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CONFERENCE REPORT

TO ACCOMPANY

H.R. 4520



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property shall be the taxpayer's gross income from such property.”.

(c) *EFFECTIVE DATE.*—The amendments made by this section shall apply to property placed in service after the date of the enactment of this Act.

SEC. 243. IMPROVEMENTS RELATED TO REAL ESTATE INVESTMENT TRUSTS.

(a) *EXPANSION OF STRAIGHT DEBT SAFE HARBOR.*—Section 856 (defining real estate investment trust) is amended—

(1) in subsection (c) by striking paragraph (7), and

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

“(m) *SAFE HARBOR IN APPLYING SUBSECTION (c)(4).*—

“(1) *IN GENERAL.*—In applying subclause (III) of subsection (c)(4)(B)(iii), except as otherwise determined by the Secretary in regulations, the following shall not be considered securities held by the trust:

“(A) Straight debt securities of an issuer which meet the requirements of paragraph (2).

“(B) Any loan to an individual or an estate.

“(C) Any section 467 rental agreement (as defined in section 467(d)), other than with a person described in subsection (d)(2)(B).

“(D) Any obligation to pay rents from real property (as defined in subsection (d)(1)).

“(E) Any security issued by a State or any political subdivision thereof, the District of Columbia, a foreign government or any political subdivision thereof, or the Commonwealth of Puerto Rico, but only if the determination of any payment received or accrued under such security does not depend in whole or in part on the profits of any entity not described in this subparagraph or payments on any obligation issued by such an entity,

“(F) Any security issued by a real estate investment trust.

“(G) Any other arrangement as determined by the Secretary.

“(2) *SPECIAL RULES RELATING TO STRAIGHT DEBT SECURITIES.*—

“(A) *IN GENERAL.*—For purposes of paragraph (1)(A), securities meet the requirements of this paragraph if such securities are straight debt, as defined in section 1361(c)(5) (without regard to subparagraph (B)(iii) thereof).

“(B) *SPECIAL RULES RELATING TO CERTAIN CONTINGENCIES.*—For purposes of subparagraph (A), any interest or principal shall not be treated as failing to satisfy section 1361(c)(5)(B)(i) solely by reason of the fact that—

“(i) the time of payment of such interest or principal is subject to a contingency, but only if—

“(I) any such contingency does not have the effect of changing the effective yield to maturity, as determined under section 1272, other than a change in the annual yield to maturity which does not exceed the greater of $\frac{1}{4}$ of 1 percent or 5 percent of the annual yield to maturity, or

“(II) neither the aggregate issue price nor the aggregate face amount of the issuer’s debt instruments held by the trust exceeds \$1,000,000 and not more than 12 months of unaccrued interest can be required to be prepaid thereunder, or

“(ii) the time or amount of payment is subject to a contingency upon a default or the exercise of a prepayment right by the issuer of the debt, but only if such contingency is consistent with customary commercial practice.

“(C) SPECIAL RULES RELATING TO CORPORATE OR PARTNERSHIP ISSUERS.—In the case of an issuer which is a corporation or a partnership, securities that otherwise would be described in paragraph (1)(A) shall be considered not to be so described if the trust holding such securities and any of its controlled taxable REIT subsidiaries (as defined in subsection (d)(8)(A)(iv)) hold any securities of the issuer which—

“(i) are not described in paragraph (1) (prior to the application of this subparagraph), and

“(ii) have an aggregate value greater than 1 percent of the issuer’s outstanding securities determined without regard to paragraph (3)(A)(i).

“(3) LOOK-THROUGH RULE FOR PARTNERSHIP SECURITIES.—

“(A) IN GENERAL.—For purposes of applying subclause (III) of subsection (c)(4)(B)(iii)—

“(i) a trust’s interest as a partner in a partnership (as defined in section 7701(a)(2)) shall not be considered a security, and

“(ii) the trust shall be deemed to own its proportionate share of each of the assets of the partnership.

“(B) DETERMINATION OF TRUST’S INTEREST IN PARTNERSHIP ASSETS.—For purposes of subparagraph (A), with respect to any taxable year beginning after the date of the enactment of this subparagraph—

“(i) the trust’s interest in the partnership assets shall be the trust’s proportionate interest in any securities issued by the partnership (determined without regard to subparagraph (A)(i) and paragraph (4), but not including securities described in paragraph (1)), and

“(ii) the value of any debt instrument shall be the adjusted issue price thereof, as defined in section 1272(a)(4).

“(4) CERTAIN PARTNERSHIP DEBT INSTRUMENTS NOT TREATED AS A SECURITY.—For purposes of applying subclause (III) of subsection (c)(4)(B)(iii)—

“(A) any debt instrument issued by a partnership and not described in paragraph (1) shall not be considered a security to the extent of the trust’s interest as a partner in the partnership, and

“(B) any debt instrument issued by a partnership and not described in paragraph (1) shall not be considered a security if at least 75 percent of the partnership’s gross income (excluding gross income from prohibited transactions) is derived from sources referred to in subsection (c)(3).

