (h)(5)(C)).

(ii) LIMITATION ON CREDIT.—In the case of a building to which clause (i) applies, the applicable fraction shall not exceed 80 percent of the unit fraction.

(iii) CERTAIN UNRENTED UNITS TREATED AS OWNER-OCCUPIED.—In the case of a building to which clause (i) applies, any unit which is not rented for 90 days or more shall be treated as occupied by the owner of the building as of the 1st day it is not rented.

(4) NEW BUILDING.—The term "new building" means a building the original use of which begins with the taxpayer.

(5) EXISTING BUILDING.—The term "existing building" means any building which is not a new building.

(6) APPLICATION TO ESTATES AND TRUSTS.—In the case of an estate or trust, the amount of the credit determined under subsection (a) and any increase in tax under subsection (j) shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each.

(7) IMPACT OF TENANT'S RIGHT OF 1ST REFUSAL TO ACQUIRE PROPERTY.—

(A) IN GENERAL.—No Federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of 1st refusal held by the tenants (in cooperative form or otherwise) or resident management corporation of such building or by a qualified nonprofit organization (as defined in subsection (h)(5)(C)) or government agency to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under subparagraph (B).

(B) MINIMUM PURCHASE PRICE.—For purposes of subparagraph (A), the minimum purchase price under this subparagraph is an amount equal to the sum of—

(i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness in-

curred within the 5-year period ending on the date of the sale to the tenants), and

(ii) all Federal, State, and local taxes attributable to such sale.

Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).

(8) TREATMENT OF RURAL PROJECTS.—For purposes of this section, in the case of any project for residential rental property located in a rural area (as defined in section 520 of the Housing Act of 1949), any income limitation measured by reference to area median gross income shall be measured by reference to the greater of area median gross income or national non-metropolitan median income. The preceding sentence shall not apply with respect to any building if paragraph (1) of section 42(h) does not apply by reason of paragraph (4) thereof to any portion of the credit determined under this section with respect to such building.

(9) COORDINATION WITH LOW-INCOME HOUSING GRANTS.—

(A) REDUCTION IN STATE HOUSING CREDIT CEILING FOR LOW-INCOME HOUSING GRANTS RECEIVED IN 2009.—For purposes of this section, the amounts described in clauses (i) through (iv) of subsection (h)(3)(C) with respect to any State for 2009 shall each be reduced by so much of such amount as is taken into account in determining the amount of any grant to such State under section 1602 of the American Recovery and Reinvestment Tax Act of 2009.

(B) SPECIAL RULE FOR BASIS.—Basis of a qualified low-income building shall not be reduced by the amount of any grant described in subparagraph (A).

(j) RECAPTURE OF CREDIT.—

(1) IN GENERAL.—If—

(A) as of the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than

(B) the amount of such basis as of the close of the preceding taxable year,

then the taxpayer's tax under this chapter for the taxable year shall be increased by the credit recapture amount.

(2) CREDIT RECAPTURE AMOUNT.—For purposes of paragraph (1), the credit recapture amount is an amount equal to the sum of—

(A) the aggregate decrease in the credits allowed to the taxpayer under section 38 for all prior taxable years which would have resulted if the accelerated portion of the credit allowable by reason of this section were not allowed for all prior taxable years with respect to the excess of the amount described in paragraph (1)(B) over the amount described in paragraph (1)(A), plus

(B) interest at the overpayment rate established under section 6621 on the amount determined under subparagraph (A) for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved.

No deduction shall be allowed under this chapter for interest described in subparagraph (B).

(3) ACCELERATED PORTION OF CREDIT.—For purposes of paragraph (2), the accelerated portion of the credit for the prior taxable years with respect to any amount of basis is the excess of—

(A) the aggregate credit allowed by reason of this section (without regard to this subsection) for such years with respect to such basis, over

(B) the aggregate credit which would be allowable by reason of this section for such years with respect to such basis if the aggregate credit which would (but for this subsection) have been allowable for the entire compliance period were allowable ratably over 15 years.

(4) SPECIAL RULES.—

(A) TAX BENEFIT RULE.—The tax for the taxable year shall be increased under paragraph (1) only with respect to credits allowed by reason of this section which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carryforwards and carrybacks under section 39 shall be appropriately adjusted.

(B) ONLY BASIS FOR WHICH CREDIT ALLOWED TAKEN INTO ACCOUNT.—Qualified basis shall be taken into account under paragraph (1)(B) only to the extent such basis was taken into account in determining the credit under subsection (a) for the preceding taxable year referred to in such paragraph.

(C) NO RECAPTURE OF ADDITIONAL CREDIT ALLOWABLE BY REASON OF SUBSECTION (F)(3).—Paragraph (1) shall apply to a decrease in qualified basis only to the extent such decrease exceeds the amount of qualified basis with respect to which a credit was allowable for the taxable year referred to in paragraph (1)(B) by reason of subsection (f)(3).

(D) NO CREDITS AGAINST TAX.—Any increase in tax under this subsection shall not be treated as a tax imposed by this chapter for purposes of determining the amount of any credit under this chapter.

(E) NO RECAPTURE BY REASON OF CASUALTY LOSS.—The increase in tax under this subsection shall not apply to a reduction in qualified basis by reason of a casualty loss to the extent such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary.

(F) NO RECAPTURE WHERE DE MINIMIS CHANGES IN FLOOR SPACE.—The Secretary may provide that the increase in tax under this subsection shall not apply with respect to any building if—

(i) such increase results from a de minimis change in the floor space fraction under subsection (c)(1), and

(ii) the building is a qualified low-income building after such change.

(5) CERTAIN PARTNERSHIPS TREATED AS THE TAXPAYER.—

(A) IN GENERAL.—For purposes of applying this subsection to a partnership to which this paragraph applies—

(i) such partnership shall be treated as the taxpayer to which the credit allowable under subsection (a) was allowed,

(ii) the amount of such credit allowed shall be treated as the amount which would have been allowed to the partnership were such credit allowable to such partnership,

(iii) paragraph (4)(A) shall not apply, and

(iv) the amount of the increase in tax under this subsection for any taxable year shall be allocated among the partners of such partnership in the same manner as such partnership's taxable income for such year is allocated among such partners.

(B) PARTNERSHIPS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to any partnership which has 35 or more partners unless the partnership elects not to have this paragraph apply.

(C) SPECIAL RULES.—

(i) HUSBAND AND WIFE TREATED AS 1 PARTNER.—For purposes of subparagraph (B)(i), a husband and wife (and their estates) shall be treated as 1 partner.

(ii) ELECTION IRREVOCABLE.—Any election under subparagraph (B), once made, shall be irrevocable.

(6) NO RECAPTURE ON DISPOSITION OF BUILDING WHICH CONTINUES IN QUALIFIED USE.—

(A) IN GENERAL.—The increase in tax under this subsection shall not apply solely by reason of the disposition of a building (or an interest therein) if it is reasonably expected that such building will continue to be operated as a qualified low-income building for the remaining compliance period with respect to such building.

(B) STATUTE OF LIMITATIONS.—If a building (or an interest therein) is disposed of during any taxable year and there is any reduction in the qualified basis of such building which results in an increase in tax under this subsection for such taxable or any subsequent taxable year, then—

(i) the statutory period for the assessment of any deficiency with respect to such increase in tax shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of such reduction in qualified basis, and

(ii) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(k) APPLICATION OF AT-RISK RULES.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, rules similar to the rules of section 49(a)(1) (other than subparagraphs (D)(ii)(II) and (D)(iv)(I) thereof), section 49(a)(2), and section 49(b)(1) shall apply in determining the qualified basis of any building in the same manner as such sections apply in determining the credit base of property.

(2) SPECIAL RULES FOR DETERMINING QUALIFIED PERSON.—For purposes of paragraph (1)—

(A) IN GENERAL.—If the requirements of subparagraphs (B), (C), and (D) are met with respect to any financing borrowed from a qualified nonprofit organization (as defined in subsection (h)(5)), the determination of whether such financing is qualified commercial financing with respect to any qualified low-income building shall be made without regard to whether such organization—

(i) is actively and regularly engaged in the business of lending money, or

(ii) is a person described in section 49(a)(1)(D)(iv)(II).

(B) FINANCING SECURED BY PROPERTY.—The requirements of this subparagraph are met with respect to any financing if such financing is secured by the qualified low-income building, except that this subparagraph shall not apply in the case of a federally assisted building described in subsection (d)(6)(C) if—

(i) a security interest in such building is not permitted by a Federal agency holding or insuring the mortgage secured by such building, and

(ii) the proceeds from the financing (if any) are applied to acquire or improve such building.

(C) PORTION OF BUILDING ATTRIBUTABLE TO FINANCING.—The requirements of this subparagraph are met with respect to any financing for any taxable year in the compliance period if, as of the close of such taxable year, not more than 60 percent of the eligible basis of the qualified low-income building is attributable to such financing (reduced by the principal and interest of any governmental financing which is part of a wrap-around mortgage involving such financing).

(D) REPAYMENT OF PRINCIPAL AND INTEREST.—The requirements of this subparagraph are met with respect to any financing if such financing is fully repaid on or before the earliest of—

(i) the date on which such financing matures,

(ii) the 90th day after the close of the compliance period with respect to the qualified low-income building, or

(iii) the date of its refinancing or the sale of the building to which such financing relates.

In the case of a qualified nonprofit organization which is not described in section 49(a)(1)(D)(iv)(II) with respect to a building, clause (ii) of this subparagraph shall be applied as if the date described therein were the 90th day after the earlier of the date the building ceases to be a qualified low-income building or the date which is 15 years after the close of a compliance period with respect thereto.

(3) PRESENT VALUE OF FINANCING.—If the rate of interest on any financing described in paragraph (2)(A) is less than the rate which is 1 percentage point below the applicable Federal rate as of the time such financing is incurred, then the qualified basis (to which such financing relates) of the qualified low-

income building shall be the present value of the amount of such financing, using as the discount rate such applicable Federal rate. For purposes of the preceding sentence, the rate of interest on any financing shall be determined by treating interest to the extent of government subsidies as not payable.

(4) FAILURE TO FULLY REPAY.—

(A) IN GENERAL.—To the extent that the requirements of paragraph (2)(D) are not met, then the taxpayer's tax under this chapter for the taxable year in which such failure occurs shall be increased by an amount equal to the applicable portion of the credit under this section with respect to such building, increased by an amount of interest for the period—

(i) beginning with the due date for the filing of the return of tax imposed by chapter 1 for the 1st taxable year for which such credit was allowable, and

(ii) ending with the due date for the taxable year in which such failure occurs,

determined by using the underpayment rate and method under section 6621.

(B) APPLICABLE PORTION.—For purposes of subparagraph (A), the term "applicable portion" means the aggregate decrease in the credits allowed to a taxpayer under section 38 for all prior taxable years which would have resulted if the eligible basis of the building were reduced by the amount of financing which does not meet requirements of paragraph (2)(D).

(C) CERTAIN RULES TO APPLY.—Rules similar to the rules of subparagraphs (A) and (D) of subsection (j)(4) shall apply for purposes of this subsection.

(l) CERTIFICATIONS AND OTHER REPORTS TO SECRETARY.—

(1) CERTIFICATION WITH RESPECT TO 1ST YEAR OF CREDIT PERIOD.—Following the close of the 1st taxable year in the credit period with respect to any qualified low-income building, the taxpayer shall certify to the Secretary (at such time and in such form and in such manner as the Secretary prescribes)—

(A) the taxable year, and calendar year, in which such building was placed in service,

(B) the adjusted basis and eligible basis of such building as of the close of the 1st year of the credit period,

(C) the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under subsection (h),

(D) the election made under subsection (g) with respect to the qualified low-income housing project of which such building is a part, and

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

In the case of a failure to make the certification required by the preceding sentence on the date prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable by reason of subsection (a) with respect to such building for any taxable year ending before such certification is made.

(2) ANNUAL REPORTS TO THE SECRETARY.—The Secretary may require taxpayers to submit an information return (at

such time and in such form and manner as the Secretary prescribes) for each taxable year setting forth—

(A) the qualified basis for the taxable year of each qualified low-income building of the taxpayer,

(B) the information described in paragraph (1)(C) for the taxable year, and

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

The penalty under section 6652(j) shall apply to any failure to submit the return required by the Secretary under the preceding sentence on the date prescribed therefor.

(3) ANNUAL REPORTS FROM HOUSING CREDIT AGENCIES.—Each agency which allocates any housing credit amount to any building for any calendar year shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual report specifying—

(A) the amount of housing credit amount allocated to each building for such year,

(B) sufficient information to identify each such building and the taxpayer with respect thereto, and

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

The penalty under section 6652(j) shall apply to any failure to submit the report required by the preceding sentence on the date prescribed therefor.

(m) RESPONSIBILITIES OF HOUSING CREDIT AGENCIES.—

(1) PLANS FOR ALLOCATION OF CREDIT AMONG PROJECTS.—

(A) IN GENERAL.—Notwithstanding any other provision of this section, the housing credit dollar amount with respect to any building shall be zero unless—

(i) such amount was allocated pursuant to a qualified allocation plan of the housing credit agency which is approved by the governmental unit (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) of which such agency is a part,

(ii) such agency notifies the chief executive officer (or the equivalent) of the local jurisdiction within which the building is located of such project and provides such individual a reasonable opportunity to comment on the project,

(iii) a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project is conducted before the credit allocation is made and at the developer's expense by a disinterested party who is approved by such agency, and

(iv) a written explanation is available to the general public for any allocation of a housing credit dollar amount which is not made in accordance with established priorities and selection criteria of the housing credit agency.

(B) QUALIFIED ALLOCATION PLAN.—For purposes of this paragraph, the term "qualified allocation plan" means any plan—

(i) which sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions,

(ii) which also gives preference in allocating housing credit dollar amounts among selected projects to—

(I) projects serving the lowest income tenants,

(II) projects obligated to serve qualified tenants for the longest periods, and

(III) projects which are located in qualified census tracts (as defined in subsection (d)(5)(B)(ii)) and the development of which contributes to a concerted community revitalization plan, and

(iii) which provides a procedure that the agency (or an agent or other private contractor of such agency) will follow in monitoring for noncompliance with the provisions of this section and in notifying the Internal Revenue Service of such noncompliance which such agency becomes aware of and in monitoring for noncompliance with habitability standards through regular site visits.

(C) CERTAIN SELECTION CRITERIA MUST BE USED.—The selection criteria set forth in a qualified allocation plan must include

(i) project location,

(ii) housing needs characteristics,

(iii) project characteristics, including whether the project includes the use of existing housing as part of a community revitalization plan,

(iv) sponsor characteristics,

(v) tenant populations with special housing needs,

(vi) public housing waiting lists,

(vii) tenant populations of individuals with children,

(viii) projects intended for eventual tenant ownership,

(ix) the energy efficiency of the project, and

(x) the historic nature of the project.

(D) APPLICATION TO BOND FINANCED PROJECTS.—Subsection (h)(4) shall not apply to any project unless the project satisfies the requirements for allocation of a housing credit dollar amount under the qualified allocation plan applicable to the area in which the project is located.

(2) CREDIT ALLOCATED TO BUILDING NOT TO EXCEED AMOUNT NECESSARY TO ASSURE PROJECT FEASIBILITY.—

(A) IN GENERAL.—The housing credit dollar amount allocated to a project shall not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period.

(B) AGENCY EVALUATION.—In making the determination under subparagraph (A), the housing credit agency shall consider—

(i) the sources and uses of funds and the total financing planned for the project,

(ii) any proceeds or receipts expected to be generated by reason of tax benefits,

(iii) the percentage of the housing credit dollar amount used for project costs other than the cost of intermediaries, and

(iv) the reasonableness of the developmental and operational costs of the project.

Clause (iii) shall not be applied so as to impede the development of projects in hard-to-develop areas. Such a determination shall not be construed to be a representation or warranty as to the feasibility or viability of the project.

(C) DETERMINATION MADE WHEN CREDIT AMOUNT APPLIED FOR AND WHEN BUILDING PLACED IN SERVICE.—

(i) IN GENERAL.—A determination under subparagraph (A) shall be made as of each of the following times:

(I) The application for the housing credit dollar amount.

(II) The allocation of the housing credit dollar amount.

(III) The date the building is placed in service.

(ii) CERTIFICATION AS TO AMOUNT OF OTHER SUBSIDIES.—Prior to each determination under clause (i), the taxpayer shall certify to the housing credit agency the full extent of all Federal, State, and local subsidies which apply (or which the taxpayer expects to apply) with respect to the building.

(D) APPLICATION TO BOND FINANCED PROJECTS.—Subsection (h)(4) shall not apply to any project unless the governmental unit which issued the bonds (or on behalf of which the bonds were issued) makes a determination under rules similar to the rules of subparagraphs (A) and (B).

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

(1) dealing with—

(A) projects which include more than 1 building or only a portion of a building,

(B) buildings which are placed in service in portions,

(2) providing for the application of this section to short taxable years,

(3) preventing the avoidance of the rules of this section, and

(4) providing the opportunity for housing credit agencies to correct administrative errors and omissions with respect to allocations and record keeping within a reasonable period after their discovery, taking into account the availability of regulations and other administrative guidance from the Secretary.

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PART VI—ALTERNATIVE MINIMUM TAX

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SEC. 56. ADJUSTMENTS IN COMPUTING ALTERNATIVE MINIMUM TAXABLE INCOME.

(a) ADJUSTMENTS APPLICABLE TO ALL TAXPAYERS.—In determining the amount of the alternative minimum taxable income for

any taxable year the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

(1) DEPRECIATION.—

(A) IN GENERAL.—

(i) PROPERTY OTHER THAN CERTAIN PERSONAL PROPERTY.—Except as provided in clause (ii), the depreciation deduction allowable under section 167 with respect to any tangible property placed in service after December 31, 1986, shall be determined under the alternative system of section 168(g). In the case of property placed in service after December 31, 1998, the preceding sentence shall not apply but clause (ii) shall continue to apply.

(ii) 150-PERCENT DECLINING BALANCE METHOD FOR CERTAIN PROPERTY.—The method of depreciation used shall be—

(I) the 150 percent declining balance method,

(II) switching to the straight line method for the 1st taxable year for which using the straight line method with respect to the adjusted basis as of the beginning of the year will yield a higher allowance.

The preceding sentence shall not apply to any section 1250 property (as defined in section 1250(c)) (and the straight line method shall be used for such section 1250 property) or to any other property if the depreciation deduction determined under section 168 with respect to such other property for purposes of the regular tax is determined by using the straight line method.

(B) EXCEPTION FOR CERTAIN PROPERTY.—This paragraph shall not apply to property described in paragraph (1), (2), (3), or (4) of section 168(f), or in section 168(e)(3)(C)(iv).

(C) COORDINATION WITH TRANSITIONAL RULES.—

(i) IN GENERAL.—This paragraph shall not apply to property placed in service after December 31, 1986, to which the amendments made by section 201 of the Tax Reform Act of 1986 do not apply by reason of section 203, 204, or 251(d) of such Act.

(ii) TREATMENT OF CERTAIN PROPERTY PLACED IN SERVICE BEFORE 1987.—This paragraph shall apply to any property to which the amendments made by section 201 of the Tax Reform Act of 1986 apply by reason of an election under section 203(a)(1)(B) of such Act without regard to the requirement of subparagraph (A) that the property be placed in service after December 31, 1986.

(D) NORMALIZATION RULES.—With respect to public utility property described in section 168(i)(10), the Secretary shall prescribe the requirements of a normalization method of accounting for this section.

(2) MINING EXPLORATION AND DEVELOPMENT COSTS.—

(A) IN GENERAL.—With respect to each mine or other natural deposit (other than an oil, gas, or geothermal well) of the taxpayer, the amount allowable as a deduction under section 616(a) or 617(a) (determined without regard

to section 291(b)) in computing the regular tax for costs paid or incurred after December 31, 1986, shall be capitalized and amortized ratably over the 10-year period beginning with the taxable year in which the expenditures were made.

(B) LOSS ALLOWED.—If a loss is sustained with respect to any property described in subparagraph (A), a deduction shall be allowed for the expenditures described in subparagraph (A) for the taxable year in which such loss is sustained in an amount equal to the lesser of—

(i) the amount allowable under section 165(a) for the expenditures if they had remained capitalized, or

(ii) the amount of such expenditures which have not previously been amortized under subparagraph (A).

(3) TREATMENT OF CERTAIN LONG-TERM CONTRACTS.—In the case of any long-term contract entered into by the taxpayer on or after March 1, 1986, the taxable income from such contract shall be determined under the percentage of completion method of accounting (as modified by section 460(b)). For purposes of the preceding sentence, in the case of a contract described in section 460(e)(1), the percentage of the contract completed shall be determined under section 460(b)(1) by using the simplified procedures for allocation of costs prescribed under section 460(b)(3). The first sentence of this paragraph shall not apply to any home construction contract (as defined in section 460(e)(6)).

(4) ALTERNATIVE TAX NET OPERATING LOSS DEDUCTION.—The alternative tax net operating loss deduction shall be allowed in lieu of the net operating loss deduction allowed under section 172.

(5) POLLUTION CONTROL FACILITIES.—In the case of any certified pollution control facility placed in service after December 31, 1986, the deduction allowable under section 169 (without regard to section 291) shall be determined under the alternative system of section 168(g). In the case of such a facility placed in service after December 31, 1998, such deduction shall be determined under section 168 using the straight line method.

(6) ADJUSTED BASIS.—The adjusted basis of any property to which paragraph (1) or (5) applies (or with respect to which there are any expenditures to which paragraph (2) or subsection (b)(2) applies) shall be determined on the basis of the treatment prescribed in paragraph (1), (2), or (5), or subsection (b)(2), whichever applies.

(7) SECTION 87 NOT APPLICABLE.—Section 87 (relating to alcohol fuel credit) shall not apply.

(b) ADJUSTMENTS APPLICABLE TO INDIVIDUALS.—In determining the amount of the alternative minimum taxable income of any taxpayer (other than a corporation), the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

(1) LIMITATION ON DEDUCTIONS.—

(A) IN GENERAL.—No deduction shall be allowed—

(i) for any miscellaneous itemized deduction (as defined in section 67(b)), or

(ii) for any taxes described in paragraph (1), (2), or (3) of section 164(a) or clause (ii) of section 164(b)(5)(A).

Clause (ii) shall not apply to any amount allowable in computing adjusted gross income.

(B) INTEREST.—In determining the amount allowable as a deduction for interest, subsections (d) and (h) of section 163 shall apply, except that—

(i) in lieu of the exception under section 163(h)(2)(D), the term "personal interest" shall not include any qualified housing interest (as defined in subsection (e)),

(ii) interest on any specified private activity bond (and any amount treated as interest on a specified private activity bond under section 57(a)(5)(B)), and any deduction referred to in section 57(a)(5)(A), shall be treated as includible in gross income (or as deductible) for purposes of applying section 163(d),

(iii) in lieu of the exception under section 163(d)(3)(B)(i), the term "investment interest" shall not include any qualified housing interest (as defined in subsection (e)), and

(iv) the adjustments of this section and sections 57 and 58 shall apply in determining net investment income under section 163(d).

(C) TREATMENT OF CERTAIN RECOVERIES.—No recovery of any tax to which subparagraph (A)(ii) applied shall be included in gross income for purposes of determining alternative minimum taxable income.

(D) STANDARD DEDUCTION AND DEDUCTION FOR PERSONAL EXEMPTIONS NOT ALLOWED.—The standard deduction under section 63(c), the deduction for personal exemptions under section 151, and the deduction under section 642(b) shall not be allowed.

(E) SECTION 68 NOT APPLICABLE.—Section 68 shall not apply.

(2) CIRCULATION AND RESEARCH AND EXPERIMENTAL EXPENDITURES.—

(A) IN GENERAL.—The amount allowable as a deduction under section 173 or [174(a)] *174A(a)* in computing the regular tax for amounts paid or incurred after December 31, 1986, shall be capitalized and—

(i) in the case of circulation expenditures described in section 173, shall be amortized ratably over the 3-year period beginning with the taxable year in which the expenditures were made, or

(ii) in the case of research and experimental expenditures described in section [174(a)] *174A(a)*, shall be amortized ratably over the 10-year period beginning with the taxable year in which the expenditures were made.

(B) LOSS ALLOWED.—If a loss is sustained with respect to any property described in subparagraph (A), a deduction shall be allowed for the expenditures described in subpara-

graph (A) for the taxable year in which such loss is sustained in an amount equal to the lesser of—

(i) the amount allowable under section 165(a) for the expenditures if they had remained capitalized, or

(ii) the amount of such expenditures which have not previously been amortized under subparagraph (A).

(C) EXCEPTION FOR CERTAIN RESEARCH AND EXPERIMENTAL EXPENDITURES.—If the taxpayer materially participates (within the meaning of section 469(h)) in an activity, this paragraph shall not apply to any amount allowable as a deduction under section [174(a)] *174A(a)* for expenditures paid or incurred in connection with such activity.

(3) TREATMENT OF INCENTIVE STOCK OPTIONS.—Section 421 shall not apply to the transfer of stock acquired pursuant to the exercise of an incentive stock option (as defined in section 422). Section 422(c)(2) shall apply in any case where the disposition and the inclusion for purposes of this part are within the same taxable year and such section shall not apply in any other case. The adjusted basis of any stock so acquired shall be determined on the basis of the treatment prescribed by this paragraph.

(d) ALTERNATIVE TAX NET OPERATING LOSS DEDUCTION DEFINED.—

(1) IN GENERAL.—For purposes of subsection (a)(4), the term "alternative tax net operating loss deduction" means the net operating loss deduction allowable for the taxable year under section 172, except that—

(A) the amount of such deduction shall not exceed the sum of—

(i) the lesser of—

(I) the amount of such deduction attributable to net operating losses (other than the deduction described in clause (ii)(I)), or

(II) 90 percent of alternative minimum taxable income determined without regard to such deduction and the deduction under section 199 plus

(ii) the lesser of—

(I) the amount of such deduction attributable to an applicable net operating loss with respect to which an election is made under section 172(b)(1)(H) (as in effect before its repeal by the Tax Increase Prevention Act of 2014), or

(II) alternative minimum taxable income determined without regard to such deduction and the deduction under section 199 [1] reduced by the amount determined under clause (i), and

(B) in determining the amount of such deduction—

(i) the net operating loss (within the meaning of section 172(c)) for any loss year shall be adjusted as provided in paragraph (2), and

(ii) appropriate adjustments in the application of section 172(b)(2) shall be made to take into account the limitation of subparagraph (A).

(2) ADJUSTMENTS TO NET OPERATING LOSS COMPUTATION.—

(A) POST-1986 LOSS YEARS.—In the case of a loss year beginning after December 31, 1986, the net operating loss for such year under section 172(c) shall—

(i) be determined with the adjustments provided in this section and section 58, and

(ii) be reduced by the items of tax preference determined under section 57 for such year.

An item of tax preference shall be taken into account under clause (ii) only to the extent such item increased the amount of the net operating loss for the taxable year under section 172(c).

(B) PRE-1987 YEARS.—In the case of loss years beginning before January 1, 1987, the amount of the net operating loss which may be carried over to taxable years beginning after December 31, 1986, for purposes of paragraph (2), shall be equal to the amount which may be carried from the loss year to the first taxable year of the taxpayer beginning after December 31, 1986.

(e) QUALIFIED HOUSING INTEREST.—For purposes of this part—

(1) IN GENERAL.—The term "qualified housing interest" means interest which is qualified residence interest (as defined in section 163(h)(3)) and is paid or accrued during the taxable year on indebtedness which is incurred in acquiring, constructing, or substantially improving any property which—

(A) is the principal residence (within the meaning of section 121) of the taxpayer at the time such interest accrues, or

(B) is a qualified dwelling which is a qualified residence (within the meaning of section 163(h)(4)).

Such term also includes interest on any indebtedness resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence; but only to the extent that the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness immediately before the refinancing.

(2) QUALIFIED DWELLING.—The term "qualified dwelling" means any—

(A) house,

(B) apartment,

(C) condominium, or

(D) mobile home not used on a transient basis (within the meaning of section 7701(a)(19)(C)(v)),

including all structures or other property appurtenant thereto.

(3) SPECIAL RULE FOR INDEBTEDNESS INCURRED BEFORE JULY 1, 1982.—The term "qualified housing interest" includes interest which is qualified residence interest (as defined in section 163(h)(3)) and is paid or accrued on indebtedness which—

(A) was incurred by the taxpayer before July 1, 1982, and

(B) is secured by property which, at the time such indebtedness was incurred, was—

(i) the principal residence (within the meaning of section 121) of the taxpayer, or

(ii) a qualified dwelling used by the taxpayer (or any member of his family (within the meaning of section 267(c)(4))).

* * * * * * *

SEC. 59. OTHER DEFINITIONS AND SPECIAL RULES.

(a) ALTERNATIVE MINIMUM TAX FOREIGN TAX CREDIT.—For purposes of this part—

(1) IN GENERAL.—The alternative minimum tax foreign tax credit for any taxable year shall be the credit which would be determined under section 27 for such taxable year if—

(A) the pre-credit tentative minimum tax were the tax against which such credit was taken for purposes of section 904 for the taxable year and all prior taxable years beginning after December 31, 1986,

(B) section 904 were applied on the basis of alternative minimum taxable income instead of taxable income, and

(C) the determination of whether any income is high-taxed income for purposes of section 904(d)(2) were made on the basis of the applicable rate specified in section 55(b)(1) in lieu of the highest rate of tax specified in section 1.

(2) PRE-CREDIT TENTATIVE MINIMUM TAX.—For purposes of this subsection, the term "pre-credit tentative minimum tax" means the amount determined under the first sentence of section 55(b)(1)(A).

(3) ELECTION TO USE SIMPLIFIED SECTION 904 LIMITATION.—

(A) IN GENERAL.—In determining the alternative minimum tax foreign tax credit for any taxable year to which an election under this paragraph applies—

(i) subparagraph (B) of paragraph (1) shall not apply, and

(ii) the limitation of section 904 shall be based on the proportion which—

(I) the taxpayer's taxable income (as determined for purposes of the regular tax) from sources without the United States (but not in excess of the taxpayer's entire alternative minimum taxable income), bears to

(II) the taxpayer's entire alternative minimum taxable income for the taxable year.

(B) ELECTION.—

(i) IN GENERAL.—An election under this paragraph may be made only for the taxpayer's first taxable year which begins after December 31, 1997, and for which the taxpayer claims an alternative minimum tax foreign tax credit.

(ii) ELECTION REVOCABLE ONLY WITH CONSENT.—An election under this paragraph, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(c) TREATMENT OF ESTATES AND TRUSTS.—In the case of any estate or trust, the alternative minimum taxable income of such estate or trust and any beneficiary thereof shall be determined by ap-

plying part I of subchapter J with the adjustments provided in this part.

(d) APPORTIONMENT OF DIFFERENTLY TREATED ITEMS IN CASE OF CERTAIN ENTITIES.—

(1) IN GENERAL.—The differently treated items for the taxable year shall be apportioned (in accordance with regulations prescribed by the Secretary)—

(A) REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—In the case of a regulated investment company to which part I of subchapter M applies or a real estate investment company to which part II of subchapter M applies, between such company or trust and shareholders and holders of beneficial interest in such company or trust.

(B) COMMON TRUST FUNDS.—In the case of a common trust fund (as defined in section 584(a)), pro rata among the participants of such fund.

(2) DIFFERENTLY TREATED ITEMS.—For purposes of this section, the term "differently treated item" means any item of tax preference or any other item which is treated differently for purposes of this part than for purposes of computing the regular tax.

(e) OPTIONAL 10-YEAR WRITEOFF OF CERTAIN TAX PREFERENCES.—

(1) IN GENERAL.—For purposes of this title, any qualified expenditure to which an election under this paragraph applies shall be allowed as a deduction ratably over the 10-year period (3-year period in the case of circulation expenditures described in section 173) beginning with the taxable year in which such expenditure was made (or, in the case of a qualified expenditure described in paragraph (2)(C), over the 60-month period beginning with the month in which such expenditure was paid or incurred).

(2) QUALIFIED EXPENDITURE.—For purposes of this subsection, the term "qualified expenditure" means any amount which, but for an election under this subsection, would have been allowable as a deduction (determined without regard to section 291) for the taxable year in which paid or incurred under—

(A) section 173 (relating to circulation expenditures),

(B) ⟦section 174(a) (relating to research and experimental expenditures)⟧ *section 174A(a) (relating to temporary rules for domestic research and experimental expenditures)*,

(C) section 263(c) (relating to intangible drilling and development expenditures),

(D) section 616(a) (relating to development expenditures), or

(E) section 617(a) (relating to mining exploration expenditures).

(3) OTHER SECTIONS NOT APPLICABLE.—Except as provided in this subsection, no deduction shall be allowed under any other section for any qualified expenditure to which an election under this subsection applies.

(4) ELECTION.—

(A) IN GENERAL.—An election may be made under paragraph (1) with respect to any portion of any qualified expenditure.

(B) REVOCABLE ONLY WITH CONSENT.—Any election under this subsection may be revoked only with the consent of the Secretary.

(C) PARTNERS AND SHAREHOLDERS OF S CORPORATIONS.—In the case of a partnership, any election under paragraph (1) shall be made separately by each partner with respect to the partner's allocable share of any qualified expenditure. A similar rule shall apply in the case of an S corporation and its shareholders.

(5) DISPOSITIONS.—

(A) APPLICATION OF SECTION 1254.—In the case of any disposition of property to which section 1254 applies (determined without regard to this section), any deduction under paragraph (1) with respect to amounts which are allocable to such property shall, for purposes of section 1254, be treated as a deduction allowable under section 263(c), 616(a), or 617(a), whichever is appropriate.

(B) APPLICATION OF SECTION 617(D).—In the case of any disposition of mining property to which section 617(d) applies (determined without regard to this subsection), any deduction under paragraph (1) with respect to amounts which are allocable to such property shall, for purposes of section 617(d), be treated as a deduction allowable under section 617(a).

(6) AMOUNTS TO WHICH ELECTION APPLY NOT TREATED AS TAX PREFERENCE.—Any portion of any qualified expenditure to which an election under paragraph (1) applies shall not be treated as an item of tax preference under section 57(a) and section 56 shall not apply to such expenditure.

(g) TAX BENEFIT RULE.—The Secretary may prescribe regulations under which differently treated items shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's regular tax for the taxable year for which the item is taken into account or for any other taxable year.

(h) COORDINATION WITH CERTAIN LIMITATIONS.—The limitations of sections 704(d), 465, and 1366(d) (and such other provisions as may be specified in regulations) shall be applied for purposes of computing the alternative minimum taxable income of the taxpayer for the taxable year with the adjustments of sections 56, 57, and 58.

(i) SPECIAL RULE FOR AMOUNTS TREATED AS TAX PREFERENCE.—For purposes of this subtitle (other than this part), any amount shall not fail to be treated as wholly exempt from tax imposed by this subtitle solely by reason of being included in alternative minimum taxable income.

(j) TREATMENT OF UNEARNED INCOME OF MINOR CHILDREN.—

(1) IN GENERAL.—In the case of a child to whom section 1(g) applies, the exemption amount for purposes of section 55 shall not exceed the sum of—

(A) such child's earned income (as defined in section 911(d)(2)) for the taxable year, plus

(B) $5,000.

(2) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 1998, the dollar amount in paragraph (1)(B) shall be increased by an amount equal to the product of—

(A) such dollar amount, and

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "1997" for "2016" in subparagraph (A)(ii) thereof.

If any increase determined under the preceding sentence is not a multiple of $50, such increase shall be rounded to the nearest multiple of $50.

(k) APPLICABLE CORPORATION.—For purposes of this part—

(1) APPLICABLE CORPORATION DEFINED.—

(A) IN GENERAL.—The term "applicable corporation" means, with respect to any taxable year, any corporation (other than an S corporation, a regulated investment company, or a real estate investment trust) which meets the average annual adjusted financial statement income test of subparagraph (B) for one or more taxable years which—

(i) are prior to such taxable year, and

(ii) end after December 31, 2021.

(B) AVERAGE ANNUAL ADJUSTED FINANCIAL STATEMENT INCOME TEST.—For purposes of this subsection—

(i) a corporation meets the average annual adjusted financial statement income test for a taxable year if the average annual adjusted financial statement income of such corporation (determined without regard to section 56A(d)) for the 3-taxable-year period ending with such taxable year exceeds $1,000,000,000, and

(ii) in the case of a corporation described in paragraph (2), such corporation meets the average annual adjusted financial statement income test for a taxable year if—

(I) the corporation meets the requirements of clause (i) for such taxable year (determined after the application of paragraph (2)), and

(II) the average annual adjusted financial statement income of such corporation (determined without regard to the application of paragraph (2) and without regard to section 56A(d)) for the 3-taxable-year-period ending with such taxable year is $100,000,000 or more.

(C) EXCEPTION.—Notwithstanding subparagraph (A), the term "applicable corporation" shall not include any corporation which otherwise meets the requirements of subparagraph (A) if—

(i) such corporation—

(I) has a change in ownership, or

(II) has a specified number (to be determined by the Secretary and which shall, as appropriate, take into account the facts and circumstances of the taxpayer) of consecutive taxable years, including the most recent taxable year, in which the cor-

poration does not meet the average annual adjusted financial statement income test of subparagraph (B), and

(ii) the Secretary determines that it would not be appropriate to continue to treat such corporation as an applicable corporation.

The preceding sentence shall not apply to any corporation if, after the Secretary makes the determination described in clause (ii), such corporation meets the average annual adjusted financial statement income test of subparagraph (B) for any taxable year beginning after the first taxable year for which such determination applies.

(D) SPECIAL RULES FOR DETERMINING APPLICABLE CORPORATION STATUS.—Solely for purposes of determining whether a corporation is an applicable corporation under this paragraph, all adjusted financial statement income of persons treated as a single employer with such corporation under subsection (a) or (b) of section 52 shall be treated as adjusted financial statement income of such corporation, and adjusted financial statement income of such corporation shall be determined without regard to paragraphs (2)(D)(i) and (11) of section 56A(c).

(E) OTHER SPECIAL RULES.—

(i) CORPORATIONS IN EXISTENCE FOR LESS THAN 3 YEARS.—If the corporation was in existence for less than 3-taxable years, subparagraph (B) shall be applied on the basis of the period during which such corporation was in existence.

(ii) SHORT TAXABLE YEARS.—Adjusted financial statement income for any taxable year of less than 12 months shall be annualized by multiplying the adjusted financial statement income for the short period by 12 and dividing the result by the number of months in the short period.

(iii) TREATMENT OF PREDECESSORS.—Any reference in this subparagraph to a corporation shall include a reference to any predecessor of such corporation.

(2) SPECIAL RULE FOR FOREIGN-PARENTED MULTINATIONAL GROUPS.—

(A) IN GENERAL.—If a corporation is a member of a foreign-parented multinational group for any taxable year, then, solely for purposes of determining whether such corporation meets the average annual adjusted financial statement income test under paragraph (1)(B)(ii)(I) for such taxable year, the adjusted financial statement income of such corporation for such taxable year shall include the adjusted financial statement income of all members of such group. Solely for purposes of this subparagraph, adjusted financial statement income shall be determined without regard to paragraphs (2)(D)(i), (3), (4), and (11) of section 56A(c).

(B) FOREIGN-PARENTED MULTINATIONAL GROUP.—For purposes of subparagraph (A), the term "foreign-parented multinational group" means, with respect to any taxable year, two or more entities if—

(i) at least one entity is a domestic corporation and another entity is a foreign corporation,

(ii) such entities are included in the same applicable financial statement with respect to such year, and

(iii) either—

(I) the common parent of such entities is a foreign corporation, or

(II) if there is no common parent, the entities are treated as having a common parent which is a foreign corporation under subparagraph (D).

(C) FOREIGN CORPORATIONS ENGAGED IN A TRADE OR BUSINESS WITHIN THE UNITED STATES.—For purposes of this paragraph, if a foreign corporation is engaged in a trade or business within the United States, such trade or business shall be treated as a separate domestic corporation that is wholly owned by the foreign corporation.

(D) OTHER RULES.—The Secretary shall, applying the principles of this section, prescribe rules for the application of this paragraph, including rules for the determination of—

(i) the entities (if any) which are to be to be treated under subparagraph (B)(iii)(II) as having a common parent which is a foreign corporation,

(ii) the entities to be included in a foreign-parented multinational group, and

(iii) the common parent of a foreign-parented multinational group.

(3) REGULATIONS OR OTHER GUIDANCE.—The Secretary shall provide regulations or other guidance for the purposes of carrying out this subsection, including regulations or other guidance—

(A) providing a simplified method for determining whether a corporation meets the requirements of paragraph (1), and

'(B) addressing the application of this subsection to a corporation that experiences a change in ownership.

(l) CORPORATE AMT FOREIGN TAX CREDIT.—

(1) IN GENERAL.—For purposes of this part, if an applicable corporation chooses to have the benefits of subpart A of part III of subchapter N for any taxable year, the corporate AMT foreign tax credit for the taxable year of the applicable corporation is an amount equal to sum of—

(A) the lesser of—

(i) the aggregate of the applicable corporation's pro rata share (as determined under section 56A(c)(3)) of the amount of income, war profits, and excess profits taxes (within the meaning of section 901) imposed by any foreign country or possession of the United States which are—

(I) taken into account on the applicable financial statement of each controlled foreign corporation with respect to which the applicable corporation is a United States shareholder, and

(II) paid or accrued (for Federal income tax purposes) by each such controlled foreign corporation, or

(ii) the product of the amount of the adjustment under section 56A(c)(3) and the percentage specified in section 55(b)(2)(A)(i), and

(B) in the case of an applicable corporation that is a domestic corporation, the amount of income, war profits, and excess profits taxes (within the meaning of section 901) imposed by any foreign country or possession of the United States to the extent such taxes are—

(i) taken into account on the applicable corporation's applicable financial statement, and

(ii) paid or accrued (for Federal income tax purposes) by the applicable corporation.

(2) CARRYOVER OF EXCESS TAX PAID.—For any taxable year for which an applicable corporation chooses to have the benefits of subpart A of part III of subchapter N, the excess of the amount described in paragraph (1)(A)(i) over the amount described in paragraph (1)(A)(ii) shall increase the amount described in paragraph (1)(A)(i) in any of the first 5 succeeding taxable years to the extent not taken into account in a prior taxable year.

(3) REGULATIONS OR OTHER GUIDANCE.—The Secretary shall provide for such regulations or other guidance as is necessary to carry out the purposes of this subsection.

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Subchapter A—DETERMINATION OF TAX LIABILITY

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Subchapter B—COMPUTATION OF TAXABLE INCOME

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PART IV—TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS

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Subpart A—PRIVATE ACTIVITY BONDS

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SEC. 144. QUALIFIED SMALL ISSUE BOND; QUALIFIED STUDENT LOAN BOND; QUALIFIED REDEVELOPMENT BOND.

(a) QUALIFIED SMALL ISSUE BOND.—

(1) IN GENERAL.—For purposes of this part, the term "qualified small issue bond" means any bond issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and 95 percent or more of the net proceeds of which are to be used—

(A) for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or

(B) to redeem part or all of a prior issue which was issued for purposes described in subparagraph (A) or this subparagraph.

(2) CERTAIN PRIOR ISSUES TAKEN INTO ACCOUNT.—If—

(A) the proceeds of 2 or more issues of bonds (whether or not the issuer of each such issue is the same) are or will be used primarily with respect to facilities located in the same incorporated municipality or located in the same county (but not in any incorporated municipality),

(B) the principal user of such facilities is or will be the same person or 2 or more related persons, and

(C) but for this paragraph, paragraph (1) (or the corresponding provision of prior law) would apply to each such issue,

then, for purposes of paragraph (1), in determining the aggregate face amount of any later issue there shall be taken into account the aggregate face amount of tax-exempt bonds issued under all prior such issues and outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

(3) RELATED PERSONS.—For purposes of this subsection, a person is a related person to another person if—

(A) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), or

(B) such persons are members of the same controlled group of corporations (as defined in section 1563(a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein).

