

NOVEMBER 19, 2004

TAX TECHNICAL CORRECTIONS

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

Amendments Related to the American Jobs Creation Act of 2004

Deduction relating to income attributable to domestic production activities (manufacturing deduction) (Act sec. 102).--The provision corrects a reference to "income attributable to domestic production activities" to refer to the defined term "qualified production activities income." The provision also clarifies the definition of an expanded affiliated group, so that a corporation eligible for the deduction with respect to income of a subsidiary must own more than 50 percent, rather than 50 percent or more, of the subsidiary's stock by vote and value.

Family members treated as one shareholder of an S corporation (Act sec. 231).--The provision conforms the treatment of certain adopted individuals and foster children to the amendments made by title II of the Working Families Relief Act of 2004.

Election to determine corporate tax on certain international shipping activities using per ton rate (Act sec. 248).--The provision strikes as deadwood the rule added by the Act regarding the operation of a qualifying vessel by a non-electing corporation that is a member of an electing group.

Computation of foreign tax credit in determining alternative minimum tax by farmers and fisherman using income averaging (Act sec. 314).--The provision clarifies that in computing the regular tax for purposes of determining the alternative minimum tax of a farmer or fisherman using income averaging, the foreign tax credit does not need to be recomputed.

Modifications to treatment of aircraft leasing and shipping (Act. sec. 415).--The provision clarifies that, for purposes of the foreign tax credit limitation as in effect for taxable years beginning before January 1, 2007, shipping income is defined to include income that meets the definition of foreign base company shipping income as in effect before the definition is repealed under section 415 of the Act. The repeal is effective for taxable years of foreign corporations beginning after December 31, 2004, and taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Application of FIRPTA to distributions from REITS (Act sec. 418).--The provision provides that RICs are not eligible for the exception from FIRPTA that the Act provides for REITS in the case of distributions to five-percent-or-less shareholders. The provision also clarifies the effective date to provide that it applies to any distribution by a REIT that is treated as a deduction for a taxable year of the REIT beginning after the date of enactment.

Incentives to reinvest foreign earnings in the United States (Act sec. 422).--The provision clarifies that for purposes of determining the amount of excess dividends eligible for

the deduction, only cash dividends received during the elected taxable year are taken into account under Code section 965(b)(2)(A). (The base-period amounts described in Code section 965(b)(2)(B) include non-cash dividends, as well as cash dividends and certain other amounts.)

The provision also provides the Treasury Secretary with explicit regulatory authority to prevent the avoidance of the purposes of Code section 965(b)(3), which reduces the amount of eligible dividends in certain cases in which an increase in related-party indebtedness has occurred. Regulations issued pursuant to this authority may include rules to provide that cash dividends are not taken into account under Code section 965(a) to the extent attributable to the direct or indirect transfer of cash or other property from a related person to a controlled foreign corporation (including through the use of intervening entities or capital contributions). It is expected that this authority, which supplements existing principles relating to the treatment of circular flows of cash, will be used to prevent the application of the deduction in the case of a dividend that is effectively funded by the U.S. shareholder or its U.S. affiliates.

The provision also clarifies the definition of “applicable financial statement” under Code section 965(c)(1). In the case of a U.S. shareholder that is required to file a financial statement with the Securities and Exchange Commission (or is included in such a statement filed by another person), the provision clarifies that the applicable financial statement is the most recent audited annual statement that was so filed and certified on or before June 30, 2003. For purposes of this rule, a restatement of a previously filed and certified financial statement that occurs after June 30, 2003 does not alter the statement’s status as having been filed and certified on or before June 30, 2003. In addition, the provision clarifies that the term “applicable financial statement” includes the notes that form an integral part of the financial statement; other materials, including work papers or materials that may be filed for some purposes with a financial statement but that do not form an integral part of such statement, may not be relied upon for purposes of producing an earnings or tax number under the provision. For example, if a note that is an integral part of an applicable financial statement states that the U.S. shareholder has not provided for deferred taxes on \$1 billion of undistributed earnings of foreign subsidiaries because such earnings are intended to be reinvested permanently (or indefinitely) abroad, the U.S. shareholder’s limit under Code section 965(b)(1) is \$1 billion. If an applicable financial statement does not show a specific earnings or tax amount described in Code section 965(b)(1)(B) or (C), a taxpayer cannot rely on underlying work papers or other materials that are not a part of the financial statement to derive such an amount. If an applicable financial statement states that an earnings or tax amount is indeterminate (or that determination of a specific amount of earnings or taxes is not feasible), then the earnings or tax amount so described is treated as being zero.