“(5) *SECRETARIAL GUIDANCE.*—The Secretary is authorized to provide guidance (including through the issuance of a written determination, as defined in section 6110(b)) that an arrangement shall not be considered a security held by the trust for purposes of applying subclause (III) of subsection (c)(4)(B)(iii) notwithstanding that such arrangement otherwise could be considered a security under subparagraph (F) of subsection (c)(5).”.

(b) *CLARIFICATION OF APPLICATION OF LIMITED RENTAL EXCEPTION.*—Subparagraph (A) of section 856(d)(8) (relating to special rules for taxable REIT subsidiaries) is amended to read as follows:

“(A) *LIMITED RENTAL EXCEPTION.*—

“(i) *IN GENERAL.*—The requirements of this subparagraph are met with respect to any property if at least 90 percent of the leased space of the property is rented to persons other than taxable REIT subsidiaries of such trust and other than persons described in paragraph (2)(B).

“(ii) *RENTS MUST BE SUBSTANTIALLY COMPARABLE.*—Clause (i) shall apply only to the extent that the amounts paid to the trust as rents from real property (as defined in paragraph (1) without regard to paragraph (2)(B)) from such property are substantially comparable to such rents paid by the other tenants of the trust’s property for comparable space.

“(iii) *TIMES FOR TESTING RENT COMPARABILITY.*—The substantial comparability requirement of clause (ii) shall be treated as met with respect to a lease to a taxable REIT subsidiary of the trust if such requirement is met under the terms of the lease—

“(I) at the time such lease is entered into,

“(II) at the time of each extension of the lease, including a failure to exercise a right to terminate, and

“(III) at the time of any modification of the lease between the trust and the taxable REIT subsidiary if the rent under such lease is effectively increased pursuant to such modification.

With respect to subclause (III), if the taxable REIT subsidiary of the trust is a controlled taxable REIT subsidiary of the trust, the term ‘rents from real property’ shall not in any event include rent under such lease to the extent of the increase in such rent on account of such modification.

“(iv) *CONTROLLED TAXABLE REIT SUBSIDIARY.*—For purposes of clause (iii), the term ‘controlled taxable REIT subsidiary’ means, with respect to any real estate investment trust, any taxable REIT subsidiary of such trust if such trust owns directly or indirectly—

“(I) stock possessing more than 50 percent of the total voting power of the outstanding stock of such subsidiary, or

“(II) stock having a value of more than 50 percent of the total value of the outstanding stock of such subsidiary.

“(v) CONTINUING QUALIFICATION BASED ON THIRD PARTY ACTIONS.—If the requirements of clause (i) are met at a time referred to in clause (iii), such requirements shall continue to be treated as met so long as there is no increase in the space leased to any taxable REIT subsidiary of such trust or to any person described in paragraph (2)(B).

“(vi) CORRECTION PERIOD.—If there is an increase referred to in clause (v) during any calendar quarter with respect to any property, the requirements of clause (iii) shall be treated as met during the quarter and the succeeding quarter if such requirements are met at the close of such succeeding quarter.”

(c) DELETION OF CUSTOMARY SERVICES EXCEPTION.—Subparagraph (B) of section 857(b)(7) (relating to redetermined rents) is amended by striking clause (ii) and by redesignating clauses (iii), (iv), (v), (vi), and (vii) as clauses (ii), (iii), (iv), (v), and (vi), respectively.

(d) CONFORMITY WITH GENERAL HEDGING DEFINITION.—Subparagraph (G) of section 856(c)(5) (relating to treatment of certain hedging instruments) is amended to read as follows:

“(G) TREATMENT OF CERTAIN HEDGING INSTRUMENTS.—Except to the extent provided by regulations, any income of a real estate investment trust from a hedging transaction (as defined in clause (ii) or (iii) of section 1221(b)(2)(A)) which is clearly identified pursuant to section 1221(a)(7), including gain from the sale or disposition of such a transaction, shall not constitute gross income under paragraph (2) to the extent that the transaction hedges any indebtedness incurred or to be incurred by the trust to acquire or carry real estate assets.”

(e) CONFORMITY WITH REGULATED INVESTMENT COMPANY RULES.—Clause (i) of section 857(b)(5)(A) (relating to imposition of tax in case of failure to meet certain requirements) is amended by striking “90 percent” and inserting “95 percent”.