(4) $10,000,000 LIMIT IN CERTAIN CASES.—

(A) IN GENERAL.—At the election of the issuer with respect to any issue, this subsection shall be applied—

(i) by substituting "$10,000,000" for "$1,000,000" in paragraph (1), and

(ii) in determining the aggregate face amount of such issue, by taking into account not only the amount described in paragraph (2), but also the aggregate amount of capital expenditures with respect to facilities described in subparagraph (B) paid or incurred during the 6-year period beginning 3 years before the date of such issue and ending 3 years after such date (and financed otherwise than out of the proceeds of outstanding tax-exempt issues to which paragraph (1) (or the corresponding provision of prior law) applied), as if the aggregate amount of such capital expenditures constituted the face amount of a prior outstanding issue described in paragraph (2).

(B) FACILITIES TAKEN INTO ACCOUNT.—For purposes of subparagraph (A)(ii), the facilities described in this subparagraph are facilities—

(i) located in the same incorporated municipality or located in the same county (but not in any incorporated municipality), and

(ii) the principal user of which is or will be the same person or 2 or more related persons.

For purposes of clause (i), the determination of whether or not facilities are located in the same governmental unit shall be made as of the date of issue of the issue in question.

(C) CERTAIN CAPITAL EXPENDITURES NOT TAKEN INTO ACCOUNT.—For purposes of subparagraph (A)(ii), any capital expenditure—

(i) to replace property destroyed or damaged by fire, storm, or other casualty, to the extent of the fair market value of the property replaced,

(ii) required by a change made after the date of issue of the issue in question in a Federal or State law or local ordinance of general application or required by a change made after such date in rules and regulations of general application issued under such a law or ordinance,

(iii) required by circumstances which could not be reasonably foreseen on such date of issue or arising out of a mistake of law or fact (but the aggregate amount of expenditures not taken into account under this clause with respect to any issue shall not exceed $1,000,000), or

(iv) described in clause (i) or (ii) of section 41(b)(2)(A) for which a deduction was allowed under section [174(a)] *174A(a)*,

shall not be taken into account.

(D) LIMITATION ON LOSS OF TAX EXEMPTION.—In applying subparagraph (A)(ii) with respect to capital expenditures made after the date of any issue, no bond issued as a part of such issue shall cease to be treated as a qualified small issue bond by reason of any such expenditure for any period before the date on which such expenditure is paid or incurred.

(E) CERTAIN REFINANCING ISSUES.—In the case of any issue described in paragraph (1)(B), an election may be made under subparagraph (A) of this paragraph only if all of the prior issues being redeemed are issues to which paragraph (1) (or the corresponding provision of prior law) applied. In applying subparagraph (A)(ii) with respect to such a refinancing issue, capital expenditures shall be taken into account only for purposes of determining whether the prior issues being redeemed qualified (and would have continued to qualify) under paragraph (1) (or the corresponding provision of prior law).

(F) AGGREGATE AMOUNT OF CAPITAL EXPENDITURES WHERE THERE IS URBAN DEVELOPMENT ACTION GRANT.—In the case of any issue 95 percent or more of the net proceeds of which are to be used to provide facilities with respect to which an urban development action grant has been made under section 119 of the Housing and Commu-

nity Development Act of 1974, capital expenditures of not to exceed $10,000,000 shall not be taken into account for purposes of applying subparagraph (A)(ii). This subparagraph shall not apply to bonds issued after December 31, 2006.

(G) ADDITIONAL CAPITAL EXPENDITURES NOT TAKEN INTO ACCOUNT.—With respect to bonds issued after December 31, 2006, in addition to any capital expenditure described in subparagraph (C), capital expenditures of not to exceed $10,000,000 shall not be taken into account for purposes of applying subparagraph (A)(ii).

(5) ISSUES FOR RESIDENTIAL PURPOSES.—This subsection shall not apply to any bond issued as part of an issue 5 percent or more of the net proceeds of which are to be used directly or indirectly to provide residential real property for family units.

(6) LIMITATIONS ON TREATMENT OF BONDS AS PART OF THE SAME ISSUE.—

(A) IN GENERAL.—For purposes of this subsection, separate lots of bonds which (but for this subparagraph) would be treated as part of the same issue shall be treated as separate issues unless the proceeds of such lots are to be used with respect to 2 or more facilities—

(i) which are located in more than 1 State, or

(ii) which have, or will have, as the same principal user the same person or related persons.

(B) FRANCHISES.—For purposes of subparagraph (A), a person (other than a governmental unit) shall be considered a principal user of a facility if such person (or a group of related persons which includes such person)—

(i) guarantees, arranges, participates in, or assists with the issuance (or pays any portion of the cost of issuance) of any bond the proceeds of which are to be used to finance or refinance such facility, and

(ii) provides any property, or any franchise, trademark, or trade name (within the meaning of section 1253), which is to be used in connection with such facility.

(7) SUBSECTION NOT TO APPLY IF BONDS ISSUED WITH CERTAIN OTHER TAX-EXEMPT BONDS.—This subsection shall not apply to any bond issued as part of an issue (other than an issue to which paragraph (4) applies) if the interest on any other bond which is part of such issue is excluded from gross income under any provision of law other than this subsection.

(8) RESTRICTIONS ON FINANCING CERTAIN FACILITIES.—This subsection shall not apply to an issue if—

(A) more than 25 percent of the net proceeds of the issue are to be used to provide a facility the primary purpose of which is one of the following: retail food and beverage services, automobile sales or service, or the provision of recreation or entertainment; or

(B) any portion of the proceeds of the issue is to be used to provide the following: any private or commercial golf course, country club, massage parlor, tennis club, skating facility (including roller skating, skateboard, and ice skating), racquet sports facility (including any handball or

racquetball court), hot tub facility, suntan facility, or racetrack.

(9) AGGREGATION OF ISSUES WITH RESPECT TO SINGLE PROJECT.—For purposes of this subsection, 2 or more issues part or all of the net proceeds of which are to be used with respect to a single building, an enclosed shopping mall, or a strip of offices, stores, or warehouses using substantial common facilities shall be treated as 1 issue (and any person who is a principal user with respect to any of such issues shall be treated as a principal user with respect to the aggregated issue).

(10) AGGREGATE LIMIT PER TAXPAYER.—

(A) IN GENERAL.—This subsection shall not apply to any issue if the aggregate authorized face amount of such issue allocated to any test-period beneficiary (when increased by the outstanding tax-exempt facility-related bonds of such beneficiary) exceeds $40,000,000.

(B) OUTSTANDING TAX-EXEMPT FACILITY-RELATED BONDS.—

(i) IN GENERAL.—For purposes of applying subparagraph (A) with respect to any issue, the outstanding tax-exempt facility-related bonds of any person who is a test-period beneficiary with respect to such issue is the aggregate amount of tax-exempt bonds referred to in clause (ii)—

(I) which are allocated to such beneficiary, and

(II) which are outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

(ii) BONDS TAKEN INTO ACCOUNT.—For purposes of clause (i), the bonds referred to in this clause are—

(I) exempt facility bonds, qualified small issue bonds, and qualified redevelopment bonds, and

(II) industrial development bonds (as defined in section 103(b)(2), as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) to which section 141(a) does not apply.

(C) ALLOCATION OF FACE AMOUNT OF ISSUE.—

(i) IN GENERAL.—Except as otherwise provided in regulations, the portion of the face amount of an issue allocated to any test-period beneficiary of a facility financed by the proceeds of such issue (other than an owner of such facility) is an amount which bears the same relationship to the entire face amount of such issue as the portion of such facility used by such beneficiary bears to the entire facility.

(ii) OWNERS.—Except as otherwise provided in regulations, the portion of the face amount of an issue allocated to any test-period beneficiary who is an owner of a facility financed by the proceeds of such issue is an amount which bears the same relationship to the entire face amount of such issue as the portion of such facility owned by such beneficiary bears to the entire facility.

(D) TEST-PERIOD BENEFICIARY.—For purposes of this paragraph, except as provided in regulations, the term "test-period beneficiary" means any person who is an owner or a principal user of facilities being financed by the issue at any time during the 3-year period beginning on the later of—

(i) the date such facilities were placed in service, or

(ii) the date of issue.

(E) TREATMENT OF RELATED PERSONS.—For purposes of this paragraph, all persons who are related (within the meaning of paragraph (3)) to each other shall be treated as 1 person.

(11) LIMITATION ON ACQUISITION OF DEPRECIABLE FARM PROPERTY.—

(A) IN GENERAL.—This subsection shall not apply to any issue if more than $250,000 of the net proceeds of such issue are to be used to provide depreciable farm property with respect to which the principal user is or will be the same person or 2 or more related persons.

(B) DEPRECIABLE FARM PROPERTY.—For purposes of this paragraph, the term "depreciable farm property" means property of a character subject to the allowance for depreciation which is to be used in a trade or business of farming.

(C) PRIOR ISSUES TAKEN INTO ACCOUNT.—In determining the amount of proceeds of an issue to be used as described in subparagraph (A), there shall be taken into account the aggregate amount of each prior issue to which paragraph (1) (or the corresponding provisions of prior law) applied which were or will be so used.

(12) TERMINATION DATES.—

(A) IN GENERAL.—This subsection shall not apply to—

(i) any bond (other than a bond described in clause (ii)) issued after December 31, 1986, or

(ii) any bond (or series of bonds) issued to refund a bond issued on or before such date unless—

(I) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue,

(II) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

(III) the net proceeds of the refunding bond are used to redeem the refunded bond not later than 90 days after the date of the issuance of the refunding bond.

For purposes of clause (ii)(I), average maturity shall be determined in accordance with section 147(b)(2)(A).

(B) BONDS ISSUED TO FINANCE MANUFACTURING FACILITIES AND FARM PROPERTY.—Subparagraph (A) shall not apply to any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide—

(i) any manufacturing facility, or

(ii) any land or property in accordance with section 147(c)(2).

(C) MANUFACTURING FACILITY.—For purposes of this paragraph—

(i) IN GENERAL.—The term "manufacturing facility" means any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). A rule similar to the rule of section 142(b)(2) shall apply for purposes of the preceding sentence.

(ii) CERTAIN FACILITIES INCLUDED.—Such term includes facilities which are directly related and ancillary to a manufacturing facility (determined without regard to this clause) if—

(I) such facilities are located on the same site as the manufacturing facility, and

(II) not more than 25 percent of the net proceeds of the issue are used to provide such facilities.

(iii) SPECIAL RULES FOR BONDS ISSUED IN 2009 AND 2010.—In the case of any issue made after the date of enactment of this clause and before January 1, 2011, clause (ii) shall not apply and the net proceeds from a bond shall be considered to be used to provide a manufacturing facility if such proceeds are used to provide—

(I) a facility which is used in the creation or production of intangible property which is described in section 197(d)(1)(C)(iii), or

(II) a facility which is functionally related and subordinate to a manufacturing facility (determined without regard to this subclause) if such facility is located on the same site as the manufacturing facility.

(b) QUALIFIED STUDENT LOAN BOND.—For purposes of this part—

(1) IN GENERAL.—The term "qualified student loan bond" means any bond issued as part of an issue the applicable percentage or more of the net proceeds of which are to be used directly or indirectly to make or finance student loans under—

(A) a program of general application to which the Higher Education Act of 1965 applies if—

(i) limitations are imposed under the program on—

(I) the maximum amount of loans outstanding to any student, and

(II) the maximum rate of interest payable on any loan,

(ii) the loans are directly or indirectly guaranteed by the Federal Government,

(iii) the financing of loans under the program is not limited by Federal law to the proceeds of tax-exempt bonds, and

(iv) special allowance payments under section 438 of the Higher Education Act of 1965—

(I) are authorized to be paid with respect to loans made under the program, or

(II) would be authorized to be made with respect to loans under the program if such loans were not financed with the proceeds of tax-exempt bonds, or

(B) a program of general application approved by the State if no loan under such program exceeds the difference between the total cost of attendance and other forms of student assistance (not including loans pursuant to section 428B(a)(1) of the Higher Education Act of 1965 (relating to parent loans) or subpart I of part C of title VII of the Public Health Service Act (relating to student assistance)) for which the student borrower may be eligible. A program shall not be treated as described in this subparagraph if such program is described in subparagraph (A).

A bond shall not be treated as a qualified student loan bond if the issue of which such bond is a part meets the private business tests of paragraphs (1) and (2) of section 141(b) (determined by treating 501(c)(3) organizations as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying section 513(a)).

(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term "applicable percentage" means—

(A) 90 percent in the case of the program described in paragraph (1)(A), and

(B) 95 percent in the case of the program described in paragraph (1)(B).

(3) STUDENT BORROWERS MUST BE RESIDENTS OF ISSUING STATE, ETC..—A student loan shall be treated as being made or financed under a program described in paragraph (1) with respect to an issue only if the student is—

(A) a resident of the State from which the volume cap under section 146 for such loan was derived, or

(B) enrolled at an educational institution located in such State.

(4) DISCRIMINATION ON BASIS OF SCHOOL LOCATION NOT PERMITTED.—A program shall not be treated as described in paragraph (1)(A) if such program discriminates on the basis of the location (in the United States) of the educational institution in which the student is enrolled.

(c) QUALIFIED REDEVELOPMENT BOND.—For purposes of this part—

(1) IN GENERAL.—The term "qualified redevelopment bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used for 1 or more redevelopment purposes in any designated blighted area.

(2) ADDITIONAL REQUIREMENTS.—A bond shall not be treated as a qualified redevelopment bond unless—

(A) the issue described in paragraph (1) is issued pursuant to—

(i) a State law which authorizes the issuance of such bonds for redevelopment purposes in blighted areas, and

(ii) a redevelopment plan which is adopted before such issuance by the governing body described in paragraph (4)(A) with respect to the designated blighted area,

(B)(i) the payment of the principal and interest on such issue is primarily secured by taxes of general applicability imposed by a general purpose governmental unit, or

(ii) any increase in real property tax revenues (attributable to increases in assessed value) by reason of the carrying out of such purposes in such area is reserved exclusively for debt service on such issue (and similar issues) to the extent such increase does not exceed such debt service,

(C) each interest in real property located in such area—

(i) which is acquired by a governmental unit with the proceeds of the issue, and

(ii) which is transferred to a person other than a governmental unit,

is transferred for fair market value,

(D) the financed area with respect to such issue meets the no additional charge requirements of paragraph (5), and

(E) the use of the proceeds of the issue meets the requirements of paragraph (6).

(3) REDEVELOPMENT PURPOSES.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "redevelopment purposes" means, with respect to any designated blighted area—

(i) the acquisition (by a governmental unit having the power to exercise eminent domain) of real property located in such area,

(ii) the clearing and preparation for redevelopment of land in such area which was acquired by such governmental unit,

(iii) the rehabilitation of real property located in such area which was acquired by such governmental unit, and

(iv) the relocation of occupants of such real property.

(B) NEW CONSTRUCTION NOT PERMITTED.—The term "redevelopment purposes" does not include the construction (other than the rehabilitation) of any property or the enlargement of an existing building.

(4) DESIGNATED BLIGHTED AREA.—For purposes of this subsection—

(A) IN GENERAL.—The term "designated blighted area" means any blighted area designated by the governing body of a local general purpose governmental unit in the jurisdiction of which such area is located.

(B) BLIGHTED AREA.—The term "blighted area" means any area which the governing body described in subparagraph (A) determines to be a blighted area on the basis of the substantial presence of factors such as excessive vacant land on which structures were previously located, abandoned or vacant buildings, substandard structures, vacancies, and delinquencies in payment of real property taxes.

(C) DESIGNATED AREAS MAY NOT EXCEED 20 PERCENT OF TOTAL ASSESSED VALUE OF REAL PROPERTY IN GOVERNMENT'S JURISDICTION.—

(i) IN GENERAL.—An area may be designated by a governmental unit as a blighted area only if the designation percentage with respect to such area, when added to the designation percentages of all other designated blighted areas within the jurisdiction of such governmental unit, does not exceed 20 percent.

(ii) DESIGNATION PERCENTAGE.—For purposes of this subparagraph, the term "designation percentage" means, with respect to any area, the percentage (determined at the time such area is designated) which the assessed value of real property located in such area is of the total assessed value of all real property located within the jurisdiction of the governmental unit which designated such area.

(iii) EXCEPTION WHERE BONDS NOT OUTSTANDING.—The designation percentage of a previously designated blighted area shall not be taken into account under clause (i) if no qualified redevelopment bond (or similar bond) is or will be outstanding with respect to such area.

(D) MINIMUM DESIGNATED AREA.—

(i) IN GENERAL.—Except as provided in clause (ii), an area shall not be treated as a designated blighted area for purposes of this subsection unless such area is contiguous and compact and its area equals or exceeds 100 acres.

(ii) 10-ACRE MINIMUM IN CERTAIN CASES.—Clause (i) shall be applied by substituting "10 acres" for "100 acres" if not more than 25 percent of the financed area is to be provided (pursuant to the issue and all other such issues) to 1 person. For purposes of the preceding sentence, all related persons (as defined in subsection (a)(3)) shall be treated as 1 person. For purposes of this clause, an area provided to a developer on a short-term interim basis shall not be treated as provided to such developer.

(5) NO ADDITIONAL CHARGE REQUIREMENTS.—The financed area with respect to any issue meets the requirements of this paragraph if, while any bond which is part of such issue is outstanding—

(A) no owner or user of property located in the financed area is subject to a charge or fee which similarly situated owners or users of comparable property located outside such area are not subject, and

(B) the assessment method or rate of real property taxes with respect to property located in the financed area does not differ from the assessment method or rate of real property taxes with respect to comparable property located outside such area.

For purposes of the preceding sentence, the term "comparable property" means property which is of the same type as the

property to which it is being compared and which is located within the jurisdiction of the designating governmental unit.

(6) USE OF PROCEEDS REQUIREMENTS.—The use of the proceeds of an issue meets the requirements of this paragraph if—

(A) not more than 25 percent of the net proceeds of such issue are to be used to provide (including the provision of land for) facilities described in subsection (a)(8) or section 147(e), and

(B) no portion of the proceeds of such issue is to be used to provide (including the provision of land for) any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

(7) FINANCED AREA.—For purposes of this subsection, the term "financed area" means, with respect to any issue, the portion of the designated blighted area with respect to which the proceeds of such issue are to be used.

(8) RESTRICTION ON ACQUISITION OF LAND NOT TO APPLY.—Section 147(c) (other than paragraphs (1)(B) and (2) thereof) shall not apply to any qualified redevelopment bond.

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PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

Sec.
Sec. 161. Allowance of deductions.

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Sec. 174. Amortization of research and experimental expenditures.
Sec. 174A. Temporary rules for domestic research and experiemental expenditures.

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SEC. 163. INTEREST.

(a) GENERAL RULE.—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

(b) INSTALLMENT PURCHASES WHERE INTEREST CHARGE IS NOT SEPARATELY STATED.—

(1) GENERAL RULE.—If personal property or educational services are purchased under a contract—

(A) which provides that payment of part or all of the purchase price is to be made in installments, and

(B) in which carrying charges are separately stated but the interest charge cannot be ascertained,

then the payments made during the taxable year under the contract shall be treated for purposes of this section as if they included interest equal to 6 percent of the average unpaid balance under the contract during the taxable year. For purposes of the preceding sentence, the average unpaid balance is the sum of the unpaid balance outstanding on the first day of each month beginning during the taxable year, divided by 12. For purposes of this paragraph, the term "educational services" means any service (including lodging) which is purchased from

an educational organization described in section 170(b)(1)(A)(ii) and which is provided for a student of such organization.

(2) LIMITATION.—In the case of any contract to which paragraph (1) applies, the amount treated as interest for any taxable year shall not exceed the aggregate carrying charges which are properly attributable to such taxable year.

(c) REDEEMABLE GROUND RENTS.—For purposes of this subtitle, any annual or periodic rental under a redeemable ground rent (excluding amounts in redemption thereof) shall be treated as interest on an indebtedness secured by a mortgage.

(d) LIMITATION ON INVESTMENT INTEREST.—

(1) IN GENERAL.—In the case of a taxpayer other than a corporation, the amount allowed as a deduction under this chapter for investment interest for any taxable year shall not exceed the net investment income of the taxpayer for the taxable year.

(2) CARRYFORWARD OF DISALLOWED INTEREST.—The amount not allowed as a deduction for any taxable year by reason of paragraph (1) shall be treated as investment interest paid or accrued by the taxpayer in the succeeding taxable year.

(3) INVESTMENT INTEREST.—For purposes of this subsection—

(A) IN GENERAL.—The term "investment interest" means any interest allowable as a deduction under this chapter (determined without regard to paragraph (1)) which is paid or accrued on indebtedness properly allocable to property held for investment.

(B) EXCEPTIONS.—The term "investment interest" shall not include—

(i) any qualified residence interest (as defined in subsection (h)(3)), or

(ii) any interest which is taken into account under section 469 in computing income or loss from a passive activity of the taxpayer.

(C) PERSONAL PROPERTY USED IN SHORT SALE.—For purposes of this paragraph, the term "interest" includes any amount allowable as a deduction in connection with personal property used in a short sale.

(4) NET INVESTMENT INCOME.—For purposes of this subsection—

(A) IN GENERAL.—The term "net investment income" means the excess of—

(i) investment income, over

(ii) investment expenses.

(B) INVESTMENT INCOME.—The term "investment income" means the sum of—

(i) gross income from property held for investment (other than any gain taken into account under clause (ii)(I)),

(ii) the excess (if any) of—

(I) the net gain attributable to the disposition of property held for investment, over

(II) the net capital gain determined by only taking into account gains and losses from dispositions of property held for investment, plus

(iii) so much of the net capital gain referred to in clause (ii)(II) (or, if lesser, the net gain referred to in clause (ii)(I)) as the taxpayer elects to take into account under this clause.

Such term shall include qualified dividend income (as defined in section 1(h)(11)(B)) only to the extent the taxpayer elects to treat such income as investment income for purposes of this subsection.

(C) INVESTMENT EXPENSES.—The term "investment expenses" means the deductions allowed under this chapter (other than for interest) which are directly connected with the production of investment income.

(D) INCOME AND EXPENSES FROM PASSIVE ACTIVITIES.—Investment income and investment expenses shall not include any income or expenses taken into account under section 469 in computing income or loss from a passive activity.

(5) PROPERTY HELD FOR INVESTMENT.—For purposes of this subsection—

(A) IN GENERAL.—The term "property held for investment" shall include—

(i) any property which produces income of a type described in section 469(e)(1), and

(ii) any interest held by a taxpayer in an activity involving the conduct of a trade or business—

(I) which is not a passive activity, and

(II) with respect to which the taxpayer does not materially participate.

(B) INVESTMENT EXPENSES.—In the case of property described in subparagraph (A)(i), expenses shall be allocated to such property in the same manner as under section 469.

(C) TERMS.—For purposes of this paragraph, the terms "activity", "passive activity", and "materially participate" have the meanings given such terms by section 469.

(e) ORIGINAL ISSUE DISCOUNT.—

(1) IN GENERAL.—The portion of the original issue discount with respect to any debt instrument which is allowable as a deduction to the issuer for any taxable year shall be equal to the aggregate daily portions of the original issue discount for days during such taxable year.

(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) DEBT INSTRUMENT.—The term "debt instrument" has the meaning given such term by section 1275(a)(1).

(B) DAILY PORTIONS.—The daily portion of the original issue discount for any day shall be determined under section 1272(a) (without regard to paragraph (7) thereof and without regard to section 1273(a)(3)).

(C) SHORT-TERM OBLIGATIONS.—In the case of an obligor of a short-term obligation (as defined in section 1283(a)(1)(A)) who uses the cash receipts and disbursements method of accounting, the original issue discount (and any other interest payable) on such obligation shall be deductible only when paid.

(3) SPECIAL RULE FOR ORIGINAL ISSUE DISCOUNT ON OBLIGATION HELD BY RELATED FOREIGN PERSON.—

(A) IN GENERAL.—If any debt instrument having original issue discount is held by a related foreign person, any portion of such original issue discount shall not be allowable as a deduction to the issuer until paid. The preceding sentence shall not apply to the extent that the original issue discount is effectively connected with the conduct by such foreign related person of a trade or business within the United States unless such original issue discount is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

(B) SPECIAL RULE FOR CERTAIN FOREIGN ENTITIES.—

(i) IN GENERAL.—In the case of any debt instrument having original issue discount which is held by a related foreign person which is a controlled foreign corporation (as defined in section 957) or a passive foreign investment company (as defined in section 1297), a deduction shall be allowable to the issuer with respect to such original issue discount for any taxable year before the taxable year in which paid only to the extent such original issue discount is includible (determined without regard to properly allocable deductions and qualified deficits under section 952(c)(1)(B)) during such prior taxable year in the gross income of a United States person who owns (within the meaning of section 958(a)) stock in such corporation.

(ii) SECRETARIAL AUTHORITY.—The Secretary may by regulation exempt transactions from the application of clause (i), including any transaction which is entered into by a payor in the ordinary course of a trade or business in which the payor is predominantly engaged.

(C) RELATED FOREIGN PERSON.—For purposes of subparagraph (A), the term "related foreign person" means any person—

(i) who is not a United States person, and

(ii) who is related (within the meaning of section 267(b)) to the issuer.

(4) EXCEPTION.—This subsection shall not apply to any debt instrument described in section 1272(a)(2)(D) (relating to loans between natural persons).

(5) SPECIAL RULES FOR ORIGINAL ISSUE DISCOUNT ON CERTAIN HIGH YIELD OBLIGATIONS.—

(A) IN GENERAL.—In the case of an applicable high yield discount obligation issued by a corporation—

(i) no deduction shall be allowed under this chapter for the disqualified portion of the original issue discount on such obligation, and

(ii) the remainder of such original issue discount shall not be allowable as a deduction until paid.

For purposes of this paragraph, rules similar to the rules of subsection (i)(3)(B) shall apply in determining the amount of the original issue discount and when the original issue discount is paid.

(B) DISQUALIFIED PORTION TREATED AS STOCK DISTRIBUTION FOR PURPOSES OF DIVIDEND RECEIVED DEDUCTION.—

(i) IN GENERAL.—Solely for purposes of sections 243, 245, 246, and 246A, the dividend equivalent portion of any amount includible in gross income of a corporation under section 1272(a) in respect of an applicable high yield discount obligation shall be treated as a dividend received by such corporation from the corporation issuing such obligation.

(ii) DIVIDEND EQUIVALENT PORTION.—For purposes of clause (i), the dividend equivalent portion of any amount includible in gross income under section 1272(a) in respect of an applicable high yield discount obligation is the portion of the amount so includible—

(I) which is attributable to the disqualified portion of the original issue discount on such obligation, and

(II) which would have been treated as a dividend if it had been a distribution made by the issuing corporation with respect to stock in such corporation.

(C) DISQUALIFIED PORTION.—

(i) IN GENERAL.—For purposes of this paragraph, the disqualified portion of the original issue discount on any applicable high yield discount obligation is the lesser of—

(I) the amount of such original issue discount, or

(II) the portion of the total return on such obligation which bears the same ratio to such total return as the disqualified yield on such obligation bears to the yield to maturity on such obligation.

(ii) DEFINITIONS.—For purposes of clause (i), the term "disqualified yield" means the excess of the yield to maturity on the obligation over the sum referred to in subsection (i)(1)(B) plus 1 percentage point, and the term "total return" is the amount which would have been the original issue discount on the obligation if interest described in the parenthetical in section 1273(a)(2) were included in the stated redemption price at maturity.

(D) EXCEPTION FOR S CORPORATIONS.—This paragraph shall not apply to any obligation issued by any corporation for any period for which such corporation is an S corporation.

(E) EFFECT ON EARNINGS AND PROFITS.—This paragraph shall not apply for purposes of determining earnings and profits; except that, for purposes of determining the dividend equivalent portion of any amount includible in gross income under section 1272(a) in respect of an applicable high yield discount obligation, no reduction shall be made for any amount attributable to the disqualified portion of any original issue discount on such obligation.

(F) SUSPENSION OF APPLICATION OF PARAGRAPH.—

(i) TEMPORARY SUSPENSION.—This paragraph shall not apply to any applicable high yield discount obliga-

tion issued during the period beginning on September 1, 2008, and ending on December 31, 2009, in exchange (including an exchange resulting from a modification of the debt instrument) for an obligation which is not an applicable high yield discount obligation and the issuer (or obligor) of which is the same as the issuer (or obligor) of such applicable high yield discount obligation. The preceding sentence shall not apply to any obligation the interest on which is interest described in section 871(h)(4) (without regard to subparagraph (D) thereof) or to any obligation issued to a related person (within the meaning of section 108(e)(4)).

(ii) SUCCESSIVE APPLICATION.—Any obligation to which clause (i) applies shall not be treated as an applicable high yield discount obligation for purposes of applying this subparagraph to any other obligation issued in exchange for such obligation.

(iii) SECRETARIAL AUTHORITY TO SUSPEND APPLICATION.—The Secretary may apply this paragraph with respect to debt instruments issued in periods following the period described in clause (i) if the Secretary determines that such application is appropriate in light of distressed conditions in the debt capital markets.

(G) CROSS REFERENCE.—For definition of applicable high yield discount obligation, see subsection (i).

(6) CROSS REFERENCES.—For provision relating to deduction of original issue discount on tax-exempt obligation, see section 1288.

For special rules in the case of the borrower under certain loans for personal use, see section 1275(b).

(f) DENIAL OF DEDUCTION FOR INTEREST ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide a deduction for interest on any registration-required obligation unless such obligation is in registered form.

(2) REGISTRATION-REQUIRED OBLIGATION.—For purposes of this section—

(A) IN GENERAL.—The term "registration-required obligation" means any obligation (including any obligation issued by a governmental entity) other than an obligation which—

(i) is issued by a natural person,

(ii) is not of a type offered to the public, or

(iii) has a maturity (at issue) of not more than 1 year.

(B) AUTHORITY TO INCLUDE OTHER OBLIGATIONS.—Clauses (ii) and (iii) of subparagraph (A) shall not apply to any obligation if—

(i) such obligation is of a type which the Secretary has determined by regulations to be used frequently in avoiding Federal taxes, and

(ii) such obligation is issued after the date on which the regulations referred to in clause (i) take effect.

(3) BOOK ENTRIES PERMITTED, ETC..—For purposes of this subsection, rules similar to the rules of section 149(a)(3) shall apply, except that a dematerialized book entry system or other book entry system specified by the Secretary shall be treated as a book entry system described in such section.

(g) REDUCTION OF DEDUCTION WHERE SECTION 25 CREDIT TAKEN.—The amount of the deduction under this section for interest paid or accrued during any taxable year on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 shall be reduced by the amount of the credit allowable with respect to such interest under section 25 (determined without regard to section 26).

(h) DISALLOWANCE OF DEDUCTION FOR PERSONAL INTEREST.—

(1) IN GENERAL.—In the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year.

(2) PERSONAL INTEREST.—For purposes of this subsection, the term "personal interest" means any interest allowable as a deduction under this chapter other than—

(A) interest paid or accrued on indebtedness properly allocable to a trade or business (other than the trade or business of performing services as an employee),

(B) any investment interest (within the meaning of subsection (d)),

(C) any interest which is taken into account under section 469 in computing income or loss from a passive activity of the taxpayer,

(D) any qualified residence interest (within the meaning of paragraph (3)),

(E) any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6163, and

(F) any interest allowable as a deduction under section 221 (relating to interest on educational loans).

(3) QUALIFIED RESIDENCE INTEREST.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified residence interest" means any interest which is paid or accrued during the taxable year on—

(i) acquisition indebtedness with respect to any qualified residence of the taxpayer, or

(ii) home equity indebtedness with respect to any qualified residence of the taxpayer.

For purposes of the preceding sentence, the determination of whether any property is a qualified residence of the taxpayer shall be made as of the time the interest is accrued.

(B) ACQUISITION INDEBTEDNESS.—

(i) IN GENERAL.—The term "acquisition indebtedness" means any indebtedness which—

(I) is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and

(II) is secured by such residence.

Such term also includes any indebtedness secured by such residence resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence (or this sentence); but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

(ii) $1,000,000 LIMITATION.—The aggregate amount treated as acquisition indebtedness for any period shall not exceed $1,000,000 ($500,000 in the case of a married individual filing a separate return).

(C) HOME EQUITY INDEBTEDNESS.—

(i) IN GENERAL.—The term "home equity indebtedness" means any indebtedness (other than acquisition indebtedness) secured by a qualified residence to the extent the aggregate amount of such indebtedness does not exceed—

(I) the fair market value of such qualified residence, reduced by

(II) the amount of acquisition indebtedness with respect to such residence.

(ii) LIMITATION.—The aggregate amount treated as home equity indebtedness for any period shall not exceed $100,000 ($50,000 in the case of a separate return by a married individual).

(D) TREATMENT OF INDEBTEDNESS INCURRED ON OR BEFORE OCTOBER 13, 1987.—

(i) IN GENERAL.—In the case of any pre-October 13, 1987, indebtedness—

(I) such indebtedness shall be treated as acquisition indebtedness, and

(II) the limitation of subparagraph (B)(ii) shall not apply.

(ii) REDUCTION IN $1,000,000 LIMITATION.—The limitation of subparagraph (B)(ii) shall be reduced (but not below zero) by the aggregate amount of outstanding pre-October 13, 1987, indebtedness.

(iii) PRE-OCTOBER 13, 1987, INDEBTEDNESS.—The term "pre-October 13, 1987, indebtedness" means—

(I) any indebtedness which was incurred on or before October 13, 1987, and which was secured by a qualified residence on October 13, 1987, and at all times thereafter before the interest is paid or accrued, or

(II) any indebtedness which is secured by the qualified residence and was incurred after October 13, 1987, to refinance indebtedness described in subclause (I) (or refinanced indebtedness meeting the requirements of this subclause) to the extent (immediately after the refinancing) the principal amount of the indebtedness resulting from the refinancing does not exceed the principal amount of the refinanced indebtedness (immediately before the refinancing).

(iv) LIMITATION ON PERIOD OF REFINANCING.—Subclause (II) of clause (iii) shall not apply to any indebtedness after—

(I) the expiration of the term of the indebtedness described in clause (iii)(I), or

(II) if the principal of the indebtedness described in clause (iii)(I) is not amortized over its term, the expiration of the term of the 1st refinancing of such indebtedness (or if earlier, the date which is 30 years after the date of such 1st refinancing).

(E) MORTGAGE INSURANCE PREMIUMS TREATED AS INTEREST.—

(i) IN GENERAL.—Premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness with respect to a qualified residence of the taxpayer shall be treated for purposes of this section as interest which is qualified residence interest.

(ii) PHASEOUT.—The amount otherwise treated as interest under clause (i) shall be reduced (but not below zero) by 10 percent of such amount for each $1,000 ($500 in the case of a married individual filing a separate return) (or fraction thereof) that the taxpayer's adjusted gross income for the taxable year exceeds $100,000 ($50,000 in the case of a married individual filing a separate return).

(iii) LIMITATION.—Clause (i) shall not apply with respect to any mortgage insurance contracts issued before January 1, 2007.

(iv) TERMINATION.—Clause (i) shall not apply to amounts—

(I) paid or accrued after December 31, 2021, or

(II) properly allocable to any period after such date.

(F) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—

(i) IN GENERAL.—In the case of taxable years beginning after December 31, 2017, and before January 1, 2026—

(I) DISALLOWANCE OF HOME EQUITY INDEBTEDNESS INTEREST.—Subparagraph (A)(ii) shall not apply.

(II) LIMITATION ON ACQUISITION INDEBTEDNESS.—Subparagraph (B)(ii) shall be applied by substituting "$750,000 ($375,000" for "$1,000,000 ($500,000".

(III) TREATMENT OF INDEBTEDNESS INCURRED ON OR BEFORE DECEMBER 15, 2017.—Subclause (II) shall not apply to any indebtedness incurred on or before December 15, 2017, and, in applying such subclause to any indebtedness incurred after such date, the limitation under such subclause shall be reduced (but not below zero) by the amount of any indebtedness incurred on or before December 15,

2017, which is treated as acquisition indebtedness for purposes of this subsection for the taxable year.

(IV) BINDING CONTRACT EXCEPTION.—In the case of a taxpayer who enters into a written binding contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, subclause (III) shall be applied by substituting "April 1, 2018" for "December 15, 2017".

(ii) TREATMENT OF LIMITATION IN TAXABLE YEARS AFTER DECEMBER 31, 2025.—In the case of taxable years beginning after December 31, 2025, the limitation under subparagraph (B)(ii) shall be applied to the aggregate amount of indebtedness of the taxpayer described in subparagraph (B)(i) without regard to the taxable year in which the indebtedness was incurred.

(iii) TREATMENT OF REFINANCINGS OF INDEBTEDNESS.—

(I) IN GENERAL.—In the case of any indebtedness which is incurred to refinance indebtedness, such refinanced indebtedness shall be treated for purposes of clause (i)(III) as incurred on the date that the original indebtedness was incurred to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

(II) LIMITATION ON PERIOD OF REFINANCING.—Subclause (I) shall not apply to any indebtedness after the expiration of the term of the original indebtedness or, if the principal of such original indebtedness is not amortized over its term, the expiration of the term of the 1st refinancing of such indebtedness (or if earlier, the date which is 30 years after the date of such 1st refinancing).

(iv) COORDINATION WITH EXCLUSION OF INCOME FROM DISCHARGE OF INDEBTEDNESS.—Section 108(h)(2) shall be applied without regard to this subparagraph.

(4) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) QUALIFIED RESIDENCE.—

(i) IN GENERAL.—The term "qualified residence" means—

(I) the principal residence (within the meaning of section 121) of the taxpayer, and

(II) 1 other residence of the taxpayer which is selected by the taxpayer for purposes of this subsection for the taxable year and which is used by the taxpayer as a residence (within the meaning of section 280A(d)(1)).

(ii) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If a married couple does not file a joint return for the taxable year—

(I) such couple shall be treated as 1 taxpayer for purposes of clause (i), and

(II) each individual shall be entitled to take into account 1 residence unless both individuals consent in writing to 1 individual taking into account the principal residence and 1 other residence.

(iii) RESIDENCE NOT RENTED.—For purposes of clause (i)(II), notwithstanding section 280A(d)(1), if the taxpayer does not rent a dwelling unit at any time during a taxable year, such unit may be treated as a residence for such taxable year.

(B) SPECIAL RULE FOR COOPERATIVE HOUSING CORPORATIONS.—Any indebtedness secured by stock held by the taxpayer as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as so defined) shall be treated as secured by the house or apartment which the taxpayer is entitled to occupy as such a tenant-stockholder. If stock described in the preceding sentence may not be used to secure indebtedness, indebtedness shall be treated as so secured if the taxpayer establishes to the satisfaction of the Secretary that such indebtedness was incurred to acquire such stock.

(C) UNENFORCEABLE SECURITY INTERESTS.—Indebtedness shall not fail to be treated as secured by any property solely because, under any applicable State or local homestead or other debtor protection law in effect on August 16, 1986, the security interest is ineffective or the enforceability of the security interest is restricted.

(D) SPECIAL RULES FOR ESTATES AND TRUSTS.—For purposes of determining whether any interest paid or accrued by an estate or trust is qualified residence interest, any residence held by such estate or trust shall be treated as a qualified residence of such estate or trust if such estate or trust establishes that such residence is a qualified residence of a beneficiary who has a present interest in such estate or trust or an interest in the residuary of such estate or trust.

(E) QUALIFIED MORTGAGE INSURANCE.—The term "qualified mortgage insurance" means—

(i) mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and

(ii) private mortgage insurance (as defined by section 2 of the Homeowners Protection Act of 1998 (12 U.S.C. 4901), as in effect on the date of the enactment of this subparagraph).

(F) SPECIAL RULES FOR PREPAID QUALIFIED MORTGAGE INSURANCE.—Any amount paid by the taxpayer for qualified mortgage insurance that is properly allocable to any mortgage the payment of which extends to periods that are after the close of the taxable year in which such amount is paid shall be chargeable to capital account and shall be treated as paid in such periods to which so allocated. No deduction shall be allowed for the unamortized balance of such account if such mortgage is satisfied before the end

of its term. The preceding sentences shall not apply to amounts paid for qualified mortgage insurance provided by the Department of Veterans Affairs or the Rural Housing Service.

(i) APPLICABLE HIGH YIELD DISCOUNT OBLIGATION.—

(1) IN GENERAL.—For purposes of this section, the term "applicable high yield discount obligation" means any debt instrument if—

(A) the maturity date of such instrument is more than 5 years from the date of issue,

(B) the yield to maturity on such instrument equals or exceeds the sum of—

(i) the applicable Federal rate in effect under section 1274(d) for the calendar month in which the obligation is issued, plus

(ii) 5 percentage points, and

(C) such instrument has significant original issue discount.

For purposes of subparagraph (B)(i), the Secretary may by regulation (i) permit a rate to be used with respect to any debt instrument which is higher than the applicable Federal rate if the taxpayer establishes to the satisfaction of the Secretary that such higher rate is based on the same principles as the applicable Federal rate and is appropriate for the term of the instrument, or (ii) permit, on a temporary basis, a rate to be used with respect to any debt instrument which is higher than the applicable Federal rate if the Secretary determines that such rate is appropriate in light of distressed conditions in the debt capital markets.

(2) SIGNIFICANT ORIGINAL ISSUE DISCOUNT.—For purposes of paragraph (1)(C), a debt instrument shall be treated as having significant original issue discount if—

(A) the aggregate amount which would be includible in gross income with respect to such instrument for periods before the close of any accrual period (as defined in section 1272(a)(5)) ending after the date 5 years after the date of issue, exceeds—

(B) the sum of—

(i) the aggregate amount of interest to be paid under the instrument before the close of such accrual period, and

(ii) the product of the issue price of such instrument (as defined in sections 1273(b) and 1274(a)) and its yield to maturity.

(3) SPECIAL RULES.—For purposes of determining whether a debt instrument is an applicable high yield discount obligation—

(A) any payment under the instrument shall be assumed to be made on the last day permitted under the instrument, and

(B) any payment to be made in the form of another obligation of the issuer (or a related person within the meaning of section 453(f)(1)) shall be assumed to be made when such obligation is required to be paid in cash or in property other than such obligation.

Except for purposes of paragraph (1)(B), any reference to an obligation in subparagraph (B) of this paragraph shall be treated as including a reference to stock.

(4) DEBT INSTRUMENT.—For purposes of this subsection, the term "debt instrument" means any instrument which is a debt instrument as defined in section 1275(a).

(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection and subsection (e)(5), including—

(A) regulations providing for modifications to the provisions of this subsection and subsection (e)(5) in the case of varying rates of interest, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments, conversion rights, or other circumstances where such modifications are appropriate to carry out the purposes of this subsection and subsection (e)(5), and

(B) regulations to prevent avoidance of the purposes of this subsection and subsection (e)(5) through the use of issuers other than C corporations, agreements to borrow amounts due under the debt instrument, or other arrangements.

(j) LIMITATION ON BUSINESS INTEREST.—

(1) IN GENERAL.—The amount allowed as a deduction under this chapter for any taxable year for business interest shall not exceed the sum of—

(A) the business interest income of such taxpayer for such taxable year,

(B) 30 percent of the adjusted taxable income of such taxpayer for such taxable year, plus

(C) the floor plan financing interest of such taxpayer for such taxable year.

The amount determined under subparagraph (B) shall not be less than zero.

(2) CARRYFORWARD OF DISALLOWED BUSINESS INTEREST.—The amount of any business interest not allowed as a deduction for any taxable year by reason of paragraph (1) shall be treated as business interest paid or accrued in the succeeding taxable year.

(3) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, paragraph (1) shall not apply to such taxpayer for such taxable year. In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if such taxpayer were a corporation or partnership.

(4) APPLICATION TO PARTNERSHIPS, ETC..—

(A) IN GENERAL.—In the case of any partnership—

(i) this subsection shall be applied at the partnership level and any deduction for business interest shall be taken into account in determining the nonseparately stated taxable income or loss of the partnership, and

(ii) the adjusted taxable income of each partner of such partnership—

(I) shall be determined without regard to such partner's distributive share of any items of income, gain, deduction, or loss of such partnership, and

(II) shall be increased by such partner's distributive share of such partnership's excess taxable income.