The provision also clarifies that the expense disallowance rule of Code section 965(d)(2) applies only to deductions for expenses that are directly allocable to the deductible portion of the dividend.

In addition, the provision clarifies that foreign taxes that are not allowed as foreign tax credits by reason of Code section 965(d) do not give rise to income inclusions under Code section 78.

The provision also clarifies that under Code section 965(e)(1), the only foreign tax credits that may be used to reduce the tax on the nondeductible portion of a dividend are credits for

foreign taxes that are attributable to the nondeductible portion of the dividend. Credits for other foreign taxes cannot be used to reduce the tax on the nondeductible portion of the dividend.

Treatment of deduction for State and local sales taxes under the alternative minimum tax Act sec. 501).--The provision clarifies that the itemized deduction for State and local sales taxes does not apply in calculating alternative minimum taxable income.

Repeal of special rules for FASITs (Act sec. 835).--The provision conforms references to the treatment of certain obligations to the terminology used in other similar references by specifically referring to obligations treated as principally secured by an interest in real property.

Nonqualified deferred compensation plans (Act sec. 885).--The provision clarifies that the additional tax and interest under the nonqualified deferred compensation provision of the Act are not treated as payments of regular tax for alternative minimum tax purposes. The provision also clarifies that the application of the rule providing that certain additional deferrals must be for a period of not less than five years is not limited to the first payment for which deferral is made. The provision also clarifies that Treasury Department guidance providing a limited period during which plans can conform to the requirements applies to plans adopted before January 1, 2005. The provision also clarifies that the effective date of the funding provisions relating to offshore trusts and financial triggers is January 1, 2005. Thus, for example, amounts set aside in an offshore trust before such date for the purpose of paying deferred compensation and plans providing for the restriction of assets in connection with a change in the employer's financial health are subject to the funding provisions on January 1, 2005. Under the provision, not later than 90 days after the date of enactment, the Secretary of the Treasury shall issue guidance under which a nonqualified deferred compensation plan which is in violation of the requirements of the funding provisions relating to offshore trusts and financial triggers will be treated as not violating such requirements if the plan comes into conformance with such requirements during a limited period as specified by the Secretary in guidance. For example, trusts or assets set aside outside of the United States that would otherwise result in income inclusion and interest under the provision as of January 1, 2005, may be modified to come into conformance with the provision during the limited period of time as specified by the Secretary.

Amendment Related to the Working Families Tax Relief Act of 2004

Uniform definition of child (Act secs. 203 and 207).--The provisions make conforming amendments, consistent with those enacted with respect to various other provisions, for purposes of health savings accounts, the dependent care credit, and dependent care assistance programs. Under the conforming amendment provisions, an individual may qualify as a dependent for these limited purposes without regard to whether the individual has gross income that exceeds an otherwise applicable gross income limitation or is married and files a joint return. In addition, such an individual who is treated as a dependent under these conforming amendment provisions is not subject to the general rule that a dependent of a taxpayer shall be treated as having no dependents for the taxable year of such individual beginning in such calendar year.

Amendment Related to the Jobs and Growth Tax Relief Reconciliation Act of 2003

Bonus depreciation (Act sec. 201).--The provision corrects the reference to a date in the rules applicable to qualified New York Liberty Zone property so that it refers to the January 1, 2005, date in the corresponding rule for additional first-year depreciation in Code section 168(k).

Amendments Related to the Trade Act of 2002 and the Victims of Terrorism Tax Relief Act of 2001

Rules relating to disclosure of taxpayer return information.--The provisions correct cross references within the disclosure rules (Code section 6103) relating to safeguards under the program for advance payment of the credit for health insurance costs (effective upon enactment), and relating to disclosure to the National Archives and Records Administration.

Amendments Related to the Taxpayer Relief Act of 1997

Tentative carryback and refund adjustments and treatment of carrybacks or adjustments for certain unused deductions (Act sec. 1055).--The provision corrects a reference in rules relating to tentative carryback and refund adjustments to refer to coordination rules in Code section 6611(f)(4)(B). The provision also corrects a reference in rules relating to carrybacks or adjustments of certain unused deductions to refer to the filing date within the meaning of Code section 6611(f)(4)(B).

Notice of certain transfers to foreign persons (Act sec. 1144).--The provision corrects the omission of a conjunction in the description of transfers that are generally subject to certain information reporting requirements.

Clerical amendments

The provisions include clerical and typographical amendments to the Code, which are effective upon enactment.