(f) SAVINGS PROVISIONS.—

(1) RULES OF APPLICATION FOR FAILURE TO SATISFY SECTION 856(c)(4).—Section 856(c) (relating to definition of real estate investment trust) is amended by inserting after paragraph (6) the following new paragraph:

“(7) RULES OF APPLICATION FOR FAILURE TO SATISFY PARAGRAPH (4).—

“(A) DE MINIMIS FAILURE.—A corporation, trust, or association that fails to meet the requirements of paragraph (4)(B)(iii) for a particular quarter shall nevertheless be considered to have satisfied the requirements of such paragraph for such quarter if—

“(i) such failure is due to the ownership of assets the total value of which does not exceed the lesser of—

“(I) 1 percent of the total value of the trust’s assets at the end of the quarter for which such measurement is done, and

“(II) \$10,000,000, and

“(ii)(I) the corporation, trust, or association, following the identification of such failure, disposes of as-

sets in order to meet the requirements of such paragraph within 6 months after the last day of the quarter in which the corporation, trust or association's identification of the failure to satisfy the requirements of such paragraph occurred or such other time period prescribed by the Secretary and in the manner prescribed by the Secretary, or

“(II) the requirements of such paragraph are otherwise met within the time period specified in subclause (I).

“(B) FAILURES EXCEEDING DE MINIMIS AMOUNT.—A corporation, trust, or association that fails to meet the requirements of paragraph (4) for a particular quarter shall nevertheless be considered to have satisfied the requirements of such paragraph for such quarter if—

“(i) such failure involves the ownership of assets the total value of which exceeds the de minimis standard described in subparagraph (A)(i) at the end of the quarter for which such measurement is done,

“(ii) following the corporation, trust, or association's identification of the failure to satisfy the requirements of such paragraph for a particular quarter, a description of each asset that causes the corporation, trust, or association to fail to satisfy the requirements of such paragraph at the close of such quarter of any taxable year is set forth in a schedule for such quarter filed in accordance with regulations prescribed by the Secretary,

“(iii) the failure to meet the requirements of such paragraph for a particular quarter is due to reasonable cause and not due to willful neglect,

“(iv) the corporation, trust, or association pays a tax computed under subparagraph (C), and

“(v)(I) the corporation, trust, or association disposes of the assets set forth on the schedule specified in clause (ii) within 6 months after the last day of the quarter in which the corporation, trust or association's identification of the failure to satisfy the requirements of such paragraph occurred or such other time period prescribed by the Secretary and in the manner prescribed by the Secretary, or

“(II) the requirements of such paragraph are otherwise met within the time period specified in subclause (I).

“(C) TAX.—For purposes of subparagraph (B)(iv)—

“(i) TAX IMPOSED.—If a corporation, trust, or association elects the application of this subparagraph, there is hereby imposed a tax on the failure described in subparagraph (B) of such corporation, trust, or association. Such tax shall be paid by the corporation, trust, or association.

“(ii) TAX COMPUTED.—The amount of the tax imposed by clause (i) shall be the greater of—

“(I) \$50,000, or

“(II) the amount determined (pursuant to regulations promulgated by the Secretary) by multiplying the net income generated by the assets described in the schedule specified in subparagraph (B)(ii) for the period specified in clause (iii) by the highest rate of tax specified in section 11.

“(iii) PERIOD.—For purposes of clause (ii)(II), the period described in this clause is the period beginning on the first date that the failure to satisfy the requirements of such paragraph (4) occurs as a result of the ownership of such assets and ending on the earlier of the date on which the trust disposes of such assets or the end of the first quarter when there is no longer a failure to satisfy such paragraph (4).

“(iv) ADMINISTRATIVE PROVISIONS.—For purposes of subtitle F, the taxes imposed by this subparagraph shall be treated as excise taxes with respect to which the deficiency procedures of such subtitle apply.”.

(2) MODIFICATION OF RULES OF APPLICATION FOR FAILURE TO SATISFY SECTIONS 856(c)(2) OR 856(c)(3).—Paragraph (6) of section 856(c) (relating to definition of real estate investment trust) is amended by striking subparagraphs (A) and (B), by redesignating subparagraph (C) as subparagraph (B), and by inserting before subparagraph (B) (as so redesignated) the following new subparagraph:

“(A) following the corporation, trust, or association’s identification of the failure to meet the requirements of paragraph (2) or (3), or of both such paragraphs, for any taxable year, a description of each item of its gross income described in such paragraphs is set forth in a schedule for such taxable year filed in accordance with regulations prescribed by the Secretary, and”.