For purposes of clause (ii)(II), a partner's distributive share of partnership excess taxable income shall be determined in the same manner as the partner's distributive share of nonseparately stated taxable income or loss of the partnership.

(B) SPECIAL RULES FOR CARRYFORWARDS.—

(i) IN GENERAL.—The amount of any business interest not allowed as a deduction to a partnership for any taxable year by reason of paragraph (1) for any taxable year—

(I) shall not be treated under paragraph (2) as business interest paid or accrued by the partnership in the succeeding taxable year, and

(II) shall, subject to clause (ii), be treated as excess business interest which is allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership.

(ii) TREATMENT OF EXCESS BUSINESS INTEREST ALLOCATED TO PARTNERS.—If a partner is allocated any excess business interest from a partnership under clause (i) for any taxable year—

(I) such excess business interest shall be treated as business interest paid or accrued by the partner in the next succeeding taxable year in which the partner is allocated excess taxable income from such partnership, but only to the extent of such excess taxable income, and

(II) any portion of such excess business interest remaining after the application of subclause (I) shall, subject to the limitations of subclause (I), be treated as business interest paid or accrued in succeeding taxable years.

For purposes of applying this paragraph, excess taxable income allocated to a partner from a partnership for any taxable year shall not be taken into account under paragraph (1)(A) with respect to any business interest other than excess business interest from the partnership until all such excess business interest for such taxable year and all preceding taxable years has been treated as paid or accrued under clause (ii).

(iii) BASIS ADJUSTMENTS.—

(I) IN GENERAL.—The adjusted basis of a partner in a partnership interest shall be reduced (but not below zero) by the amount of excess business interest allocated to the partner under clause (i)(II).

(II) SPECIAL RULE FOR DISPOSITIONS.—If a partner disposes of a partnership interest, the adjusted basis of the partner in the partnership interest shall be increased immediately before the disposition by the amount of the excess (if any) of the amount of the basis reduction under subclause (I) over the portion of any excess business interest allocated to the partner under clause (i)(II) which has previously been treated under clause (ii) as business interest paid or accrued by the partner. The preceding sentence shall also apply to transfers of the partnership interest (including by reason of death) in a transaction in which gain is not recognized in whole or in part. No deduction shall be allowed to the transferor or transferee under this chapter for any excess business interest resulting in a basis increase under this subclause.

(C) EXCESS TAXABLE INCOME.—The term "excess taxable income" means, with respect to any partnership, the amount which bears the same ratio to the partnership's adjusted taxable income as—

(i) the excess (if any) of—

(I) the amount determined for the partnership under paragraph (1)(B), over

(II) the amount (if any) by which the business interest of the partnership, reduced by the floor plan financing interest, exceeds the business interest income of the partnership, bears to

(ii) the amount determined for the partnership under paragraph (1)(B).

(D) APPLICATION TO S CORPORATIONS.—Rules similar to the rules of subparagraphs (A) and (C) shall apply with respect to any S corporation and its shareholders.

(5) BUSINESS INTEREST.—For purposes of this subsection, the term "business interest" means any interest paid or accrued on indebtedness properly allocable to a trade or business. Such term shall not include investment interest (within the meaning of subsection (d)).

(6) BUSINESS INTEREST INCOME.—For purposes of this subsection, the term "business interest income" means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Such term shall not include investment income (within the meaning of subsection (d)).

(7) TRADE OR BUSINESS.—For purposes of this subsection—

(A) IN GENERAL.—The term "trade or business" shall not include—

(i) the trade or business of performing services as an employee,

(ii) any electing real property trade or business,

(iii) any electing farming business, or

(iv) the trade or business of the furnishing or sale of—

(I) electrical energy, water, or sewage disposal services,

(II) gas or steam through a local distribution system, or

(III) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.

(B) ELECTING REAL PROPERTY TRADE OR BUSINESS.—For purposes of this paragraph, the term "electing real property trade or business" means any trade or business which is described in section 469(c)(7)(C) and which makes an election under this subparagraph. Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.

(C) ELECTING FARMING BUSINESS.—For purposes of this paragraph, the term "electing farming business" means—

(i) a farming business (as defined in section 263A(e)(4)) which makes an election under this subparagraph, or

(ii) any trade or business of a specified agricultural or horticultural cooperative (as defined in section 199A(g)(2)) with respect to which the cooperative makes an election under this subparagraph.

Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.

(8) ADJUSTED TAXABLE INCOME.—For purposes of this subsection, the term "adjusted taxable income" means the taxable income of the taxpayer—

(A) computed without regard to—

(i) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business,

(ii) any business interest or business interest income,

(iii) the amount of any net operating loss deduction under section 172,

(iv) the amount of any deduction allowed under section 199A, and

(v) in the case of taxable years beginning before **[**January 1, 2022**]** *January 1, 2026*, any deduction allowable for depreciation, amortization, or depletion, and

(B) computed with such other adjustments as provided by the Secretary.

(9) FLOOR PLAN FINANCING INTEREST DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—The term "floor plan financing interest" means interest paid or accrued on floor plan financing indebtedness.

(B) FLOOR PLAN FINANCING INDEBTEDNESS.—The term "floor plan financing indebtedness" means indebtedness—

(i) used to finance the acquisition of motor vehicles held for sale or lease, and

(ii) secured by the inventory so acquired.

(C) MOTOR VEHICLE.—The term "motor vehicle" means a motor vehicle that is any of the following:

(i) Any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road.

(ii) A boat.

(iii) Farm machinery or equipment.

(10) SPECIAL RULE FOR TAXABLE YEARS BEGINNING IN 2019 AND 2020.—

(A) IN GENERAL.—

(i) IN GENERAL.—Except as provided in clause (ii) or (iii), in the case of any taxable year beginning in 2019 or 2020, paragraph (1)(B) shall be applied by substituting "50 percent" for "30 percent".

(ii) SPECIAL RULE FOR PARTNERSHIPS.—In the case of a partnership—

(I) clause (i) shall not apply to any taxable year beginning in 2019, but

(II) unless a partner elects not to have this subclause apply, in the case of any excess business interest of the partnership for any taxable year beginning in 2019 which is allocated to the partner under paragraph (4)(B)(i)(II)—

(aa) 50 percent of such excess business interest shall be treated as business interest which, notwithstanding paragraph (4)(B)(ii), is paid or accrued by the partner in the partner's first taxable year beginning in 2020 and which is not subject to the limits of paragraph (1), and

(bb) 50 percent of such excess business interest shall be subject to the limitations of paragraph (4)(B)(ii) in the same manner as any other excess business interest so allocated.

(iii) ELECTION OUT.—A taxpayer may elect, at such time and in such manner as the Secretary may prescribe, not to have clause (i) apply to any taxable year. Such an election, once made, may be revoked only with the consent of the Secretary. In the case of a partnership, any such election shall be made by the partnership and may be made only for taxable years beginning in 2020.

(B) ELECTION TO USE 2019 ADJUSTED TAXABLE INCOME FOR TAXABLE YEARS BEGINNING IN 2020.—

(i) IN GENERAL.—Subject to clause (ii), in the case of any taxable year beginning in 2020, the taxpayer may elect to apply this subsection by substituting the adjusted taxable income of the taxpayer for the last taxable year beginning in 2019 for the adjusted taxable income for such taxable year. In the case of a partner-

ship, any such election shall be made by the partnership.

(ii) SPECIAL RULE FOR SHORT TAXABLE YEARS.—If an election is made under clause (i) for a taxable year which is a short taxable year, the adjusted taxable income for the taxpayer's last taxable year beginning in 2019 which is substituted under clause (i) shall be equal to the amount which bears the same ratio to such adjusted taxable income determined without regard to this clause as the number of months in the short taxable year bears to 12

(11) CROSS REFERENCES.—(A) For requirement that an electing real property trade or business use the alternative depreciation system, see section 168(g)(1)(F).

(B) For requirement that an electing farming business use the alternative depreciation system, see section 168(g)(1)(G).

(k) SECTION 6166 INTEREST.—No deduction shall be allowed under this section for any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6166.

(l) DISALLOWANCE OF DEDUCTION ON CERTAIN DEBT INSTRUMENTS OF CORPORATIONS.—

(1) IN GENERAL.—No deduction shall be allowed under this chapter for any interest paid or accrued on a disqualified debt instrument.

(2) DISQUALIFIED DEBT INSTRUMENT.—For purposes of this subsection, the term "disqualified debt instrument" means any indebtedness of a corporation which is payable in equity of the issuer or a related party or equity held by the issuer (or any related party) in any other person.

(3) SPECIAL RULES FOR AMOUNTS PAYABLE IN EQUITY.—For purposes of paragraph (2), indebtedness shall be treated as payable in equity of the issuer or any other person only if—

(A) a substantial amount of the principal or interest is required to be paid or converted, or at the option of the issuer or a related party is payable in, or convertible into, such equity,

(B) a substantial amount of the principal or interest is required to be determined, or at the option of the issuer or a related party is determined, by reference to the value of such equity, or

(C) the indebtedness is part of an arrangement which is reasonably expected to result in a transaction described in subparagraph (A) or (B).

For purposes of this paragraph, principal or interest shall be treated as required to be so paid, converted, or determined if it may be required at the option of the holder or a related party and there is a substantial certainty the option will be exercised.

(4) CAPITALIZATION ALLOWED WITH RESPECT TO EQUITY OF PERSONS OTHER THAN ISSUER AND RELATED PARTIES.—If the disqualified debt instrument of a corporation is payable in equity held by the issuer (or any related party) in any other person (other than a related party), the basis of such equity shall

be increased by the amount not allowed as a deduction by reason of paragraph (1) with respect to the instrument.

(5) EXCEPTION FOR CERTAIN INSTRUMENTS ISSUED BY DEALERS IN SECURITIES.—For purposes of this subsection, the term "disqualified debt instrument" does not include indebtedness issued by a dealer in securities (or a related party) which is payable in, or by reference to, equity (other than equity of the issuer or a related party) held by such dealer in its capacity as a dealer in securities. For purposes of this paragraph, the term "dealer in securities" has the meaning given such term by section 475.

(6) RELATED PARTY.—For purposes of this subsection, a person is a related party with respect to another person if such person bears a relationship to such other person described in section 267(b) or 707(b).

(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations preventing avoidance of this subsection through the use of an issuer other than a corporation.

(m) INTEREST ON UNPAID TAXES ATTRIBUTABLE TO NONDISCLOSED REPORTABLE TRANSACTIONS.—No deduction shall be allowed under this chapter for any interest paid or accrued under section 6601 on any underpayment of tax which is attributable to the portion of any reportable transaction understatement (as defined in section 6662A(b)) with respect to which the requirement of section 6664(d)(2)(A) is not met.

(n) CROSS REFERENCES.—

(1) For disallowance of certain amounts paid in connection with insurance, endowment, or annuity contracts, see section 264.

(2) For disallowance of deduction for interest relating to tax-exempt income, see section 265(a)(2).

(3) For disallowance of deduction for carrying charges chargeable to capital account, see section 266.

(4) For disallowance of interest with respect to transactions between related taxpayers, see section 267.

(5) For treatment of redeemable ground rents and real property held subject to liabilities under redeemable ground rents, see section 1055.

* * * * * * *

SEC. 168. ACCELERATED COST RECOVERY SYSTEM.

(a) GENERAL RULE.—Except as otherwise provided in this section, the depreciation deduction provided by section 167(a) for any tangible property shall be determined by using—

(1) the applicable depreciation method,

(2) the applicable recovery period, and

(3) the applicable convention.

(b) APPLICABLE DEPRECIATION METHOD.—For purposes of this section—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the applicable depreciation method is—

(A) the 200 percent declining balance method,

(B) switching to the straight line method for the 1st taxable year for which using the straight line method with respect to the adjusted basis as of the beginning of such year will yield a larger allowance.

(2) 150 PERCENT DECLINING BALANCE METHOD IN CERTAIN CASES.—Paragraph (1) shall be applied by substituting "150 percent" for "200 percent" in the case of—

(A) any 15-year or 20-year property not referred to in paragraph (3),

(B) any property (other than property described in paragraph (3)) which is a qualified smart electric meter or qualified smart electric grid system, or

(C) any property (other than property described in paragraph (3)) with respect to which the taxpayer elects under paragraph (5) to have the provisions of this paragraph apply.

(3) PROPERTY TO WHICH STRAIGHT LINE METHOD APPLIES.—The applicable depreciation method shall be the straight line method in the case of the following property:

(A) Nonresidential real property.

(B) Residential rental property.

(C) Any railroad grading or tunnel bore.

(D) Property with respect to which the taxpayer elects under paragraph (5) to have the provisions of this paragraph apply.

(E) Property described in subsection (e)(3)(D)(ii).

(F) Water utility property described in subsection (e)(5).

(G) Qualified improvement property described in subsection (e)(6).

(4) SALVAGE VALUE TREATED AS ZERO.—Salvage value shall be treated as zero.

(5) ELECTION.—An election under paragraph (2)(D) or (3)(D) may be made with respect to 1 or more classes of property for any taxable year and once made with respect to any class shall apply to all property in such class placed in service during such taxable year. Such an election, once made, shall be irrevocable.

(c) APPLICABLE RECOVERY PERIOD.—For purposes of this section, the applicable recovery period shall be determined in accordance with the following table:

(d) APPLICABLE CONVENTION.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the applicable convention is the half-year convention.

(2) REAL PROPERTY.—In the case of—

(A) nonresidential real property,

(B) residential rental property, and

(C) any railroad grading or tunnel bore,

the applicable convention is the mid-month convention.

(3) SPECIAL RULE WHERE SUBSTANTIAL PROPERTY PLACED IN SERVICE DURING LAST 3 MONTHS OF TAXABLE YEAR.—

(A) IN GENERAL.—Except as provided in regulations, if during any taxable year—

(i) the aggregate bases of property to which this section applies placed in service during the last 3 months of the taxable year, exceed

(ii) 40 percent of the aggregate bases of property to which this section applies placed in service during such taxable year,

the applicable convention for all property to which this section applies placed in service during such taxable year shall be the mid-quarter convention.

(B) CERTAIN PROPERTY NOT TAKEN INTO ACCOUNT.—For purposes of subparagraph (A), there shall not be taken into account—

(i) any nonresidential real property, residential rental property, and railroad grading or tunnel bore, and

(ii) any other property placed in service and disposed of during the same taxable year.

(4) DEFINITIONS.—

(A) HALF-YEAR CONVENTION.—The half-year convention is a convention which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year.

(B) MID-MONTH CONVENTION.—The mid-month convention is a convention which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month.

(C) MID-QUARTER CONVENTION.—The mid-quarter convention is a convention which treats all property placed in service during any quarter of a taxable year (or disposed of during any quarter of a taxable year) as placed in service (or disposed of) on the mid-point of such quarter.

(e) CLASSIFICATION OF PROPERTY.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, property shall be classified under the following table:

(2) RESIDENTIAL RENTAL OR NONRESIDENTIAL REAL PROPERTY.—

(A) RESIDENTIAL RENTAL PROPERTY.—

(i) RESIDENTIAL RENTAL PROPERTY.—The term "residential rental property" means any building or structure if 80 percent or more of the gross rental income from such building or structure for the taxable year is rental income from dwelling units.

(ii) DEFINITIONS.—For purposes of clause (i)—

(I) the term "dwelling unit" means a house or apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, or other establishment more than one-half of the units in which are used on a transient basis, and

(II) if any portion of the building or structure is occupied by the taxpayer, the gross rental income from such building or structure shall include the rental value of the portion so occupied.

(B) NONRESIDENTIAL REAL PROPERTY.—The term "nonresidential real property" means section 1250 property which is not—

(i) residential rental property, or

(ii) property with a class life of less than 27.5 years.

(3) CLASSIFICATION OF CERTAIN PROPERTY.—

(A) 3-YEAR PROPERTY.—The term "3-year property" includes—

(i) any race horse—

(I) which is placed in service before January 1, 2022, and

(II) which is placed in service after December 31, 2021, and which is more than 2 years old at the time such horse is placed in service by such purchaser,

(ii) any horse other than a race horse which is more than 12 years old at the time it is placed in service, and

(iii) any qualified rent-to-own property.

(B) 5-YEAR PROPERTY.—The term "5-year property" includes—

(i) any automobile or light general purpose truck,

(ii) any semi-conductor manufacturing equipment,

(iii) any computer-based telephone central office switching equipment,

(iv) any qualified technological equipment,

(v) any section 1245 property used in connection with research and experimentation,

(vi) any property which—

(I) is described in subparagraph (A) of section 48(a)(3) (or would be so described if "solar or wind energy" were substituted for "solar energy" in clause (i) thereof and the last sentence of such section did not apply to such subparagraph),

(II) is described in paragraph (15) of section 48(*l*) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) and has a power production capacity of not greater than 80 megawatts, or

(III) is described in section 48(*l*)(3)(A)(ix) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), and

(vii) any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which is used in a farming business (as defined in section 263A(e)(4)), the original use of which commences with the taxpayer after December 31, 2017.

Nothing in any provision of law shall be construed to treat property as not being described in subclause (I) or (II) of clause (vi) by reason of being public utility property.

(C) 7-YEAR PROPERTY.—The term "7-year property" includes—

(i) any railroad track,

(ii) any motorsports entertainment complex,

(iii) any Alaska natural gas pipeline,

(iv) any natural gas gathering line the original use of which commences with the taxpayer after April 11, 2005, and

(v) any property which—

(I) does not have a class life, and

(II) is not otherwise classified under paragraph (2) or this paragraph.

(D) 10-YEAR PROPERTY.—The term "10-year property" includes—

(i) any single purpose agricultural or horticultural structure (within the meaning of subsection (i)(13)),

(ii) any tree or vine bearing fruit or nuts,

(iii) any qualified smart electric meter, and

(iv) any qualified smart electric grid system.

(E) 15-YEAR PROPERTY.—The term "15-year property" includes—

(i) any municipal wastewater treatment plant,

(ii) any telephone distribution plant and comparable equipment used for 2-way exchange of voice and data communications,

(iii) any section 1250 property which is a retail motor fuels outlet (whether or not food or other convenience items are sold at the outlet),

(iv) initial clearing and grading land improvements with respect to gas utility property,

(v) any section 1245 property (as defined in section 1245(a)(3)) used in the transmission at 69 or more kilovolts of electricity for sale and the original use of which commences with the taxpayer after April 11, 2005,

(vi) any natural gas distribution line the original use of which commences with the taxpayer after April 11, 2005, and which is placed in service before January 1, 2011, and

(vii) any qualified improvement property.

(F) 20-YEAR PROPERTY.—The term "20-year property" means initial clearing and grading land improvements with respect to any electric utility transmission and distribution plant.

(4) RAILROAD GRADING OR TUNNEL BORE.—The term "railroad grading or tunnel bore" means all improvements resulting from excavations (including tunneling), construction of embankments, clearings, diversions of roads and streams, sodding of slopes, and from similar work necessary to provide, construct, reconstruct, alter, protect, improve, replace, or restore a roadbed or right-of-way for railroad track.

(5) WATER UTILITY PROPERTY.—The term "water utility property" means property—

(A) which is an integral part of the gathering, treatment, or commercial distribution of water, and which, without regard to this paragraph, would be 20-year property, and

(B) any municipal sewer.

(6) QUALIFIED IMPROVEMENT PROPERTY.—

(A) IN GENERAL.—The term "qualified improvement property" means any improvement made by the taxpayer to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.

(B) CERTAIN IMPROVEMENTS NOT INCLUDED.—Such term shall not include any improvement for which the expenditure is attributable to—

(i) the enlargement of the building,

(ii) any elevator or escalator, or

(iii) the internal structural framework of the building.

(f) PROPERTY TO WHICH SECTION DOES NOT APPLY.—This section shall not apply to—

(1) CERTAIN METHODS OF DEPRECIATION.—Any property if—

(A) the taxpayer elects to exclude such property from the application of this section, and

(B) for the 1st taxable year for which a depreciation deduction would be allowable with respect to such property in the hands of the taxpayer, the property is properly depreciated under the unit-of-production method or any method of depreciation not expressed in a term of years (other than the retirement-replacement-betterment method or similar method).

(2) CERTAIN PUBLIC UTILITY PROPERTY.—Any public utility property (within the meaning of subsection (i)(10)) if the taxpayer does not use a normalization method of accounting.

(3) FILMS AND VIDEO TAPE.—Any motion picture film or video tape.

(4) SOUND RECORDINGS.—Any works which result from the fixation of a series of musical, spoken, or other sounds, regardless of the nature of the material (such as discs, tapes, or other phonorecordings) in which such sounds are embodied.

(5) CERTAIN PROPERTY PLACED IN SERVICE IN CHURNING TRANSACTIONS.—

(A) IN GENERAL.—Property—

(i) described in paragraph (4) of section 168(e) (as in effect before the amendments made by the Tax Reform Act of 1986), or

(ii) which would be described in such paragraph if such paragraph were applied by substituting "1987" for "1981" and "1986" for "1980" each place such terms appear.

(B) SUBPARAGRAPH (A)(II) NOT TO APPLY.—Clause (ii) of subparagraph (A) shall not apply to—

(i) any residential rental property or nonresidential real property,

(ii) any property if, for the 1st taxable year in which such property is placed in service—

(I) the amount allowable as a deduction under this section (as in effect before the date of the enactment of this paragraph) with respect to such property is greater than,

(II) the amount allowable as a deduction under this section (as in effect on or after such date and using the half-year convention) for such taxable year, or

(iii) any property to which this section (as amended by the Tax Reform Act of 1986) applied in the hands of the transferor.

(C) SPECIAL RULE.—In the case of any property to which this section would apply but for this paragraph, the depreciation deduction under section 167 shall be determined under the provisions of this section as in effect before the amendments made by section 201 of the Tax Reform Act of 1986.

(g) ALTERNATIVE DEPRECIATION SYSTEM FOR CERTAIN PROPERTY.—

(1) IN GENERAL.—In the case of—

(A) any tangible property which during the taxable year is used predominantly outside the United States,

(B) any tax-exempt use property,

(C) any tax-exempt bond financed property,

(D) any imported property covered by an Executive order under paragraph (6),

(E) any property to which an election under paragraph (7) applies,

(F) any property described in paragraph (8), and

(G) any property with a recovery period of 10 years or more which is held by an electing farming business (as defined in section 163(j)(7)(C)),

the depreciation deduction provided by section 167(a) shall be determined under the alternative depreciation system.

(2) ALTERNATIVE DEPRECIATION SYSTEM.—For purposes of paragraph (1), the alternative depreciation system is depreciation determined by using—

(A) the straight line method (without regard to salvage value),

(B) the applicable convention determined under subsection (d), and

(C) a recovery period determined under the following table:

(3) SPECIAL RULES FOR DETERMINING CLASS LIFE.—

(A) TAX-EXEMPT USE PROPERTY SUBJECT TO LEASE.—In the case of any tax-exempt use property subject to a lease, the recovery period used for purposes of paragraph (2) shall (notwithstanding any other subparagraph of this paragraph) in no event be less than 125 percent of the lease term.

(B) SPECIAL RULE FOR CERTAIN PROPERTY ASSIGNED TO CLASSES.—For purposes of paragraph (2), in the case of property described in any of the following subparagraphs of subsection (e)(3), the class life shall be determined as follows:

(C) QUALIFIED TECHNOLOGICAL EQUIPMENT.—In the case of any qualified technological equipment, the recovery period used for purposes of paragraph (2) shall be 5 years.

(D) AUTOMOBILES, ETC..—In the case of any automobile or light general purpose truck, the recovery period used for purposes of paragraph (2) shall be 5 years.

(E) CERTAIN REAL PROPERTY.—In the case of any section 1245 property which is real property with no class life, the recovery period used for purposes of paragraph (2) shall be 40 years.

(4) EXCEPTION FOR CERTAIN PROPERTY USED OUTSIDE UNITED STATES.—Subparagraph (A) of paragraph (1) shall not apply to—

(A) any aircraft which is registered by the Administrator of the Federal Aviation Agency and which is operated to and from the United States or is operated under contract with the United States;

(B) rolling stock which is used within and without the United States and which is—

(i) of a rail carrier subject to part A of subtitle IV of title 49, or

(ii) of a United States person (other than a corporation described in clause (i)) but only if the rolling stock is not leased to one or more foreign persons for periods aggregating more than 12 months in any 24-month period;

(C) any vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States;

(D) any motor vehicle of a United States person (as defined in section 7701(a)(30)) which is operated to and from the United States;

(E) any container of a United States person which is used in the transportation of property to and from the United States;

(F) any property (other than a vessel or an aircraft) of a United States person which is used for the purpose of exploring for, developing, removing, or transporting resources from the outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; (43 U.S.C. 1331));

(G) any property which is owned by a domestic corporation or by a United States citizen (other than a citizen entitled to the benefits of section 931 or 933) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States;

(H) any communications satellite (as defined in section 103(3) of the Communications Satellite Act of 1962, 47 U.S.C. 702(3)), or any interest therein, of a United States person;

(I) any cable, or any interest therein, of a domestic corporation engaged in furnishing telephone service to which section 168(i)(10)(C) applies (or of a wholly owned domestic subsidiary of such a corporation), if such cable is part of a submarine cable system which constitutes part of a communication link exclusively between the United States and one or more foreign countries;

(J) any property (other than a vessel or an aircraft) of a United States person which is used in international or territorial waters within the northern portion of the Western Hemisphere for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or deposits under such waters;

(K) any property described in section 48(*l*)(3)(A)(ix) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) which is owned by a United States person and which is used in international or territorial waters to generate energy for use in the United States; and

(L) any satellite (not described in subparagraph (H)) or other spacecraft (or any interest therein) held by a United States person if such satellite or other spacecraft was launched from within the United States.

For purposes of subparagraph (J), the term "northern portion of the Western Hemisphere" means the area lying west of the 30th meridian west of Greenwich, east of the international dateline, and north of the Equator, but not including any foreign country which is a country of South America.

(5) TAX-EXEMPT BOND FINANCED PROPERTY.—For purposes of this subsection—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term "tax-exempt bond financed property" means any property to the extent such property is financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a).

(B) ALLOCATION OF BOND PROCEEDS.—For purposes of subparagraph (A), the proceeds of any obligation shall be treated as used to finance property acquired in connection with the issuance of such obligation in the order in which such property is placed in service.

(C) QUALIFIED RESIDENTIAL RENTAL PROJECTS.—The term "tax-exempt bond financed property" shall not include any qualified residential rental project (within the meaning of section 142(a)(7)).

(6) IMPORTED PROPERTY.—

(A) COUNTRIES MAINTAINING TRADE RESTRICTIONS OR ENGAGING IN DISCRIMINATORY ACTS.—If the President determines that a foreign country—

(i) maintains nontariff trade restrictions, including variable import fees, which substantially burden United States commerce in a manner inconsistent with provisions of trade agreements, or

(ii) engages in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce,

the President may by Executive order provide for the application of paragraph (1)(D) to any article or class of articles manufactured or produced in such foreign country for such period as may be provided by such Executive order. Any period specified in the preceding sentence shall not apply to any property ordered before (or the construction, reconstruction, or erection of which began before) the date of the Executive order unless the President determines an earlier date to be in the public interest and specifies such date in the Executive order.

(B) IMPORTED PROPERTY.—For purposes of this subsection, the term "imported property" means any property if—

(i) such property was completed outside the United States, or

(ii) less than 50 percent of the basis of such property is attributable to value added within the United States.

For purposes of this subparagraph, the term "United States" includes the Commonwealth of Puerto Rico and the possessions of the United States.

(7) ELECTION TO USE ALTERNATIVE DEPRECIATION SYSTEM.—

(A) IN GENERAL.—If the taxpayer makes an election under this paragraph with respect to any class of property for any taxable year, the alternative depreciation system under this subsection shall apply to all property in such class placed in service during such taxable year. Notwithstanding the preceding sentence, in the case of nonresidential real property or residential rental property, such election may be made separately with respect to each property.

(B) ELECTION IRREVOCABLE.—An election under subparagraph (A), once made, shall be irrevocable.

(8) ELECTING REAL PROPERTY TRADE OR BUSINESS.—The property described in this paragraph shall consist of any nonresidential real property, residential rental property, and qualified improvement property held by an electing real property trade or business (as defined in 163(j)(7)(B)).

(h) TAX-EXEMPT USE PROPERTY.—

(1) IN GENERAL.—For purposes of this section—

(A) PROPERTY OTHER THAN NONRESIDENTIAL REAL PROPERTY.—Except as otherwise provided in this subsection, the term "tax-exempt use property" means that portion of any tangible property (other than nonresidential real property) leased to a tax-exempt entity.

(B) NONRESIDENTIAL REAL PROPERTY.—

(i) IN GENERAL.—In the case of nonresidential real property, the term "tax-exempt use property" means that portion of the property leased to a tax-exempt entity in a disqualified lease.

(ii) DISQUALIFIED LEASE.—For purposes of this subparagraph, the term "disqualified lease" means any lease of the property to a tax-exempt entity, but only if—

(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a) and such entity (or a related entity) participated in such financing,

(II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an option,

(III) such lease has a lease term in excess of 20 years, or

(IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and

such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

(iii) 35-PERCENT THRESHOLD TEST.—Clause (i) shall apply to any property only if the portion of such property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property.

(iv) TREATMENT OF IMPROVEMENTS.—For purposes of this subparagraph, improvements to a property (other than land) shall not be treated as a separate property.

(v) LEASEBACKS DURING 1ST 3 MONTHS OF USE NOT TAKEN INTO ACCOUNT.—Subclause (IV) of clause (ii) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).

(C) EXCEPTION FOR SHORT-TERM LEASES.—

(i) IN GENERAL.—Property shall not be treated as tax-exempt use property merely by reason of a short-term lease.

(ii) SHORT-TERM LEASE.—For purposes of clause (i), the term "short-term lease" means any lease the term of which is—

(I) less than 3 years, and

(II) less than the greater of 1 year or 30 percent of the property's present class life.

In the case of nonresidential real property and property with no present class life, subclause (II) shall not apply.

(D) EXCEPTION WHERE PROPERTY USED IN UNRELATED TRADE OR BUSINESS.—The term "tax-exempt use property" shall not include any portion of a property if such portion is predominantly used by the tax-exempt entity (directly or through a partnership of which such entity is a partner) in an unrelated trade or business the income of which is subject to tax under section 511. For purposes of subparagraph (B)(iii), any portion of a property so used shall not be treated as leased to a tax-exempt entity in a disqualified lease.

(E) NONRESIDENTIAL REAL PROPERTY DEFINED.—For purposes of this paragraph, the term "nonresidential real property" includes residential rental property.

(2) TAX-EXEMPT ENTITY.—

(A) IN GENERAL.—For purposes of this subsection, the term "tax-exempt entity" means—

(i) the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing,

(ii) an organization (other than a cooperative described in section 521) which is exempt from tax imposed by this chapter,

(iii) any foreign person or entity, and

(iv) any Indian tribal government described in section 7701(a)(40).

For purposes of applying this subsection, any Indian tribal government referred to in clause (iv) shall be treated in the same manner as a State.

(B) EXCEPTION FOR CERTAIN PROPERTY SUBJECT TO UNITED STATES TAX AND USED BY FOREIGN PERSON OR ENTITY.—Clause (iii) of subparagraph (A) shall not apply with respect to any property if more than 50 percent of the gross income for the taxable year derived by the foreign person or entity from the use of such property is—

(i) subject to tax under this chapter, or

(ii) included under section 951 in the gross income of a United States shareholder for the taxable year with or within which ends the taxable year of the controlled foreign corporation in which such income was derived.

For purposes of the preceding sentence, any exclusion or exemption shall not apply for purposes of determining the amount of the gross income so derived, but shall apply for purposes of determining the portion of such gross income subject to tax under this chapter.

(C) FOREIGN PERSON OR ENTITY.—For purposes of this paragraph, the term "foreign person or entity" means—

(i) any foreign government, any international organization, or any agency or instrumentality of any of the foregoing, and

(ii) any person who is not a United States person.

Such term does not include any foreign partnership or other foreign pass-thru entity.

(D) TREATMENT OF CERTAIN TAXABLE INSTRUMENTALITIES.—For purposes of this subsection, a corporation shall not be treated as an instrumentality of the United States or of any State or political subdivision thereof if—

(i) all of the activities of such corporation are subject to tax under this chapter, and

(ii) a majority of the board of directors of such corporation is not selected by the United States or any State or political subdivision thereof.

(E) CERTAIN PREVIOUSLY TAX-EXEMPT ORGANIZATIONS.—

(i) IN GENERAL.—For purposes of this subsection, an organization shall be treated as an organization described in subparagraph (A)(ii) with respect to any property (other than property held by such organization) if such organization was an organization (other than a cooperative described in section 521) exempt from tax imposed by this chapter at any time during the 5-year period ending on the date such property was first used by such organization. The preceding sentence and subparagraph (D)(ii) shall not apply to the Federal Home Loan Mortgage Corporation.

(ii) ELECTION NOT TO HAVE CLAUSE (I) APPLY.—

(I) IN GENERAL.—In the case of an organization formerly exempt from tax under section 501(a) as an organization described in section 501(c)(12), clause (i) shall not apply to such organization with respect to any property if such organization elects not to be exempt from tax under section 501(a) during the tax-exempt use period with respect to such property.

(II) TAX-EXEMPT USE PERIOD.—For purposes of subclause (I), the term "tax-exempt use period" means the period beginning with the taxable year in which the property described in subclause (I) is first used by the organization and ending with the close of the 15th taxable year following the last taxable year of the applicable recovery period of such property.

(III) ELECTION.—Any election under subclause (I), once made, shall be irrevocable.

(iii) TREATMENT OF SUCCESSOR ORGANIZATIONS.—Any organization which is engaged in activities substantially similar to those engaged in by a predecessor organization shall succeed to the treatment under this subparagraph of such predecessor organization.

(iv) FIRST USED.—For purposes of this subparagraph, property shall be treated as first used by the organization—

(I) when the property is first placed in service under a lease to such organization, or

(II) in the case of property leased to (or held by) a partnership (or other pass-thru entity) in which the organization is a member, the later of when such property is first used by such partnership or pass-thru entity or when such organization is first a member of such partnership or pass-thru entity.

(3) SPECIAL RULES FOR CERTAIN HIGH TECHNOLOGY EQUIPMENT.—

(A) EXEMPTION WHERE LEASE TERM IS 5 YEARS OR LESS.—For purposes of this section, the term "tax-exempt use property" shall not include any qualified technological equipment if the lease to the tax-exempt entity has a lease term of 5 years or less. Notwithstanding subsection (i)(3)(A)(i), in determining a lease term for purposes of the preceding sentence, there shall not be taken into account any option of the lessee to renew at the fair market value rent determined at the time of renewal; except that the aggregate period not taken into account by reason of this sentence shall not exceed 24 months.

(B) EXCEPTION FOR CERTAIN PROPERTY.—

(i) IN GENERAL.—For purposes of subparagraph (A), the term "qualified technological equipment" shall not include any property leased to a tax-exempt entity if—

(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a),

(II) such lease occurs after a sale (or other transfer) of the property by, or lease of such property from, such entity (or related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease, or

(III) such tax-exempt entity is the United States or any agency or instrumentality of the United States.

(ii) LEASEBACKS DURING 1ST 3 MONTHS OF USE NOT TAKEN INTO ACCOUNT.—Subclause (II) of clause (i) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).

(4) RELATED ENTITIES.—For purposes of this subsection—

(A)(i) Each governmental unit and each agency or instrumentality of a governmental unit is related to each other such unit, agency, or instrumentality which directly or indirectly derives its powers, rights, and duties in whole or in part from the same sovereign authority.

(ii) For purposes of clause (i), the United States, each State, and each possession of the United States shall be treated as a separate sovereign authority.

(B) Any entity not described in subparagraph (A)(i) is related to any other entity if the 2 entities have—

(i) significant common purposes and substantial common membership, or

(ii) directly or indirectly substantial common direction or control.

(C)(i) An entity is related to another entity if either entity owns (directly or through 1 or more entities) a 50 percent or greater interest in the capital or profits of the other entity.

(ii) For purposes of clause (i), entities treated as related under subparagraph (A) or (B) shall be treated as 1 entity.

(D) An entity is related to another entity with respect to a transaction if such transaction is part of an attempt by such entities to avoid the application of this subsection.

(5) TAX-EXEMPT USE OF PROPERTY LEASED TO PARTNERSHIPS, ETC., DETERMINED AT PARTNER LEVEL.—For purposes of this subsection—

(A) IN GENERAL.—In the case of any property which is leased to a partnership, the determination of whether any portion of such property is tax-exempt use property shall be made by treating each tax-exempt entity partner's proportionate share (determined under paragraph (6)(C)) of such property as being leased to such partner.

(B) OTHER PASS-THRU ENTITIES; TIERED ENTITIES.—Rules similar to the rules of subparagraph (A) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

(C) PRESUMPTION WITH RESPECT TO FOREIGN ENTITIES.—Unless it is otherwise established to the satisfaction of the Secretary, it shall be presumed that the partners of a foreign partnership (and the beneficiaries of any other foreign pass-thru entity) are persons who are not United States persons.

(6) TREATMENT OF PROPERTY OWNED BY PARTNERSHIPS, ETC..—

(A) IN GENERAL.—For purposes of this subsection, if—

(i) any property which (but for this subparagraph) is not tax-exempt use property is owned by a partnership

which has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, and

(ii) any allocation to the tax-exempt entity of partnership items is not a qualified allocation,

an amount equal to such tax-exempt entity's proportionate share of such property shall (except as provided in paragraph (1)(D)) be treated as tax-exempt use property.

(B) QUALIFIED ALLOCATION.—For purposes of subparagraph (A), the term "qualified allocation" means any allocation to a tax-exempt entity which—

(i) is consistent with such entity's being allocated the same distributive share of each item of income, gain, loss, deduction, credit, and basis and such share remains the same during the entire period the entity is a partner in the partnership, and

(ii) has substantial economic effect within the meaning of section 704(b)(2).

For purposes of this subparagraph, items allocated under section 704(c) shall not be taken into account.

(C) DETERMINATION OF PROPORTIONATE SHARE.—

(i) IN GENERAL.—For purposes of subparagraph (A), a tax-exempt entity's proportionate share of any property owned by a partnership shall be determined on the basis of such entity's share of partnership items of income or gain (excluding gain allocated under section 704(c)), whichever results in the largest proportionate share.

(ii) DETERMINATION WHERE ALLOCATIONS VARY.—For purposes of clause (i), if a tax-exempt entity's share of partnership items of income or gain (excluding gain allocated under section 704(c)) may vary during the period such entity is a partner in the partnership, such share shall be the highest share such entity may receive.

(D) DETERMINATION OF WHETHER PROPERTY USED IN UNRELATED TRADE OR BUSINESS.—For purposes of this subsection, in the case of any property which is owned by a partnership which has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, the determination of whether such property is used in an unrelated trade or business of such an entity shall be made without regard to section 514.

(E) OTHER PASS-THRU ENTITIES; TIERED ENTITIES.—Rules similar to the rules of subparagraphs (A), (B), (C), and (D) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

(F) TREATMENT OF CERTAIN TAXABLE ENTITIES.—

(i) IN GENERAL.—For purposes of this paragraph and paragraph (5), except as otherwise provided in this subparagraph, any tax-exempt controlled entity shall be treated as a tax-exempt entity.

(ii) ELECTION.—If a tax-exempt controlled entity makes an election under this clause—

(I) such entity shall not be treated as a tax-exempt entity for purposes of this paragraph and paragraph (5), and

(II) any gain recognized by a tax-exempt entity on any disposition of an interest in such entity (and any dividend or interest received or accrued by a tax-exempt entity from such tax-exempt controlled entity) shall be treated as unrelated business taxable income for purposes of section 511.

Any such election shall be irrevocable and shall bind all tax-exempt entities holding interests in such tax-exempt controlled entity. For purposes of subclause (II), there shall only be taken into account dividends which are properly allocable to income of the tax-exempt controlled entity which was not subject to tax under this chapter.

(iii) TAX-EXEMPT CONTROLLED ENTITY.—

(I) IN GENERAL.—The term "tax-exempt controlled entity" means any corporation (which is not a tax-exempt entity determined without regard to this subparagraph and paragraph (2)(E)) if 50 percent or more (in value) of the stock in such corporation is held by 1 or more tax-exempt entities (other than a foreign person or entity).

(II) ONLY 5-PERCENT SHAREHOLDERS TAKEN INTO ACCOUNT IN CASE OF PUBLICLY TRADED STOCK.—For purposes of subclause (I), in the case of a corporation the stock of which is publicly traded on an established securities market, stock held by a tax-exempt entity shall not be taken into account unless such entity holds at least 5 percent (in value) of the stock in such corporation. For purposes of this subclause, related entities (within the meaning of paragraph (4)) shall be treated as 1 entity.

(III) SECTION 318 TO APPLY.—For purposes of this clause, a tax-exempt entity shall be treated as holding stock which it holds through application of section 318 (determined without regard to the 50-percent limitation contained in subsection (a)(2)(C) thereof).

(G) REGULATIONS.—For purposes of determining whether there is a qualified allocation under subparagraph (B), the regulations prescribed under paragraph (8) for purposes of this paragraph—

(i) shall set forth the proper treatment for partnership guaranteed payments, and

(ii) may provide for the exclusion or segregation of items.

(7) LEASE.—For purposes of this subsection, the term "lease" includes any grant of a right to use property.

(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

(i) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) CLASS LIFE.—Except as provided in this section, the term "class life" means the class life (if any) which would be applicable with respect to any property as of January 1, 1986, under subsection (m) of section 167 (determined without regard to paragraph (4) and as if the taxpayer had made an election under such subsection). The Secretary, through an office established in the Treasury, shall monitor and analyze actual experience with respect to all depreciable assets. The reference in this paragraph to subsection (m) of section 167 shall be treated as a reference to such subsection as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990.

(2) QUALIFIED TECHNOLOGICAL EQUIPMENT.—

(A) IN GENERAL.—The term "qualified technological equipment" means—

(i) any computer or peripheral equipment,

(ii) any high technology telephone station equipment installed on the customer's premises, and

(iii) any high technology medical equipment.

(B) COMPUTER OR PERIPHERAL EQUIPMENT DEFINED.—For purposes of this paragraph—

(i) IN GENERAL.—The term "computer or peripheral equipment" means—

(I) any computer, and

(II) any related peripheral equipment.

(ii) COMPUTER.—The term "computer" means a programmable electronically activated device which—

(I) is capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention, and

(II) consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities.

(iii) RELATED PERIPHERAL EQUIPMENT.—The term "related peripheral equipment" means any auxiliary machine (whether on-line or off-line) which is designed to be placed under the control of the central processing unit of a computer.

(iv) EXCEPTIONS.—The term "computer or peripheral equipment" shall not include—

(I) any equipment which is an integral part of other property which is not a computer,

(II) typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment, and

(III) equipment of a kind used primarily for amusement or entertainment of the user.

(C) HIGH TECHNOLOGY MEDICAL EQUIPMENT.—For purposes of this paragraph, the term "high technology medical equipment" means any electronic, electromechanical, or computer-based high technology equipment used in the screening, monitoring, observation, diagnosis, or treatment of patients in a laboratory, medical, or hospital environment.

(3) LEASE TERM.—

(A) IN GENERAL.—In determining a lease term—

(i) there shall be taken into account options to renew,

(ii) the term of a lease shall include the term of any service contract or similar arrangement (whether or not treated as a lease under section 7701(e))—

(I) which is part of the same transaction (or series of related transactions) which includes the lease, and

(II) which is with respect to the property subject to the lease or substantially similar property, and

(iii) 2 or more successive leases which are part of the same transaction (or a series of related transactions) with respect to the same or substantially similar property shall be treated as 1 lease.