(3) REASONABLE CAUSE EXCEPTION TO LOSS OF REIT STATUS IF FAILURE TO SATISFY REQUIREMENTS.—Subsection (g) of section 856 (relating to termination of election) is amended—

(A) in paragraph (1) by inserting before the period at the end of the first sentence the following: “unless paragraph (5) applies”, and

(B) by adding at the end the following new paragraph:

“(5) ENTITIES TO WHICH PARAGRAPH APPLIES.—This paragraph applies to a corporation, trust, or association—

“(A) which is not a real estate investment trust to which the provisions of this part apply for the taxable year due to one or more failures to comply with one or more of the provisions of this part (other than subsection (c)(6) or (c)(7) of section 856),

“(B) such failures are due to reasonable cause and not due to willful neglect, and

“(C) if such corporation, trust, or association pays (as prescribed by the Secretary in regulations and in the same manner as tax) a penalty of \$50,000 for each failure to satisfy a provision of this part due to reasonable cause and not willful neglect.”.

(4) DEDUCTION OF TAX PAID FROM AMOUNT REQUIRED TO BE DISTRIBUTED.—Subparagraph (E) of section 857(b)(2) is amend-

ed by striking “(7)” and inserting “(7) of this subsection, section 856(c)(7)(B)(iii), and section 856(g)(1).”.

(5) **EXPANSION OF DEFICIENCY DIVIDEND PROCEDURE.**—Subsection (e) of section 860 is amended by striking “or” at the end of paragraph (2), by striking the period at the end of paragraph (3) and inserting “; or”, and by adding at the end the following new paragraph:

“(4) a statement by the taxpayer attached to its amendment or supplement to a return of tax for the relevant tax year.”.

(g) **EFFECTIVE DATES.**—

(1) **IN GENERAL.**—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) **SUBSECTIONS (c) THROUGH (f).**—The amendments made by subsections (c), (d), (e), and (f) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 244. SPECIAL RULES FOR CERTAIN FILM AND TELEVISION PRODUCTIONS.

(a) **IN GENERAL.**—Part VI of subchapter B of chapter 1 is amended by inserting after section 180 the following new section:

“SEC. 181. TREATMENT OF CERTAIN QUALIFIED FILM AND TELEVISION PRODUCTIONS.

“(a) ELECTION TO TREAT COSTS AS EXPENSES.—

“(1) **IN GENERAL.**—A taxpayer may elect to treat the cost of any qualified film or television production as an expense which is not chargeable to capital account. Any cost so treated shall be allowed as a deduction.

“(2) **DOLLAR LIMITATION.**—

“(A) **IN GENERAL.**—Paragraph (1) shall not apply to any qualified film or television production the aggregate cost of which exceeds \$15,000,000.

“(B) **HIGHER DOLLAR LIMITATION FOR PRODUCTIONS IN CERTAIN AREAS.**—In the case of any qualified film or television production the aggregate cost of which is significantly incurred in an area eligible for designation as—

“(i) a low-income community under section 45D, or

“(ii) a distressed county or isolated area of distress by the Delta Regional Authority established under section 2009aa–1 of title 7, United States Code,

subparagraph (A) shall be applied by substituting ‘\$20,000,000’ for ‘\$15,000,000’.

“(b) NO OTHER DEDUCTION OR AMORTIZATION DEDUCTION ALLOWABLE.—With respect to the basis of any qualified film or television production to which an election is made under subsection (a), no other depreciation or amortization deduction shall be allowable.

“(c) ELECTION.—

“(1) **IN GENERAL.**—An election under this section with respect to any qualified film or television production shall be made in such manner as prescribed by the Secretary and by the due date (including extensions) for filing the taxpayer’s return of tax under this chapter for the taxable year in which costs of the production are first incurred.

“(2) **REVOCATION OF ELECTION.**—Any election made under this section may not be revoked without the consent of the Secretary.

SEC. 320. EXCLUSION FOR PAYMENTS TO INDIVIDUALS UNDER NATIONAL HEALTH SERVICE CORPS LOAN REPAYMENT PROGRAM AND CERTAIN STATE LOAN REPAYMENT PROGRAMS.

(a) *IN GENERAL.*—Section 108(f) (relating to student loans) is amended by adding at the end the following new paragraph:

“(4) *PAYMENTS UNDER NATIONAL HEALTH SERVICE CORPS LOAN REPAYMENT PROGRAM AND CERTAIN STATE LOAN REPAYMENT PROGRAMS.*—In the case of an individual, gross income shall not include any amount received under section 338B(g) of the Public Health Service Act or under a State program described in section 338I of such Act.”.

(b) *TREATMENT FOR PURPOSES OF EMPLOYMENT TAXES.*—Each of the following provisions is amended by inserting “108(f)(4),” after “74(c),”:

(1) Section 3121(a)(20).

(2) Section 3231(e)(5).

(3) Section 3306(b)(16).

(4) Section 3401(a)(19).

(5) Section 209(a)(17) of the Social Security Act.

(c) *EFFECTIVE DATE.*—The amendments made by this section shall apply to amounts received by an individual in taxable years beginning after December 31, 2003.