(B) SPECIAL RULE FOR FAIR RENTAL OPTIONS ON NONRESIDENTIAL REAL PROPERTY OR RESIDENTIAL RENTAL PROPERTY.—For purposes of clause (i) of subparagraph (A), in the case of nonresidential real property or residential rental property, there shall not be taken into account any option to renew at fair market value, determined at the time of renewal.

(4) GENERAL ASSET ACCOUNTS.—Under regulations, a taxpayer may maintain 1 or more general asset accounts for any property to which this section applies. Except as provided in regulations, all proceeds realized on any disposition of property in a general asset account shall be included in income as ordinary income.

(5) CHANGES IN USE.—The Secretary shall, by regulations, provide for the method of determining the deduction allowable under section 167(a) with respect to any tangible property for any taxable year (and the succeeding taxable years) during which such property changes status under this section but continues to be held by the same person.

(6) TREATMENTS OF ADDITIONS OR IMPROVEMENTS TO PROPERTY.—In the case of any addition to (or improvement of) any property—

(A) any deduction under subsection (a) for such addition or improvement shall be computed in the same manner as the deduction for such property would be computed if such property had been placed in service at the same time as such addition or improvement, and

(B) the applicable recovery period for such addition or improvement shall begin on the later of—

(i) the date on which such addition (or improvement) is placed in service, or

(ii) the date on which the property with respect to which such addition (or improvement) was made is placed in service.

(7) TREATMENT OF CERTAIN TRANSFEREES.—

(A) IN GENERAL.—In the case of any property transferred in a transaction described in subparagraph (B), the transferee shall be treated as the transferor for purposes of computing the depreciation deduction determined under

this section with respect to so much of the basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor. In any case where this section as in effect before the amendments made by section 201 of the Tax Reform Act of 1986 applied to the property in the hands of the transferor, the reference in the preceding sentence to this section shall be treated as a reference to this section as so in effect.

(B) TRANSACTIONS COVERED.—The transactions described in this subparagraph are—

(i) any transaction described in section 332, 351, 361, 721, or 731, and

(ii) any transaction between members of the same affiliated group during any taxable year for which a consolidated return is made by such group.

(C) PROPERTY REACQUIRED BY THE TAXPAYER.—Under regulations, property which is disposed of and then reacquired by the taxpayer shall be treated for purposes of computing the deduction allowable under subsection (a) as if such property had not been disposed of.

(8) TREATMENT OF LEASEHOLD IMPROVEMENTS.—

(A) IN GENERAL.—In the case of any building erected (or improvements made) on leased property, if such building or improvement is property to which this section applies, the depreciation deduction shall be determined under the provisions of this section.

(B) TREATMENT OF LESSOR IMPROVEMENTS WHICH ARE ABANDONED AT TERMINATION OF LEASE.—An improvement—

(i) which is made by the lessor of leased property for the lessee of such property, and

(ii) which is irrevocably disposed of or abandoned by the lessor at the termination of the lease by such lessee,

shall be treated for purposes of determining gain or loss under this title as disposed of by the lessor when so disposed of or abandoned.

(C) CROSS REFERENCE.—For treatment of qualified long-term real property constructed or improved in connection with cash or rent reduction from lessor to lessee, see section 110(b).

(9) NORMALIZATION RULES.—

(A) IN GENERAL.—In order to use a normalization method of accounting with respect to any public utility property for purposes of subsection (f)(2)—

(i) the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes; and

(ii) if the amount allowable as a deduction under this section with respect to such property (respecting

all elections made by the taxpayer under this section) differs from the amount that would be allowable as a deduction under section 167 using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

(B) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS, ETC..—

(i) IN GENERAL.—One way in which the requirements of subparagraph (A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A).

(ii) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS.—The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

(iii) REGULATORY AUTHORITY.—The Secretary may by regulations prescribe procedures and adjustments (in addition to those specified in clause (ii)) which are to be treated as inconsistent for purposes of clause (i).

(C) PUBLIC UTILITY PROPERTY WHICH DOES NOT MEET NORMALIZATION RULES.—In the case of any public utility property to which this section does not apply by reason of subsection (f)(2), the allowance for depreciation under section 167(a) shall be an amount computed using the method and period referred to in subparagraph (A)(i).

(10) PUBLIC UTILITY PROPERTY.—The term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of—

(A) electrical energy, water, or sewage disposal services,

(B) gas or steam through a local distribution system,

(C) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(D) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

(11) RESEARCH AND EXPERIMENTATION.—The term "research and experimentation" has the same meaning as the term research and experimental has under section 174.

(12) SECTION 1245 AND 1250 PROPERTY.—The terms "section 1245 property" and "section 1250 property" have the meanings given such terms by sections 1245(a)(3) and 1250(c), respectively.

(13) SINGLE PURPOSE AGRICULTURAL OR HORTICULTURAL STRUCTURE.—

(A) IN GENERAL.—The term "single purpose agricultural or horticultural structure" means—

(i) a single purpose livestock structure, and

(ii) a single purpose horticultural structure.

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

(i) SINGLE PURPOSE LIVESTOCK STRUCTURE.—The term "single purpose livestock structure" means any enclosure or structure specifically designed, constructed, and used—

(I) for housing, raising, and feeding a particular type of livestock and their produce, and

(II) for housing the equipment (including any replacements) necessary for the housing, raising, and feeding referred to in subclause (I).

(ii) SINGLE PURPOSE HORTICULTURAL STRUCTURE.—The term "single purpose horticultural structure" means—

(I) a greenhouse specifically designed, constructed, and used for the commercial production of plants, and

(II) a structure specifically designed, constructed, and used for the commercial production of mushrooms.

(iii) STRUCTURES WHICH INCLUDE WORK SPACE.—An enclosure or structure which provides work space shall be treated as a single purpose agricultural or horticultural structure only if such work space is solely for—

(I) the stocking, caring for, or collecting of livestock or plants (as the case may be) or their produce,

(II) the maintenance of the enclosure or structure, and

(III) the maintenance or replacement of the equipment or stock enclosed or housed therein.

(iv) LIVESTOCK.—The term "livestock" includes poultry.

(14) QUALIFIED RENT-TO-OWN PROPERTY.—

(A) IN GENERAL.—The term "qualified rent-to-own property" means property held by a rent-to-own dealer for purposes of being subject to a rent-to-own contract.

(B) RENT-TO-OWN DEALER.—The term "rent-to-own dealer" means a person that, in the ordinary course of business, regularly enters into rent-to-own contracts with customers for the use of consumer property, if a substantial portion of those contracts terminate and the property is returned to such person before the receipt of all payments required to transfer ownership of the property from such person to the customer.

(C) CONSUMER PROPERTY.—The term "consumer property" means tangible personal property of a type generally used within the home for personal use.

(D) RENT-TO-OWN CONTRACT.—The term "rent-to-own contract" means any lease for the use of consumer property between a rent-to-own dealer and a customer who is an individual which—

(i) is titled "Rent-to-Own Agreement" or "Lease Agreement with Ownership Option," or uses other similar language,

(ii) provides for level (or decreasing where no payment is less than 40 percent of the largest payment), regular periodic payments (for a payment period which is a week or month),

(iii) provides that legal title to such property remains with the rent-to-own dealer until the customer makes all the payments described in clause (ii) or early purchase payments required under the contract to acquire legal title to the item of property,

(iv) provides a beginning date and a maximum period of time for which the contract may be in effect that does not exceed 156 weeks or 36 months from such beginning date (including renewals or options to extend),

(v) provides for payments within the 156-week or 36-month period that, in the aggregate, generally exceed the normal retail price of the consumer property plus interest,

(vi) provides for payments under the contract that, in the aggregate, do not exceed $10,000 per item of consumer property,

(vii) provides that the customer does not have any legal obligation to make all the payments referred to in clause (ii) set forth under the contract, and that at the end of each payment period the customer may either continue to use the consumer property by making the payment for the next payment period or return such property to the rent-to-own dealer in good working order, in which case the customer does not incur any further obligations under the contract and is not entitled to a return of any payments previously made under the contract, and

(viii) provides that the customer has no right to sell, sublease, mortgage, pawn, pledge, encumber, or otherwise dispose of the consumer property until all the payments stated in the contract have been made.

(15) MOTORSPORTS ENTERTAINMENT COMPLEX.—

(A) IN GENERAL.—The term "motorsports entertainment complex" means a racing track facility which—

(i) is permanently situated on land, and

(ii) during the 36-month period following the first day of the month in which the asset is placed in service, hosts 1 or more racing events for automobiles (of any type), trucks, or motorcycles which are open to the public for the price of admission.

(B) ANCILLARY AND SUPPORT FACILITIES.—Such term shall include, if owned by the taxpayer who owns the complex and provided for the benefit of patrons of the complex—

(i) ancillary facilities and land improvements in support of the complex's activities (including parking lots, sidewalks, waterways, bridges, fences, and landscaping),

(ii) support facilities (including food and beverage retailing, souvenir vending, and other nonlodging accommodations), and

(iii) appurtenances associated with such facilities and related attractions and amusements (including ticket booths, race track surfaces, suites and hospitality facilities, grandstands and viewing structures, props, walls, facilities that support the delivery of entertainment services, other special purpose structures, facades, shop interiors, and buildings).

(C) EXCEPTION.—Such term shall not include any transportation equipment, administrative services assets, warehouses, administrative buildings, hotels, or motels.

(D) TERMINATION.—Such term shall not include any property placed in service after December 31, 2025.

(16) ALASKA NATURAL GAS PIPELINE.—The term "Alaska natural gas pipeline" means the natural gas pipeline system located in the State of Alaska which—

(A) has a capacity of more than 500,000,000,000 Btu of natural gas per day, and

(B) is—

(i) placed in service after December 31, 2013, or

(ii) treated as placed in service on January 1, 2014, if the taxpayer who places such system in service before January 1, 2014, elects such treatment.

Such term includes the pipe, trunk lines, related equipment, and appurtenances used to carry natural gas, but does not include any gas processing plant.

(17) NATURAL GAS GATHERING LINE.—The term "natural gas gathering line" means—

(A) the pipe, equipment, and appurtenances determined to be a gathering line by the Federal Energy Regulatory Commission, and

(B) the pipe, equipment, and appurtenances used to deliver natural gas from the wellhead or a commonpoint to the point at which such gas first reaches—

(i) a gas processing plant,

(ii) an interconnection with a transmission pipeline for which a certificate as an interstate transmission pipeline has been issued by the Federal Energy Regulatory Commission,

(iii) an interconnection with an intrastate transmission pipeline, or

(iv) a direct interconnection with a local distribution company, a gas storage facility, or an industrial consumer.

(18) QUALIFIED SMART ELECTRIC METERS.—

(A) IN GENERAL.—The term "qualified smart electric meter" means any smart electric meter which—

(i) is placed in service by a taxpayer who is a supplier of electric energy or a provider of electric energy services, and

(ii) does not have a class life (determined without regard to subsection (e)) of less than 16 years.

(B) SMART ELECTRIC METER.—For purposes of subparagraph (A), the term "smart electric meter" means any time-based meter and related communication equipment which is capable of being used by the taxpayer as part of a system that—

(i) measures and records electricity usage data on a time-differentiated basis in at least 24 separate time segments per day,

(ii) provides for the exchange of information between supplier or provider and the customer's electric meter in support of time-based rates or other forms of demand response,

(iii) provides data to such supplier or provider so that the supplier or provider can provide energy usage information to customers electronically, and

(iv) provides net metering.

(19) QUALIFIED SMART ELECTRIC GRID SYSTEMS.—

(A) IN GENERAL.—The term "qualified smart electric grid system" means any smart grid property which—

(i) is used as part of a system for electric distribution grid communications, monitoring, and management placed in service by a taxpayer who is a supplier of electric energy or a provider of electric energy services, and

(ii) does not have a class life (determined without regard to subsection (e)) of less than 16 years.

(B) SMART GRID PROPERTY.—For the purposes of subparagraph (A), the term "smart grid property" means electronics and related equipment that is capable of—

(i) sensing, collecting, and monitoring data of or from all portions of a utility's electric distribution grid,

(ii) providing real-time, two-way communications to monitor or manage such grid, and

(iii) providing real time analysis of and event prediction based upon collected data that can be used to improve electric distribution system reliability, quality, and performance.

(j) PROPERTY ON INDIAN RESERVATIONS.—

(1) IN GENERAL.—For purposes of subsection (a), the applicable recovery period for qualified Indian reservation property shall be determined in accordance with the table contained in paragraph (2) in lieu of the table contained in subsection (c).

(2) APPLICABLE RECOVERY PERIOD FOR INDIAN RESERVATION PROPERTY.—For purposes of paragraph (1)—

(3) DEDUCTION ALLOWED IN COMPUTING MINIMUM TAX.—For purposes of determining alternative minimum taxable income under section 55, the deduction under subsection (a) for quali-

fied Indian reservation property shall be determined under this section without regard to any adjustment under section 56.

(4) QUALIFIED INDIAN RESERVATION PROPERTY DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified Indian reservation property" means property which is property described in the table in paragraph (2) and which is—

(i) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation,

(ii) not used or located outside the Indian reservation on a regular basis,

(iii) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer (within the meaning of section 465(b)(3)(C)), and

(iv) not property (or any portion thereof) placed in service for purposes of conducting or housing class I, II, or III gaming (as defined in section 4 of the Indian Regulatory Act (25 U.S.C. 2703)).

(B) EXCEPTION FOR ALTERNATIVE DEPRECIATION PROPERTY.—The term "qualified Indian reservation property" does not include any property to which the alternative depreciation system under subsection (g) applies, determined—

(i) without regard to subsection (g)(7) (relating to election to use alternative depreciation system), and

(ii) after the application of section 280F(b) (relating to listed property with limited business use).

(C) SPECIAL RULE FOR RESERVATION INFRASTRUCTURE INVESTMENT.—

(i) IN GENERAL.—Subparagraph (A)(ii) shall not apply to qualified infrastructure property located outside of the Indian reservation if the purpose of such property is to connect with qualified infrastructure property located within the Indian reservation.

(ii) QUALIFIED INFRASTRUCTURE PROPERTY.—For purposes of this subparagraph, the term "qualified infrastructure property" means qualified Indian reservation property (determined without regard to subparagraph (A)(ii)) which—

(I) benefits the tribal infrastructure,

(II) is available to the general public, and

(III) is placed in service in connection with the taxpayer's active conduct of a trade or business within an Indian reservation.

Such term includes, but is not limited to, roads, power lines, water systems, railroad spurs, and communications facilities.

(5) REAL ESTATE RENTALS.—For purposes of this subsection, the rental to others of real property located within an Indian reservation shall be treated as the active conduct of a trade or business within an Indian reservation.

(6) INDIAN RESERVATION DEFINED.—For purposes of this subsection, the term "Indian reservation" means a reservation, as defined in—

(A) section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d)), or

(B) section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).

For purposes of the preceding sentence, such section 3(d) shall be applied by treating the term "former Indian reservations in Oklahoma" as including only lands which are within the jurisdictional area of an Oklahoma Indian tribe (as determined by the Secretary of the Interior) and are recognized by such Secretary as eligible for trust land status under 25 CFR Part 151 (as in effect on the date of the enactment of this sentence).

(7) COORDINATION WITH NONREVENUE LAWS.—Any reference in this subsection to a provision not contained in this title shall be treated for purposes of this subsection as a reference to such provision as in effect on the date of the enactment of this paragraph.

(8) ELECTION OUT.—If a taxpayer makes an election under this paragraph with respect to any class of property for any taxable year, paragraph (1) shall not apply to all property in such class placed in service during such taxable year. Such election, once made, shall be irrevocable.

(9) TERMINATION.—This subsection shall not apply to property placed in service after December 31, 2021.

(k) SPECIAL ALLOWANCE FOR CERTAIN PROPERTY.—

(1) ADDITIONAL ALLOWANCE.—In the case of any qualified property—

(A) the depreciation deduction provided by section 167(a) for the taxable year in which such property is placed in service shall include an allowance equal to the applicable percentage of the adjusted basis of the qualified property, and

(B) the adjusted basis of the qualified property shall be reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

(2) QUALIFIED PROPERTY.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified property" means property—

(i)(I) to which this section applies which has a recovery period of 20 years or less,

(II) which is computer software (as defined in section 167(f)(1)(B)) for which a deduction is allowable under section 167(a) without regard to this subsection,

(III) which is water utility property, or

(IV) which is a qualified film or television production (as defined in subsection (d) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection, or

(V) which is a qualified live theatrical production (as defined in subsection (e) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection,

(ii) the original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets the requirements of clause (ii) of subparagraph (E), and

(iii) which is placed in service by the taxpayer before January 1, 2027.

(B) CERTAIN PROPERTY HAVING LONGER PRODUCTION PERIODS TREATED AS QUALIFIED PROPERTY.—

(i) IN GENERAL.—The term "qualified property" includes any property if such property—

(I) meets the requirements of clauses (i) and (ii) of subparagraph (A),

(II) is placed in service by the taxpayer before January 1, 2028,

(III) is acquired by the taxpayer (or acquired pursuant to a written binding contract entered into) before January 1, 2027,

(IV) has a recovery period of at least 10 years or is transportation property,

(V) is subject to section 263A, and

(VI) meets the requirements of clause (iii) of section 263A(f)(1)(B) (determined as if such clause also applies to property which has a long useful life (within the meaning of section 263A(f))).

(ii) ONLY PRE-JANUARY 1, 2027 BASIS ELIGIBLE FOR ADDITIONAL ALLOWANCE.—In the case of property which is qualified property solely by reason of clause (i), paragraph (1) shall apply only to the extent of the adjusted basis thereof attributable to manufacture, construction, or production before January 1, 2027.

(iii) TRANSPORTATION PROPERTY.—For purposes of this subparagraph, the term "transportation property" means tangible personal property used in the trade or business of transporting persons or property.

(iv) APPLICATION OF SUBPARAGRAPH.—This subparagraph shall not apply to any property which is described in subparagraph (C).

(C) CERTAIN AIRCRAFT.—The term "qualified property" includes property—

(i) which meets the requirements of subparagraph (A)(ii) and subclauses (II) and (III) of subparagraph (B)(i),

(ii) which is an aircraft which is not a transportation property (as defined in subparagraph (B)(iii)) other than for agricultural or firefighting purposes,

(iii) which is purchased and on which such purchaser, at the time of the contract for purchase, has made a nonrefundable deposit of the lesser of—

(I) 10 percent of the cost, or

(II) $100,000, and

(iv) which has—

(I) an estimated production period exceeding 4 months, and

(II) a cost exceeding $200,000.

(D) EXCEPTION FOR ALTERNATIVE DEPRECIATION PROPERTY.—The term "qualified property" shall not include any property to which the alternative depreciation system under subsection (g) applies, determined—

(i) without regard to paragraph (7) of subsection (g) (relating to election to have system apply), and

(ii) after application of section 280F(b) (relating to listed property with limited business use).

(E) SPECIAL RULES.—

(i) SELF-CONSTRUCTED PROPERTY.—In the case of a taxpayer manufacturing, constructing, or producing property for the taxpayer's own use, the requirements of subclause (III) of subparagraph (B)(i) shall be treated as met if the taxpayer begins manufacturing, constructing, or producing the property before January 1, 2027.

(ii) ACQUISITION REQUIREMENTS.—An acquisition of property meets the requirements of this clause if—

(I) such property was not used by the taxpayer at any time prior to such acquisition, and

(II) the acquisition of such property meets the requirements of paragraphs (2)(A), (2)(B), (2)(C), and (3) of section 179(d).

(iii) SYNDICATION.—For purposes of subparagraph (A)(ii), if—

(I) property is used by a lessor of such property and such use is the lessor's first use of such property,

(II) such property is sold by such lessor or any subsequent purchaser within 3 months after the date such property was originally placed in service (or, in the case of multiple units of property subject to the same lease, within 3 months after the date the final unit is placed in service, so long as the period between the time the first unit is placed in service and the time the last unit is placed in service does not exceed 12 months), and

(III) the user of such property after the last sale during such 3-month period remains the same as when such property was originally placed in service,

such property shall be treated as originally placed in service not earlier than the date of such last sale.

(F) COORDINATION WITH SECTION 280F.—For purposes of section 280F—

(i) AUTOMOBILES.—In the case of a passenger automobile (as defined in section 280F(d)(5)) which is qualified property, the Secretary shall increase the limitation under section 280F(a)(1)(A)(i) by $8,000.

(ii) LISTED PROPERTY.—The deduction allowable under paragraph (1) shall be taken into account in computing any recapture amount under section 280F(b)(2).

(iii) PHASE DOWN.—In the case of a passenger automobile acquired by the taxpayer before September 28,

2017, and placed in service by the taxpayer after September 27, 2017, clause (i) shall be applied by substituting for "$8,000"—

(I) in the case of an automobile placed in service during 2018, $6,400, and

(II) in the case of an automobile placed in service during 2019, $4,800.

(G) DEDUCTION ALLOWED IN COMPUTING MINIMUM TAX.—For purposes of determining alternative minimum taxable income under section 55, the deduction under section 167 for qualified property shall be determined without regard to any adjustment under section 56.

(H) PRODUCTION PLACED IN SERVICE.—For purposes of subparagraph (A)—

(i) a qualified film or television production shall be considered to be placed in service at the time of initial release or broadcast, and

(ii) a qualified live theatrical production shall be considered to be placed in service at the time of the initial live staged performance.

(5) SPECIAL RULES FOR CERTAIN PLANTS BEARING FRUITS AND NUTS.—

(A) IN GENERAL.—In the case of any specified plant which is planted before January 1, 2027, or is grafted before such date to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer's farming business (as defined in section 263A(e)(4)) during a taxable year for which the taxpayer has elected the application of this paragraph—

(i) a depreciation deduction equal to the applicable percentage of the adjusted basis of such specified plant shall be allowed under section 167(a) for the taxable year in which such specified plant is so planted or grafted, and

(ii) the adjusted basis of such specified plant shall be reduced by the amount of such deduction.

(B) SPECIFIED PLANT.—For purposes of this paragraph, the term "specified plant" means—

(i) any tree or vine which bears fruits or nuts, and

(ii) any other plant which will have more than one crop or yield of fruits or nuts and which generally has a pre-productive period of more than 2 years from the time of planting or grafting to the time at which such plant begins bearing a marketable crop or yield of fruits or nuts.

Such term shall not include any property which is planted or grafted outside of the United States.

(C) ELECTION REVOCABLE ONLY WITH CONSENT.—An election under this paragraph may be revoked only with the consent of the Secretary.

(D) ADDITIONAL DEPRECIATION MAY BE CLAIMED ONLY ONCE.—If this paragraph applies to any specified plant, such specified plant shall not be treated as qualified property in the taxable year in which placed in service.

(E) DEDUCTION ALLOWED IN COMPUTING MINIMUM TAX.—Rules similar to the rules of paragraph (2)(G) shall apply for purposes of this paragraph.

(6) APPLICABLE PERCENTAGE.—For purposes of this subsection—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term "applicable percentage" means—

(i) in the case of property placed in service after September 27, 2017, and before January 1, [2023] *2026*, 100 percent, *and*

[(ii) in the case of property placed in service after December 31, 2022, and before January 1, 2024, 80 percent,

[(iii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 60 percent,

[(iv) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 40 percent, and]

[(v)] *(ii)* in the case of property placed in service after December 31, 2025, and before January 1, 2027, 20 percent.

(B) RULE FOR PROPERTY WITH LONGER PRODUCTION PERIODS.—In the case of property described in subparagraph (B) or (C) of paragraph (2), the term "applicable percentage" means—

(i) in the case of property placed in service after September 27, 2017, and before January 1, [2024] *2027*, 100 percent, *and*

[(ii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 80 percent,

[(iii) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 60 percent,

[(iv) in the case of property placed in service after December 31, 2025, and before January 1, 2027, 40 percent, and]

[(v)] *(ii)* in the case of property placed in service after December 31, 2026, and before January 1, 2028, 20 percent.

(C) RULE FOR PLANTS BEARING FRUITS AND NUTS.—In the case of a specified plant described in paragraph (5), the term "applicable percentage" means—

(i) in the case of a plant which is planted or grafted after September 27, 2017, and before January 1, [2023] *2026*, 100 percent, *and*

[(ii) in the case of a plant which is planted or grafted after December 31, 2022, and before January 1, 2024, 80 percent,

[(iii) in the case of a plant which is planted or grafted after December 31, 2023, and before January 1, 2025, 60 percent,

[(iv) in the case of a plant which is planted or grafted after December 31, 2024, and before January 1, 2026, 40 percent, and]

[(v)] *(ii)* in the case of a plant which is planted or grafted after December 31, 2025, and before January 1, 2027, 20 percent.

(7) ELECTION OUT.—If a taxpayer makes an election under this paragraph with respect to any class of property for any taxable year, paragraphs (1) and (2)(F) shall not apply to any qualified property in such class placed in service during such taxable year. An election under this paragraph may be revoked only with the consent of the Secretary.

(8) PHASE DOWN.—In the case of qualified property acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017, paragraph (6) shall be applied by substituting for each percentage therein—

(A) "50 percent" in the case of—

(i) property placed in service before January 1, 2018, and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2018,

(B) "40 percent" in the case of—

(i) property placed in service in 2018 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2019,

(C) "30 percent" in the case of—

(i) property placed in service in 2019 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2020, and

(D) "0 percent" in the case of—

(i) property placed in service after 2019 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service after 2020.

(9) EXCEPTION FOR CERTAIN PROPERTY.—The term "qualified property" shall not include—

(A) any property which is primarily used in a trade or business described in clause (iv) of section 163(j)(7)(A), or

(B) any property used in a trade or business that has had floor plan financing indebtedness (as defined in paragraph (9) of section 163(j)), if the floor plan financing interest related to such indebtedness was taken into account under paragraph (1)(C) of such section.

(10) SPECIAL RULE FOR PROPERTY PLACED IN SERVICE DURING CERTAIN PERIODS.—

(A) IN GENERAL.—In the case of qualified property placed in service by the taxpayer during the first taxable year ending after September 27, 2017, if the taxpayer elects to have this paragraph apply for such taxable year, para-

graphs (1)(A) and (5)(A)(i) shall be applied by substituting "50 percent" for "the applicable percentage".

(B) FORM OF ELECTION.—Any election under this paragraph shall be made at such time and in such form and manner as the Secretary may prescribe.

(l) SPECIAL ALLOWANCE FOR SECOND GENERATION BIOFUEL PLANT PROPERTY.—

(1) ADDITIONAL ALLOWANCE.—In the case of any qualified second generation biofuel plant property—

(A) the depreciation deduction provided by section 167(a) for the taxable year in which such property is placed in service shall include an allowance equal to 50 percent of the adjusted basis of such property, and

(B) the adjusted basis of such property shall be reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

(2) QUALIFIED SECOND GENERATION BIOFUEL PLANT PROPERTY.—The term "qualified second generation biofuel plant property" means property of a character subject to the allowance for depreciation—

(A) which is used in the United States solely to produce second generation biofuel (as defined in section 40(b)(6)(E)),

(B) the original use of which commences with the taxpayer after the date of the enactment of this subsection,

(C) which is acquired by the taxpayer by purchase (as defined in section 179(d)) after the date of the enactment of this subsection, but only if no written binding contract for the acquisition was in effect on or before the date of the enactment of this subsection, and

(D) which is placed in service by the taxpayer before January 1, 2021.

(3) EXCEPTIONS.—

(A) BONUS DEPRECIATION PROPERTY UNDER SUBSECTION (K).—Such term shall not include any property to which subsection (k) applies.

(B) ALTERNATIVE DEPRECIATION PROPERTY.—Such term shall not include any property described in subsection (k)(2)(D).

(C) TAX-EXEMPT BOND-FINANCED PROPERTY.—Such term shall not include any property any portion of which is financed with the proceeds of any obligation the interest on which is exempt from tax under section 103.

(D) ELECTION OUT.—If a taxpayer makes an election under this subparagraph with respect to any class of property for any taxable year, this subsection shall not apply to all property in such class placed in service during such taxable year.

(4) SPECIAL RULES.—For purposes of this subsection, rules similar to the rules of subsection (k)(2)(E) shall apply.

(5) ALLOWANCE AGAINST ALTERNATIVE MINIMUM TAX.—For purposes of this subsection, rules similar to the rules of subsection (k)(2)(G) shall apply.

(6) RECAPTURE.—For purposes of this subsection, rules similar to the rules under section 179(d)(10) shall apply with respect to any qualified second generation biofuel plant property which ceases to be qualified second generation biofuel plant property.

(7) DENIAL OF DOUBLE BENEFIT.—Paragraph (1) shall not apply to any qualified second generation biofuel plant property with respect to which an election has been made under section 179C (relating to election to expense certain refineries).

(m) SPECIAL ALLOWANCE FOR CERTAIN REUSE AND RECYCLING PROPERTY.—

(1) IN GENERAL.—In the case of any qualified reuse and recycling property—

(A) the depreciation deduction provided by section 167(a) for the taxable year in which such property is placed in service shall include an allowance equal to 50 percent of the adjusted basis of the qualified reuse and recycling property, and

(B) the adjusted basis of the qualified reuse and recycling property shall be reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

(2) QUALIFIED REUSE AND RECYCLING PROPERTY.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified reuse and recycling property" means any reuse and recycling property—

(i) to which this section applies,

(ii) which has a useful life of at least 5 years,

(iii) the original use of which commences with the taxpayer after August 31, 2008, and

(iv) which is—

(I) acquired by purchase (as defined in section 179(d)(2)) by the taxpayer after August 31, 2008, but only if no written binding contract for the acquisition was in effect before September 1, 2008, or

(II) acquired by the taxpayer pursuant to a written binding contract which was entered into after August 31, 2008.

(B) EXCEPTIONS.—

(i) BONUS DEPRECIATION PROPERTY UNDER SUBSECTION (K).—The term "qualified reuse and recycling property" shall not include any property to which subsection (k) (determined without regard to paragraph (4) thereof) applies.

(ii) ALTERNATIVE DEPRECIATION PROPERTY.—The term "qualified reuse and recycling property" shall not include any property to which the alternative depreciation system under subsection (g) applies, determined without regard to paragraph (7) of subsection (g) (relating to election to have system apply).

(iii) ELECTION OUT.—If a taxpayer makes an election under this clause with respect to any class of property for any taxable year, this subsection shall not apply to

all property in such class placed in service during such taxable year.

(C) SPECIAL RULE FOR SELF-CONSTRUCTED PROPERTY.—In the case of a taxpayer manufacturing, constructing, or producing property for the taxpayer's own use, the requirements of clause (iv) of subparagraph (A) shall be treated as met if the taxpayer begins manufacturing, constructing, or producing the property after August 31, 2008.

(D) DEDUCTION ALLOWED IN COMPUTING MINIMUM TAX.—For purposes of determining alternative minimum taxable income under section 55, the deduction under subsection (a) for qualified reuse and recycling property shall be determined under this section without regard to any adjustment under section 56.

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

(A) REUSE AND RECYCLING PROPERTY.—

(i) IN GENERAL.—The term "reuse and recycling property" means any machinery and equipment (not including buildings or real estate), along with all appurtenances thereto, including software necessary to operate such equipment, which is used exclusively to collect, distribute, or recycle qualified reuse and recyclable materials.

(ii) EXCLUSION.—Such term does not include rolling stock or other equipment used to transport reuse and recyclable materials.

(B) QUALIFIED REUSE AND RECYCLABLE MATERIALS.—

(i) IN GENERAL.—The term "qualified reuse and recyclable materials" means scrap plastic, scrap glass, scrap textiles, scrap rubber, scrap packaging, recovered fiber, scrap ferrous and nonferrous metals, or electronic scrap generated by an individual or business.

(ii) ELECTRONIC SCRAP.—For purposes of clause (i), the term "electronic scrap" means—

(I) any cathode ray tube, flat panel screen, or similar video display device with a screen size greater than 4 inches measured diagonally, or

(II) any central processing unit.

(C) RECYCLING OR RECYCLE.—The term "recycling" or "recycle" means that process (including sorting) by which worn or superfluous materials are manufactured or processed into specification grade commodities that are suitable for use as a replacement or substitute for virgin materials in manufacturing tangible consumer and commercial products, including packaging.

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SEC. 174. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) IN GENERAL.—In the case of a taxpayer's specified research or experimental expenditures for any taxable year—

(1) except as provided in paragraph (2), no deduction shall be allowed for such expenditures, and

(2) the taxpayer shall—

(A) charge such expenditures to capital account, and

(B) be allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research (within the meaning of section 41(d)(4)(F))) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred.

(b) SPECIFIED RESEARCH OR EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term "specified research or experimental expenditures" means, with respect to any taxable year, research or experimental expenditures which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business.

(c) SPECIAL RULES.—

(1) LAND AND OTHER PROPERTY.—This section shall not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion); but for purposes of this section allowances under section 167, and allowances under section 611, shall be considered as expenditures.

(2) EXPLORATION EXPENDITURES.—This section shall not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(3) SOFTWARE DEVELOPMENT.—For purposes of this section, any amount paid or incurred in connection with the development of any software shall be treated as a research or experimental expenditure.

(d) TREATMENT UPON DISPOSITION, RETIREMENT, OR ABANDONMENT.—If any property with respect to which specified research or experimental expenditures are paid or incurred is disposed, retired, or abandoned during the period during which such expenditures are allowed as an amortization deduction under this section, no deduction shall be allowed with respect to such expenditures on account of such disposition, retirement, or abandonment and such amortization deduction shall continue with respect to such expenditures.

(e) SUSPENSION OF APPLICATION OF SECTION TO DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.—In the case of any domestic research or experimental expenditures (as defined in section 174A(b)), this section—

(1) shall apply to such expenditures paid or incurred in taxable years beginning after December 31, 2025, and

(2) shall not apply to such expenditures paid or incurred in taxable years beginning on or before such date.

SEC. 174A. TEMPORARY RULES FOR DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) TREATMENT AS EXPENSES.—Notwithstanding section 263, there shall be allowed as a deduction any domestic research or experimental expenditures which are paid or incurred by the taxpayer during the taxable year.

(b) DOMESTIC RESEARCH OR EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term "domestic research or experimental expenditures" means research or experimental expenditures paid or incurred by the taxpayer in connection with the taxpayer's trade or business other than such expenditures which are attributable to foreign research (within the meaning of section 41(d)(4)(F)).

(c) AMORTIZATION OF CERTAIN DOMESTIC RESEARCH AND EXPERIMENTAL EXPENDITURES.—

(1) IN GENERAL.—At the election of the taxpayer, made in accordance with regulations or other guidance provided by the Secretary, in the case of domestic research or experimental expenditures which would (but for subsection (a)) be chargeable to capital account but not chargeable to property of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion), subsection (a) shall not apply and the taxpayer shall—

(A) charge such expenditures to capital account, and

(B) be allowed an amortization deduction of such expenditures ratably over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures).

(2) TIME FOR AND SCOPE OF ELECTION.—The election provided by paragraph (1) may be made for any taxable year, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The method so elected, and the period selected by the taxpayer, shall be adhered to in computing taxable income for the taxable year for which the election is made and for all subsequent taxable years unless, with the approval of the Secretary, a change to a different method (or to a different period) is authorized with respect to part or all of such expenditures. The election shall not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer makes the election.

(d) ELECTION TO CAPITALIZE EXPENSES.—In the case of a taxpayer which elects (at such time and in such manner as the Secretary may provide) the application of this subsection, subsections (a) and (c) shall not apply and domestic research or experimental expenditures shall be chargeable to capital account. Such election shall not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer makes the election and may be made with respect to part of the expenditures paid or incurred during any taxable year only with the approval of the Secretary.

(e) SPECIAL RULES.—

(1) LAND AND OTHER PROPERTY.—This section shall not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion); but for purposes of this section

allowances under section 167, and allowances under section 611, shall be considered as expenditures.

(2) EXPLORATION EXPENDITURES.—This section shall not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(3) SOFTWARE DEVELOPMENT.—For purposes of this section, any amount paid or incurred in connection with the development of any software shall be treated as a research or experimental expenditure.

(f) TERMINATION.—

(1) IN GENERAL.—This section shall not apply to amounts paid or incurred in taxable years beginning after December 31, 2025.

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of a taxpayer's first taxable year beginning after December 31, 2025, paragraph (1) (and the corresponding application of section 174) shall be treated as a change in method of accounting for purposes of section 481 and—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary, and

(C) such change shall be applied only on a cut-off basis for any domestic research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2025, and no adjustment under section 481(a) shall be made.

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SEC. 179. ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS.

(a) TREATMENT AS EXPENSES.—A taxpayer may elect to treat the cost of any section 179 property as an expense which is not chargeable to capital account. Any cost so treated shall be allowed as a deduction for the taxable year in which the section 179 property is placed in service.

(b) LIMITATIONS.—

(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed **[**$1,000,000**]** *$1,290,000*.

(2) REDUCTION IN LIMITATION.—The limitation under paragraph (1) for any taxable year shall be reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during such taxable year exceeds **[**$2,500,000**]** *$3,220,000*.

(3) LIMITATION BASED ON INCOME FROM TRADE OR BUSINESS.—

(A) IN GENERAL.—The amount allowed as a deduction under subsection (a) for any taxable year (determined after the application of paragraphs (1) and (2)) shall not exceed the aggregate amount of taxable income of the taxpayer for such taxable year which is derived from the active conduct by the taxpayer of any trade or business during such taxable year.

(B) CARRYOVER OF DISALLOWED DEDUCTION.—The amount allowable as a deduction under subsection (a) for any taxable year shall be increased by the lesser of—

(i) the aggregate amount disallowed under subparagraph (A) for all prior taxable years (to the extent not previously allowed as a deduction by reason of this subparagraph), or

(ii) the excess (if any) of—

(I) the limitation of paragraphs (1) and (2) (or if lesser, the aggregate amount of taxable income referred to in subparagraph (A)), over

(II) the amount allowable as a deduction under subsection (a) for such taxable year without regard to this subparagraph.

(C) COMPUTATION OF TAXABLE INCOME.—For purposes of this paragraph, taxable income derived from the conduct of a trade or business shall be computed without regard to the deduction allowable under this section.

(4) MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of a husband and wife filing separate returns for the taxable year—

(A) such individuals shall be treated as 1 taxpayer for purposes of paragraphs (1) and (2), and

(B) unless such individuals elect otherwise, 50 percent of the cost which may be taken into account under subsection (a) for such taxable year (before application of paragraph (3)) shall be allocated to each such individual.

(5) LIMITATION ON COST TAKEN INTO ACCOUNT FOR CERTAIN PASSENGER VEHICLES.—

(A) IN GENERAL.—The cost of any sport utility vehicle for any taxable year which may be taken into account under this section shall not exceed $25,000.

(B) SPORT UTILITY VEHICLE.—For purposes of subparagraph (A)—

(i) IN GENERAL.—The term "sport utility vehicle" means any 4-wheeled vehicle—

(I) which is primarily designed or which can be used to carry passengers over public streets, roads, or highways (except any vehicle operated exclusively on a rail or rails),

(II) which is not subject to section 280F, and

(III) which is rated at not more than 14,000 pounds gross vehicle weight.

(ii) CERTAIN VEHICLES EXCLUDED.—Such term does not include any vehicle which—

(I) is designed to have a seating capacity of more than 9 persons behind the driver's seat,

(II) is equipped with a cargo area of at least 6 feet in interior length which is an open area or is designed for use as an open area but is enclosed by a cap and is not readily accessible directly from the passenger compartment, or

(III) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's

seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

(6) INFLATION ADJUSTMENT.—

(A) IN GENERAL.—In the case of any taxable year beginning after [2018] *2024 (2018 in the case of the dollar amount in paragraph (5)(A))*, the dollar amounts in paragraphs (1), (2), and (5)(A) shall each be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting ["calendar year 2017"] *"calendar year 2024" ("calendar year 2017" in the case of the dollar amount in paragraph (5)(A))* for "calendar year 2016" in subparagraph (A)(ii) thereof.

(B) ROUNDING.—The amount of any increase under subparagraph (A) shall be rounded to the nearest multiple of $10,000 ($100 in the case of any increase in the amount under paragraph (5)(A)).

(c) ELECTION.—

(1) IN GENERAL.—An election under this section for any taxable year shall—

(A) specify the items of section 179 property to which the election applies and the portion of the cost of each of such items which is to be taken into account under subsection (a), and

(B) be made on the taxpayer's return of the tax imposed by this chapter for the taxable year.

Such election shall be made in such manner as the Secretary may by regulations prescribe.

(2) ELECTION.—Any election made under this section, and any specification contained in any such election, may be revoked by the taxpayer with respect to any property, and such revocation, once made, shall be irrevocable.

(d) DEFINITIONS AND SPECIAL RULES.—

(1) SECTION 179 PROPERTY.—For purposes of this section, the term "section 179 property" means property—

(A) which is—

(i) tangible property (to which section 168 applies), or

(ii) computer software (as defined in section 197(e)(3)(B)) which is described in section 197(e)(3)(A)(i) and to which section 167 applies,

(B) which is—

(i) section 1245 property (as defined in section 1245(a)(3)), or

(ii) at the election of the taxpayer, qualified real property (as defined in subsection (e)), and

(C) which is acquired by purchase for use in the active conduct of a trade or business.

Such term shall not include any property described in section 50(b) (other than paragraph (2) thereof).

(2) PURCHASE DEFINED.—For purposes of paragraph (1), the term "purchase" means any acquisition of property, but only if—

(A) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants),

(B) the property is not acquired by one component member of a controlled group from another component member of the same controlled group, and

(C) the basis of the property in the hands of the person acquiring it is not determined—

(i) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(ii) under section 1014(a) (relating to property acquired from a decedent).

(3) COST.—For purposes of this section, the cost of property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the person acquiring such property.

(4) SECTION NOT TO APPLY TO ESTATES AND TRUSTS.—This section shall not apply to estates and trusts.

(5) SECTION NOT TO APPLY TO CERTAIN NONCORPORATE LESSORS.—This section shall not apply to any section 179 property which is purchased by a person who is not a corporation and with respect to which such person is the lessor unless—

(A) the property subject to the lease has been manufactured or produced by the lessor, or

(B) the term of the lease (taking into account options to renew) is less than 50 percent of the class life of the property (as defined in section 168(i)(1)), and for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property.

(6) DOLLAR LIMITATION OF CONTROLLED GROUP.—For purposes of subsection (b) of this section—

(A) all component members of a controlled group shall be treated as one taxpayer, and

(B) the Secretary shall apportion the dollar limitation contained in subsection (b)(1) among the component members of such controlled group in such manner as he shall by regulations prescribe.

(7) CONTROLLED GROUP DEFINED.—For purposes of paragraphs (2) and (6), the term "controlled group" has the meaning assigned to it by section 1563(a), except that, for such purposes, the phrase "more than 50 percent" shall be substituted

for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

(8) TREATMENT OF PARTNERSHIPS AND S CORPORATIONS.—In the case of a partnership, the limitations of subsection (b) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.

(9) COORDINATION WITH SECTION 38.—No credit shall be allowed under section 38 with respect to any amount for which a deduction is allowed under subsection (a).

(10) RECAPTURE IN CERTAIN CASES.—The Secretary shall, by regulations, provide for recapturing the benefit under any deduction allowable under subsection (a) with respect to any property which is not used predominantly in a trade or business at any time.

(e) QUALIFIED REAL PROPERTY.—For purposes of this section, the term "qualified real property" means—

(1) any qualified improvement property described in section 168(e)(6), and

(2) any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service:

(A) Roofs.

(B) Heating, ventilation, and air-conditioning property.

(C) Fire protection and alarm systems.

(D) Security systems.

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SEC. 195. START-UP EXPENDITURES.

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

(b) ELECTION TO DEDUCT.—

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

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

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

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

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

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

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

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

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

(c) DEFINITIONS.—For purposes of this section—

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

(A) paid or incurred in connection with—

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

(ii) creating an active trade or business, or

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

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

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

(2) BEGINNING OF TRADE OR BUSINESS.—

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

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

(d) ELECTION.—

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

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

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PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 263. CAPITAL EXPENDITURES.