SEC. 321. MODIFICATION OF SAFE HARBOR RULES FOR TIMBER REITS.

(a) *EXPANSION OF PROHIBITED TRANSACTION SAFE HARBOR.*—Section 857(b)(6) (relating to income from prohibited transactions) is amended by redesignating subparagraphs (D) and (E) as subparagraphs (E) and (F), respectively, and by inserting after subparagraph (C) the following new subparagraph:

“(D) *CERTAIN SALES NOT TO CONSTITUTE PROHIBITED TRANSACTIONS.*—For purposes of this part, the term ‘prohibited transaction’ does not include a sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) if—

“(i) the trust held the property for not less than 4 years in connection with the trade or business of producing timber,

“(ii) the aggregate expenditures made by the trust, or a partner of the trust, during the 4-year period preceding the date of sale which—

“(I) are includible in the basis of the property (other than timberland acquisition expenditures), and

“(II) are directly related to operation of the property for the production of timber or for the preservation of the property for use as timberland, do not exceed 30 percent of the net selling price of the property,

“(iii) the aggregate expenditures made by the trust, or a partner of the trust, during the 4-year period preceding the date of sale which—

“(I) are includible in the basis of the property (other than timberland acquisition expenditures), and

“(II) are not directly related to operation of the property for the production of timber, or for the preservation of the property for use as timberland, do not exceed 5 percent of the net selling price of the property,

“(iv)(I) during the taxable year the trust does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or

“(II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the trust as of the beginning of the taxable year,

“(v) in the case that the requirement of clause (iv)(I) is not satisfied, substantially all of the marketing expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the trust itself does not derive or receive any income, and

“(vi) the sales price of the property sold by the trust is not based in whole or in part on income or profits, including income or profits derived from the sale or operation of such property.”.

(b) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 322. EXPENSING OF CERTAIN REFORESTATION EXPENDITURES.

(a) **IN GENERAL.**—So much of subsection (b) of section 194 (relating to amortization of reforestation expenditures) as precedes paragraph (2) is amended to read as follows:

“(b) **TREATMENT AS EXPENSES.**—

“(1) **ELECTION TO TREAT CERTAIN REFORESTATION EXPENDITURES AS EXPENSES.**—

“(A) **IN GENERAL.**—In the case of any qualified timber property with respect to which the taxpayer has made (in accordance with regulations prescribed by the Secretary) an election under this subsection, the taxpayer shall treat reforestation expenditures which are paid or incurred during the taxable year with respect to such property as an expense which is not chargeable to capital account. The reforestation expenditures so treated shall be allowed as a deduction.

“(B) **DOLLAR LIMITATION.**—The aggregate amount of reforestation expenditures which may be taken into account under subparagraph (A) with respect to each qualified timber property for any taxable year shall not exceed \$10,000 (\$5,000 in the case of a separate return by a married individual (as defined in section 7703)).”.

(b) **NET AMORTIZABLE BASIS.**—Section 194(c)(2) (defining amortizable basis) is amended by inserting “which have not been taken into account under subsection (b)” after “expenditures”.

(c) **CONFORMING AMENDMENTS.**—

(1) *IN GENERAL.*—Section 986(a)(1), as amended by subsection (a), is amended by redesignating subparagraph (E) as subparagraph (F) and by inserting after subparagraph (D) the following:

“(E) *SPECIAL RULE FOR REGULATED INVESTMENT COMPANIES.*—In the case of a regulated investment company which takes into account income on an accrual basis, subparagraphs (A) through (D) shall not apply and foreign income taxes paid or accrued with respect to such income shall be translated into dollars using the exchange rate as of the date the income accrues.”.

(2) *CONFORMING AMENDMENT.*—Section 986(a)(2) is amended by inserting “or (E)” after “subparagraph (A)”.

(c) *EFFECTIVE DATE.*—The amendments made by this section shall apply to taxable years beginning after December 31, 2004.

SEC. 409. REPEAL OF WITHHOLDING TAX ON DIVIDENDS FROM CERTAIN FOREIGN CORPORATIONS.

(a) *IN GENERAL.*—Paragraph (2) of section 871(i) (relating to tax not to apply to certain interest and dividends) is amended by adding at the end the following new subparagraph:

“(D) Dividends paid by a foreign corporation which are treated under section 861(a)(2)(B) as income from sources within the United States.”.

(b) *EFFECTIVE DATE.*—The amendment made by this section shall apply to payments made after December 31, 2004.

SEC. 410. EQUAL TREATMENT OF INTEREST PAID BY FOREIGN PARTNERSHIPS AND FOREIGN CORPORATIONS.