(a) GENERAL RULE.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174 *or 174A*,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180,

(E) expenditures for removal of architectural and transportation barriers to the handicapped and elderly which the taxpayer elects to deduct under section 190,

(F) expenditures for tertiary injectants with respect to which a deduction is allowed under section 193,

(G) expenditures for which a deduction is allowed under section 179,

(H) expenditures for which a deduction is allowed under section 179B,

(I) expenditures for which a deduction is allowed under section 179C,

(J) expenditures for which a deduction is allowed under section 179D, or

(K) expenditures for which a deduction is allowed under section 179E.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

(c) INTANGIBLE DRILLING AND DEVELOPMENT COSTS IN THE CASE OF OIL AND GAS WELLS AND GEOTHERMAL WELLS.—Notwithstanding subsection (a), and except as provided in subsection (i), regulations shall be prescribed by the Secretary under this subtitle corresponding to the regulations which granted the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells and which were recognized and approved by the Congress in House Concurrent Resolution 50, Seventy-ninth Congress. Such regulations shall also grant the option to deduct as expenses intangible drilling and development costs in the case of wells drilled for any geothermal deposit (as defined in section 613(e)(2)) to the same extent and in the same manner as such expenses are deductible in the case of oil and gas wells. This subsection shall not apply with respect to any costs to which any deduction is allowed under section 59(e) or 291.

(d) EXPENDITURES IN CONNECTION WITH CERTAIN RAILROAD ROLLING STOCK.—In the case of expenditures in connection with the rehabilitation of a unit of railroad rolling stock (except a locomotive) used by a domestic common carrier by railroad which would, but for this subsection, be properly chargeable to capital account, such expenditures, if during any 12-month period they do not exceed an amount equal to 20 percent of the basis of such unit in the hands of the taxpayer, shall, at the election of the taxpayer, be treated (notwithstanding subsection (a)) as deductible repairs under section 162 or 212. An election under this subsection shall be made for any taxable year at such time and in such manner as the Secretary prescribes by regulations. An election may not be made under this subsection for any taxable year to which an election under subsection (e) applies to railroad rolling stock (other than locomotives).

(f) RAILROAD TIES.—In the case of a domestic common carrier by rail (including a railroad switching or terminal company) which uses the retirement-replacement method of accounting for depreciation of its railroad track, expenditures for acquiring and installing

replacement ties of any material (and fastenings related to such ties) shall be accorded the same tax accounting treatment as expenditures for replacement ties of wood (and fastenings related to such ties).

(g) CERTAIN INTEREST AND CARRYING COSTS IN THE CASE OF STRADDLES.—

(1) GENERAL RULE.—No deduction shall be allowed for interest and carrying charges properly allocable to personal property which is part of a straddle (as defined in section 1092(c)). Any amount not allowed as a deduction by reason of the preceding sentence shall be chargeable to the capital account with respect to the personal property to which such amount relates.

(2) INTEREST AND CARRYING CHARGES DEFINED.—For purposes of paragraph (1), the term "interest and carrying charges" means the excess of—

(A) the sum of—

(i) interest on indebtedness incurred or continued to purchase or carry the personal property, and

(ii) all other amounts (including charges to insure, store, or transport the personal property) paid or incurred to carry the personal property, over

(B) the sum of—

(i) the amount of interest (including original issue discount) includible in gross income for the taxable year with respect to the property described in subparagraph (A),

(ii) any amount treated as ordinary income under section 1271(a)(3)(A), 1276, or 1281(a) with respect to such property for the taxable year,

(iii) the excess of any dividends includible in gross income with respect to such property for the taxable year over the amount of any deduction allowable with respect to such dividends under section 243 or 245, and

(iv) any amount which is a payment with respect to a security loan (within the meaning of section 512(a)(5)) includible in gross income with respect to such property for the taxable year.

For purposes of subparagraph (A), the term "interest" includes any amount paid or incurred in connection with personal property used in a short sale.

(3) EXCEPTION FOR HEDGING TRANSACTIONS.—This subsection shall not apply in the case of any hedging transaction (as defined in section 1256(e)).

(4) APPLICATION WITH OTHER PROVISIONS.—

(A) SUBSECTION (C).—In the case of any short sale, this subsection shall be applied after subsection (h).

(B) SECTION 1277 OR 1282.—In the case of any obligation to which section 1277 or 1282 applies, this subsection shall be applied after section 1277 or 1282.

(h) PAYMENTS IN LIEU OF DIVIDENDS IN CONNECTION WITH SHORT SALES.—

(1) IN GENERAL.—If—

(A) a taxpayer makes any payment with respect to any stock used by such taxpayer in a short sale and such payment is in lieu of a dividend payment on such stock, and

(B) the closing of such short sale occurs on or before the 45th day after the date of such short sale,

then no deduction shall be allowed for such payment. The basis of the stock used to close the short sale shall be increased by the amount not allowed as a deduction by reason of the preceding sentence.

(2) LONGER PERIOD IN CASE OF EXTRAORDINARY DIVIDENDS.—If the payment described in paragraph (1)(A) is in respect of an extraordinary dividend, paragraph (1)(B) shall be applied by substituting "the day 1 year after the date of such short sale" for "the 45th day after the date of such short sale".

(3) EXTRAORDINARY DIVIDEND.—For purposes of this subsection, the term "extraordinary dividend" has the meaning given to such term by section 1059(c); except that such section shall be applied by treating the amount realized by the taxpayer in the short sale as his adjusted basis in the stock.

(4) SPECIAL RULE WHERE RISK OF LOSS DIMINISHED.—The running of any period of time applicable under paragraph (1)(B) (as modified by paragraph (2)) shall be suspended during any period in which—

(A) the taxpayer holds, has an option to buy, or is under a contractual obligation to buy, substantially identical stock or securities, or

(B) under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

(5) DEDUCTION ALLOWABLE TO EXTENT OF ORDINARY INCOME FROM AMOUNTS PAID BY LENDING BROKER FOR USE OF COLLATERAL.—

(A) IN GENERAL.—Paragraph (1) shall apply only to the extent that the payments or distributions with respect to any short sale exceed the amount which—

(i) is treated as ordinary income by the taxpayer, and

(ii) is received by the taxpayer as compensation for the use of any collateral with respect to any stock used in such short sale.

(B) EXCEPTION NOT TO APPLY TO EXTRAORDINARY DIVIDENDS.—Subparagraph (A) shall not apply if one or more payments or distributions is in respect of an extraordinary dividend.

(6) APPLICATION OF THIS SUBSECTION WITH SUBSECTION (G).—In the case of any short sale, this subsection shall be applied before subsection (g).

(i) SPECIAL RULES FOR INTANGIBLE DRILLING AND DEVELOPMENT COSTS INCURRED OUTSIDE THE UNITED STATES.—In the case of intangible drilling and development costs paid or incurred with respect to an oil, gas, or geothermal well located outside the United States—

(1) subsection (c) shall not apply, and

(2) such costs shall—

(A) at the election of the taxpayer, be included in adjusted basis for purposes of computing the amount of any deduction allowable under section 611 (determined without regard to section 613), or

(B) if subparagraph (A) does not apply, be allowed as a deduction ratably over the 10-taxable year period beginning with the taxable year in which such costs were paid or incurred.

This subsection shall not apply to costs paid or incurred with respect to a nonproductive well.

SEC. 263A. CAPITALIZATION AND INCLUSION IN INVENTORY COSTS OF CERTAIN EXPENSES.

(a) NONDEDUCTIBILITY OF CERTAIN DIRECT AND INDIRECT COSTS.—

(1) IN GENERAL.—In the case of any property to which this section applies, any costs described in paragraph (2)—

(A) in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and

(B) in the case of any other property, shall be capitalized.

(2) ALLOCABLE COSTS.—The costs described in this paragraph with respect to any property are—

(A) the direct costs of such property, and

(B) such property's proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.

(b) PROPERTY TO WHICH SECTION APPLIES.—Except as otherwise provided in this section, this section shall apply to—

(1) PROPERTY PRODUCED BY TAXPAYER.—Real or tangible personal property produced by the taxpayer.

(2) PROPERTY ACQUIRED FOR RESALE.—Real or personal property described in section 1221(a)(1) which is acquired by the taxpayer for resale.

For purposes of paragraph (1), the term "tangible personal property" shall include a film, sound recording, video tape, book, or similar property.

(c) GENERAL EXCEPTIONS.—

(1) PERSONAL USE PROPERTY.—This section shall not apply to any property produced by the taxpayer for use by the taxpayer other than in a trade or business or an activity conducted for profit.

(2) RESEARCH AND EXPERIMENTAL EXPENDITURES.—This section shall not apply to any amount allowable as a deduction under section 174 *or 174A*.

(3) CERTAIN DEVELOPMENT AND OTHER COSTS OF OIL AND GAS WELLS OR OTHER MINERAL PROPERTY.—This section shall not apply to any cost allowable as a deduction under section 167(h), 179B, 263(c), 263(i), 291(b)(2), 616, or 617.

(4) COORDINATION WITH LONG-TERM CONTRACT RULES.—This section shall not apply to any property produced by the taxpayer pursuant to a long-term contract.

(5) TIMBER AND CERTAIN ORNAMENTAL TREES.—This section shall not apply to—

(A) trees raised, harvested, or grown by the taxpayer other than trees described in clause (ii) of subsection (e)(4)(B) (after application of the last sentence thereof), and

(B) any real property underlying such trees.

(6) COORDINATION WITH SECTION 59(E).—Paragraphs (2) and (3) shall apply to any amount allowable as a deduction under section 59(e) for qualified expenditures described in subparagraphs (B), (C), (D), and (E) of paragraph (2) thereof.

(7) COORDINATION WITH SECTION 168(K)(5).—This section shall not apply to any amount allowed as a deduction by reason of section 168(k)(5) (relating to special rules for certain plants bearing fruits and nuts).

(d) EXCEPTION FOR FARMING BUSINESSES.—

(1) SECTION NOT TO APPLY TO CERTAIN PROPERTY.—

(A) IN GENERAL.—This section shall not apply to any of the following which is produced by the taxpayer in a farming business:

(i) Any animal.

(ii) Any plant which has a preproductive period of 2 years or less.

(B) EXCEPTION FOR TAXPAYERS REQUIRED TO USE ACCRUAL METHOD.—Subparagraph (A) shall not apply to any corporation, partnership, or tax shelter required to use an accrual method of accounting under section 447 or 448(a)(3).

(2) TREATMENT OF CERTAIN PLANTS LOST BY REASON OF CASUALTY.—

(A) IN GENERAL.—If plants bearing an edible crop for human consumption were lost or damaged (while in the hands of the taxpayer) by reason of freezing temperatures, disease, drought, pests, or casualty, this section shall not apply to any costs of the taxpayer of replanting plants bearing the same type of crop (whether on the same parcel of land on which such lost or damaged plants were located or any other parcel of land of the same acreage in the United States).

(B) SPECIAL RULE FOR PERSON WITH MINORITY INTEREST WHO MATERIALLY PARTICIPATES.—Subparagraph (A) shall apply to amounts paid or incurred by a person (other than the taxpayer described in subparagraph (A)) if—

(i) the taxpayer described in subparagraph (A) has an equity interest of more than 50 percent in the plants described in subparagraph (A) at all times during the taxable year in which such amounts were paid or incurred, and

(ii) such other person holds any part of the remaining equity interest and materially participates in the planting, maintenance, cultivation, or development of the plants described in subparagraph (A) during the taxable year in which such amounts were paid or incurred.

The determination of whether an individual materially participates in any activity shall be made in a manner similar to the manner in which such determination is made under section 2032A(e)(6).

(C) SPECIAL TEMPORARY RULE FOR CITRUS PLANTS LOST BY REASON OF CASUALTY.—

(i) IN GENERAL.—In the case of the replanting of citrus plants, subparagraph (A) shall apply to amounts paid or incurred by a person (other than the taxpayer described in subparagraph (A)) if—

(I) the taxpayer described in subparagraph (A) has an equity interest of not less than 50 percent in the replanted citrus plants at all times during the taxable year in which such amounts were paid or incurred and such other person holds any part of the remaining equity interest, or

(II) such other person acquired the entirety of such taxpayer's equity interest in the land on which the lost or damaged citrus plants were located at the time of such loss or damage, and the replanting is on such land.

(ii) TERMINATION.—Clause (i) shall not apply to any cost paid or incurred after the date which is 10 years after the date of the enactment of the Tax Cuts and Jobs Act.

(3) ELECTION TO HAVE THIS SECTION NOT APPLY.—

(A) IN GENERAL.—If a taxpayer makes an election under this paragraph, this section shall not apply to any plant produced in any farming business carried on by such taxpayer.

(B) CERTAIN PERSONS NOT ELIGIBLE.—No election may be made under this paragraph by a corporation, partnership, or tax shelter, if such corporation, partnership, or tax shelter is required to use an accrual method of accounting under section 447 or 448(a)(3).

(C) SPECIAL RULE FOR CITRUS AND ALMOND GROWERS.—An election under this paragraph shall not apply with respect to any item which is attributable to the planting, cultivation, maintenance, or development of any citrus or almond grove (or part thereof) and which is incurred before the close of the 4th taxable year beginning with the taxable year in which the trees were planted. For purposes of the preceding sentence, the portion of a citrus or almond grove planted in 1 taxable year shall be treated separately from the portion of such grove planted in another taxable year.

(D) ELECTION.—Unless the Secretary otherwise consents, an election under this paragraph may be made only for the taxpayer's 1st taxable year which begins after December 31, 1986, and during which the taxpayer engages in a farming business. Any such election, once made, may be revoked only with the consent of the Secretary.

(e) DEFINITIONS AND SPECIAL RULES FOR PURPOSES OF SUBSECTION (D).—

(1) RECAPTURE OF EXPENSED AMOUNTS ON DISPOSITION.—

(A) IN GENERAL.—In the case of any plant with respect to which amounts would have been capitalized under subsection (a) but for an election under subsection (d)(3)—

(i) such plant (if not otherwise section 1245 property) shall be treated as section 1245 property, and

(ii) for purposes of section 1245, the recapture amount shall be treated as a deduction allowed for depreciation with respect to such property.

(B) RECAPTURE AMOUNT.—For purposes of subparagraph (A), the term "recapture amount" means any amount allowable as a deduction to the taxpayer which, but for an election under subsection (d)(3), would have been capitalized with respect to the plant.

(2) EFFECTS OF ELECTION ON DEPRECIATION.—

(A) IN GENERAL.—If the taxpayer (or any related person) makes an election under subsection (d)(3), the provisions of section 168(g)(2) (relating to alternative depreciation) shall apply to all property of the taxpayer used predominantly in the farming business and placed in service in any taxable year during which any such election is in effect.

(B) RELATED PERSON.—For purposes of subparagraph (A), the term "related person" means—

(i) the taxpayer and members of the taxpayer's family,

(ii) any corporation (including an S corporation) if 50 percent or more (in value) of the stock of such corporation is owned (directly or through the application of section 318) by the taxpayer or members of the taxpayer's family,

(iii) a corporation and any other corporation which is a member of the same controlled group described in section 1563(a)(1), and

(iv) any partnership if 50 percent or more (in value) of the interests in such partnership is owned directly or indirectly by the taxpayer or members of the taxpayer's family.

(C) MEMBERS OF FAMILY.—For purposes of this paragraph, the term "family" means the taxpayer, the spouse of the taxpayer, and any of their children who have not attained age 18 before the close of the taxable year.

(3) PREPRODUCTIVE PERIOD.—

(A) IN GENERAL.—For purposes of this section, the term "preproductive period" means—

(i) in the case of a plant which will have more than 1 crop or yield, the period before the 1st marketable crop or yield from such plant, or

(ii) in the case of any other plant, the period before such plant is reasonably expected to be disposed of.

For purposes of this subparagraph, use by the taxpayer in a farming business of any supply produced in such business shall be treated as a disposition.

(B) RULE FOR DETERMINING PERIOD.—In the case of a plant grown in commercial quantities in the United States, the preproductive period for such plant if grown in the

United States shall be based on the nationwide weighted average preproductive period for such plant.

(4) FARMING BUSINESS.—For purposes of this section—

(A) IN GENERAL.—The term "farming business" means the trade or business of farming.

(B) CERTAIN TRADES AND BUSINESSES INCLUDED.—The term "farming business" shall include the trade or business of—

(i) operating a nursery or sod farm, or

(ii) the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees.

For purposes of clause (ii), an evergreen tree which is more than 6 years old at the time severed from the roots shall not be treated as an ornamental tree.

(5) CERTAIN INVENTORY VALUATION METHODS PERMITTED.—The Secretary shall by regulations permit the taxpayer to use reasonable inventory valuation methods to compute the amount required to be capitalized under subsection (a) in the case of any plant.

(f) SPECIAL RULES FOR ALLOCATION OF INTEREST TO PROPERTY PRODUCED BY THE TAXPAYER.—

(1) INTEREST CAPITALIZED ONLY IN CERTAIN CASES.—Subsection (a) shall only apply to interest costs which are—

(A) paid or incurred during the production period, and

(B) allocable to property which is described in subsection (b)(1) and which has—

(i) a long useful life,

(ii) an estimated production period exceeding 2 years, or

(iii) an estimated production period exceeding 1 year and a cost exceeding $1,000,000.

(2) ALLOCATION RULES.—

(A) IN GENERAL.—In determining the amount of interest required to be capitalized under subsection (a) with respect to any property—

(i) interest on any indebtedness directly attributable to production expenditures with respect to such property shall be assigned to such property, and

(ii) interest on any other indebtedness shall be assigned to such property to the extent that the taxpayer's interest costs could have been reduced if production expenditures (not attributable to indebtedness described in clause (i)) had not been incurred.

(B) EXCEPTION FOR QUALIFIED RESIDENCE INTEREST.—Subparagraph (A) shall not apply to any qualified residence interest (within the meaning of section 163(h)).

(C) SPECIAL RULE FOR FLOW-THROUGH ENTITIES.—Except as provided in regulations, in the case of any flow-through entity, this paragraph shall be applied first at the entity level and then at the beneficiary level.

(3) INTEREST RELATING TO PROPERTY USED TO PRODUCE PROPERTY.—This subsection shall apply to any interest on indebtedness allocable (as determined under paragraph (2)) to property used to produce property to which this subsection applies to

the extent such interest is allocable (as so determined) to the produced property.

(4) EXEMPTION FOR AGING PROCESS OF BEER, WINE, AND DISTILLED SPIRITS.—For purposes of this subsection, the production period shall not include the aging period for—

(A) beer (as defined in section 5052(a)),

(B) wine (as described in section 5041(a)), or

(C) distilled spirits (as defined in section 5002(a)(8)), except such spirits that are unfit for use for beverage purposes.

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

(A) LONG USEFUL LIFE.—Property has a long useful life if such property is—

(i) real property, or

(ii) property with a class life of 20 years or more (as determined under section 168).

(B) PRODUCTION PERIOD.—The term "production period" means, when used with respect to any property, the period—

(i) beginning on the date on which production of the property begins, and

(ii) except as provided in paragraph (4), ending on the date on which the property is ready to be placed in service or is ready to be held for sale.

(C) PRODUCTION EXPENDITURES.—The term "production expenditures" means the costs (whether or not incurred during the production period) required to be capitalized under subsection (a) with respect to the property.

(g) PRODUCTION.—For purposes of this section—

(1) IN GENERAL.—The term "produce" includes construct, build, install, manufacture, develop, or improve.

(2) TREATMENT OF PROPERTY PRODUCED UNDER CONTRACT FOR THE TAXPAYER.—The taxpayer shall be treated as producing any property produced for the taxpayer under a contract with the taxpayer; except that only costs paid or incurred by the taxpayer (whether under such contract or otherwise) shall be taken into account in applying subsection (a) to the taxpayer.

(h) EXEMPTION FOR FREE LANCE AUTHORS, PHOTOGRAPHERS, AND ARTISTS.—

(1) IN GENERAL.—Nothing in this section shall require the capitalization of any qualified creative expense.

(2) QUALIFIED CREATIVE EXPENSE.—For purposes of this subsection, the term "qualified creative expense" means any expense—

(A) which is paid or incurred by an individual in the trade or business of such individual (other than as an employee) of being a writer, photographer, or artist, and

(B) which, without regard to this section, would be allowable as a deduction for the taxable year.

Such term does not include any expense related to printing, photographic plates, motion picture films, video tapes, or similar items.

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

(A) WRITER.—The term "writer" means any individual if the personal efforts of such individual create (or may reasonably be expected to create) a literary manuscript, musical composition (including any accompanying words), or dance score.

(B) PHOTOGRAPHER.—The term "photographer" means any individual if the personal efforts of such individual create (or may reasonably be expected to create) a photograph or photographic negative or transparency.

(C) ARTIST.—

(i) IN GENERAL.—The term "artist" means any individual if the personal efforts of such individual create (or may reasonably be expected to create) a picture, painting, sculpture, statue, etching, drawing, cartoon, graphic design, or original print edition.

(ii) CRITERIA.—In determining whether any expense is paid or incurred in the trade or business of being an artist, the following criteria shall be taken into account:

(I) The originality and uniqueness of the item created (or to be created).

(II) The predominance of aesthetic value over utilitarian value of the item created (or to be created).

(D) TREATMENT OF CERTAIN CORPORATIONS.—

(i) IN GENERAL.—If—

(I) substantially all of the stock of a corporation is owned by a qualified employee-owner and members of his family (as defined in section 267(c)(4)), and

(II) the principal activity of such corporation is performance of personal services directly related to the activities of the qualified employee-owner and such services are substantially performed by the qualified employee-owner,

this subsection shall apply to any expense of such corporation which directly relates to the activities of such employee-owner in the same manner as if such expense were incurred by such employee-owner.

(ii) QUALIFIED EMPLOYEE-OWNER.—For purposes of this subparagraph, the term "qualified employee-owner" means any individual who is an employee-owner of the corporation (as defined in section 269A(b)(2)) and who is a writer, photographer, or artist.

(i) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—

(1) IN GENERAL.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, this section shall not apply with respect to such taxpayer for such taxable year.

(2) APPLICATION OF GROSS RECEIPTS TEST TO INDIVIDUALS, ETC..—In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall

be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

(3) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this subsection shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.

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

(1) regulations to prevent the use of related parties, pass-thru entities, or intermediaries to avoid the application of this section, and

(2) regulations providing for simplified procedures for the application of this section in the case of property described in subsection (b)(2).

* * * * * * *

SEC. 280C. CERTAIN EXPENSES FOR WHICH CREDITS ARE ALLOWABLE.

(a) RULE FOR EMPLOYMENT CREDITS.—No deduction shall be allowed for that portion of the wages or salaries paid or incurred for the taxable year which is equal to the sum of the credits determined for the taxable year under sections 45A(a), 45P(a), 45S(a), 51(a), and 1396(a). In the case of a corporation which is a member of a controlled group of corporations (within the meaning of section 52(a)) or a trade or business which is treated as being under common control with other trades or businesses (within the meaning of section 52(b)), this subsection shall be applied under rules prescribed by the Secretary similar to the rules applicable under subsections (a) and (b) of section 52.

(b) CREDIT FOR QUALIFIED CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified clinical testing expenses (as defined in section 45C(b)) otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit allowable for the taxable year under section 45C (determined without regard to section 38(c)).

(2) SIMILAR RULE WHERE TAXPAYER CAPITALIZES RATHER THAN DEDUCTS EXPENSES.—If—

(A) the amount of the credit allowable for the taxable year under section 45C (determined without regard to section 38(c)), exceeds

(B) the amount allowable as a deduction for the taxable year for qualified clinical testing expenses (determined without regard to paragraph (1)),

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

(3) ELECTION OF REDUCED CREDIT.—

(A) IN GENERAL.—In the case of any taxable year for which an election is made under this paragraph—

(i) paragraphs (1) and (2) shall not apply, and

(ii) the amount of the credit under section 45C(a) shall be the amount determined under subparagraph (B).

(B) AMOUNT OF REDUCED CREDIT.—The amount of credit determined under this subparagraph for any taxable year shall be the amount equal to the excess of—

(i) the amount of credit determined under section 45C(a) without regard to this paragraph, over

(ii) the product of—

(I) the amount described in clause (i), and

(II) the maximum rate of tax under section 11(b).

(C) ELECTION.—An election under this paragraph for any taxable year shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on such return, and shall be made in such manner as the Secretary shall prescribe. Such an election, once made, shall be irrevocable.

(4) CONTROLLED GROUPS.—In the case of a corporation which is a member of a controlled group of corporations (within the meaning of section 41(f)(5)) or a trade or business which is treated as being under common control with other trades or business (within the meaning of section 41(f)(1)(B)), this subsection shall be applied under rules prescribed by the Secretary similar to the rules applicable under subparagraphs (A) and (B) of section 41(f)(1).

(c) CREDIT FOR INCREASING RESEARCH ACTIVITIES.—

[(1) IN GENERAL.—If—

[(A) the amount of the credit determined for the taxable year under section 41(a)(1), exceeds

[(B) the amount allowable as a deduction for such taxable year for qualified research expenses or basic research expenses,

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.]

(1) IN GENERAL.—The domestic research or experimental expenditures otherwise taken into account under section 174 or 174A (as the case may be) shall be reduced by the amount of the credit allowed under section 41(a).

(2) ELECTION OF REDUCED CREDIT.—

(A) IN GENERAL.—In the case of any taxable year for which an election is made under this paragraph—

(i) paragraph (1) shall not apply, and

(ii) the amount of the credit under section 41(a) shall be the amount determined under subparagraph (B).

(B) AMOUNT OF REDUCED CREDIT.—The amount of credit determined under this subparagraph for any taxable year shall be the amount equal to the excess of—

(i) the amount of credit determined under section 41(a) without regard to this paragraph, over

(ii) the product of—

(I) the amount described in clause (i), and

(II) the maximum rate of tax under section 11(b).

(C) ELECTION.—An election under this paragraph for any taxable year shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on such return, and shall be made in such manner as the Secretary may prescribe. Such an election, once made, shall be irrevocable.

(3) CONTROLLED GROUPS.—Paragraph (3) of subsection (b) shall apply for purposes of this subsection.

(d) CREDIT FOR LOW SULFUR DIESEL FUEL PRODUCTION.—The deductions otherwise allowed under this chapter for the taxable year shall be reduced by the amount of the credit determined for the taxable year under section 45H(a).

(e) MINE RESCUE TEAM TRAINING CREDIT.—No deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for the taxable year under section 45N(a).

(f) CREDIT FOR SECURITY OF AGRICULTURAL CHEMICALS.—No deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction taken into account in determining the credit under section 45O for the taxable year which is equal to the amount of the credit determined for such taxable year under section 45O(a).

(g) CREDIT FOR HEALTH INSURANCE PREMIUMS.—No deduction shall be allowed for the portion of the premiums paid by the taxpayer for coverage of 1 or more individuals under a qualified health plan which is equal to the amount of the credit determined for the taxable year under section 36B(a) with respect to such premiums.

(h) CREDIT FOR EMPLOYEE HEALTH INSURANCE EXPENSES OF SMALL EMPLOYERS.—No deduction shall be allowed for that portion of the premiums for qualified health plans (as defined in section 1301(a) of the Patient Protection and Affordable Care Act), or for health insurance coverage in the case of taxable years beginning in 2010, 2011, 2012, or 2013, paid by an employer which is equal to the amount of the credit determined under section 45R(a) with respect to the premiums.

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Subchapter G—CORPORATIONS USED TO AVOID INCOME TAX ON SHAREHOLDERS

* * * * * * *

PART II—PERSONAL HOLDING COMPANIES

* * * * * * *

SEC. 543. PERSONAL HOLDING COMPANY INCOME

(a) GENERAL RULE.—For purposes of this subtitle, the term "personal holding company income" means the portion of the adjusted ordinary gross income which consists of:

(1) DIVIDENDS, ETC..—Dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities. This paragraph shall not apply to—

(A) interest constituting rent (as defined in subsection (b)(3)),

(B) interest on amounts set aside in a reserve fund under chapter 533 or 535 of title 46, United States Code,

(C) dividends received by a United States shareholder (as defined in section 951(b)) from a controlled foreign corporation (as defined in section 957(a)),

(D) active business computer software royalties (within the meaning of subsection (d)), and

(E) interest received by a broker or dealer (within the meaning of section 3(a)(4) or (5) of the Securities and Exchange Act of 1934) in connection with—

(i) any securities or money market instruments held as property described in section 1221(a)(1),

(ii) margin accounts, or

(iii) any financing for a customer secured by securities or money market instruments.

(2) RENTS.—The adjusted income from rents; except that such adjusted income shall not be included if—

(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income, and

(B) the sum of—

(i) the dividends paid during the taxable year (determined under section 562),

(ii) the dividends considered as paid on the last day of the taxable year under section 563(c) (as limited by the second sentence of section 563(b)), and

(iii) the consent dividends for the taxable year (determined under section 565),

equals or exceeds the amount, if any, by which the personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (6), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) exceeds 10 percent of the ordinary gross income.

(3) MINERAL, OIL, AND GAS ROYALTIES.—The adjusted income from mineral, oil, and gas royalties; except that such adjusted income shall not be included if—

(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income,

(B) the personal holding company income for the taxable year (computed without regard to this paragraph, and computed by including as personal holding company income copyright royalties and the adjusted income from rents) is not more than 10 percent of the ordinary gross income, and

(C) the sum of the deductions which are allowable under section 162 (relating to trade or business expenses) other than—

(i) deductions for compensation for personal services rendered by the shareholders, and

(ii) deductions which are specifically allowable under sections other than section 162,

equals or exceeds 15 percent of the adjusted ordinary gross income.

(4) COPYRIGHT ROYALTIES.—Copyright royalties; except that copyright royalties shall not be included if—

(A) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

(B) the personal holding company income for the taxable year computed—

(i) without regard to copyright royalties, other than royalties received for the use of, or right to use, copyrights or interests in copyrights in works created in whole, or in part, by any shareholder owning more than 10 percent of the total outstanding capital stock of the corporation,

(ii) without regard to dividends from any corporation in which the taxpayer owns at least 50 percent of all classes of stock entitled to vote and at least 50 percent of the total value of all classes of stock and which corporation meets the requirements of this subparagraph and subparagraphs (A) and (C), and

(iii) by including as personal holding company income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties,

is not more than 10 percent of the ordinary gross income, and

(C) the sum of the deductions which are properly allocable to such royalties and which are allowable under section 162, other than—

(i) deductions for compensation for personal services rendered by the shareholders,

(ii) deductions for royalties paid or accrued, and

(iii) deductions which are specifically allowable under sections other than section 162,

equals or exceeds 25 percent of the amount by which the ordinary gross income exceeds the sum of the royalties paid or accrued and the amounts allowable as deductions under section 167 (relating to depreciation) with respect to copyright royalties.

For purposes of this subsection, the term "copyright royalties" means compensation, however designated, for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work and payments (other than produced film rents as defined in paragraph (5)(B)) received for the use of, or right to use, films. For purposes of this paragraph, the term "shareholder" shall include any person who owns stock within the meaning of section 544. This paragraph shall not apply to active business computer software royalties.

(5) PRODUCED FILM RENTS.—

(A) Produced film rents; except that such rents shall not be included if such rents constitute 50 percent or more of the ordinary gross income.

(B) For purposes of this section, the term "produced film rents" means payments received with respect to an interest in a film for the use of, or right to use, such film, but only to the extent that such interest was acquired before substantial completion of production of such film. In the case of a producer who actively participates in the production of the film, such term includes an interest in the proceeds or profits from the film, but only to the extent such interest is attributable to such active participation.

(6) USE OF CORPORATE PROPERTY BY SHAREHOLDER.—

(A) Amounts received as compensation (however designated and from whomever received) for the use of, or the right to use, tangible property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property (whether such right is obtained directly from the corporation or by means of a sublease or other arrangement).

(B) Subparagraph (A) shall apply only to a corporation which has personal holding company income in excess of 10 percent of its ordinary gross income.

(C) For purposes of the limitation in subparagraph (B), personal holding company income shall be computed—

(i) without regard to subparagraph (A) or paragraph (2),

(ii) by excluding amounts received as compensation for the use of (or right to use) intangible property (other than mineral, oil, or gas royalties or copyright royalties) if a substantial part of the tangible property used in connection with such intangible property is owned by the corporation and all such tangible and intangible property is used in the active conduct of a trade or business by an individual or individuals described in subparagraph (A), and

(iii) by including copyright royalties and adjusted income from mineral, oil, and gas royalties.

(7) PERSONAL SERVICE CONTRACTS.—

(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to per-

form, or may be designated (by name or by description) as the one to perform, such services.

(8) ESTATES AND TRUSTS.—Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries).

(b) DEFINITIONS.—For purposes of this part—

(1) ORDINARY GROSS INCOME.—The term "ordinary gross income" means the gross income determined by excluding—

(A) all gains from the sale or other disposition of capital assets, and

(B) all gains (other than those referred to in subparagraph (A)) from the sale or other disposition of property described in section 1231(b).

(2) ADJUSTED ORDINARY GROSS INCOME.—The term "adjusted ordinary gross income" means the ordinary gross income adjusted as follows:

(A) RENTS.—From the gross income from rents (as defined in the second sentence of paragraph (3) of this subsection) subtract the amount allowable as deductions for—

(i) exhaustion, wear and tear, obsolescence, and amortization of property other than tangible personal property which is not customarily retained by any one lessee for more than three years,

(ii) property taxes,

(iii) interest, and

(iv) rent,

to the extent allocable, under regulations prescribed by the Secretary, to such gross income from rents. The amount subtracted under this subparagraph shall not exceed such gross income from rents.

(B) MINERAL ROYALTIES, ETC..—From the gross income from mineral, oil, and gas royalties described in paragraph (4), and from the gross income from working interests in an oil or gas well, subtract the amount allowable as deductions for—

(i) exhaustion, wear and tear, obsolescence, amortization, and depletion,

(ii) property and severance taxes,

(iii) interest, and

(iv) rent,

to the extent allocable, under regulations prescribed by the Secretary, to such gross income from royalties or such gross income from working interests in oil or gas wells. The amount subtracted under this subparagraph with respect to royalties shall not exceed the gross income from such royalties, and the amount subtracted under this subparagraph with respect to working interests shall not exceed the gross income from such working interests.

(C) INTEREST.—There shall be excluded—

(i) interest received on a direct obligation of the United States held for sale to customers in the ordinary course of trade or business by a regular dealer who is making a primary market in such obligations, and

(ii) interest on a condemnation award, a judgment, and a tax refund.

(D) CERTAIN EXCLUDED RENTS.—From the gross income consisting of compensation described in subparagraph (D) of paragraph (3) subtract the amount allowable as deductions for the items described in clauses (i), (ii), (iii), and (iv) of subparagraph (A) to the extent allocable, under regulations prescribed by the Secretary, to such gross income. The amount subtracted under this subparagraph shall not exceed such gross income.

(3) ADJUSTED INCOME FROM RENTS.—The term "adjusted income from rents" means the gross income from rents, reduced by the amount subtracted under paragraph (2)(A) of this subsection. For purposes of the preceding sentence, the term "rents" means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but such term does not include—

(A) amounts constituting personal holding company income under subsection (a)(6),

(B) copyright royalties (as defined in subsection (a)(4)),

(C) produced film rents (as defined in subsection (a)(5)(B)),

(D) compensation, however designated, for the use of, or the right to use, any tangible personal property manufactured or produced by the taxpayer, if during the taxable year the taxpayer is engaged in substantial manufacturing or production of tangible personal property of the same type, or

(E) active business computer software royalties (as defined in subsection (d)).

(4) ADJUSTED INCOME FROM MINERAL, OIL, AND GAS ROYALTIES.—The term "adjusted income from mineral, oil, and gas royalties" means the gross income from mineral, oil, and gas royalties (including production payments and overriding royalties), reduced by the amount subtracted under paragraph (2)(B) of this subsection in respect of such royalties.

(c) GROSS INCOME OF INSURANCE COMPANIES OTHER THAN LIFE INSURANCE COMPANIES.—In the case of an insurance company other than a life insurance company, the term "gross income" as used in this part means the gross income, as defined in section 832(b)(1), increased by the amount of losses incurred, as defined in section 832(b)(5), and the amount of expenses incurred, as defined in section 832(b)(6), and decreased by the amount deductible under section 832(c)(7) (relating to tax-free interest).

(d) ACTIVE BUSINESS COMPUTER SOFTWARE ROYALTIES.—

(1) IN GENERAL.—For purposes of this section, the term "active business computer software royalties" means any royalties—

(A) received by any corporation during the taxable year in connection with the licensing of computer software, and

(B) with respect to which the requirements of paragraphs (2), (3), (4), and (5) are met.

(2) ROYALTIES MUST BE RECEIVED BY CORPORATION ACTIVELY ENGAGED IN COMPUTER SOFTWARE BUSINESS.—The requirements of this paragraph are met if the royalties described in paragraph (1)—

(A) are received by a corporation engaged in the active conduct of the trade or business of developing, manufacturing, or producing computer software, and

(B) are attributable to computer software which—

(i) is developed, manufactured, or produced by such corporation (or its predecessor) in connection with the trade or business described in subparagraph (A), or

(ii) is directly related to such trade or business.

(3) ROYALTIES MUST CONSTITUTE AT LEAST 50 PERCENT OF INCOME.—The requirements of this paragraph are met if the royalties described in paragraph (1) constitute at least 50 percent of the ordinary gross income of the corporation for the taxable year.

(4) DEDUCTIONS UNDER SECTIONS 162 AND 174 RELATING TO ROYALTIES MUST EQUAL OR EXCEED 25 PERCENT OF ORDINARY GROSS INCOME.—

(A) IN GENERAL.—The requirements of this paragraph are met if—

(i) the sum of the deductions allowable to the corporation under sections 162, 174, *174A,* and 195 for the taxable year which are properly allocable to the trade or business described in paragraph (2) equals or exceeds 25 percent of the ordinary gross income of such corporation for such taxable year, or

(ii) the average of such deductions for the 5-taxable year period ending with such taxable year equals or exceeds 25 percent of the average ordinary gross income of such corporation for such period.

If a corporation has not been in existence during the 5-taxable year period described in clause (ii), then the period of existence of such corporation shall be substituted for such 5-taxable year period.

(B) DEDUCTIONS ALLOWABLE UNDER SECTION 162.—For purposes of subparagraph (A), a deduction shall not be treated as allowable under section 162 if it is specifically allowable under another section.

(C) LIMITATION ON ALLOWABLE DEDUCTIONS.—For purposes of subparagraph (A), no deduction shall be taken into account with respect to compensation for personal services rendered by the 5 individual shareholders holding the largest percentage (by value) of the outstanding stock of the corporation. For purposes of the preceding sentence—

(i) individuals holding less than 5 percent (by value) of the stock of such corporation shall not be taken into account, and

(ii) stock deemed to be owned by a shareholder solely by attribution from a partner under section 544(a)(2) shall be disregarded.

(5) DIVIDENDS MUST EQUAL OR EXCEED EXCESS OF PERSONAL HOLDING COMPANY INCOME OVER 10 PERCENT OF ORDINARY GROSS INCOME.—

(A) IN GENERAL.—The requirements of this paragraph are met if the sum of—

(i) the dividends paid during the taxable year (determined under section 562),

(ii) the dividends considered as paid on the last day of the taxable year under section 563(c) (as limited by the second sentence of section 563(b)), and

(iii) the consent dividends for the taxable year (determined under section 565),

equals or exceeds the amount, if any, by which the personal holding company income for the taxable year exceeds 10 percent of the ordinary gross income of such corporation for such taxable year.

(B) COMPUTATION OF PERSONAL HOLDING COMPANY INCOME.—For purposes of this paragraph, personal holding company income shall be computed—

(i) without regard to amounts described in subsection (a)(1)(C),

(ii) without regard to interest income during any taxable year—

(I) which is in the 5-taxable year period beginning with the later of the 1st taxable year of the corporation or the 1st taxable year in which the corporation conducted the trade or business described in paragraph (2)(A), and

(II) during which the corporation meets the requirements of paragraphs (2), (3), and (4), and

(iii) by including adjusted income from rents and adjusted income from mineral, oil, and gas royalties (within the meaning of paragraphs (2) and (3) of subsection (a)).

(6) SPECIAL RULES FOR AFFILIATED GROUP MEMBERS.—

(A) IN GENERAL.—In any case in which—

(i) the taxpayer receives royalties in connection with the licensing of computer software, and

(ii) another corporation which is a member of the same affiliated group as the taxpayer meets the requirements of paragraphs (2), (3), (4), and (5) with respect to such computer software,

the taxpayer shall be treated as having met such requirements.

(B) AFFILIATED GROUP.—For purposes of this paragraph, the term "affiliated group" has the meaning given such term by section 1504(a).

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Subchapter N—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

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PART I—SOURCE RULES AND OTHER GENERAL RULES RELATING TO FOREIGN INCOME

* * * * * * *

SEC. 864. DEFINITIONS AND SPECIAL RULES.

(a) PRODUCED.—For purposes of this part, the term "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

(b) TRADE OR BUSINESS WITHIN THE UNITED STATES.—For purposes of this part, part II, and chapter 3, the term "trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include—

(1) PERFORMANCE OF PERSONAL SERVICES FOR FOREIGN EMPLOYER.—The performance of personal services—

(A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(B) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,

by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

(2) TRADING IN SECURITIES OR COMMODITIES.—

(A) STOCKS AND SECURITIES.—

(i) IN GENERAL.—Trading in stocks or securities through a resident broker, commission agent, custodian, or other independent agent.

(ii) TRADING FOR TAXPAYER'S OWN ACCOUNT.—Trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in stocks or securities.

(B) COMMODITIES.—

(i) IN GENERAL.—Trading in commodities through a resident broker, commission agent, custodian, or other independent agent.

(ii) TRADING FOR TAXPAYER'S OWN ACCOUNT.—Trading in commodities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in commodities.

(iii) LIMITATION.—Clauses (i) and (ii) shall apply only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the

transaction is of a kind customarily consummated at such place.

(C) LIMITATION.—Subparagraphs (A)(i) and (B)(i) shall apply only if, at no time during the taxable year, the taxpayer has an office or other fixed place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be, are effected.

(c) EFFECTIVELY CONNECTED INCOME, ETC..—

(1) GENERAL RULE.—For purposes of this title—

(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), (4), (6), (7), and (8) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Except as provided in paragraph (6) (7), or (8) or in section 871(d) or sections 882(d) and (e), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States.

(2) PERIODICAL, ETC., INCOME FROM SOURCES WITHIN UNITED STATES—FACTORS.—In determining whether income from sources within the United States of the types described in section 871(a)(1), section 871(h), section 881(a), or section 881(c), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether—

(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss.

In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or business.

(3) OTHER INCOME FROM SOURCES WITHIN UNITED STATES.—All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

(4) INCOME FROM SOURCES WITHOUT UNITED STATES.—(A) Except as provided in subparagraphs (B) and (C), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or loss—

(i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) derived in the active conduct of such trade or business;

(ii) consists of dividends, interest, or amounts received for the provision of guarantees of indebtedness, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stocks or securities for its own account; or

(iii) is derived from the sale or exchange (outside the United States) through such office or other fixed place of business of personal property described in section 1221(a)(1), except that this clause shall not apply if the property is sold or exchanged for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer in a foreign country participated materially in such sale.

Any income or gain which is equivalent to any item of income or gain described in clause (i), (ii), or (iii) shall be treated in the same manner as such item for purposes of this subparagraph.

(C) In the case of a foreign corporation taxable under part I or part II of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States.

(D) No income from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either—

(i) consists of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

(ii) is subpart F income within the meaning of section 952(a).