(a) *IN GENERAL.*—Paragraph (1) of section 861(a) is amended by striking “and” at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting “, and”, and by adding at the end the following new subparagraph:

“(C) in the case of a foreign partnership, which is predominantly engaged in the active conduct of a trade or business outside the United States, any interest not paid by a trade or business engaged in by the partnership in the United States and not allocable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States.”.

(b) *EFFECTIVE DATE.*—The amendments made by this section shall apply to taxable years beginning after December 31, 2003.

SEC. 411. TREATMENT OF CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.

(a) *TREATMENT OF CERTAIN DIVIDENDS.*—

(1) *NONRESIDENT ALIEN INDIVIDUALS.*—Section 871 (relating to tax on nonresident alien individuals) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

“(k) *EXEMPTION FOR CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.*—

“(1) *INTEREST-RELATED DIVIDENDS.*—

“(A) *IN GENERAL.*—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any interest-related dividend received from a regulated investment company.

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

“(i) to any interest-related dividend received from a regulated investment company by a person to the extent such dividend is attributable to interest (other than interest described in subparagraph (E) (i) or (iii)) received by such company on indebtedness issued by such person or by any corporation or partnership with respect to which such person is a 10-percent shareholder,

“(ii) to any interest-related dividend with respect to stock of a regulated investment company unless the person who would otherwise be required to deduct and withhold tax from such dividend under chapter 3 receives a statement (which meets requirements similar to the requirements of subsection (h)(5)) that the beneficial owner of such stock is not a United States person, and

“(iii) to any interest-related dividend paid to any person within a foreign country (or any interest-related dividend payment addressed to, or for the account of, persons within such foreign country) during any period described in subsection (h)(6) with respect to such country.

Clause (iii) shall not apply to any dividend with respect to any stock which was acquired on or before the date of the publication of the Secretary’s determination under subsection (h)(6).

“(C) INTEREST-RELATED DIVIDEND.—For purposes of this paragraph, the term ‘interest-related dividend’ means any dividend (or part thereof) which is designated by the regulated investment company as an interest-related dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified net interest income of the company for such taxable year, the portion of each distribution which shall be an interest-related dividend shall be only that portion of the amounts so designated which such qualified net interest income bears to the aggregate amount so designated. Such term shall not include any dividend with respect to any taxable year of the company beginning after December 31, 2007.

“(D) QUALIFIED NET INTEREST INCOME.—For purposes of subparagraph (C), the term ‘qualified net interest income’ means the qualified interest income of the regulated investment company reduced by the deductions properly allocable to such income.

“(E) QUALIFIED INTEREST INCOME.—For purposes of subparagraph (D), the term ‘qualified interest income’ means the sum of the following amounts derived by the regulated investment company from sources within the United States:

“(i) Any amount includible in gross income as original issue discount (within the meaning of section

1273) on an obligation payable 183 days or less from the date of original issue (without regard to the period held by the company).

“(ii) Any interest includible in gross income (including amounts recognized as ordinary income in respect of original issue discount or market discount or acquisition discount under part V of subchapter P and such other amounts as regulations may provide) on an obligation which is in registered form; except that this clause shall not apply to—

“(I) any interest on an obligation issued by a corporation or partnership if the regulated investment company is a 10-percent shareholder in such corporation or partnership, and

“(II) any interest which is treated as not being portfolio interest under the rules of subsection (h)(4).

“(iii) Any interest referred to in subsection (i)(2)(A) (without regard to the trade or business of the regulated investment company).

“(iv) Any interest-related dividend includable in gross income with respect to stock of another regulated investment company.

“(F) 10-PERCENT SHAREHOLDER.—For purposes of this paragraph, the term ‘10-percent shareholder’ has the meaning given such term by subsection (h)(3)(B).

“(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—

“(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any short-term capital gain dividend received from a regulated investment company.

“(B) EXCEPTION FOR ALIENS TAXABLE UNDER SUBSECTION (a)(2).—Subparagraph (A) shall not apply in the case of any nonresident alien individual subject to tax under subsection (a)(2).

“(C) SHORT-TERM CAPITAL GAIN DIVIDEND.—For purposes of this paragraph, the term ‘short-term capital gain dividend’ means any dividend (or part thereof) which is designated by the regulated investment company as a short-term capital gain dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified short-term gain of the company for such taxable year, the portion of each distribution which shall be a short-term capital gain dividend shall be only that portion of the amounts so designated which such qualified short-term gain bears to the aggregate amount so designated. Such term shall not include any dividend with respect to any taxable year of the company beginning after December 31, 2007.