(5) RULES FOR APPLICATION OF PARAGRAPH (4)(B).—For purposes of subparagraph (B) of paragraph (4)—

(A) in determining whether a nonresident alien individual or a foreign corporation has an office or other fixed place of business, an office or other fixed place of business of an agent shall be disregarded unless such agent (i) has the authority to negotiate and conclude contracts in the name of the nonresident alien individual or foreign corporation and regularly exercises that authority or has a stock of merchandise from which he regularly fills orders on behalf of such individual or foreign corporation, and (ii)

is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business,

(B) income, gain, or loss shall not be considered as attributable to an office or other fixed place of business within the United States unless such office or fixed place of business is a material factor in the production of such income, gain, or loss and such office or fixed place of business regularly carries on activities of the type from which such income, gain, or loss is derived, and

(C) the income, gain, or loss which shall be attributable to an office or other fixed place of business within the United States shall be the income, gain, or loss property allocable thereto, but, in the case of a sale or exchange described in clause (iii) of such subparagraph, the income which shall be treated as attributable to an office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale or exchange were made in the United States.

(6) TREATMENT OF CERTAIN DEFERRED PAYMENTS, ETC..—For purposes of this title, in the case of any income or gain of a nonresident alien individual or a foreign corporation which—

(A) is taken into account for any taxable year, but

(B) is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year,

the determination of whether such income or gain is taxable under section 871(b) or 882 (as the case may be) shall be made as if such income or gain were taken into account in such other taxable year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year referred to in subparagraph (A).

(7) TREATMENT OF CERTAIN PROPERTY TRANSACTIONS.—For purposes of this title, if—

(A) any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, and

(B) such property is disposed of within 10 years after such cessation,

the determination of whether any income or gain attributable to such disposition is taxable under section 871(b) or 882 (as the case may be) shall be made as if such sale or exchange occurred immediately before such cessation and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year for which such income or gain is taken into account.

(8) GAIN OR LOSS OF FOREIGN PERSONS FROM SALE OR EXCHANGE OF CERTAIN PARTNERSHIP INTERESTS.—

(A) IN GENERAL.—Notwithstanding any other provision of this subtitle, if a nonresident alien individual or foreign corporation owns, directly or indirectly, an interest in a partnership which is engaged in any trade or business within the United States, gain or loss on the sale or exchange of all (or any portion of) such interest shall be

treated as effectively connected with the conduct of such trade or business to the extent such gain or loss does not exceed the amount determined under subparagraph (B).

(B) AMOUNT TREATED AS EFFECTIVELY CONNECTED.—The amount determined under this subparagraph with respect to any partnership interest sold or exchanged—

(i) in the case of any gain on the sale or exchange of the partnership interest, is—

(I) the portion of the partner's distributive share of the amount of gain which would have been effectively connected with the conduct of a trade or business within the United States if the partnership had sold all of its assets at their fair market value as of the date of the sale or exchange of such interest, or

(II) zero if no gain on such deemed sale would have been so effectively connected, and

(ii) in the case of any loss on the sale or exchange of the partnership interest, is—

(I) the portion of the partner's distributive share of the amount of loss on the deemed sale described in clause (i)(I) which would have been so effectively connected, or

(II) zero if no loss on such deemed sale would be have been so effectively connected.

For purposes of this subparagraph, a partner's distributive share of gain or loss on the deemed sale shall be determined in the same manner as such partner's distributive share of the non-separately stated taxable income or loss of such partnership.

(C) COORDINATION WITH UNITED STATES REAL PROPERTY INTERESTS.—If a partnership described in subparagraph (A) holds any United States real property interest (as defined in section 897(c)) at the time of the sale or exchange of the partnership interest, then the gain or loss treated as effectively connected income under subparagraph (A) shall be reduced by the amount so treated with respect to such United States real property interest under section 897.

(D) SALE OR EXCHANGE.—For purposes of this paragraph, the term "sale or exchange" means any sale, exchange, or other disposition.

(E) SECRETARIAL AUTHORITY.—The Secretary shall prescribe such regulations or other guidance as the Secretary determines appropriate for the application of this paragraph, including with respect to exchanges described in section 332, 351, 354, 355, 356, or 361.

(d) TREATMENT OF RELATED PERSON FACTORING INCOME.—

(1) IN GENERAL.—For purposes of the provisions set forth in paragraph (2), if any person acquires (directly or indirectly) a trade or service receivable from a related person, any income of such person from the trade or service receivable so acquired shall be treated as if it were interest on a loan to the obligor under the receivable.

(2) PROVISIONS TO WHICH PARAGRAPH (1) APPLIES.—The provisions set forth in this paragraph are as follows:

(A) Section 904 (relating to limitation on foreign tax credit).

(B) Subpart F of part III of this subchapter (relating to controlled foreign corporations).

(3) TRADE OR SERVICE RECEIVABLE.—For purposes of this subsection, the term "trade or service receivable" means any account receivable or evidence of indebtedness arising out of—

(A) the disposition by a related person of property described in section 1221(a)(1), or

(B) the performance of services by a related person.

(4) RELATED PERSON.—For purposes of this subsection, the term "related person" means—

(A) any person who is a related person (within the meaning of section 267(b)), and

(B) any United States shareholder (as defined in section 951(b)) and any person who is a related person (within the meaning of section 267(b)) to such a shareholder.

(5) CERTAIN PROVISIONS NOT TO APPLY.—The following provisions shall not apply to any amount treated as interest under paragraph (1) or (6):

(A) Section 904(d)(2)(B)(iii)(I) (relating to exceptions for export financing interest).

(B) Subparagraph (A) of section 954(b)(3) (relating to exception where foreign base company income is less than 5 percent or $1,000,000).

(C) Subparagraph (B) of section 954(c)(2) (relating to certain export financing).

(D) Clause (i) of section 954(c)(3)(A) (relating to certain income received from related persons).

(6) SPECIAL RULE FOR CERTAIN INCOME FROM LOANS OF A CONTROLLED FOREIGN CORPORATION.—Any income of a controlled foreign corporation (within the meaning of section 957(a)) from a loan to a person for the purpose of financing—

(A) the purchase of property described in section 1221(a)(1) of a related person, or

(B) the payment for the performance of services by a related person,

shall be treated as interest described in paragraph (1).

(7) EXCEPTION FOR CERTAIN RELATED PERSONS DOING BUSINESS IN SAME FOREIGN COUNTRY.—Paragraph (1) shall not apply to any trade or service receivable acquired by any person from a related person if—

(A) the person acquiring such receivable and such related person are created or organized under the laws of the same foreign country and such related person has a substantial part of its assets used in its trade or business located in such same foreign country, and

(B) such related person would not have derived any foreign base company income (as defined in section 954(a), determined without regard to section 954(b)(3)(A)), or any income effectively connected with the conduct of a trade or business within the United States, from such receivable if it had been collected by such related person.

(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to prevent the avoidance of the provisions of this subsection or section 956(c)(3).

(e) RULES FOR ALLOCATING INTEREST, ETC..—For purposes of this subchapter—

(1) TREATMENT OF AFFILIATED GROUPS.—The taxable income of each member of an affiliated group shall be determined by allocating and apportioning interest expense of each member as if all members of such group were a single corporation.

(2) GROSS INCOME AND FAIR MARKET VALUE METHODS MAY NOT BE USED FOR INTEREST.—All allocations and apportionments of interest expense shall be determined using the adjusted bases of assets rather than on the basis of the fair market value of the assets or gross income.

(3) TAX-EXEMPT ASSETS NOT TAKEN INTO ACCOUNT.—For purposes of allocating and apportioning any deductible expense, any tax-exempt asset (and any income from such an asset) shall not be taken into account. A similar rule shall apply in the case of the portion of any dividend (other than a qualifying dividend as defined in section 243(b)) equal to the deduction allowable under section 243 or 245(a) with respect to such dividend and in the case of a like portion of any stock the dividends on which would be so deductible and would not be qualifying dividends (as so defined).

(4) BASIS OF STOCK IN NONAFFILIATED 10-PERCENT OWNED CORPORATIONS ADJUSTED FOR EARNINGS AND PROFITS CHANGES.—

(A) IN GENERAL.—For purposes of allocating and apportioning expenses on the basis of assets, the adjusted basis of any stock in a nonaffiliated 10-percent owned corporation shall be—

(i) increased by the amount of the earnings and profits of such corporation attributable to such stock and accumulated during the period the taxpayer held such stock, or

(ii) reduced (but not below zero) by any deficit in earnings and profits of such corporation attributable to such stock for such period.

(B) NONAFFILIATED 10-PERCENT OWNED CORPORATION.—For purposes of this paragraph, the term "nonaffiliated 10-percent owned corporation" means any corporation if—

(i) such corporation is not included in the taxpayer's affiliated group, and

(ii) members of such affiliated group own 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote.

(C) EARNINGS AND PROFITS OF LOWER TIER CORPORATIONS TAKEN INTO ACCOUNT.—

(i) IN GENERAL.—If, by reason of holding stock in a nonaffiliated 10-percent owned corporation, the taxpayer is treated under clause (iii) as owning stock in another corporation with respect to which the stock ownership requirements of clause (ii) are met, the adjustment under subparagraph (A) shall include an adjustment for the amount of the earnings and profits

(or deficit therein) of such other corporation which are attributable to the stock the taxpayer is so treated as owning and to the period during which the taxpayer is treated as owning such stock.

(ii) STOCK OWNERSHIP REQUIREMENTS.—The stock ownership requirements of this clause are met with respect to any corporation if members of the taxpayer's affiliated group own (directly or through the application of clause (iii)) 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote.

(iii) STOCK OWNED THROUGH ENTITIES.—For purposes of this subparagraph, stock owned (directly or indirectly) by a corporation, partnership, or trust shall be treated as being owned proportionately by its shareholders, partners, or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence, shall, for purposes of applying such sentence, be treated as actually owned by such person.

(D) COORDINATION WITH SUBPART F, ETC..—For purposes of this paragraph, proper adjustment shall be made to the earnings and profits of any corporation to take into account any earnings and profits included in gross income under section 951 or under any other provision of this title and reflected in the adjusted basis of the stock.

(5) AFFILIATED GROUP.—For purposes of this subsection—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term "affiliated group" has the meaning given such term by section 1504. Notwithstanding the preceding sentence, a foreign corporation shall be treated as a member of the affiliated group if—

(i) more than 50 percent of the gross income of such foreign corporation for the taxable year is effectively connected with the conduct of a trade or business within the United States, and

(ii) at least 80 percent of either the vote or value of all outstanding stock of such foreign corporation is owned directly or indirectly by members of the affiliated group (determined with regard to this sentence).

(B) TREATMENT OF CERTAIN FINANCIAL INSTITUTIONS.—For purposes of subparagraph (A), any corporation described in subparagraph (C) shall be treated as an includible corporation for purposes of section 1504 only for purposes of applying such section separately to corporations so described. This subparagraph shall not apply for purposes of paragraph (6).

(C) DESCRIPTION.—A corporation is described in this subparagraph if—

(i) such corporation is a financial institution described in section 581 or 591,

(ii) the business of such financial institution is predominantly with persons other than related persons (within the meaning of subsection (d)(4)) or their customers, and

(iii) such financial institution is required by State or Federal law to be operated separately from any other entity which is not such an institution.

(D) TREATMENT OF BANK HOLDING COMPANIES.—To the extent provided in regulations—

(i) a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956), and

(ii) any subsidiary of a financial institution described in section 581 or 591 or of any bank holding company if such subsidiary is predominantly engaged (directly or indirectly) in the active conduct of a banking, financing, or similar business,

shall be treated as a corporation described in subparagraph (C).

(6) ALLOCATION AND APPORTIONMENT OF OTHER EXPENSES.—Expenses other than interest which are not directly allocable or apportioned to any specific income producing activity shall be allocated and apportioned as if all members of the affiliated group were a single corporation.

(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing—

(A) for the resourcing of income of any member of an affiliated group or modifications to the consolidated return regulations to the extent such resourcing or modification is necessary to carry out the purposes of this section,

(B) for direct allocation of interest expense incurred to carry out an integrated financial transaction to any interest (or interest-type income) derived from such transaction and in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,

(C) for the apportionment of expenses allocated to foreign source income among the members of the affiliated group and various categories of income described in section 904(d)(1),

(D) for direct allocation of interest expense in the case of indebtedness resulting in a disallowance under section 246A,

(E) for appropriate adjustments in the application of paragraph (3) in the case of an insurance company,

(F) preventing assets or interest expense from being taken into account more than once, and

(G) that this subsection shall not apply for purposes of any provision of this subchapter to the extent the Secretary determines that the application of this subsection for such purposes would not be appropriate.

(g) ALLOCATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.—

(1) IN GENERAL.—For purposes of sections 861(b), 862(b), and 863(b), qualified research and experimental expenditures shall be allocated and apportioned as follows:

(A) Any qualified research and experimental expenditures expended solely to meet legal requirements imposed by a political entity with respect to the improvement or

marketing of specific products or processes for purposes not reasonably expected to generate gross income (beyond de minimis amounts) outside the jurisdiction of the political entity shall be allocated only to gross income from sources within such jurisdiction.

(B) In the case of any qualified research and experimental expenditures (not allocated under subparagraph (A)) to the extent—

(i) that such expenditures are attributable to activities conducted in the United States, 50 percent of such expenditures shall be allocated and apportioned to income from sources within the United States and deducted from such income in determining the amount of taxable income from sources within the United States, and

(ii) that such expenditures are attributable to activities conducted outside the United States, 50 percent of such expenditures shall be allocated and apportioned to income from sources outside the United States and deducted from such income in determining the amount of taxable income from sources outside the United States.

(C) The remaining portion of qualified research and experimental expenditures (not allocated under subparagraphs (A) and (B)) shall be apportioned, at the annual election of the taxpayer, on the basis of gross sales or gross income, except that, if the taxpayer elects to apportion on the basis of gross income, the amount apportioned to income from sources outside the United States shall at least be 30 percent of the amount which would be so apportioned on the basis of gross sales.

(2) QUALIFIED RESEARCH AND EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term "qualified research and experimental expenditures" means amounts which are research and experimental expenditures within the meaning of section 174. For purposes of this paragraph, rules similar to the rules of subsection (c) of section 174 shall apply. Any qualified research and experimental expenditures [treated as deferred expenses under subsection (b) of section 174] *allowed as an amortization deduction under section 174(a) or section 174A(c),* shall be taken into account under this subsection for the taxable year for which such expenditures are allowed as a deduction under [such subsection] *such section (as the case may be)*.

(3) SPECIAL RULES FOR EXPENDITURES ATTRIBUTABLE TO ACTIVITIES CONDUCTED IN SPACE, ETC..—

(A) IN GENERAL.—Any qualified research and experimental expenditures described in subparagraph (B)—

(i) if incurred by a United States person, shall be allocated and apportioned under this section in the same manner as if they were attributable to activities conducted in the United States, and

(ii) if incurred by a person other than a United States person, shall be allocated and apportioned under this section in the same manner as if they were

attributable to activities conducted outside the United States.

(B) DESCRIPTION OF EXPENDITURES.—For purposes of subparagraph (A), qualified research and experimental expenditures are described in this subparagraph if such expenditures are attributable to activities conducted—

(i) in space,

(ii) on or under water not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States, or

(iii) in Antarctica.

(4) AFFILIATED GROUP.—(A) Except as provided in subparagraph (B), the allocation and apportionment required by paragraph (1) shall be determined as if all members of the affiliated group (as defined in subsection (e)(5)) were a single corporation.

(B) For purposes of the allocation and apportionment required by paragraph (1)—

(i) sales and gross income from products produced in whole or in part in a possession by an electing corporation (within the meaning of section 936(h)(5)(E)),[2] and

(ii) dividends from an electing corporation,

shall not be taken into account, except that this subparagraph shall not apply to sales of (and gross income and dividends attributable to sales of) products with respect to which an election under section 936(h)(5)(F) [2] is not in effect.

(C) The qualified research and experimental expenditures taken into account for purposes of paragraph (1) shall be adjusted to reflect the amount of such expenditures included in computing the cost-sharing amount (determined under section 936(h)(5)(C)(i)(I)).

(D) The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including regulations providing for the source of gross income and the allocation and apportionment of deductions to take into account the adjustments required by subparagraph (B) or (C).

(E) Paragraph (6) of subsection (e) shall not apply to qualified research and experimental expenditures.

(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection, including regulations relating to the determination of whether any expenses are attributable to activities conducted in the United States or outside the United States and regulations providing such adjustments to the provisions of this subsection as may be appropriate in the case of cost-sharing arrangements and contract research.

(6) APPLICABILITY.—This subsection shall apply to the taxpayer's first taxable year (beginning on or before August 1, 1994) following the taxpayer's last taxable year to which Revenue Procedure 92–56 applies or would apply if the taxpayer elected the benefits of such Revenue Procedure.

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PART II—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

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Subpart D—MISCELLANEOUS PROVISIONS

SEC. 894A. SPECIAL RULES FOR QUALIFIED RESIDENTS OF TAIWAN.

(a) CERTAIN INCOME FROM UNITED STATES SOURCES.—

(1) INTEREST, DIVIDENDS, AND ROYALTIES, ETC.—

(A) IN GENERAL.—In the case of interest (other than original issue discount), dividends, royalties, amounts described in section 871(a)(1)(C), and gains described in section 871(a)(1)(D) received by or paid to a qualified resident of Taiwan—

(i) sections 871(a), 881(a), 1441(a), 1441(c)(5), and 1442(a) shall each be applied by substituting "the applicable percentage (as defined in section 894A(a)(1)(C))" for "30 percent" each place it appears, and

(ii) sections 871(a), 881(a), and 1441(c)(1) shall each be applied by substituting "a United States permanent establishment of a qualified resident of Taiwan" for "a trade or business within the United States" each place it appears.

(B) EXCEPTIONS.—

(i) IN GENERAL.—Subparagraph (A) shall not apply to—

(I) any dividend received from or paid by a real estate investment trust which is not a qualified REIT dividend,

(II) any amount subject to section 897,

(III) any amount received from or paid by an expatriated entity (as defined in section 7874(a)(2)) to a foreign related person (as defined in section 7874(d)(3)), and

(IV) any amount which is included in income under section 860C to the extent that such amount does not exceed an excess inclusion with respect to a REMIC.

(ii) QUALIFIED REIT DIVIDEND.—For purposes of clause (i)(I), the term "qualified REIT dividend" means any dividend received from or paid by a real estate investment trust if such dividend is paid with respect to a class of shares that is publicly traded and the recipient of the dividend is a person who holds an interest in any class of shares of the real estate investment trust of not more than 5 percent.

(C) APPLICABLE PERCENTAGE.—For purposes of applying subparagraph (A)(i)—

(i) IN GENERAL.—Except as provided in clause (ii), the term "applicable percentage" means 10 percent.

(ii) SPECIAL RULES FOR DIVIDENDS.— In the case of any dividend in respect of stock received by or paid to a qualified resident of Taiwan, the applicable percentage shall be 15 percent (10 percent in the case of a dividend which meets the requirements of subparagraph (D) and is received by or paid to an entity taxed as a corporation in Taiwan).

(D) REQUIREMENTS FOR LOWER DIVIDEND RATE.—

(i) IN GENERAL.—The requirements of this subparagraph are met with respect to any dividend in respect of stock in a corporation if, at all times during the 12-month period ending on the date such stock becomes ex-dividend with respect to such dividend—

(I) the dividend is derived by a qualified resident of Taiwan, and

(II) such qualified resident of Taiwan has held directly at least 10 percent (by vote and value) of the total outstanding shares of stock in such corporation.

For purposes of subclause (II), a person shall be treated as directly holding a share of stock during any period described in the preceding sentence if the share was held by a corporation from which such person later acquired that share and such corporation was, at the time the share was acquired, both a connected person to such person and a qualified resident of Taiwan.

(ii) EXCEPTION FOR RICS AND REITS.—Notwithstanding clause (i), the requirements of this subparagraph shall not be treated as met with respect to any dividend paid by a regulated investment company or a real estate investment trust.

(2) QUALIFIED WAGES.—

(A) IN GENERAL.—No tax shall be imposed under this chapter (and no amount shall be withheld under section 1441(a) or chapter 24) with respect to qualified wages paid to a qualified resident of Taiwan who—

(i) is not a resident of the United States (determined without regard to subsection (c)(3)(E)), or

(ii) is employed as a member of the regular component of a ship or aircraft operated in international traffic.

(B) QUALIFIED WAGES.—

(i) IN GENERAL.—The term "qualified wages" means wages, salaries, or similar remunerations with respect to employment involving the performance of personal services within the United States which—

(I) are paid by (or on behalf of) any employer other than a United States person, and

(II) are not borne by a United States permanent establishment of any person other than a United States person.

(ii) EXCEPTIONS.—Such term shall not include directors' fees, income derived as an entertainer or athlete,

income derived as a student or trainee, pensions, amounts paid with respect to employment with the United States, any State (or political subdivision thereof), or any possession of the United States (or any political subdivision thereof), or other amounts specified in regulations or guidance under subsection (f)(1)(F).

(3) INCOME DERIVED FROM ENTERTAINMENT OR ATHLETIC ACTIVITIES.—

(A) IN GENERAL.—No tax shall be imposed under this chapter (and no amount shall be withheld under section 1441(a) or chapter 24) with respect to income derived by an entertainer or athlete who is a qualified resident of Taiwan from personal activities as such performed in the United States if the aggregate amount of gross receipts from such activities for the taxable year do not exceed $30,000.

(B) EXCEPTION.—Subparagraph (A) shall not apply with respect to—

(i) income which is qualified wages (as defined in paragraph (2)(B), determined without regard to clause (ii) thereof), or

(ii) income which is effectively connected with a United States permanent establishment.

(b) INCOME CONNECTED WITH A UNITED STATES PERMANENT ESTABLISHMENT OF A QUALIFIED RESIDENT OF TAIWAN.—

(1) IN GENERAL.—

(A) IN GENERAL.—In lieu of applying sections 871(b) and 882, a qualified resident of Taiwan that carries on a trade or business within the United States through a United States permanent establishment shall be taxable as provided in section 1, 11, 55, or 59A, on its taxable income which is effectively connected with such permanent establishment.

(B) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the permanent establishment.

(2) TREATMENT OF DISPOSITIONS OF UNITED STATES REAL PROPERTY.—In the case of a qualified resident of Taiwan, section 897(a) shall be applied—

(A) by substituting "carried on a trade or business within the United States through a United States permanent establishment" for "were engaged in a trade or business within the United States", and

(B) by substituting "such United States permanent establishment" for "such trade or business".

(3) TREATMENT OF BRANCH PROFITS TAXES.—In the case of any corporation which is a qualified resident of Taiwan, section 884 shall be applied—

(A) by substituting "10 percent" for "30 percent " in subsection (a) thereof, and

(B) by substituting "a United States permanent establishment of a qualified resident of Taiwan" for "the conduct of a trade or business within the United States" in subsection (d)(1) thereof.

(4) SPECIAL RULE WITH RESPECT TO INCOME DERIVED FROM CERTAIN ENTERTAINMENT OR ATHLETIC ACTIVITIES.—

(A) IN GENERAL.—Paragraph (1) shall not apply to the extent that the income is derived—

(i) in respect of entertainment or athletic activities performed in the United States, and

(ii) by a qualified resident of Taiwan who is not the entertainer or athlete performing such activities.

(B) EXCEPTION.—Subparagraph (A) shall not apply if the person described in subparagraph (A)(ii) is contractually authorized to designate the individual who is to perform such activities.

(5) SPECIAL RULE WITH RESPECT TO CERTAIN AMOUNTS.—Paragraph (1) shall not apply to any income which is wages, salaries, or similar remuneration with respect to employment or with respect to any amount which is described in subsection (a)(2)(B)(ii).

(c) QUALIFIED RESIDENT OF TAIWAN.—For purposes of this section—

(1) IN GENERAL.—The term "qualified resident of Taiwan" means any person who—

(A) is liable to tax under the laws of Taiwan by reason of such person's domicile, residence, place of management, place of incorporation, or any similar criterion,

(B) is not a United States person (determined without regard to paragraph (3)(E)), and

(C) in the case of an entity taxed as a corporation in Taiwan, meets the requirements of paragraph (2).

(2) LIMITATION ON BENEFITS FOR CORPORATE ENTITIES OF TAIWAN.—

(A) IN GENERAL.—Subject to subparagraphs (E) and (F), an entity meets the requirements of this paragraph only if it—

(i) meets the ownership and income requirements of subparagraph (B),

(ii) meets the publicly traded requirements of subparagraph (C), or

(iii) meets the qualified subsidiary requirements of subparagraph (D).

(B) OWNERSHIP AND INCOME REQUIREMENTS.—The requirements of this subparagraph are met for an entity if—

(i) at least 50 percent (by vote and value) of the total outstanding shares of stock in such entity are owned directly or indirectly by qualified residents of Taiwan, and

(ii) less than 50 percent of such entity's gross income (and in the case of an entity that is a member of a tested group, less than 50 percent of the tested group's gross income) is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the income taxes imposed by Taiwan, to persons who are not—

(I) qualified residents of Taiwan, or

(II) United States persons who meet such requirements with respect to the United States as de-

termined by the Secretary to be equivalent to the requirements of this subsection (determined without regard to paragraph (1)(B)) with respect to residents of Taiwan.

(C) PUBLICLY TRADED REQUIREMENTS.—An entity meets the requirements of this subparagraph if—

(i) the principal class of its shares (and any disproportionate class of shares) of such entity are primarily and regularly traded on an established securities market in Taiwan, or

(ii) the primary place of management and control of the entity is in Taiwan and all classes of its outstanding shares described in clause (i) are regularly traded on an established securities market in Taiwan.

(D) QUALIFIED SUBSIDIARY REQUIREMENTS.—An entity meets the requirement of this subparagraph if—

(i) at least 50 percent (by vote and value) of the total outstanding shares of the stock of such entity are owned directly or indirectly by 5 or fewer entities—

(I) which meet the requirements of subparagraph (C), or

(II) which are United States persons the principal class of the shares (and any disproportionate class of shares) of which are primarily and regularly traded on an established securities market in the United States, and

(ii) the entity meets the requirements of clause (ii) of subparagraph (B).

(E) ONLY INDIRECT OWNERSHIP THROUGH QUALIFYING INTERMEDIARIES COUNTED.—

(i) IN GENERAL.—Stock in an entity owned by a person indirectly through 1 or more other persons shall not be treated as owned by such person in determining whether the person meets the requirements of subparagraph (B)(i) or (D)(i) unless all such other persons are qualifying intermediate owners.

(ii) QUALIFYING INTERMEDIATE OWNERS.—The term "qualifying intermediate owner" means a person that is—

(I) a qualified resident of Taiwan, or

(II) a resident of any other foreign country (other than a foreign country that is a foreign country of concern) that has in effect a comprehensive convention with the United States for the avoidance of double taxation.

(iii) SPECIAL RULE FOR QUALIFIED SUBSIDIARIES.—For purposes of applying subparagraph (D)(i), the term "qualifying intermediate owner" shall include any person who is a United States person who meets such requirements with respect to the United States as determined by the Secretary to be equivalent to the requirements of this subsection (determined without regard to paragraph (1)(B)) with respect to residents of Taiwan.

(F) CERTAIN PAYMENTS NOT INCLUDED.—In determining whether the requirements of subparagraph (B)(ii) or (D)(ii)

are met with respect to an entity, the following payments shall not be taken into account:

(i) Arm's-length payments by the entity in the ordinary course of business for services or tangible property.

(ii) In the case of a tested group, intra-group transactions.

(3) DUAL RESIDENTS.—

(A) RULES FOR DETERMINATION OF STATUS.—

(i) IN GENERAL.—An individual who is an applicable dual resident and who is described in subparagraph (B), (C), or (D) shall be treated as a qualified resident of Taiwan.

(ii) APPLICABLE DUAL RESIDENT.—For purposes of this paragraph, the term "applicable dual resident" means an individual who—

(I) is not a United States citizen,

(II) is a resident of the United States (determined without regard to subparagraph (E)), and

(III) would be a qualified resident of Taiwan but for paragraph (1)(B).

(B) PERMANENT HOME.—An individual is described in this subparagraph if such individual—

(i) has a permanent home available to such individual in Taiwan, and

(ii) does not have a permanent home available to such individual in the United States.

(C) CENTER OF VITAL INTERESTS.—An individual is described in this subparagraph if—

(i) such individual has a permanent home available to such individual in both Taiwan and the United States, and

(ii) such individual's personal and economic relations (center of vital interests) are closer to Taiwan than to the United States.

(D) HABITUAL ABODE.—An individual is described in this subparagraph if—

(i) such individual—

(I) does not have a permanent home available to such individual in either Taiwan or the United States, or

(II) has a permanent home available to such individual in both Taiwan and the United States but such individual's center of vital interests under subparagraph (C)(ii) cannot be determined, and

(ii) such individual has a habitual abode in Taiwan and not the United States.

(E) UNITED STATES TAX TREATMENT OF QUALIFIED RESIDENT OF TAIWAN.—Notwithstanding section 7701, an individual who is treated as a qualified resident of Taiwan by reason of this paragraph for all or any portion of a taxable year shall not be treated as a resident of the United States for purposes of computing such individual's United States income tax liability for such taxable year or portion thereof.

(4) RULES OF SPECIAL APPLICATION.—

(A) DIVIDENDS.—For purposes of applying this section to any dividend, paragraph (2)(D) shall be applied without regard to clause (ii) thereof.

(B) ITEMS OF INCOME EMANATING FROM AN ACTIVE TRADE OR BUSINESS IN TAIWAN.—For purposes of this section—

(i) IN GENERAL.—Notwithstanding the preceding paragraphs of this subsection, if an entity taxed as a corporation in Taiwan is not a qualified resident of Taiwan but meets the requirements of subparagraphs (A) and (B) of paragraph (1), any qualified item of income such entity derived from the United States shall be treated as income of a qualified resident of Taiwan.

(ii) QUALIFIED ITEMS OF INCOME.—

(I) IN GENERAL.—The term "qualified item of income" means any item of income which emanates from, or is incidental to, the conduct of an active trade or business in Taiwan (other than operating as a holding company, providing overall supervision or administration of a group of companies, providing group financing, or making or managing investments (unless such making or managing investments is carried on by a bank, insurance company, or registered securities dealer in the ordinary course of its business as such)).

(II) SUBSTANTIAL ACTIVITY REQUIREMENT.—An item of income which is derived from a trade or business conducted in the United States or from a connected person shall be a qualified item of income only if the trade or business activity conducted in Taiwan to which the item is related is substantial in relation to the same or a complementary trade or business activity carried on in the United States. For purposes of applying this subclause, activities conducted by persons that are connected to the entity described in clause (i) shall be deemed to be conducted by such entity.

(iii) EXCEPTION.—This subparagraph shall not apply to any item of income derived by an entity if at least 50 percent (by vote or value) of such entity is owned (directly or indirectly) or controlled by residents of a foreign country of concern.

(d) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) UNITED STATES PERMANENT ESTABLISHMENT.—

(A) IN GENERAL.—The term "United States permanent establishment" means, with respect to a qualified resident of Taiwan, a permanent establishment of such resident which is within the United States.

(B) SPECIAL RULE.—The determination of whether there is a permanent establishment of a qualified resident of Taiwan within the United States shall be made without regard to whether an entity which is taxed as a corporation in Taiwan and which is a qualified resident of Taiwan controls or is controlled by—

(i) a domestic corporation, or

(ii) any other person that carries on business in the United States (whether through a permanent establishment or otherwise).

(2) PERMANENT ESTABLISHMENT.—

(A) IN GENERAL.—The term "permanent establishment" means a fixed place of business through which a trade or business is wholly or partly carried on. Such term shall include—

(i) a place of management,

(ii) a branch,

(iii) an office,

(iv) a factory,

(v) a workshop, and

(vi) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

(B) SPECIAL RULES FOR CERTAIN TEMPORARY PROJECTS.—

(i) IN GENERAL.—A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or exploitation of the sea bed and its subsoil and their natural resources, constitutes a permanent establishment only if it lasts, or the activities of the rig or ship lasts, for more than 12 months.

(ii) DETERMINATION OF 12-MONTH PERIOD.—For purposes of clause (i), the period over which a building site or construction or installation project of a person lasts shall include any period of more than 30 days during which such person does not carry on activities at such building site or construction or installation project but connected activities are carried on at such building site or construction or installation project by one or more connected persons.

(C) HABITUAL EXERCISE OF CONTRACT AUTHORITY TREATED AS PERMANENT ESTABLISHMENT.—Notwithstanding subparagraphs (A) and (B), where a person (other than an agent of an independent status to whom subparagraph (D)(ii) applies) is acting on behalf of a trade or business of a qualified resident of Taiwan and has and habitually exercises an authority to conclude contracts that are binding on the trade or business, that trade or business shall be deemed to have a permanent establishment in the country in which such authority is exercised in respect of any activities that the person undertakes for the trade or business, unless the activities of such person are limited to those described in subparagraph (D)(i) that, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that subparagraph.

(D) EXCLUSIONS.—

(i) IN GENERAL.—Notwithstanding subparagraphs (A) and (B), the term "permanent establishment" shall not include—

(I) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the trade or business,

(II) the maintenance of a stock of goods or merchandise belonging to the trade or business solely for the purpose of storage, display, or delivery,

(III) the maintenance of a stock of goods or merchandise belonging to the trade or business solely for the purpose of processing by another trade or business,

(IV) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the trade or business,

(V) the maintenance of a fixed place of business solely for the purpose of carrying on, for the trade or business, any other activity of a preparatory or auxiliary character, or

(VI) the maintenance of a fixed place of business solely for any combination of the activities mentioned in subclauses (I) through (V), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

(ii) BROKERS AND OTHER INDEPENDENT AGENTS.—A trade or business shall not be considered to have a permanent establishment in a country merely because it carries on business in such country through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business as independent agents.

(3) TESTED GROUP.—The term "tested group" includes, with respect to any entity taxed as a corporation in Taiwan, such entity and any other entity taxed as a corporation in Taiwan that—

(A) participates as a member with such entity in a tax consolidation, fiscal unity, or similar regime that requires members of the group to share profits or losses, or

(B) shares losses with such entity pursuant to a group relief or other loss sharing regime.

(4) CONNECTED PERSON.—Two persons shall be "connected persons" if one owns, directly or indirectly, at least 50 percent of the interests in the other (or, in the case of a corporation, at least 50 percent of the aggregate vote and value of the corporation's shares) or another person owns, directly or indirectly, at least 50 percent of the interests (or, in the case of a corporation, at least 50 percent of the aggregate vote and value of the corporation's shares) in each person. In any case, a person shall be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

(5) FOREIGN COUNTRY OF CONCERN.—The term "foreign country of concern" has the meaning given such term under paragraph (7) of section 9901 of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 (15 U.S.C. 4651(7)), as added by section 103(a)(4) of the CHIPS Act of 2022).

(6) PARTNERSHIPS; BENEFICIARIES OF ESTATES AND TRUSTS.—For purposes of this section—

(A) a qualified resident of Taiwan which is a partner of a partnership which carries on a trade or business within the United States through a United States permanent establishment shall be treated as carrying on such trade or business through such permanent establishment, and

(B) a qualified resident of Taiwan which is a beneficiary of an estate or trust which carries on a trade or business within the United States through a United States permanent establishment shall be treated as carrying on such trade or business through such permanent establishment.

(7) DENIAL OF BENEFITS FOR CERTAIN PAYMENTS THROUGH HYBRID ENTITIES.—For purposes of this section, rules similar to the rules of section 894(c) shall apply.

(e) APPLICATION.—

(1) IN GENERAL.—This section shall not apply to any period unless the Secretary has determined that Taiwan has provided benefits to United States persons for such period that are reciprocal to the benefits provided to qualified residents of Taiwan under this section.

(2) PROVISION OF RECIPROCITY.—The President or his designee is authorized to exchange letters, enter into an agreement, or take other necessary and appropriate steps relative to Taiwan for the reciprocal provision of the benefits described in this section.

(f) REGULATIONS OR OTHER GUIDANCE.—

(1) IN GENERAL.—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including such regulations or guidance for—

(A) determining—

(i) what constitutes a United States permanent establishment of a qualified resident of Taiwan, and

(ii) income that is effectively connected with such a permanent establishment,

(B) preventing the abuse of the provisions of this section by persons who are not (or who should not be treated as) qualified residents of Taiwan,

(C) requirements for record keeping and reporting,

(D) rules to assist withholding agents or employers in determining whether a foreign person is a qualified resident of Taiwan for purposes of determining whether withholding or reporting is required for a payment (and, if withholding is required, whether it should be applied at a reduced rate),

(E) the application of subsection (a)(1)(D)(i) to stock held by predecessor owners,

(F) determining what amounts are to be treated as qualified wages for purposes of subsection (a)(2),

(G) determining the amounts to which subsection (a)(3) applies,

(H) defining established securities market for purposes of subsection (c),

(I) the application of the rules of subsection (c)(4)(B),

(J) the application of subsection (d)(6) and section 1446,

(K) determining ownership interests held by residents of a foreign country of concern, and

(L) determining the starting and ending dates for periods with respect to the application of this section under subsection (e), which may be separate dates for taxes withheld at the source and other taxes.

(2) REGULATIONS TO BE CONSISTENT WITH MODEL TREATY.—Any regulations or other guidance issued under this section shall, to the extent practical, be consistent with the provisions of the United States model income tax convention dated February 7, 2016.

Subchapter O—GAIN OR LOSS ON DISPOSITION OF PROPERTY

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PART II—BASIS RULES OF GENERAL APPLICATION

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SEC. 1016. ADJUSTMENTS TO BASIS

(a) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made—

(A) for—

(i) taxes or other carrying charges described in section 266; or

(ii) expenditures described in section 173 (relating to circulation expenditures),

for which deductions have been taken by the taxpayer in determining taxable income for the taxable year or prior taxable years; or

(B) for mortality, expense, or other reasonable charges incurred under an annuity or life insurance contract;

(2) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount—

(A) allowed as deductions in computing taxable income under this subtitle or prior income tax laws, and

(B) resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under this subtitle (other than chapter 2, relating to tax on self-employment income), or prior income, war-profits, or excess-profits tax laws,

but not less than the amount allowable under this subtitle or prior income tax laws. Where no method has been adopted under section 167 (relating to depreciation deduction), the amount allowable shall be determined under the straight line method. Subparagraph (B) of this paragraph shall not apply in respect of any period since February 28, 1913, and before January 1, 1952, unless an election has been made under section 1020 (as in effect before the date of the enactment of the Tax Reform Act of 1976). Where for any taxable year before the

taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

(3) in respect of any period—

(A) before March 1, 1913,

(B) since February 28, 1913, during which such property was held by a person or an organization not subject to income taxation under this chapter or prior income tax laws,

(C) since February 28, 1913, and before January 1, 1958, during which such property was held by a person subject to tax under part I of subchapter L (or the corresponding provisions of prior income tax laws), to the extent that paragraph (2) does not apply, and

(D) since February 28, 1913, during which such property was held by a person subject to tax under part II of subchapter L as in effect prior to its repeal by the Tax Reform Act of 1986 (or the corresponding provisions of prior income tax laws), to the extent that paragraph (2) does not apply,

for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent sustained;

(4) in the case of stock (to the extent not provided for in the foregoing paragraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 (40 Stat. 1057), or the Revenue Act of 1921 (42 Stat. 227), out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921);

(5) in the case of any bond (as defined in section 171(d)) the interest on which is wholly exempt from the tax imposed by this subtitle, to the extent of the amortizable bond premium disallowable as a deduction pursuant to section 171(a)(2), and in the case of any other bond (as defined in section 171(d)) to the extent of the deductions allowable pursuant to section 171(a)(1) (or the amount applied to reduce interest payments under section 171(e)(2)) with respect thereto;

(6) in the case of any municipal bond (as defined in section 75(b)), to the extent provided in section 75(a)(2);

(7) in the case of a residence the acquisition of which resulted, under section 1034 (as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997), in the nonrecognition of any part of the gain realized on the sale, exchange, or involuntary conversion of another residence, to the extent provided in section 1034(e) (as so in effect);

(8) in the case of property pledged to the Commodity Credit Corporation, to the extent of the amount received as a loan from the Commodity Credit Corporation and treated by the taxpayer as income for the year in which received pursuant to section 77, and to the extent of any deficiency on such loan

with respect to which the taxpayer has been relieved from liability;

(9) for amounts allowed as deductions as deferred expenses under section 616(b) (relating to certain expenditures in the development of mines) and resulting in a reduction of the taxpayer's taxes under this subtitle, but not less than the amounts allowable under such section for the taxable year and prior years;

(11) for deductions to the extent disallowed under section 268 (relating to sale of land with unharvested crops), notwithstanding the provisions of any other paragraph of this subsection;

(14) for amounts allowed as [deductions as deferred expenses under section 174(b)(1) (relating to research and experimental expenditures)] *deductions under section 174 or 174A* and resulting in a reduction of the taxpayers' taxes under this subtitle, but not less than the amounts allowable under such section for the taxable year and prior years;

(15) for deductions to the extent disallowed under section 272 (relating to disposal of coal or domestic iron ore), notwithstanding the provisions of any other paragraph of this subsection;

(16) in the case of any evidence of indebtedness referred to in section 811(b) (relating to amortization of premium and accrual of discount in the case of life insurance companies), to the extent of the adjustments required under section 811(b) (or the corresponding provisions of prior income tax laws) for the taxable year and all prior taxable years;

(17) to the extent provided in section 1367 in the case of stock of, and indebtedness owed to, shareholders of an S corporation;

(18) to the extent provided in section 961 in the case of stock in controlled foreign corporations (or foreign corporations which were controlled foreign corporations) and of property by reason of which a person is considered as owning such stock;

(19) to the extent provided in section 50(c), in the case of expenditures with respect to which a credit has been allowed under section 38;

(20) for amounts allowed as deductions under section 59(e) (relating to optional 10-year writeoff of certain tax preferences);

(21) to the extent provided in section 1059 (relating to reduction in basis for extraordinary dividends);

(22) in the case of qualified replacement property the acquisition of which resulted under section 1042 in the nonrecognition of any part of the gain realized on the sale or exchange of any property, to the extent provided in section 1042(d),

(23) in the case of property the acquisition of which resulted under section 1043, 1045, or 1397B in the nonrecognition of any part of the gain realized on the sale of other property, to the extent provided in section 1043(c), 1045(b)(3), or 1397B(b)(4), as the case may be,

(26) to the extent provided in sections 23(g) and 137(e),

(28) in the case of a facility with respect to which a credit was allowed under section 45F, to the extent provided in section 45F(f)(1),

(29) in the case of railroad track with respect to which a credit was allowed under section 45G, to the extent provided in section 45G(e)(3),

(30) to the extent provided in section 179B(c),

(31) to the extent provided in section 179D(e),

(32) to the extent provided in section 45L(e), in the case of amounts with respect to which a credit has been allowed under section 45L,

(33) to the extent provided in section 25C(g), in the case of amounts with respect to which a credit has been allowed under section 25C,

(34) to the extent provided in section 25D(f), in the case of amounts with respect to which a credit has been allowed under section 25D,

(35) to the extent provided in section 30B(h)(4),

(36) to the extent provided in section 30C(e)(1),

(37) to the extent provided in section 30D(f)(1), and

(38) to the extent provided in subsections (b)(2) and (c) of section 1400Z–2.

(b) SUBSTITUTED BASIS.—Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, then the adjustments provided in subsection (a) shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases.

(c) INCREASE IN BASIS OF PROPERTY ON WHICH ADDITIONAL ESTATE TAX IS IMPOSED.—

(1) TAX IMPOSED WITH RESPECT TO ENTIRE INTEREST.—If an additional estate tax is imposed under section 2032A(c)(1) with respect to any interest in property and the qualified heir makes an election under this subsection with respect to the imposition of such tax, the adjusted basis of such interest shall be increased by an amount equal to the excess of—

(A) the fair market value of such interest on the date of the decedent's death (or the alternate valuation date under section 2032, if the executor of the decedent's estate elected the application of such section), over

(B) the value of such interest determined under section 2032A(a).

(2) PARTIAL DISPOSITIONS.—

(A) IN GENERAL.—In the case of any partial disposition for which an election under this subsection is made, the increase in basis under paragraph (1) shall be an amount—

(i) which bears the same ratio to the increase which would be determined under paragraph (1) (without regard to this paragraph) with respect to the entire interest, as

(ii) the amount of the tax imposed under section 2032A(c)(1) with respect to such disposition bears to

the adjusted tax difference attributable to the entire interest (as determined under section 2032A(c)(2)(B)).

(B) PARTIAL DISPOSITION.—For purposes of subparagraph (A), the term "partial disposition" means any disposition or cessation to which subsection (c)(2)(D), (h)(1)(B), or (i)(1)(B) of section 2032A applies.

(3) TIME ADJUSTMENT MADE.—Any increase in basis under this subsection shall be deemed to have occurred immediately before the disposition or cessation resulting in the imposition of the tax under section 2032A(c)(1).

(4) SPECIAL RULE IN THE CASE OF SUBSTITUTED PROPERTY.—If the tax under section 2032A(c)(1) is imposed with respect to qualified replacement property (as defined in section 2032A(h)(3)(B)) or qualified exchange property (as defined in section 2032A(i)(3)), the increase in basis under paragraph (1) shall be made by reference to the property involuntarily converted or exchanged (as the case may be).

(5) ELECTION.—

(A) IN GENERAL.—An election under this subsection shall be made at such time and in such manner as the Secretary shall by regulations prescribe. Such an election, once made, shall be irrevocable.

(B) INTEREST ON RECAPTURED AMOUNT.—If an election is made under this subsection with respect to any additional estate tax imposed under section 2032A(c)(1), for purposes of section 6601 (relating to interest on underpayments), the last date prescribed for payment of such tax shall be deemed to be the last date prescribed for payment of the tax imposed by section 2001 with respect to the estate of the decedent (as determined for purposes of section 6601).

(d) REDUCTION IN BASIS OF AUTOMOBILE ON WHICH GAS GUZZLER TAX WAS IMPOSED.—If—

(1) the taxpayer acquires any automobile with respect to which a tax was imposed by section 4064, and

(2) the use of such automobile by the taxpayer begins not more than 1 year after the date of the first sale for ultimate use of such automobile,

the basis of such automobile shall be reduced by the amount of the tax imposed by section 4064 with respect to such automobile. In the case of importation, if the date of entry or withdrawal from warehouse for consumption is later than the date of the first sale for ultimate use, such later date shall be substituted for the date of such first sale in the preceding sentence.

(e) CROSS REFERENCE.—For treatment of separate mineral interests as one property, see section 614.

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Subchapter P—Capital Gains and Losses

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PART I—TREATMENT OF CAPITAL GAINS

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SEC. 1202. PARTIAL EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK

(a) EXCLUSION.—

(1) IN GENERAL.—In the case of a taxpayer other than a corporation, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

(2) EMPOWERMENT ZONE BUSINESSES.—

(A) IN GENERAL.—In the case of qualified small business stock acquired after the date of the enactment of this paragraph in a corporation which is a qualified business entity (as defined in section 1397C(b)) during substantially all of the taxpayer's holding period for such stock, paragraph (1) shall be applied by substituting "60 percent" for "50 percent".

(B) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (5) and (7) of section 1400B(b) (as in effect before its repeal) shall apply for purposes of this paragraph.

(C) GAIN AFTER 2018 NOT QUALIFIED.—Subparagraph (A) shall not apply to gain attributable to periods after December 31, 2018.

(D) TREATMENT OF DC ZONE.—The District of Columbia Enterprise Zone shall not be treated as an empowerment zone for purposes of this paragraph.

(3) SPECIAL RULES FOR 2009 AND CERTAIN PERIODS IN 2010.—In the case of qualified small business stock acquired after the date of the enactment of this paragraph and on or before the date of the enactment of the Creating Small Business Jobs Act of 2010—

(A) paragraph (1) shall be applied by substituting "75 percent" for "50 percent", and

(B) paragraph (2) shall not apply.

In the case of any stock which would be described in the preceding sentence (but for this sentence), the acquisition date for purposes of this subsection shall be the first day on which such stock was held by the taxpayer determined after the application of section 1223.

(4) 100 PERCENT EXCLUSION FOR STOCK ACQUIRED DURING CERTAIN PERIODS IN 2010 AND THEREAFTER.—In the case of qualified small business stock acquired after the date of the enactment of the Creating Small Business Jobs Act of 2010—

(A) paragraph (1) shall be applied by substituting "100 percent" for "50 percent",

(B) paragraph (2) shall not apply, and

(C) paragraph (7) of section 57(a) shall not apply.

In the case of any stock which would be described in the preceding sentence (but for this sentence), the acquisition date for purposes of this subsection shall be the first day on which such stock was held by the taxpayer determined after the application of section 1223.

(b) PER-ISSUER LIMITATION ON TAXPAYER'S ELIGIBLE GAIN.—

(1) IN GENERAL.—If the taxpayer has eligible gain for the taxable year from 1 or more dispositions of stock issued by any corporation, the aggregate amount of such gain from disposi-

tions of stock issued by such corporation which may be taken into account under subsection (a) for the taxable year shall not exceed the greater of—

(A) $10,000,000 reduced by the aggregate amount of eligible gain taken into account by the taxpayer under subsection (a) for prior taxable years and attributable to dispositions of stock issued by such corporation, or

(B) 10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year.

For purposes of subparagraph (B), the adjusted basis of any stock shall be determined without regard to any addition to basis after the date on which such stock was originally issued.

(2) ELIGIBLE GAIN.—For purposes of this subsection, the term "eligible gain" means any gain from the sale or exchange of qualified small business stock held for more than 5 years.

(3) TREATMENT OF MARRIED INDIVIDUALS.—

(A) SEPARATE RETURNS.—In the case of a separate return by a married individual, paragraph (1)(A) shall be applied by substituting "$5,000,000" for "$10,000,000".

(B) ALLOCATION OF EXCLUSION.—In the case of any joint return, the amount of gain taken into account under subsection (a) shall be allocated equally between the spouses for purposes of applying this subsection to subsequent taxable years.

(C) MARITAL STATUS.—For purposes of this subsection, marital status shall be determined under section 7703.

(c) QUALIFIED SMALL BUSINESS STOCK.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this section, the term "qualified small business stock" means any stock in a C corporation which is originally issued after the date of the enactment of the Revenue Reconciliation Act of 1993, if—

(A) as of the date of issuance, such corporation is a qualified small business, and

(B) except as provided in subsections (f) and (h), such stock is acquired by the taxpayer at its original issue (directly or through an underwriter)—

(i) in exchange for money or other property (not including stock), or

(ii) as compensation for services provided to such corporation (other than services performed as an underwriter of such stock).

(2) ACTIVE BUSINESS REQUIREMENT; ETC..—

(A) IN GENERAL.—Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for such stock, such corporation meets the active business requirements of subsection (e) and such corporation is a C corporation.

(B) SPECIAL RULE FOR CERTAIN SMALL BUSINESS INVESTMENT COMPANIES.—

(i) WAIVER OF ACTIVE BUSINESS REQUIREMENT.—Notwithstanding any provision of subsection (e), a corporation shall be treated as meeting the active busi-

ness requirements of such subsection for any period during which such corporation qualifies as a specialized small business investment company.

(ii) SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY.—For purposes of clause (i), the term "specialized small business investment company" means any eligible corporation (as defined in subsection (e)(4)) which is licensed to operate under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993).

(3) CERTAIN PURCHASES BY CORPORATION OF ITS OWN STOCK.—

(A) REDEMPTIONS FROM TAXPAYER OR RELATED PERSON.—Stock acquired by the taxpayer shall not be treated as qualified small business stock if, at any time during the 4-year period beginning on the date 2 years before the issuance of such stock, the corporation issuing such stock purchased (directly or indirectly) any of its stock from the taxpayer or from a person related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

(B) SIGNIFICANT REDEMPTIONS.—Stock issued by a corporation shall not be treated as qualified business stock if, during the 2-year period beginning on the date 1 year before the issuance of such stock, such corporation made 1 or more purchases of its stock with an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of its stock as of the beginning of such 2-year period.

(C) TREATMENT OF CERTAIN TRANSACTIONS.—If any transaction is treated under section 304(a) as a distribution in redemption of the stock of any corporation, for purposes of subparagraphs (A) and (B), such corporation shall be treated as purchasing an amount of its stock equal to the amount treated as such a distribution under section 304(a).

(d) QUALIFIED SMALL BUSINESS.—For purposes of this section—

(1) IN GENERAL.—The term "qualified small business" means any domestic corporation which is a C corporation if—

(A) the aggregate gross assets of such corporation (or any predecessor thereof) at all times on or after the date of the enactment of the Revenue Reconciliation Act of 1993 and before the issuance did not exceed $50,000,000,

(B) the aggregate gross assets of such corporation immediately after the issuance (determined by taking into account amounts received in the issuance) do not exceed $50,000,000, and

(C) such corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.

(2) AGGREGATE GROSS ASSETS.—

(A) IN GENERAL.—For purposes of paragraph (1), the term "aggregate gross assets" means the amount of cash and the aggregate adjusted bases of other property held by the corporation.

(B) TREATMENT OF CONTRIBUTED PROPERTY.—For purposes of subparagraph (A), the adjusted basis of any property contributed to the corporation (or other property with a basis determined in whole or in part by reference to the adjusted basis of property so contributed) shall be determined as if the basis of the property contributed to the corporation (immediately after such contribution) were equal to its fair market value as of the time of such contribution.

(3) AGGREGATION RULES.—

(A) IN GENERAL.—All corporations which are members of the same parent-subsidiary controlled group shall be treated as 1 corporation for purposes of this subsection.

(B) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of subparagraph (A), the term "parent-subsidiary controlled group" means any controlled group of corporations as defined in section 1563(a)(1), except that—

(i) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and

(ii) section 1563(a)(4) shall not apply.

(e) ACTIVE BUSINESS REQUIREMENT.—

(1) IN GENERAL.—For purposes of subsection (c)(2), the requirements of this subsection are met by a corporation for any period if during such period—

(A) at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses, and

(B) such corporation is an eligible corporation.

(2) SPECIAL RULE FOR CERTAIN ACTIVITIES.—For purposes of paragraph (1), if, in connection with any future qualified trade or business, a corporation is engaged in—

(A) start-up activities described in section 195(c)(1)(A),

(B) activities resulting in the payment or incurring of expenditures which may be treated as **[**research and experimental expenditures under section 174**]** *specified research or experimental expenditures under section 174 or domestic research or experimental expenditures under section 174A*, or

(C) activities with respect to in-house research expenses described in section 41(b)(4),

assets used in such activities shall be treated as used in the active conduct of a qualified trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from such activities at the time of the determination.

(3) QUALIFIED TRADE OR BUSINESS.—For purposes of this subsection, the term "qualified trade or business" means any trade or business other than—

(A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,

(B) any banking, insurance, financing, leasing, investing, or similar business,

(C) any farming business (including the business of raising or harvesting trees),

(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

(E) any business of operating a hotel, motel, restaurant, or similar business.

(4) ELIGIBLE CORPORATION.—For purposes of this subsection, the term "eligible corporation" means any domestic corporation; except that such term shall not include—

(A) a DISC or former DISC,

(B) a regulated investment company, real estate investment trust, or REMIC, and

(C) a cooperative.

(5) STOCK IN OTHER CORPORATIONS.—

(A) LOOK-THRU IN CASE OF SUBSIDIARIES.—For purposes of this subsection, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary's assets, and to conduct its ratable share of the subsidiary's activities.

(B) PORTFOLIO STOCK OR SECURITIES.—A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consists of stock or securities in other corporations which are not subsidiaries of such corporation (other than assets described in paragraph (6)).

(C) SUBSIDIARY.—For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of such corporation.

(6) WORKING CAPITAL.—For purposes of paragraph (1)(A), any assets which—

(A) are held as a part of the reasonably required working capital needs of a qualified trade or business of the corporation, or

(B) are held for investment and are reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business,

shall be treated as used in the active conduct of a qualified trade or business. For periods after the corporation has been in existence for at least 2 years, in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business by reason of this paragraph.

(7) MAXIMUM REAL ESTATE HOLDINGS.—A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets consists of real property which is not used in the active conduct of a qualified trade or business. For pur-

poses of the preceding sentence, the ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a qualified trade or business.

(8) COMPUTER SOFTWARE ROYALTIES.—For purposes of paragraph (1), rights to computer software which produces active business computer software royalties (within the meaning of section 543(d)(1)) shall be treated as an asset used in the active conduct of a trade or business.

(f) STOCK ACQUIRED ON CONVERSION OF OTHER STOCK.—If any stock in a corporation is acquired solely through the conversion of other stock in such corporation which is qualified small business stock in the hands of the taxpayer—

(1) the stock so acquired shall be treated as qualified small business stock in the hands of the taxpayer, and

(2) the stock so acquired shall be treated as having been held during the period during which the converted stock was held.

(g) TREATMENT OF PASS-THRU ENTITIES.—

(1) IN GENERAL.—If any amount included in gross income by reason of holding an interest in a pass-thru entity meets the requirements of paragraph (2)—

(A) such amount shall be treated as gain described in subsection (a), and

(B) for purposes of applying subsection (b), such amount shall be treated as gain from a disposition of stock in the corporation issuing the stock disposed of by the pass-thru entity and the taxpayer's proportionate share of the adjusted basis of the pass-thru entity in such stock shall be taken into account.

(2) REQUIREMENTS.—An amount meets the requirements of this paragraph if—

(A) such amount is attributable to gain on the sale or exchange by the pass-thru entity of stock which is qualified small business stock in the hands of such entity (determined by treating such entity as an individual) and which was held by such entity for more than 5 years, and

(B) such amount is includible in the gross income of the taxpayer by reason of the holding of an interest in such entity which was held by the taxpayer on the date on which such pass-thru entity acquired such stock and at all times thereafter before the disposition of such stock by such pass-thru entity.

(3) LIMITATION BASED ON INTEREST ORIGINALLY HELD BY TAXPAYER.—Paragraph (1) shall not apply to any amount to the extent such amount exceeds the amount to which paragraph (1) would have applied if such amount were determined by reference to the interest the taxpayer held in the pass-thru entity on the date the qualified small business stock was acquired.

(4) PASS-THRU ENTITY.—For purposes of this subsection, the term "pass-thru entity" means—

(A) any partnership,

(B) any S corporation,

(C) any regulated investment company, and

(D) any common trust fund.

(h) CERTAIN TAX-FREE AND OTHER TRANSFERS.—For purposes of this section—

(1) IN GENERAL.—In the case of a transfer described in paragraph (2), the transferee shall be treated as—

(A) having acquired such stock in the same manner as the transferor, and

(B) having held such stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subsection) by the transferor.

(2) DESCRIPTION OF TRANSFERS.—A transfer is described in this subsection if such transfer is—

(A) by gift,

(B) at death, or

(C) from a partnership to a partner of stock with respect to which requirements similar to the requirements of subsection (g) are met at the time of the transfer (without regard to the 5-year holding period requirement).

(3) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of section 1244(d)(2) shall apply for purposes of this section.

(4) INCORPORATIONS AND REORGANIZATIONS INVOLVING NONQUALIFIED STOCK.—

(A) IN GENERAL.—In the case of a transaction described in section 351 or a reorganization described in section 368, if qualified small business stock is exchanged for other stock which would not qualify as qualified small business stock but for this subparagraph, such other stock shall be treated as qualified small business stock acquired on the date on which the exchanged stock was acquired.

(B) LIMITATION.—This section shall apply to gain from the sale or exchange of stock treated as qualified small business stock by reason of subparagraph (A) only to the extent of the gain which would have been recognized at the time of the transfer described in subparagraph (A) if section 351 or 368 had not applied at such time. The preceding sentence shall not apply if the stock which is treated as qualified small business stock by reason of subparagraph (A) is issued by a corporation which (as of the time of the transfer described in subparagraph (A)) is a qualified small business.

(C) SUCCESSIVE APPLICATION.—For purposes of this paragraph, stock treated as qualified small business stock under subparagraph (A) shall be so treated for subsequent transactions or reorganizations, except that the limitation of subparagraph (B) shall be applied as of the time of the first transfer to which such limitation applied (determined after the application of the second sentence of subparagraph (B)).

(D) CONTROL TEST.—In the case of a transaction described in section 351, this paragraph shall apply only if, immediately after the transaction, the corporation issuing the stock owns directly or indirectly stock representing control (within the meaning of section 368(c)) of the corporation whose stock was exchanged.

(i) BASIS RULES.—For purposes of this section—

(1) STOCK EXCHANGED FOR PROPERTY.—In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation—

(A) such stock shall be treated as having been acquired by the taxpayer on the date of such exchange, and

(B) the basis of such stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

(2) TREATMENT OF CONTRIBUTIONS TO CAPITAL.—If the adjusted basis of any qualified small business stock is adjusted by reason of any contribution to capital after the date on which such stock was originally issued, in determining the amount of the adjustment by reason of such contribution, the basis of the contributed property shall in no event be treated as less than its fair market value on the date of the contribution.

(j) TREATMENT OF CERTAIN SHORT POSITIONS.—

(1) IN GENERAL.—If the taxpayer has an offsetting short position with respect to any qualified small business stock, subsection (a) shall not apply to any gain from the sale or exchange of such stock unless—

(A) such stock was held by the taxpayer for more than 5 years as of the first day on which there was such a short position, and

(B) the taxpayer elects to recognize gain as if such stock were sold on such first day for its fair market value.

(2) OFFSETTING SHORT POSITION.—For purposes of paragraph (1), the taxpayer shall be treated as having an offsetting short position with respect to any qualified small business stock if—

(A) the taxpayer has made a short sale of substantially identical property,

(B) the taxpayer has acquired an option to sell substantially identical property at a fixed price, or

(C) to the extent provided in regulations, the taxpayer has entered into any other transaction which substantially reduces the risk of loss from holding such qualified small business stock.

For purposes of the preceding sentence, any reference to the taxpayer shall be treated as including a reference to any person who is related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

(k) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise.

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CHAPTER 3—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subchapter A—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

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SEC. 1447. WITHHOLDING FOR QUALIFIED RESIDENTS OF TAIWAN.

For reduced rates of withholding for certain residents of Taiwan, see section 894A.

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Subtitle C—Employment Taxes

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CHAPTER 21—FEDERAL INSURANCE CONTRIBUTIONS ACT

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Subchapter D—CREDITS

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SEC. 3134. EMPLOYEE RETENTION CREDIT FOR EMPLOYERS SUBJECT TO CLOSURE DUE TO COVID–19.

(a) IN GENERAL.—In the case of an eligible employer, there shall be allowed as a credit against applicable employment taxes for each calendar quarter an amount equal to 70 percent of the qualified wages with respect to each employee of such employer for such calendar quarter.

(b) LIMITATIONS AND REFUNDABILITY.—

(1) IN GENERAL.—

(A) WAGES TAKEN INTO ACCOUNT.—The amount of qualified wages with respect to any employee which may be taken into account under subsection (a) by the eligible employer for any calendar quarter shall not exceed $10,000.

(B) RECOVERY STARTUP BUSINESSES.—In the case of an eligible employer which is a recovery startup business (as defined in subsection (c)(5)), the amount of the credit allowed under subsection (a) (after application of subparagraph (A)) for any calendar quarter shall not exceed $50,000.

(2) CREDIT LIMITED TO EMPLOYMENT TAXES.—The credit allowed by subsection (a) with respect to any calendar quarter shall not exceed the applicable employment taxes (reduced by any credits allowed under sections 3131 and 3132) on the

wages paid with respect to the employment of all the employees of the eligible employer for such calendar quarter.

(3) REFUNDABILITY OF EXCESS CREDIT.—If the amount of the credit under subsection (a) exceeds the limitation of paragraph (2) for any calendar quarter, such excess shall be treated as an overpayment that shall be refunded under sections 6402(a) and 6413(b).

(c) DEFINITIONS.—For purposes of this section—

(1) APPLICABLE EMPLOYMENT TAXES.—The term "applicable employment taxes" means the following:

(A) The taxes imposed under section 3111(b).

(B) So much of the taxes imposed under section 3221(a) as are attributable to the rate in effect under section 3111(b).

(2) ELIGIBLE EMPLOYER.—

(A) IN GENERAL.—The term "eligible employer" means any employer—

(i) which was carrying on a trade or business during the calendar quarter for which the credit is determined under subsection (a), and

(ii) with respect to any calendar quarter, for which—

(I) the operation of the trade or business described in clause (i) is fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID–19),

(II) the gross receipts (within the meaning of section 448(c)) of such employer for such calendar quarter are less than 80 percent of the gross receipts of such employer for the same calendar quarter in calendar year 2019, or

(III) the employer is a recovery startup business (as defined in paragraph (5)).

With respect to any employer for any calendar quarter, if such employer was not in existence as of the beginning of the same calendar quarter in calendar year 2019, clause (ii)(II) shall be applied by substituting "2020" for "2019".

(B) ELECTION TO USE ALTERNATIVE QUARTER.—At the election of the employer—

(i) subparagraph (A)(ii)(II) shall be applied—

(I) by substituting "for the immediately preceding calendar quarter" for "for such calendar quarter", and

(II) by substituting "the corresponding calendar quarter in calendar year 2019" for "the same calendar quarter in calendar year 2019", and

(ii) the last sentence of subparagraph (A) shall be applied by substituting "the corresponding calendar quarter in calendar year 2019" for "the same calendar quarter in calendar year 2019".

An election under this subparagraph shall be made at such time and in such manner as the Secretary shall prescribe.

(C) TAX-EXEMPT ORGANIZATIONS.—In the case of an organization which is described in section 501(c) and exempt from tax under section 501(a)—

(i) clauses (i) and (ii)(I) of subparagraph (A) shall apply to all operations of such organization, and

(ii) any reference in this section to gross receipts shall be treated as a reference to gross receipts within the meaning of section 6033.

(3) QUALIFIED WAGES.—

(A) IN GENERAL.—The term "qualified wages" means—

(i) in the case of an eligible employer for which the average number of full-time employees (within the meaning of section 4980H) employed by such eligible employer during 2019 was greater than 500, wages paid by such eligible employer with respect to which an employee is not providing services due to circumstances described in subclause (I) or (II) of paragraph (2)(A)(ii), or

(ii) in the case of an eligible employer for which the average number of full-time employees (within the meaning of section 4980H) employed by such eligible employer during 2019 was not greater than 500—

(I) with respect to an eligible employer described in subclause (I) of paragraph (2)(A)(ii), wages paid by such eligible employer with respect to an employee during any period described in such clause, or

(II) with respect to an eligible employer described in subclause (II) of such paragraph, wages paid by such eligible employer with respect to an employee during such quarter.

(B) SPECIAL RULE FOR EMPLOYERS NOT IN EXISTENCE IN 2019.—In the case of any employer that was not in existence in 2019, subparagraph (A) shall be applied by substituting "2020" for "2019" each place it appears.

(C) SEVERELY FINANCIALLY DISTRESSED EMPLOYERS.—

(i) IN GENERAL.—Notwithstanding subparagraph (A)(i), in the case of a severely financially distressed employer, the term "qualified wages" means wages paid by such employer with respect to an employee during any calendar quarter.

(ii) DEFINITION.—The term "severely financially distressed employer" means an eligible employer as defined in paragraph (2), determined by substituting "less than 10 percent" for "less than 80 percent" in subparagraph (A)(ii)(II) thereof.

(D) EXCEPTION.—The term "qualified wages" shall not include any wages taken into account under sections 41, 45A, 45P, 45S, 51, 1396, 3131, and 3132.

(4) WAGES.—

(A) IN GENERAL.—The term "wages" means wages (as defined in section 3121(a)) and compensation (as defined in section 3231(e)). For purposes of the preceding sentence, in the case of any organization or entity described in subsection (f)(2), wages as defined in section 3121(a) shall be

determined without regard to paragraphs (5), (6), (7), (10), and (13) of section 3121(b) (except with respect to services performed in a penal institution by an inmate thereof).

(B) ALLOWANCE FOR CERTAIN HEALTH PLAN EXPENSES.—

(i) IN GENERAL.—Such term shall include amounts paid by the eligible employer to provide and maintain a group health plan (as defined in section 5000(b)(1)), but only to the extent that such amounts are excluded from the gross income of employees by reason of section 106(a).

(ii) ALLOCATION RULES.—For purposes of this section, amounts treated as wages under clause (i) shall be treated as paid with respect to any employee (and with respect to any period) to the extent that such amounts are properly allocable to such employee (and to such period) in such manner as the Secretary may prescribe. Except as otherwise provided by the Secretary, such allocation shall be treated as properly made if made on the basis of being pro rata among periods of coverage.

(5) RECOVERY STARTUP BUSINESS.—The term "recovery startup business" means any employer—

(A) which began carrying on any trade or business after February 15, 2020, and

(B) for which the average annual gross receipts of such employer (as determined under rules similar to the rules under section 448(c)(3)) for the 3-taxable-year period ending with the taxable year which precedes the calendar quarter for which the credit is determined under subsection (a) does not exceed $1,000,000.

(6) OTHER TERMS.—Any term used in this section which is also used in this chapter or chapter 22 shall have the same meaning as when used in such chapter.

(d) AGGREGATION RULE.—All persons treated as a single employer under subsection (a) or (b) of section 52, or subsection (m) or (*o*) of section 414, shall be treated as one employer for purposes of this section.

(e) CERTAIN RULES TO APPLY.—For purposes of this section, rules similar to the rules of sections 51(i)(1) and 280C(a) shall apply.

(f) CERTAIN GOVERNMENTAL EMPLOYERS.—

(1) IN GENERAL.—This credit shall not apply to the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing.

(2) EXCEPTION.—Paragraph (1) shall not apply to—

(A) any organization described in section 501(c)(1) and exempt from tax under section 501(a), or

(B) any entity described in paragraph (1) if—

(i) such entity is a college or university, or

(ii) the principal purpose or function of such entity is providing medical or hospital care.

In the case of any entity described in subparagraph (B), such entity shall be treated as satisfying the requirements of subsection (c)(2)(A)(i).

(g) ELECTION TO NOT TAKE CERTAIN WAGES INTO ACCOUNT.—This section shall not apply to so much of the qualified wages paid by an eligible employer as such employer elects (at such time and in such manner as the Secretary may prescribe) to not take into account for purposes of this section.

(h) COORDINATION WITH CERTAIN PROGRAMS.—

(1) IN GENERAL.—This section shall not apply to so much of the qualified wages paid by an eligible employer as are taken into account as payroll costs in connection with—

(A) a covered loan under section 7(a)(37) or 7A of the Small Business Act,

(B) a grant under section 324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act, or

(C) a restaurant revitalization grant under section 5003 of the American Rescue Plan Act of 2021.

(2) APPLICATION WHERE PPP LOANS NOT FORGIVEN.—The Secretary shall issue guidance providing that payroll costs paid during the covered period shall not fail to be treated as qualified wages under this section by reason of paragraph (1) to the extent that—

(A) a covered loan of the taxpayer under section 7(a)(37) of the Small Business Act is not forgiven by reason of a decision under section 7(a)(37)(J) of such Act, or

(B) a covered loan of the taxpayer under section 7A of the Small Business Act is not forgiven by reason of a decision under section 7A(g) of such Act.

Terms used in the preceding sentence which are also used in section 7A(g) or 7(a)(37)(J) of the Small Business Act shall, when applied in connection with either such section, have the same meaning as when used in such section, respectively.

(i) THIRD PARTY PAYORS.—Any credit allowed under this section shall be treated as a credit described in section 3511(d)(2).

(j) ADVANCE PAYMENTS.—

(1) IN GENERAL.—Except as provided in paragraph (2), no advance payment of the credit under subsection (a) shall be allowed.

(2) ADVANCE PAYMENTS TO SMALL EMPLOYERS.—

(A) IN GENERAL.—Under rules provided by the Secretary, an eligible employer for which the average number of full-time employees (within the meaning of section 4980H) employed by such eligible employer during 2019 was not greater than 500 may elect for any calendar quarter to receive an advance payment of the credit under subsection (a) for such quarter in an amount not to exceed 70 percent of the average quarterly wages paid by the employer in calendar year 2019.

(B) SPECIAL RULE FOR SEASONAL EMPLOYERS.—In the case of any employer who employs seasonal workers (as defined in section 45R(d)(5)(B)), the employer may elect to apply subparagraph (A) by substituting "the wages for the calendar quarter in 2019 which corresponds to the calendar quarter to which the election relates" for "the average quarterly wages paid by the employer in calendar year 2019".

(C) SPECIAL RULE FOR EMPLOYERS NOT IN EXISTENCE IN 2019.—In the case of any employer that was not in existence in 2019, subparagraphs (A) and (B) shall each be applied by substituting "2020" for "2019" each place it appears.

(3) RECONCILIATION OF CREDIT WITH ADVANCE PAYMENTS.—

(A) IN GENERAL.—The amount of credit which would (but for this subsection) be allowed under this section shall be reduced (but not below zero) by the aggregate payment allowed to the taxpayer under paragraph (2). Any failure to so reduce the credit shall be treated as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1).

(B) EXCESS ADVANCE PAYMENTS.—If the advance payments to a taxpayer under paragraph (2) for a calendar quarter exceed the credit allowed by this section (determined without regard to subparagraph (A)), the tax imposed under section 3111(b) or so much of the tax imposed under section 3221(a) as is attributable to the rate in effect under section 3111(b) (whichever is applicable) for the calendar quarter shall be increased by the amount of such excess.

(k) TREATMENT OF DEPOSITS.—The Secretary shall waive any penalty under section 6656 for any failure to make a deposit of any applicable employment taxes if the Secretary determines that such failure was due to the reasonable anticipation of the credit allowed under this section.

[(l) EXTENSION OF LIMITATION ON ASSESSMENT.—Notwithstanding section 6501, the limitation on the time period for the assessment of any amount attributable to a credit claimed under this section shall not expire before the date that is 5 years after the later of—

[(1) the date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed, or

[(2) the date on which such return is treated as filed under section 6501(b)(2).**]**

(l) EXTENSION OF LIMITATION ON ASSESSMENT.—

(1) IN GENERAL.—Notwithstanding section 6501, the limitation on the time period for the assessment of any amount attributable to a credit claimed under this section shall not expire before the date that is 6 years after the latest of—

(A) the date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed,

(B) the date on which such return is treated as filed under section 6501(b)(2), or

(C) the date on which the claim for credit or refund with respect to such credit is made.

(2) DEDUCTION FOR WAGES TAKEN INTO ACCOUNT IN DETERMINING IMPROPERLY CLAIMED CREDIT.—

(A) IN GENERAL.—Notwithstanding section 6511, in the case of an assessment attributable to a credit claimed under this section, the limitation on the time period for credit or refund of any amount attributable to a deduction for improperly claimed ERTC wages shall not expire before

the time period for such assessment expires under paragraph (1).

(B) IMPROPERLY CLAIMED ERTC WAGES.—For purposes of this paragraph, the term "improperly claimed ERTC wages" means, with respect to an assessment attributable to a credit claimed under this section, the wages with respect to which a deduction would not have been allowed if the portion of the credit to which such assessment relates had been properly claimed.

(m) REGULATIONS AND GUIDANCE.—The Secretary shall issue such forms, instructions, regulations, and other guidance as are necessary—

(1) to allow the advance payment of the credit under subsection (a) as provided in subsection (j)(2), subject to the limitations provided in this section, based on such information as the Secretary shall require,

(2) with respect to the application of the credit under subsection (a) to third party payors (including professional employer organizations, certified professional employer organizations, or agents under section 3504), including regulations or guidance allowing such payors to submit documentation necessary to substantiate the eligible employer status of employers that use such payors, and

(3) to prevent the avoidance of the purposes of the limitations under this section, including through the leaseback of employees.

Any forms, instructions, regulations, or other guidance described in paragraph (2) shall require the customer to be responsible for the accounting of the credit and for any liability for improperly claimed credits and shall require the certified professional employer organization or other third party payor to accurately report such tax credits based on the information provided by the customer.

(n) APPLICATION.—This section shall only apply to wages paid after June 30, 2021, and before October 1, 2021 (or, in the case of wages paid by an eligible employer which is a recovery startup business, January 1, 2022).

CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

* * * * * * *

SEC. 3406. BACKUP WITHHOLDING.

(a) REQUIREMENT TO DEDUCT AND WITHHOLD.—

(1) IN GENERAL.—In the case of any reportable payment, if—

(A) the payee fails to furnish his TIN to the payor in the manner required,

(B) the Secretary notifies the payor that the TIN furnished by the payee is incorrect,

(C) there has been a notified payee underreporting described in subsection (c), or

(D) there has been a payee certification failure described in subsection (d),

then the payor shall deduct and withhold from such payment a tax equal to the product of the fourth lowest rate of tax applicable under section 1(c) and such payment.

(2) SUBPARAGRAPHS (C) AND (D) OF PARAGRAPH (1) APPLY ONLY TO INTEREST AND DIVIDEND PAYMENTS.—Subparagraphs (C) and (D) of paragraph (1) shall apply only to reportable interest or dividend payments.

(b) REPORTABLE PAYMENT, ETC..—For purposes of this section—

(1) REPORTABLE PAYMENT.—The term "reportable payment" means—

(A) any reportable interest or dividend payment, and

(B) any other reportable payment.

(2) REPORTABLE INTEREST OR DIVIDEND PAYMENT.—

(A) IN GENERAL.—The term "reportable interest or dividend payment" means any payment of a kind, and to a payee, required to be shown on a return required under—

(i) section 6049(a) (relating to payments of interest),

(ii) section 6042(a) (relating to payments of dividends), or

(iii) section 6044 (relating to payments of patronage dividends) but only to the extent such payment is in money.

(B) SPECIAL RULE FOR PATRONAGE DIVIDENDS.—For purposes of subparagraphs (C) and (D) of subsection (a)(1), the term "reportable interest or dividend payment" shall not include any payment to which section 6044 (relating to patronage dividends) applies unless 50 percent or more of such payment is in money.

(3) OTHER REPORTABLE PAYMENT.—The term "other reportable payment" means any payment of a kind, and to a payee, required to be shown on a return required under—

(A) section 6041 (relating to certain information at source),

(B) section 6041A(a) (relating to payments of remuneration for services),

(C) section 6045 (relating to returns of brokers),

(D) section 6050A (relating to reporting requirements of certain fishing boat operators), but only to the extent such payment is in money and represents a share of the proceeds of the catch,

(E) section 6050N (relating to payments of royalties), or

(F) section 6050W (relating to returns relating to payments made in settlement of payment card transactions).

(4) WHETHER PAYMENT IS OF REPORTABLE KIND DETERMINED WITHOUT REGARD TO MINIMUM AMOUNT.—The determination of whether any payment is of a kind required to be shown on a return described in paragraph (2) or (3) shall be made without regard to any minimum amount which must be paid before a return is required.

(5) EXCEPTION FOR CERTAIN SMALL PAYMENTS.—To the extent provided in regulations, the term "reportable payment" shall not include any payment which—

(A) does not exceed $10, and

(B) if determined for a 1-year period, would not exceed $10.

(6) OTHER REPORTABLE PAYMENTS INCLUDE PAYMENTS DESCRIBED IN SECTION 6041(A) OR 6041A(A) [ONLY WHERE AGGREGATE FOR CALENDAR YEAR IS $600 OR MORE] *ONLY IF IN EXCESS OF THRESHOLD*.—Any payment of a kind required to be shown on a return required under section 6041(a) or 6041A(a) which is made during any calendar year shall be treated as a reportable payment only if—

(A) the aggregate amount of such payment and all previous payments described in such sections by the payor to the payee during such calendar year equals or exceeds [$600] *the dollar amount in effect for such calendar year under section 6041(a)*,

(B) the payor was required under section 6041(a) or 6041A(a) to file a return for the preceding calendar year with respect to payments to the payee, or

(C) during the preceding calendar year, the payor made reportable payments to the payee with respect to which amounts were required to be deducted and withheld under subsection (a).

(7) EXCEPTION FOR CERTAIN WINDOW PAYMENTS OF INTEREST, ETC..—For purposes of subparagraphs (C) and (D) of subsection (a)(1), the term "reportable interest or dividend payment" shall not include any payment—

(A) in redemption of a coupon on a bearer instrument or in redemption of a United States savings bond, or

(B) to the extent provided in regulations, of interest on instruments similar to those described in subparagraph (A).

The preceding sentence shall not apply for purposes of determining whether there is payee underreporting described in subsection (c).

(c) NOTIFIED PAYEE UNDERREPORTING WITH RESPECT TO INTEREST AND DIVIDENDS.—

(1) NOTIFIED PAYEE UNDERREPORTING.—If—

(A) the Secretary determines with respect to any payee that there has been payee underreporting,

(B) at least 4 notices have been mailed by the Secretary to the payee (over a period of at least 120 days) with respect to the underreporting, and

(C) in the case of any payee who has filed a return for the taxable year, any deficiency of tax attributable to such failure has been assessed,

the Secretary may notify payors of reportable interest or dividend payments with respect to such payee of the requirement to deduct and withhold under subsection (a)(1)(C) (but not the reasons for the withholding under subsection (a)(1)(C)).

(2) PAYEE UNDERREPORTING DEFINED.—For purposes of this section, there has been payee underreporting if for any taxable year the Secretary determines that—

(A) the payee failed to include in his return of tax under chapter 1 for such year any portion of a reportable interest or dividend payment required to be shown on such return, or

(B) the payee may be required to file a return for such year and to include a reportable interest or dividend payment in such return, but failed to file such return.

(3) DETERMINATION BY SECRETARY TO STOP (OR NOT TO START) WITHHOLDING.—

(A) IN GENERAL.—If the Secretary determines that—

(i) there was no payee underreporting,

(ii) any payee underreporting has been corrected (and any tax, penalty, or interest with respect to the payee underreporting has been paid),

(iii) withholding under subsection (a)(1)(C) has caused (or would cause) undue hardship to the payee and it is unlikely that any payee underreporting by such payee will occur again, or

(iv) there is a bona fide dispute as to whether there has been any payee underreporting,

then the Secretary shall take the action described in subparagraph (B).

(B) SECRETARY TO TAKE ACTION TO STOP (OR NOT TO START) WITHHOLDING.—For purposes of subparagraph (A), if at the time of the Secretary's determination under subparagraph (A)—

(i) no notice has been given under paragraph (1) to any payor with respect to the underreporting, the Secretary shall not give any such notice, or

(ii) if such notice has been given, the Secretary shall—

(I) provide the payee with a written certification that withholding under subsection (a)(1)(C) is to stop, and

(II) notify the applicable payors (and brokers) that such withholding is to stop.

(C) TIME FOR TAKING ACTION WHERE NOTICE TO PAYOR HAS BEEN GIVEN.—In any case where notice has been given under paragraph (1) to any payor with respect to any underreporting, if the Secretary makes a determination under subparagraph (A) during the 12-month period ending on October 15 of any calendar year—

(i) except as provided in clause (ii), the Secretary shall take the action described in subparagraph (B)(ii) to bring about the stopping of withholding no later than December 1 of such calendar year, or

(ii) in the case of—

(I) a no payee underreporting determination under clause (i) of subparagraph (A), or

(II) a hardship determination under clause (iii) of subparagraph (A),

such action shall be taken no later than the 45th day after the day on which the Secretary made the determination.

(D) OPPORTUNITY TO REQUEST DETERMINATION.—The Secretary shall prescribe procedures under which—

(i) a payee may request a determination under subparagraph (A), and

(ii) the payee may provide information with respect to such request.

(4) PAYOR NOTIFIES PAYEE OF WITHHOLDING BECAUSE OF PAYEE UNDERREPORTING.—Any payor required to withhold any tax under subsection (a)(1)(C) shall, at the time such withholding begins, notify the payee of such withholding.

(5) PAYEE MAY BE REQUIRED TO NOTIFY SECRETARY WHO HIS PAYORS AND BROKERS ARE.—For purposes of this section, the Secretary may require any payee of reportable interest or dividend payments who is subject to withholding under subsection (a)(1)(C) to notify the Secretary of—

(A) all payors from whom the payee receives reportable interest or dividend payments, and

(B) all brokers with whom the payee has accounts which may involve reportable interest or dividend payments.

The Secretary may notify any such broker that such payee is subject to withholding under subsection (a)(1)(C).

(d) INTEREST AND DIVIDEND BACKUP WITHHOLDING APPLIES TO NEW ACCOUNTS AND INSTRUMENTS UNLESS PAYEE CERTIFIES THAT HE IS NOT SUBJECT TO SUCH WITHHOLDING.—

(1) IN GENERAL.—There is a payee certification failure unless the payee has certified to the payor, under penalty of perjury, that such payee is not subject to withholding under subsection (a)(1)(C).

(2) SPECIAL RULES FOR READILY TRADABLE INSTRUMENTS.—

(A) IN GENERAL.—Subsection (a)(1)(D) shall apply to any reportable interest or dividend payment to any payee on any readily tradable instrument if (and only if) the payor was notified by a broker under subparagraph (B) or no certification was provided to the payor by the payee under paragraph (1) and—

(i) such instrument was acquired directly by the payee from the payor, or

(ii) such instrument is held by the payor as nominee for the payee.

(B) BROKER NOTIFIES PAYOR.—If—

(i) a payee acquires any readily tradable instrument through a broker, and

(ii) with respect to such acquisition—

(I) the payee fails to furnish his TIN to the broker in the manner required under subsection (a)(1)(A),

(II) the Secretary notifies such broker before such acquisition that the TIN furnished by the payee is incorrect,

(III) the Secretary notifies such broker before such acquisition that such payee is subject to withholding under subsection (a)(1)(C), or

(IV) the payee does not provide a certification to such broker under subparagraph (C),

such broker shall, within such period as the Secretary may prescribe by regulations (but not later than 15 days after such acquisition), notify the payor that such payee is subject to withholding under subparagraph (A), (B), (C), or (D) of subsection (a)(1), respectively.

(C) TIME FOR PAYEE TO PROVIDE CERTIFICATION TO BROKER.—In the case of any readily tradable instrument

acquired by a payee through a broker, the certification described in paragraph (1) may be provided by the payee to such broker—

(i) at any time after the payee's account with the broker was established and before the acquisition of such instrument, or

(ii) in connection with the acquisition of such instrument.

(3) EXCEPTION FOR EXISTING ACCOUNTS, ETC..—This subsection and subsection (a)(1)(D) shall not apply to any reportable interest or dividend payment which is paid or credited—

(A) in the case of interest or any other amount of a kind reportable under section 6049, with respect to any account (whatever called) established before January 1, 1984, or with respect to any instrument acquired before January 1, 1984,

(B) in the case of dividends or any other amount reportable under section 6042, on any stock or other instrument acquired before January 1, 1984, or

(C) in the case of patronage dividends or other amounts of a kind reportable under section 6044, with respect to any membership acquired, or contract entered into, before January 1, 1984.

(4) EXCEPTION FOR READILY TRADABLE INSTRUMENTS ACQUIRED THROUGH EXISTING BROKERAGE ACCOUNTS.—Subparagraph (B) of paragraph (2) shall not apply with respect to a readily tradable instrument which was acquired through an account with a broker if—

(A) such account was established before January 1, 1984, and

(B) during 1983, such broker bought or sold instruments for the payee (or acted as a nominee for the payee) through such account.

The preceding sentence shall not apply with respect to any readily tradable instrument acquired through such account after the broker was notified by the Secretary that the payee is subject to withholding under subsection (a)(1)(C).

(e) PERIOD FOR WHICH WITHHOLDING IS IN EFFECT.—

(1) FAILURE TO FURNISH TIN.—In the case of any failure by a payee to furnish his TIN to a payor in the manner required, subsection (a) shall apply to any reportable payment made by such payor during the period during which the TIN has not been furnished in the manner required. The Secretary may require that a TIN required to be furnished under subsection (a)(1)(A) be provided under penalties of perjury only with respect to interest, dividends, patronage dividends, and amounts subject to broker reporting.

(2) NOTIFICATION OF INCORRECT NUMBER.—In any case in which the Secretary notifies the payor that the TIN furnished by the payee is incorrect, subsection (a) shall apply to any reportable payment made by such payor—

(A) after the close of the 30th day after the day on which the payor received such notification, and

(B) before the payee furnishes another TIN in the manner required.