“(D) QUALIFIED SHORT-TERM GAIN.—For purposes of subparagraph (C), the term ‘qualified short-term gain’

means the excess of the net short-term capital gain of the regulated investment company for the taxable year over the net long-term capital loss (if any) of such company for such taxable year. For purposes of this subparagraph—

“(i) the net short-term capital gain of the regulated investment company shall be computed by treating any short-term capital gain dividend includible in gross income with respect to stock of another regulated investment company as a short-term capital gain, and

“(ii) the excess of the net short-term capital gain for a taxable year over the net long-term capital loss for a taxable year (to which an election under section 4982(e)(4) does not apply) shall be determined without regard to any net capital loss or net short-term capital loss attributable to transactions after October 31 of such year, and any such net capital loss or net short-term capital loss shall be treated as arising on the 1st day of the next taxable year.

To the extent provided in regulations, clause (ii) shall apply also for purposes of computing the taxable income of the regulated investment company.”

(2) **FOREIGN CORPORATIONS.**—Section 881 (relating to tax on income of foreign corporations not connected with United States business) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

“(e) **TAX NOT TO APPLY TO CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.**—

“(1) **INTEREST-RELATED DIVIDENDS.**—

“(A) **IN GENERAL.**—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1) of subsection (a) on any interest-related dividend (as defined in section 871(k)(1)) received from a regulated investment company.

“(B) **EXCEPTION.**—Subparagraph (A) shall not apply—

“(i) to any dividend referred to in section 871(k)(1)(B), and

“(ii) to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company from a person who is a related person (within the meaning of section 864(d)(4)) with respect to such controlled foreign corporation.

“(C) **TREATMENT OF DIVIDENDS RECEIVED BY CONTROLLED FOREIGN CORPORATIONS.**—The rules of subsection (c)(5)(A) shall apply to any (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company which is described in clause (ii) of section 871(k)(1)(E) (and not described in clause (i) or (iii) of such section).

“(2) **SHORT-TERM CAPITAL GAIN DIVIDENDS.**—No tax shall be imposed under paragraph (1) of subsection (a) on any short-term capital gain dividend (as defined in section 871(k)(2)) received from a regulated investment company.”

(3) *WITHHOLDING TAXES.*—

(A) Section 1441(c) (relating to exceptions) is amended by adding at the end the following new paragraph:

“(12) CERTAIN DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANIES.—

“(A) IN GENERAL.—No tax shall be required to be deducted and withheld under subsection (a) from any amount exempt from the tax imposed by section 871(a)(1)(A) by reason of section 871(k).

“(B) SPECIAL RULE.—For purposes of subparagraph (A), clause (i) of section 871(k)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause. A similar rule shall apply with respect to the exception contained in section 871(k)(2)(B).”.

(B) Section 1442(a) (relating to withholding of tax on foreign corporations) is amended—

(i) by striking “and the reference in section 1441(c)(10)” and inserting “the reference in section 1441(c)(10)”, and

(ii) by inserting before the period at the end the following: “, and the references in section 1441(c)(12) to sections 871(a) and 871(k) shall be treated as referring to sections 881(a) and 881(e) (except that for purposes of applying subparagraph (A) of section 1441(c)(12), as so modified, clause (ii) of section 881(e)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause)”.

(b) *ESTATE TAX TREATMENT OF INTEREST IN CERTAIN REGULATED INVESTMENT COMPANIES.*—Section 2105 (relating to property without the United States for estate tax purposes) is amended by adding at the end the following new subsection:

“(d) *STOCK IN A RIC.*—

“(1) IN GENERAL.—For purposes of this subchapter, stock in a regulated investment company (as defined in section 851) owned by a nonresident not a citizen of the United States shall not be deemed property within the United States in the proportion that, at the end of the quarter of such investment company’s taxable year immediately preceding a decedent’s date of death (or at such other time as the Secretary may designate in regulations), the assets of the investment company that were qualifying assets with respect to the decedent bore to the total assets of the investment company.

“(2) *QUALIFYING ASSETS.*—For purposes of this subsection, qualifying assets with respect to a decedent are assets that, if owned directly by the decedent, would have been—

“(A) amounts, deposits, or debt obligations described in subsection (b) of this section,

“(B) debt obligations described in the last sentence of section 2104(c), or

“(C) other property not within the United States.

“(3) *TERMINATION.*—This subsection shall not apply to estates of decedents dying after December 31, 2007.”

(c) *TREATMENT OF REGULATED INVESTMENT COMPANIES UNDER SECTION 897.*—

(1) Paragraph (1) of section 897(h) is amended by striking “REIT” each place it appears and inserting “qualified investment entity”.

(2) Paragraphs (2) and (3) of section 897(h) are amended to read as follows:

“(2) *SALE OF STOCK IN DOMESTICALLY CONTROLLED ENTITY NOT TAXED.*—The term ‘United States real property interest’ does not include any interest in a domestically controlled qualified investment entity.

“(3) *DISTRIBUTIONS BY DOMESTICALLY CONTROLLED QUALIFIED INVESTMENT ENTITIES.*—In the case of a domestically controlled qualified investment entity, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain.”