(3) NOTIFIED PAYEE UNDERREPORTING DESCRIBED IN SUBSECTION (C).—

(A) IN GENERAL.—In the case of any notified payee underreporting described in subsection (c), subsection (a) shall apply to any reportable interest or dividend payment made—

(i) after the close of the 30th day after the day on which the payor received notification from the Secretary of such underreporting, and

(ii) before the stop date.

(B) STOP DATE.—For purposes of this subsection, the term "stop date" means the determination effective date or, if later, the earlier of—

(i) the day on which the payor received notification from the Secretary under subsection (c)(3)(B) to stop withholding, or

(ii) the day on which the payor receives from the payee a certification provided by the Secretary under subsection (c)(3)(B).

(C) DETERMINATION EFFECTIVE DATE.—For purposes of this subsection—

(i) IN GENERAL.—Except as provided in clause (ii), the determination effective date of any determination under subsection (c)(3)(A) which is made during the 12-month period ending on October 15 of any calendar year shall be the first January 1 following such October 15.

(ii) DETERMINATION THAT THERE WAS NO UNDERREPORTING; HARDSHIP.—In the case of any determination under clause (i) or (iii) of subsection (c)(3)(A), the determination effective date shall be the date on which the Secretary's determination is made.

(4) FAILURE TO PROVIDE CERTIFICATION THAT PAYEE IS NOT SUBJECT TO WITHHOLDING.—

(A) IN GENERAL.—In the case of any payee certification failure described in subsection (d)(1), subsection (a) shall apply to any reportable interest or dividend payment made during the period during which the certification described in subsection (d)(1) has not been furnished to the payor.

(B) SPECIAL RULE FOR READILY TRADABLE INSTRUMENTS ACQUIRED THROUGH BROKER WHERE NOTIFICATION.—In the case of any readily tradable instrument acquired by the payee through a broker, the period described in subparagraph (A) shall start with payments to the payee made after the close of the 30th day after the payor receives notification from a broker under subsection (d)(2)(B).

(5) 30-DAY GRACE PERIODS.—

(A) START-UP.—If the payor elects the application of this subparagraph with respect to the payee, subsection (a) shall also apply to any reportable payment made during the 30-day period described in paragraph (2)(A), (3)(A), or (4)(B).

(B) STOPPING.—Unless the payor elects not to have this subparagraph apply with respect to the payee, subsection (a) shall also apply to any reportable payment made after

the close of the period described in paragraph (1), (2), or (4) (as the case may be) and before the 30th day after the close of such period. A similar rule shall also apply with respect to the period described in paragraph (3)(A) where the stop date is determined under clause (i) or (ii) of paragraph (3)(B).

(C) ELECTION OF SHORTER GRACE PERIOD.—The payor may elect a period shorter than the grace period set forth in subparagraph (A) or (B), as the case may be.

(f) CONFIDENTIALITY OF INFORMATION.—

(1) IN GENERAL.—No person may use any information obtained under this section (including any failure to certify under subsection (d)) except for purposes of meeting any requirement under this section or (subject to the safeguards set forth in section 6103) for purposes permitted under section 6103.

(2) CROSS REFERENCE.—For provision providing for civil damages for violation of paragraph (1), see section 7431.

(g) EXCEPTIONS.—

(1) PAYMENTS TO CERTAIN PAYEES.—Subsection (a) shall not apply to any payment made to—

(A) any organization or governmental unit described in subparagraph (B), (C), (D), (E), or (F) of section 6049(b)(4), or

(B) any other person specified in regulations.

(2) AMOUNTS FOR WHICH WITHHOLDING OTHERWISE REQUIRED.—Subsection (a) shall not apply to any amount for which withholding is otherwise required by this title.

(3) EXEMPTION WHILE WAITING FOR TIN.—The Secretary shall prescribe regulations for exemptions from the tax imposed by subsection (a) during the period during which a person is waiting for receipt of a TIN.

(h) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) OBVIOUSLY INCORRECT NUMBER.—A person shall be treated as failing to furnish his TIN if the TIN furnished does not contain the proper number of digits.

(2) PAYEE FURNISHES 2 INCORRECT TINS.—If the payee furnishes the payor 2 incorrect TINs in any 3-year period, the payor shall, after receiving notice of the second incorrect TIN, treat the payee as not having furnished another TIN under subsection (e)(2)(B) until the day on which the payor receives notification from the Secretary that a correct TIN has been furnished.

(3) JOINT PAYEES.—Except to the extent otherwise provided in regulations, any payment to joint payees shall be treated as if all the payment were made to the first person listed in the payment.

(4) PAYOR DEFINED.—The term "payor" means, with respect to any reportable payment, a person required to file a return described in paragraph (2) or (3) of subsection (b) with respect to such payment.

(5) BROKER.—

(A) IN GENERAL.—The term "broker" has the meaning given to such term by section 6045(c)(1).

(B) ONLY 1 BROKER PER ACQUISITION.—If, but for this subparagraph, there would be more than 1 broker with respect to any acquisition, only the broker having the closest contact with the payee shall be treated as the broker.

(C) PAYOR NOT TREATED AS BROKER.—In the case of any instrument, such term shall not include any person who is the payor with respect to such instrument.

(D) REAL ESTATE BROKER NOT TREATED AS A BROKER.—Except as provided by regulations, such term shall not include any real estate broker (as defined in section 6045(e)(2)).

(6) READILY TRADABLE INSTRUMENT.—The term "readily tradable instrument" means—

(A) any instrument which is part of an issue any portion of which is traded on an established securities market (within the meaning of section 453(f)(5)), and

(B) except as otherwise provided in regulations prescribed by the Secretary, any instrument which is regularly quoted by brokers or dealers making a market.

(7) ORIGINAL ISSUE DISCOUNT.—To the extent provided in regulations, rules similar to the rules of paragraph (6) of section 6049(d) shall apply.

(8) REQUIREMENT OF NOTICE TO PAYEE.—Whenever the Secretary notifies a payor under paragraph (1)(B) of subsection (a) that the TIN furnished by any payee is incorrect, the Secretary shall at the same time furnish a copy of such notice to the payor, and the payor shall promptly furnish such copy to the payee.

(9) REQUIREMENT OF NOTICE TO SECRETARY.—If the Secretary notifies a payor under paragraph (1)(B) of subsection (a) that the TIN furnished by any payee is incorrect and such payee subsequently furnishes another TIN to the payor, the payor shall promptly notify the Secretary of the other TIN so furnished.

(10) COORDINATION WITH OTHER SECTIONS.—For purposes of section 31, this chapter (other than section 3402(n)), and so much of subtitle F (other than section 7205) as relates to this chapter, payments which are subject to withholding under this section shall be treated as if they were wages paid by an employer to an employee (and amounts deducted and withheld under this section shall be treated as if deducted and withheld under section 3402).

(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

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Subtitle F—Procedure and Administration

CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—RETURNS AND RECORDS

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PART III—INFORMATION RETURNS

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Subpart B—INFORMATION CONCERNING TRANSACTIONS WITH OTHER PERSONS

SEC. 6041. INFORMATION AT SOURCE.

(a) PAYMENTS [OF $600 OR MORE] *EXCEEDING THRESHOLD*.—All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments to which section 6042(a)(1), 6044(a)(1), 6047(e), 6049(a), or 6050N(a) applies, and other than payments with respect to which a statement is required under the authority of section 6042(a)(2), 6044(a)(2), or 6045), of [$600] *$1,000* or more in any [taxable year] *calendar year*, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

(b) COLLECTION OF FOREIGN ITEMS.—In the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by any person undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange, such person shall make a return according to the forms or regulations prescribed by the Secretary, setting forth the amount paid and the name and address of the recipient of each such payment.

(c) RECIPIENT TO FURNISH NAME AND ADDRESS.—When necessary to make effective the provisions of this section, the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

(d) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each person with respect to whom such a return is required a written statement showing—

(1) the name, address, and phone number of the information contact of the person required to make such return, and

(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a)

was required to be made. To the extent provided in regulations prescribed by the Secretary, this subsection shall also apply to persons required to make returns under subsection (b).

(e) SECTION DOES NOT APPLY TO CERTAIN TIPS.—This section shall not apply to tips with respect to which section 6053(a) (relating to reporting of tips) applies.

(f) SECTION DOES NOT APPLY TO CERTAIN HEALTH ARRANGEMENTS.—This section shall not apply to any payment for medical care (as defined in section 213(d)) made under—

(1) a flexible spending arrangement (as defined in section 106(c)(2)), or

(2) a health reimbursement arrangement which is treated as employer-provided coverage under an accident or health plan for purposes of section 106.

(g) NONQUALIFIED DEFERRED COMPENSATION.—Subsection (a) shall apply to—

(1) any deferrals for the year under a nonqualified deferred compensation plan (within the meaning of section 409A(d)), whether or not paid, except that this paragraph shall not apply to deferrals which are required to be reported under section 6051(a)(13) (without regard to any de minimis exception), and

(2) any amount includible under section 409A and which is not treated as wages under section 3401(a).

(h) INFLATION ADJUSTMENT.—In the case of any calendar year after 2024, the dollar amount in subsection (a) shall be increased by an amount equal to—

(1) such dollar amount, multiplied by

(2) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting "calendar year 2023" for "calendar year 2016" in subparagraph (A)(ii) thereof.

If any increase under the preceding sentence is not a multiple of $100, such increase shall be rounded to the nearest multiple of $100.

SEC. 6041A. RETURNS REGARDING PAYMENTS OF REMUNERATION FOR SERVICES AND DIRECT SALES.

(a) RETURNS REGARDING REMUNERATION FOR SERVICES.—If—

(1) any service-recipient engaged in a trade or business pays in the course of such trade or business during any calendar year remuneration to any person for services performed by such person, and

(2) the aggregate of such remuneration paid to such person during such calendar year **[**is $600 or more**]** *equals or exceeds the dollar amount in effect for such calendar year under section 6041(a)*,

then the service-recipient shall make a return, according to the forms or regulations prescribed by the Secretary, setting forth the aggregate amount of such payments and the name and address of the recipient of such payments. For purposes of the preceding sentence, the term "service-recipient" means the person for whom the service is performed.

(b) DIRECT SALES OF $5,000 OR MORE.—

(1) IN GENERAL.—If—

(A) any person engaged in a trade or business in the course of such trade or business during any calendar year

sells consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis which the Secretary prescribes by regulations, for resale (by the buyer or any other person) in the home or otherwise than in a permanent retail establishment, and

(B) the aggregate amount of the sales to such buyer during such calendar year [is $5,000 or more] *equals or exceeds the dollar amount in effect for such calendar year under section 6041(a)*,

then such person shall make a return, according to the forms or regulations prescribed by the Secretary, setting forth the name and address of the buyer to whom such sales are made.

(2) DEFINITIONS.—For purposes of paragraph (1)—

(A) BUY-SELL BASIS.—A transaction is on a buy-sell basis if the buyer performing the services is entitled to retain part or all of the difference between the price at which the buyer purchases the product and the price at which the buyer sells the product as part or all of the buyer's remuneration for the services, and

(B) DEPOSIT-COMMISSION BASIS.—A transaction is on a deposit-commission basis if the buyer performing the services is entitled to retain part or all of a purchase deposit paid by the consumer in connection with the transaction as part or all of the buyer's remuneration for the services.

(c) CERTAIN SERVICES NOT INCLUDED.—No return shall be required under subsection (a) or (b) if a statement with respect to the services is required to be furnished under section 6051, 6052, or 6053.

(d) APPLICATIONS TO GOVERNMENTAL UNITS.—

(1) TREATED AS PERSONS.—The term "person" includes any governmental unit (and any agency or instrumentality thereof).

(2) SPECIAL RULES.—In the case of any payment by a governmental entity or any agency or instrumentality thereof—

(A) subsection (a) shall be applied without regard to the trade or business requirement contained therein, and

(B) any return under this section shall be made by the officer or employee having control of the payment or appropriately designated for the purpose of making such return.

(3) PAYMENTS TO CORPORATIONS BY FEDERAL EXECUTIVE AGENCIES.—

(A) IN GENERAL.—Notwithstanding any regulation prescribed by the Secretary before the date of the enactment of this paragraph, subsection (a) shall apply to remuneration paid to a corporation by any Federal executive agency (as defined in section 6050M(b)).

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

(i) services under contracts described in section 6050M(e)(3) with respect to which the requirements of section 6050M(e)(2) are met, and

(ii) such other services as the Secretary may specify in regulations prescribed after the date of the enactment of this paragraph.

(e) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED TO BE FURNISHED.—Every person required to make a return under subsection (a) or (b) shall furnish

to each person whose name is required to be set forth in such return a written statement showing—

(1) the name, address, and phone number of the information contact of the person required to make such return, and

(2) in the case of subsection (a), the aggregate amount of payments to the person required to be shown on such return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was made.

(f) RECIPIENT TO FURNISH NAME, ADDRESS, AND IDENTIFICATION NUMBER; INCLUSION ON RETURN.—

(1) FURNISHING OF INFORMATION.—Any person with respect to whom a return or statement is required under this section to be made by another person shall furnish to such other person his name, address, and identification number at such time and in such manner as the Secretary may prescribe by regulations.

(2) INCLUSION ON RETURN.—The person to whom an identification number is furnished under paragraph (1) shall include such number on any return which such person is required to file under this section and to which such identification number relates.

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CHAPTER 63—ASSESSMENT

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Subchapter B—DEFICIENCY PROCEDURES IN THE CASE OF INCOME, ESTATE, GIFT, AND CERTAIN EXCISE TAXES

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SEC. 6213. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

(a) TIME FOR FILING PETITION AND RESTRICTION ON ASSESSMENT.—Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in section 6851, 6852, or 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A, or B, chapter 41, 42, 43, or 44 and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421(a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court, including the Tax Court, and a refund may be

ordered by such court of any amount collected within the period during which the Secretary is prohibited from collecting by levy or through a proceeding in court under the provisions of this subsection. The Tax Court shall have no jurisdiction to enjoin any action or proceeding or order any refund under this subsection unless a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition. Any petition filed with the Tax Court on or before the last date specified for filing such petition by the Secretary in the notice of deficiency shall be treated as timely filed.

(b) EXCEPTIONS TO RESTRICTIONS ON ASSESSMENT.—

(1) ASSESSMENTS ARISING OUT OF MATHEMATICAL OR CLERICAL ERRORS.—If the taxpayer is notified that, on account of a mathematical or clerical error appearing on the return, an amount of tax in excess of that shown on the return is due, and that an assessment of the tax has been or will be made on the basis of what would have been the correct amount of tax but for the mathematical or clerical error, such notice shall not be considered as a notice of deficiency for the purposes of subsection (a) (prohibiting assessment and collection until notice of the deficiency has been mailed), or of section 6212(c)(1) (restricting further deficiency letters), or of section 6512(a) (prohibiting credits or refunds after petition to the Tax Court), and the taxpayer shall have no right to file a petition with the Tax Court based on such notice, nor shall such assessment or collection be prohibited by the provisions of subsection (a) of this section. Each notice under this paragraph shall set forth the error alleged and an explanation thereof.

(2) ABATEMENT OF ASSESSMENT OF MATHEMATICAL OR CLERICAL ERRORS.—

(A) REQUEST FOR ABATEMENT.—Notwithstanding section 6404(b), a taxpayer may file with the Secretary within 60 days after notice is sent under paragraph (1) a request for an abatement of any assessment specified in such notice, and upon receipt of such request, the Secretary shall abate the assessment. Any reassessment of the tax with respect to which an abatement is made under this subparagraph shall be subject to the deficiency procedures prescribed by this subchapter.

(B) STAY OF COLLECTION.—In the case of any assessment referred to in paragraph (1), notwithstanding paragraph (1), no levy or proceeding in court for the collection of such assessment shall be made, begun, or prosecuted during the period in which such assessment may be abated under this paragraph.

(3) ASSESSMENTS ARISING OUT OF TENTATIVE CARRYBACK OR REFUND ADJUSTMENTS.—If the Secretary determines that the amount applied, credited, or refunded under section 6411 is in excess of the overassessment attributable to the carryback or the amount described in section 1341(b)(1) with respect to which such amount was applied, credited, or refunded, he may assess without regard to the provisions of paragraph (2) the amount of the excess as a deficiency as if it were due to a mathematical or clerical error appearing on the return.

(4) ASSESSMENT OF AMOUNT PAID.—Any amount paid as a tax or in respect of a tax may be assessed upon the receipt of such payment notwithstanding the provisions of subsection (a). In any case where such amount is paid after the mailing of a notice of deficiency under section 6212, such payment shall not deprive the Tax Court of jurisdiction over such deficiency determined under section 6211 without regard to such assessment.

(5) CERTAIN ORDERS OF CRIMINAL RESTITUTION.—If the taxpayer is notified that an assessment has been or will be made pursuant to section 6201(a)(4)—

(A) such notice shall not be considered as a notice of deficiency for the purposes of subsection (a) (prohibiting assessment and collection until notice of the deficiency has been mailed), section 6212(c)(1) (restricting further deficiency letters), or section 6512(a) (prohibiting credits or refunds after petition to the Tax Court), and

(B) subsection (a) shall not apply with respect to the amount of such assessment.

(c) FAILURE TO FILE PETITION.—If the taxpayer does not file a petition with the Tax Court within the time prescribed in subsection (a), the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the Secretary.

(d) WAIVER OF RESTRICTIONS.—The taxpayer shall at any time (whether or not a notice of deficiency has been issued) have the right, by a signed notice in writing filed with the Secretary, to waive the restrictions provided in subsection (a) on the assessment and collection of the whole or any part of the deficiency.

(e) SUSPENSION OF FILING PERIOD FOR CERTAIN EXCISE TAXES.—The running of the time prescribed by subsection (a) for filing a petition in the Tax Court with respect to the taxes imposed by section 4941 (relating to taxes on self-dealing), 4942 (relating to taxes on failure to distribute income), 4943 (relating to taxes on excess business holdings), 4944 (relating to investments which jeopardize charitable purpose), 4945 (relating to taxes on taxable expenditures), 4951 (relating to taxes on self-dealing), or 4952 (relating to taxes on taxable expenditures), 4955 (relating to taxes on political expenditures), 4958 (relating to private excess benefit), 4971 (relating to excise taxes on failure to meet minimum funding standard), 4975 (relating to excise taxes on prohibited transactions) shall be suspended for any period during which the Secretary has extended the time allowed for making correction under section 4963(e).

(f) COORDINATION WITH TITLE 11.—

(1) SUSPENSION OF RUNNING OF PERIOD FOR FILING PETITION IN TITLE 11 CASES.—In any case under title 11 of the United States Code, the running of the time prescribed by subsection (a) for filing a petition in the Tax Court with respect to any deficiency shall be suspended for the period during which the debtor is prohibited by reason of such case from filing a petition in the Tax Court with respect to such deficiency, and for 60 days thereafter.

(2) CERTAIN ACTION NOT TAKEN INTO ACCOUNT.—For purposes of the second and third sentences of subsection (a), the filing of a proof of claim or request for payment (or the taking

of any other action) in a case under title 11 of the United States Code shall not be treated as action prohibited by such second sentence.

(g) DEFINITIONS.—For purposes of this section—

(1) RETURN.—The term "return" includes any return, statement, schedule, or list, and any amendment or supplement thereto, filed with respect to any tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44.

(2) MATHEMATICAL OR CLERICAL ERROR.—The term "mathematical or clerical error" means—

(A) an error in addition, subtraction, multiplication, or division shown on any return,

(B) an incorrect use of any table provided by the Internal Revenue Service with respect to any return if such incorrect use is apparent from the existence of other information on the return,

(C) an entry on a return of an item which is inconsistent with another entry of the same or another item on such return,

(D) an omission of information which is required to be supplied on the return to substantiate an entry on the return,

(E) an entry on a return of a deduction or credit in an amount which exceeds a statutory limit imposed by subtitle A or B, or chapter 41, 42, 43, or 44, if such limit is expressed—

(i) as a specified monetary amount, or

(ii) as a percentage, ratio, or fraction,

and if the items entering into the application of such limit appear on such return,

(F) an omission of a correct taxpayer identification number required under section 32 (relating to the earned income credit) to be included on a return,

(G) an entry on a return claiming the credit under section 32 with respect to net earnings from self-employment described in section 32(c)(2)(A) to the extent the tax imposed by section 1401 (relating to self-employment tax) on such net earnings has not been paid,

(H) an omission of a correct TIN required under section 21 (relating to expenses for household and dependent care services necessary for gainful employment) or section 151 (relating to allowance of deductions for personal exemptions),

(I) an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return,

(J) an omission of a correct TIN required under section 25A(g)(1) (relating to higher education tuition and related expenses) to be included on a return,

(K) an omission of information required by section 32(k)(2) (relating to taxpayers making improper prior claims of earned income credit) or an entry on the return claiming the credit under section 32 for a taxable year for which the credit is disallowed under subsection (k)(1) thereof,

(L) the inclusion on a return of a TIN required to be included on the return under section 21, 24, 32, 6428, or 6428A if—

(i) such TIN is of an individual whose age affects the amount of the credit under such section, and

(ii) the computation of the credit on the return reflects the treatment of such individual as being of an age different from the individual's age based on such TIN,

(M) the entry on the return claiming the credit under section 32 with respect to a child if, according to the Federal Case Registry of Child Support Orders established under section 453(h) of the Social Security Act, the taxpayer is a noncustodial parent of such child,

(N) an omission of any increase required under section 36(f) with respect to the recapture of a credit allowed under section 36,

(O) the inclusion on a return of an individual taxpayer identification number issued under section 6109(i) which has expired, been revoked by the Secretary, or is otherwise invalid,

(P) an omission of information required by section 24(g)(2) or an entry on the return claiming the credit under section 24 for a taxable year for which the credit is disallowed under subsection (g)(1) thereof,

(Q) an omission of information required by section 25A(b)(4)(B) or an entry on the return claiming the American Opportunity Tax Credit for a taxable year for which such credit is disallowed under section 25A(b)(4)(A),

(R) an omission of information or documentation required under section 25C(b)(6)(B) (relating to home energy audits) to be included on a return,

(S) an omission of a correct product identification number required under section 25C(h) (relating to credit for nonbusiness energy property) to be included on a return,

(T) an omission of a correct vehicle identification number required under section 30D(f)(9) (relating to credit for new clean vehicles) to be included on a return,

(U) an omission of a correct vehicle identification number required under section 25E(d) (relating to credit for previously-owned clean vehicles) to be included on a return, **[**and**]**

(V) an omission of a correct vehicle identification number required under section 45W(e) (relating to commercial clean vehicle credit) to be included on a return**[**.**]**, *and*

(W) in the case of a taxpayer electing the application of section 24(h)(6)(B) for any taxable year, an entry on a return of earned income pursuant to such section which is inconsistent with the amount of such earned income determined by the Secretary for the preceding taxable year.

A taxpayer shall be treated as having omitted a correct TIN for purposes of the preceding sentence if information provided by the taxpayer on the return with respect to the individual whose TIN was provided differs from the information the Secretary obtains from the person issuing the TIN.

(h) CROSS REFERENCES.—

(1) For assessment as if a mathematical error on the return, in the case of erroneous claims for income tax prepayment credits, see section 6201(a)(3).

(2) For assessments without regard to restrictions imposed by this section in the case of—

(A) Recovery of foreign income taxes, see section 905(c).

(B) Recovery of foreign estate tax, see section 2016.

(3) For provisions relating to application of this subchapter in the case of certain partnership items, etc., see section 6230(a).

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PUBLIC LAW 115-97

TITLE I

* * * * * * *

Subtitle C—Business-related Provisions

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PART III—COST RECOVERY AND ACCOUNTING METHODS

Subpart A—Cost Recovery

* * * * * * *

SEC. 13206. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) IN GENERAL.—Section 174 is amended to read as follows:

* * * * * * *".

[(b) CHANGE IN METHOD OF ACCOUNTING.—The amendments made by subsection (a) shall be treated as a change in method of accounting for purposes of section 481 of the Internal Revenue Code of 1986 and—

[(1) such change shall be treated as initiated by the taxpayer,

[(2) such change shall be treated as made with the consent of the Secretary, and

[(3) such change shall be applied only on a cut-off basis for any research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and no adjustments under section 481(a) shall be made.]

(c) CLERICAL AMENDMENT.—The table of sections for part VI of subchapter B of chapter 1 is amended by striking the item relating to section 174 and inserting the following new item:

"Sec. 174. Amortization of research and experimental expenditures.".

(d) CONFORMING AMENDMENTS.—

(1) Section 41(d)(1)(A) is amended by striking "expenses under section 174" and inserting "specified research or experimental expenditures under section 174".

(2) Subsection (c) of section 280C is amended—

(A) by striking paragraph (1) and inserting the following:

"(1) IN GENERAL.—If—

"(A) the amount of the credit determined for the taxable year under section 41(a)(1), exceeds

"(B) the amount allowable as a deduction for such taxable year for qualified research expenses or basic research expenses,

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.",

(B) by striking paragraph (2),

(C) by redesignating paragraphs (3) (as amended by this Act) and (4) as paragraphs (2) and (3), respectively, and

(D) in paragraph (2), as redesignated by subparagraph (C), by striking "paragraphs (1) and (2)" and inserting "paragraph (1)".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 2021.

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CARES ACT

* * * * * * *

DIVISION A—KEEPING WORKERS PAID AND EMPLOYED, HEALTH CARE SYSTEM ENHANCEMENTS, AND ECONOMIC STABILIZATION

* * * * * * *

TITLE II—ASSISTANCE FOR AMERICAN WORKERS, FAMILIES, AND BUSINESSES

* * * * * * *

Subtitle C—Business Provisions

SEC. 2301. EMPLOYEE RETENTION CREDIT FOR EMPLOYERS SUBJECT TO CLOSURE DUE TO COVID-19.

(a) IN GENERAL.—In the case of an eligible employer, there shall be allowed as a credit against applicable employment taxes for each calendar quarter an amount equal to 70 percent of the qualified wages with respect to each employee of such employer for such calendar quarter.

(b) LIMITATIONS AND REFUNDABILITY.—

(1) WAGES TAKEN INTO ACCOUNT.—The amount of qualified wages with respect to any employee which may be taken into account under subsection (a) by the eligible employer for any calendar quarter shall not exceed $10,000.

(2) CREDIT LIMITED TO EMPLOYMENT TAXES.—The credit allowed by subsection (a) with respect to any calendar quarter shall not exceed the applicable employment taxes (reduced by any credits allowed under subsections (e) and (f) of section 3111 of the Internal Revenue Code of 1986, sections 7001 and 7003 of the Families First Coronavirus Response Act, and section 303(d) of the Taxpayer Certainty and Disaster Tax Relief Act of 2020) on the wages paid with respect to the employment of all the employees of the eligible employer for such calendar quarter.

(3) REFUNDABILITY OF EXCESS CREDIT.—

(A) IN GENERAL.—If the amount of the credit under subsection (a) exceeds the limitation of paragraph (2) for any calendar quarter, such excess shall be treated as an overpayment that shall be refunded under sections 6402(a) and 6413(b) of the Internal Revenue Code of 1986.

(B) TREATMENT OF PAYMENTS.—For purposes of section 1324 of title 31, United States Code, any amounts due to the employer under this paragraph shall be treated in the same manner as a refund due from a credit provision referred to in subsection (b)(2) of such section.

(c) DEFINITIONS.—For purposes of this section—

(1) APPLICABLE EMPLOYMENT TAXES.—The term "applicable employment taxes" means the following:

(A) The taxes imposed under section 3111(a) of the Internal Revenue Code of 1986.

(B) So much of the taxes imposed under section 3221(a) of such Code as are attributable to the rate in effect under section 3111(a) of such Code.

(2) ELIGIBLE EMPLOYER.—

(A) IN GENERAL.—The term "eligible employer" means any employer—

(i) which was carrying on a trade or business during the calendar quarter for which the credit is determined under subsection (a), and

(ii) with respect to any calendar quarter, for which—

(I) the operation of the trade or business described in clause (i) is fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID-19), or

(II) the gross receipts (within the meaning of section 448(c) of the Internal Revenue Code of 1986) of such employer for such calendar quarter are less than 80 percent of the gross receipts of such employer for the same calendar quarter in calendar year 2019.

With respect to any employer for any calendar quarter, if such employer was not in existence as of the beginning of

the same calendar quarter in calendar year 2019, clause (ii)(II) shall be applied by substituting "2020" for "2019".

(B) ELECTION TO USE ALTERNATIVE QUARTER.—At the election of the employer—

(i) subparagraph (A)(ii)(II) shall be applied—

(I) by substituting "for the immediately preceding calendar quarter" for "for such calendar quarter", and

(II) by substituting "the corresponding calendar quarter in calendar year 2019" for "the same calendar quarter in calendar year 2019", and

(ii) the last sentence of subparagraph (A) shall be applied by substituting "the corresponding calendar quarter in calendar year 2019" for "the same calendar quarter in calendar year 2019".

An election under this subparagraph shall be made at such time and in such manner as the Secretary shall prescribe.

(C) TAX-EXEMPT ORGANIZATIONS.—In the case of an organization which is described in section 501(c) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code—

(i) clauses (i) and (ii)(I) of subparagraph (A) shall apply to all operations of such organization, and

(ii) any reference in this section to gross receipts shall be treated as a reference to gross receipts within the meaning of section 6033 of such Code.

(3) QUALIFIED WAGES.—

(A) IN GENERAL.—The term "qualified wages" means—

(i) in the case of an eligible employer for which the average number of full-time employees (within the meaning of section 4980H of the Internal Revenue Code of 1986) employed by such eligible employer during 2019 was greater than 500, wages paid by such eligible employer with respect to which an employee is not providing services due to circumstances described in subclause (I) or (II) of paragraph (2)(A)(ii), or

(ii) in the case of an eligible employer for which the average number of full-time employees (within the meaning of section 4980H of the Internal Revenue Code of 1986) employed by such eligible employer during 2019 was not greater than 500—

(I) with respect to an eligible employer described in subclause (I) of paragraph (2)(A)(ii), wages paid by such eligible employer with respect to an employee during any period described in such clause, or

(II) with respect to an eligible employer described in subclause (II) of such paragraph, wages paid by such eligible employer with respect to an employee during such quarter.

(B) EXCEPTION.—The term "qualified wages" shall not include any wages taken into account under section 7001 or section 7003 of the Families First Coronavirus Response Act.

(4) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or the Secretary's delegate.

(5) WAGES.—

(A) IN GENERAL.—The term"wages" means wages (as defined in section 3121(a) of the Internal Revenue Code of 1986) and compensation (as defined in section 3231(e) of such Code). For purposes of the preceding sentence, in the case of any organization or entity described in subsection (f)(2), wages as defined in section 3121(a) of the Internal Revenue Code of 1986 shall be determined without regard to paragraphs (5), (6), (7), (10), and (13) of section 3121(b) of such Code (except with respect to services performed in a penal institution by an inmate thereof).

(B) ALLOWANCE FOR CERTAIN HEALTH PLAN EXPENSES.—

(i) IN GENERAL.—Such term shall include amounts paid by the eligible employer to provide and maintain a group health plan (as defined in section 5000(b)(1) of the Internal Revenue Code of 1986), but only to the extent that such amounts are excluded from the gross income of employees by reason of section 106(a) of such Code.

(ii) ALLOCATION RULES.—For purposes of this section, amounts treated as wages under clause (i) shall be treated as paid with respect to any employee (and with respect to any period) to the extent that such amounts are properly allocable to such employee (and to such period) in such manner as the Secretary may prescribe. Except as otherwise provided by the Secretary, such allocation shall be treated as properly made if made on the basis of being pro rata among periods of coverage.

(6) OTHER TERMS.—Any term used in this section which is also used in chapter 21 or 22 of the Internal Revenue Code of 1986 shall have the same meaning as when used in such chapter.

(d) AGGREGATION RULE.—All persons treated as a single employer under subsection (a) or (b) of section 52 of the Internal Revenue Code of 1986, or subsection (m) or (o) of section 414 of such Code, shall be treated as one employer for purposes of this section.

(e) CERTAIN RULES TO APPLY.—For purposes of this section, rules similar to the rules of sections 51(i)(1) and 280C(a) of the Internal Revenue Code of 1986 shall apply.

(f) CERTAIN GOVERNMENTAL EMPLOYERS.—

(1) IN GENERAL.—This credit shall not apply to the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing.

(2) EXCEPTION.—Paragraph (1) shall not apply to—

(A) any organization described in section 501(c)(1) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code, or

(B) any entity described in paragraph (1) if —

(i) such entity is a college or university, or

(ii) the principal purpose or function of such entity is providing medical or hospital care.

In the case of any entity described in subparagraph (B), such entity shall be treated as satisfying the requirements of subsection (c)(2)(A)(i).

(g) ELECTION TO NOT TAKE CERTAIN WAGES INTO ACCOUNT.—

(1) IN GENERAL.—This section shall not apply to so much of the qualified wages paid by an eligible employer as such employer elects (at such time and in such manner as the Secretary may prescribe) to not take into account for purposes of this section.

(2) COORDINATION WITH PAYCHECK PROTECTION PROGRAM.—The Secretary, in consultation with the Administrator of the Small Business Administration, shall issue guidance providing that payroll costs paid during the covered period shall not fail to be treated as qualified wages under this section by reason of an election under paragraph (1) to the extent that a covered loan of the eligible employer is not forgiven by reason of a decision under section 7A(g) of the Small Business Act or the application of section 7(a)(37)(J) of the Small Business Act. Terms used in the preceding sentence which are also used in section 7A(g) or 7(a)(37)(J) of the Small Business Act shall, when applied in connection with either such section, have the same meaning as when used in such section, respectively.

(h) SPECIAL RULES.—

(1) DENIAL OF DOUBLE BENEFIT.—Any wages taken into account in determining the credit allowed under this section shall not be taken into account as wages for purposes of sections 41, 45A, 45P, 45S, 51, and 1396 of the Internal Revenue Code of 1986.

(2) THIRD PARTY PAYORS.—Any credit allowed under this section shall be treated as a credit described in section 3511(d)(2) of such Code.

(i) TRANSFERS TO FEDERAL OLD-AGE AND SURVIVORS INSURANCE TRUST FUND.—There are hereby appropriated to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund established under section 201 of the Social Security Act (42 U.S.C. 401) and the Social Security Equivalent Benefit Account established under section 15A(a) of the Railroad Retirement Act of 1974 (45 U.S.C. 14 231n-1(a)) amounts equal to the reduction in revenues to the Treasury by reason of this section (without regard to this subsection). Amounts appropriated by the preceding sentence shall be transferred from the general fund at such times and in such manner as to replicate to the extent possible the transfers which would have occurred to such Trust Fund or Account had this section not been enacted.

(j) ADVANCE PAYMENTS.—

(1) IN GENERAL.—Except as provided in paragraph (2), no advance payment of the credit under subsection (a) shall be allowed.

(2) ADVANCE PAYMENTS TO SMALL EMPLOYERS.—

(A) IN GENERAL.—Under rules provided by the Secretary, an eligible employer for which the average number of full-time employees (within the meaning of section 4980H of the Internal Revenue Code of 1986) employed by such eligible employer during 2019 was not greater than 500 may elect for any calendar quarter to receive an advance pay-

ment of the credit under subsection (a) for such quarter in an amount not to exceed 70 percent of the average quarterly wages paid by the employer in calendar year 2019.

(B) SPECIAL RULE FOR SEASONAL EMPLOYERS.—In the case of any employer who employs seasonal workers (as defined in section 45R(d)(5)(B) of the Internal Revenue Code of 1986), the employer may elect to substitute "the wages for the calendar quarter in 2019 which corresponds to the calendar quarter to which the election relates" for "the average quarterly wages paid by the employer in calendar year 2019".

(C) SPECIAL RULE FOR EMPLOYERS NOT IN EXISTENCE IN 2019.—In the case of any employer that was not in existence in 2019, subparagraphs (A) and (B) shall each be applied by substituting "2020" for "2019" each place it appears.

(3) RECONCILIATION OF CREDIT WITH ADVANCE PAYMENTS.—

(A) IN GENERAL.—The amount of credit which would (but for this subsection) be allowed under this section shall be reduced (but not below zero) by the aggregate payment allowed to the taxpayer under paragraph (2). Any failure to so reduce the credit shall be treated as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1) of the Internal Revenue Code of 1986.

(B) EXCESS ADVANCE PAYMENTS.—If the advance payments to a taxpayer under paragraph (2) for a calendar quarter exceed the credit allowed by this section (determined without regard to subparagraph (A)), the tax imposed by chapter 21 or 22 of the Internal Revenue Code of 1986 (whichever is applicable) for the calendar quarter shall be increased by the amount of such excess.

(k) TREATMENT OF DEPOSITS.—The Secretary shall waive any penalty under section 6656 of the Internal Revenue Code of 1986 for any failure to make a deposit of any applicable employment taxes if the Secretary determines that such failure was due to the reasonable anticipation of the credit allowed under this section.

(l) REGULATIONS AND GUIDANCE.—The Secretary shall issue such forms, instructions, regulations, and guidance as are necessary—

(1) to allow the advance payment of the credit under subsection (a) as provided in subsection (j)(2), subject to the limitations provided in this section, based on such information as the Secretary shall require,

(2) with respect to the application of the credit under subsection (a) to third party payors (including professional employer organizations, certified professional employer organizations, or agents under section 3504 of the Internal Revenue Code of 1986), including regulations or guidance allowing such payors to submit documentation necessary to substantiate the eligible employer status of employers that use such payors, and

(3) to prevent the avoidance of the purposes of the limitations under this section, including through the leaseback of employees.

Any forms, instructions, regulations, or guidance described in paragraph (2) shall require the customer to be responsible for the accounting of the credit and for any liability for improperly claimed

credits and shall require the certified professional employer organization or other third party payor to accurately report such tax credits based on the information provided by the customer.

(m) APPLICATION.—This section shall only apply to wages paid after March 12, 2020, and before July 1, 2021.

(n) PUBLIC AWARENESS CAMPAIGN.—

(1) IN GENERAL.—The Secretary shall conduct a public awareness campaign, in coordination with the Administrator of the Small Business Administration, to provide information regarding the availability of the credit allowed under this section.

(2) OUTREACH.—Under the campaign conducted under paragraph (1), the Secretary shall—

(A) provide to all employers which reported not more than 500 employees on the most recently filed return of applicable employment taxes a notice about the credit allowed under this section and the requirements for eligibility to claim the credit, and

(B) not later than 30 days after the date of the enactment of this subsection, provide to all employers educational materials relating to the credit allowed under this section, including specific materials for businesses with not more than 500 employees.

(o) EXTENSION OF LIMITATION ON ASSESSMENT.—

(1) IN GENERAL.—Notwithstanding section 6501 of the Internal Revenue Code of 1986, the limitation on the time period for the assessment of any amount attributable to a credit claimed under this section shall not expire before the date that is 6 years after the latest of—

(A) the date on which the original return which includes the calendar quarter with respect to which such credit is determined is filed,

(B) the date on which such return is treated as filed under section 6501(b)(2) of such Code, or

(C) the date on which the claim for credit or refund with respect to such credit is made.

(2) DEDUCTION FOR WAGES TAKEN INTO ACCOUNT IN DETERMINING IMPROPERLY CLAIMED CREDIT.—

(A) IN GENERAL.—Notwithstanding section 6511 of such Code, in the case of an assessment attributable to a credit claimed under this section, the limitation on the time period for credit or refund of any amount attributable to a deduction for improperly claimed ERTC wages shall not expire before the time period for such assessment expires under paragraph (1).

(B) IMPROPERLY CLAIMED ERTC WAGES.—For purposes of this paragraph, the term "improperly claimed ERTC wages" means, with respect to an assessment attributable to a credit claimed under this section, the wages with respect to which a deduction would not have been allowed if the portion of the credit to which such assessment relates had been properly claimed.

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VII. ADDITIONAL VIEWS

Supporting American working families and uplifting children are of paramount importance to Committee Democrats, which is why we have long fought to expand the Child Tax Credit. Committee Democrats helped advance H.R. 7024 in large part due to the several enhancements it will make to this critical tax relief for working families. The measure, if signed into law by President Biden, will modify the computation of the Child Tax Credit amount to allow families with more than one child to compute the refundability maximum for each child concurrently: a significant difference for larger families. Additionally, H.R. 7024 will increase the refundability cap over the next three years, such that the refundable credit will reach the same level as the base credit (which is adjusted for inflation in the bill as well). Finally, the bill will give eligible families the option to use their earned income from the prior year to calculate their child tax credit, a substantial benefit for taxpayers whose income may have fallen from one year to the next.

Unfortunately, Committee Republicans rejected the opportunity to go even further to help working families by refusing to restore the expanded Child Tax Credit House Democrats delivered in the American Rescue Plan Act of 2021. The expanded Child Tax Credit brought child poverty to its lowest rate on record in 2021.[1] Never before in modern memory has a newly-implemented program seen such immediate and tangible success, and this bill is a missed opportunity to revive that policy triumph.

The American Rescue Plan vastly improved the credit by enacting three principal changes: First, it increased the size of the credit from $2,000 per child to $3,600 per child (0–5 years old) and $3,000 per child (6–17 years old), an essential increase for parents who struggle to afford the rising costs of child care and maintaining a household. Second, it made the credit fully refundable, ensuring that the full value of the credit was available to taxpayers with little or no earned income, aiding those who needed it most. Finally, the American Rescue Plan changed the method of the credit's delivery, issuing it in the form of monthly installments rather than a lump-sum with the tax return, so that families could draw on the benefit immediately and use the credit to meet their monthly expenses.

Committee Democrats continue efforts to combat the structural challenge of childhood poverty and strengthen the economy through supporting working families. While H.R. 7024 does not go as far it could to help American families, we are proud to support legisla-

[1] FACT SHEET: Biden-Harris Report: "Advancing Equity Through the American Rescue Plan" (May 24, 2022). https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/24/fact-sheet-biden-harris-report-advancing-equity-through-the-american-rescue-plan/.

tion that will deliver for our nation's children and put more money back in families' pockets.

Sincerely,

RICHARD E. NEAL,
Ranking Member.

RANKING MEMBER RICHARD E. NEAL, COMMITTEE ON WAYS AND MEANS, MARKUP OF H.R. 7024, ADDITIONAL VIEWS, FRIDAY, JANUARY 18, 2024

Democrats are here today because of a simple truth: when we invest in workers and families, we invest in our economy. Democrats' 2021 expansion of the Child Tax Credit put money back in the pockets of working families across the country, keeping the lights on and children fed. The results were resounding: historic reductions in child poverty and better lives for millions.

When Republicans blocked the extension of this vital tax relief for middle-class families, Democrats never lost sight of its importance. We've worked tirelessly to see the Child Tax Credit revitalized and renewed, while Republicans have single-mindedly pursed tax breaks for the wealthy and well-connected, as we saw in their DOA Tax Scam 2.0 last summer. Indeed, today's markup is only possible due to Democrats' insistence on putting workers and their families first.

While this bill is a start towards the future America's children deserve, more could've been done. Republicans are once again letting politics get in the way of good policy for America's working families by refusing to expand the Child Tax Credit to include our country's poorest children. If Democrats had our way, we'd have gone further. We know that when you grow the middle class, you grow the economy.

Our Committee has important work to do, and the American people depend on us to do it. When we held the Majority, we passed historic legislation that kickstarted our record economic growth and created jobs for American workers across the country. Instead of working together on policies that have a chance of being signed into law, the Majority has wasted nearly half this Congress on a fact-free "impeachment inquiry," four potential government shutdowns, and extreme, unworkable legislation. It's time to put the political stunts aside and govern.

I want to acknowledge the great work of my colleagues, who not only fought for the Child Tax Credit but also critical disaster tax relief, low-income housing credits, and tax relief to strengthen our relationship with Taiwan, among other top priorities.

Cutting child poverty, putting families on a pathway to prosperity, and setting parents up to better participate in our workforce are all within our reach, and it's my hope that today we can take a meaningful step forward on delivering them for the people.

RICHARD E. NEAL,
Ranking Member.

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