(3) Subparagraphs (A) and (B) of section 897(h)(4) are amended to read as follows:

“(A) *QUALIFIED INVESTMENT ENTITY.*—

“(i) *IN GENERAL.*—The term ‘qualified investment entity’ means—

“(I) any real estate investment trust, and

“(II) any regulated investment company.

“(ii) *TERMINATION.*—Clause (i)(II) shall not apply after December 31, 2007.

“(B) *DOMESTICALLY CONTROLLED.*—The term ‘domestically controlled qualified investment entity’ means any qualified investment entity in which at all times during the testing period less than 50 percent in value of the stock was held directly or indirectly by foreign persons.”

(4) Subparagraphs (C) and (D) of section 897(h)(4) are each amended by striking “REIT” and inserting “qualified investment entity”.

(5) The subsection heading for subsection (h) of section 897 is amended by striking “REITS” and inserting “CERTAIN INVESTMENT ENTITIES”.

(d) *EFFECTIVE DATE.*—

(1) *IN GENERAL.*—Except as otherwise provided in this subsection, the amendments made by this section shall apply to dividends with respect to taxable years of regulated investment companies beginning after December 31, 2004.

(2) *ESTATE TAX TREATMENT.*—The amendment made by subsection (b) shall apply to estates of decedents dying after December 31, 2004.

(3) *CERTAIN OTHER PROVISIONS.*—The amendments made by subsection (c) (other than paragraph (1) thereof) shall take effect after December 31, 2004.

SEC. 412. LOOK-THRU TREATMENT FOR SALES OF PARTNERSHIP INTERESTS.

(a) *IN GENERAL.*—Section 954(c) (defining foreign personal holding company income) is amended by adding after paragraph (3) the following new paragraph:

“(4) *LOOK-THRU RULE FOR CERTAIN PARTNERSHIP SALES.*—

“(A) *IN GENERAL.*—In the case of any sale by a controlled foreign corporation of an interest in a partnership

SEC. 418. MODIFICATION OF THE TREATMENT OF CERTAIN REIT DISTRIBUTIONS ATTRIBUTABLE TO GAIN FROM SALES OR EXCHANGES OF UNITED STATES REAL PROPERTY INTERESTS.

(a) *IN GENERAL.*—Paragraph (1) of section 897(h) (relating to look-through of distributions) is amended by adding at the end the following new sentence: “Notwithstanding the preceding sentence, any distribution by a REIT with respect to any class of stock which is regularly traded on an established securities market located in the United States shall not be treated as gain recognized from the sale or exchange of a United States real property interest if the shareholder did not own more than 5 percent of such class of stock at any time during the taxable year.”.

(b) *CONFORMING AMENDMENT.*—Paragraph (3) of section 857(b) (relating to capital gains) is amended by adding at the end the following new subparagraph:

“(F) *CERTAIN DISTRIBUTIONS.*—In the case of a shareholder of a real estate investment trust to whom section 897 does not apply by reason of the second sentence of section 897(h)(1), the amount which would be included in computing long-term capital gains for such shareholder under subparagraph (B) or (D) (without regard to this subparagraph)—

“(i) shall not be included in computing such shareholder’s long-term capital gains, and

“(ii) shall be included in such shareholder’s gross income as a dividend from the real estate investment trust.”.

(c) *EFFECTIVE DATE.*—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 419. EXCLUSION OF INCOME DERIVED FROM CERTAIN WAGERS ON HORSE RACES AND DOG RACES FROM GROSS INCOME OF NONRESIDENT ALIEN INDIVIDUALS.

(a) *IN GENERAL.*—Subsection (b) of section 872 (relating to exclusions) is amended by redesignating paragraphs (5), (6), and (7) as paragraphs (6), (7), and (8), respectively, and inserting after paragraph (4) the following new paragraph:

“(5) *INCOME DERIVED FROM WAGERING TRANSACTIONS IN CERTAIN PARIMUTUEL POOLS.*—Gross income derived by a nonresident alien individual from a legal wagering transaction initiated outside the United States in a parimutuel pool with respect to a live horse race or dog race in the United States.”.

(b) *CONFORMING AMENDMENT.*—Section 883(a)(4) is amended by striking “(5), (6), and (7)” and inserting “(6), (7), and (8)”.

(c) *EFFECTIVE DATE.*—The amendments made by this section shall apply to wagers made after the date of the enactment of this Act.

SEC. 420. LIMITATION OF WITHHOLDING TAX FOR PUERTO RICO CORPORATIONS.

(a) *IN GENERAL.*—Subsection (b) of section 881 is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

“(2) *COMMONWEALTH OF PUERTO RICO.*—

“(A) *IN GENERAL.*—If dividends are received during a taxable year by a corporation—