

528. Certain homeowners associations

(a) General rule. -- A homeowners association (as defined in subsection (c)) shall be subject to taxation under this subtitle only to the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(b) Tax imposed. -- A tax is hereby imposed for each taxable year on the homeowners association taxable income of every homeowners association. Such tax shall be equal to 30 percent of the homeowners association taxable income.

(c) Homeowners association defined. -- For purposes of this section --

(1) Homeowners association. -- The term "homeowners association" means an organization which is a condominium management association or a residential real estate management association if --

(A) such organization is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property,

(B) 60 percent or more of the gross income of such organization for the taxable year consists solely of amount received as membership dues, fees, or assessments from --

(i) owners of residential units in the case of a condominium management association, or

(ii) owners of residences or residential lots in the case of a residential real estate management association.

(C) 90 percent or more of the expenditures of the organization for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property,

(D) no part of the net earnings of such organization inures (other than by acquiring, constructing, or providing management, maintenance, and care of association property, and other than by a rebate of excess membership dues, fees, or assessments) to the benefit of any private shareholder or individual, and

(E) such organization elects (at such time and in such manner as the Secretary by regulations prescribes) to have this section apply for the taxable year.

(2) Condominium management association. -- The term "condominium management association" means any organization meeting the requirement of subparagraph (A) of paragraph (1) with respect to a condominium project substantially all of the units of which are used by individuals for residences.

(3) Residential real estate management association. -- The term "residential real estate management association" means any organization meeting the requirement of subparagraph (A) of paragraph (1) with respect to a subdivision, development, or similar area substantially all the lots or building of which may only be used by individuals for residences.

(4) Association property. -- The term "association property" means --

(A) property held by the organization,

(B) property commonly held by the members of the organization,

(C) property within the organization privately held by the members of the organization, and

(D) property owned by a governmental unit and used for the benefit of residents of such unit.

(d) Homeowners association taxable income defined. --

(1) Taxable income defined. -- For purposes of this section, the homeowners association taxable income of any organization for any taxable year is an amount equal to the excess (if any) of --

(A) the gross income for the taxable year (excluding any exempt function income), over

(B) the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), computed with the modifications provided in paragraph (2).

(2) Modifications. -- For purposes of this subsection --

(A) there shall be allowed a specific deduction of \$100,

(B) no net operating loss deduction shall be allowed under section 172, and

(C) no deduction shall be allowed under part VIII of subchapter B (relating to special deductions for corporations).

(3) Exempt function income. -- For purposes of this subsection, the term "exempt function income" means any amount received as membership dues, fees, or assessments from --

(A) owners of condominium housing units in the case of a condominium management association, or

(B) owners of real property in the case of a residential real estate management association.

#### 531. Imposition of accumulated earnings tax

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of each corporation described in section 532, an accumulated earnings tax equal to 28 percent of the accumulated taxable income.

#### 532. Corporations subject to accumulated earnings tax

(a) General rule. -- The accumulated earnings tax imposed by section 531 shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

(b) Exceptions. -- The accumulated earnings tax imposed by section 531 shall not apply to --

(1) a personal holding company (as defined in section 542),

(2) a foreign personal holding company (as defined in section 552),

(3) a corporation exempt from tax under subchapter F (section 501 and following), or

(4) a passive foreign investment company (as defined in section 1296).

(c) Application determined without regard to number of shareholders. --- The application of this part to a corporation shall be determined without regard to the number of shareholders of such corporation.

#### 533. Evidence of purpose to avoid income tax

(a) Unreasonable accumulation determinative of purpose. -- For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

(b) Holding or investment company. -- The fact that any corporation is a mere holding or investment company shall be prima facie evidence of the purpose to avoid the income tax with respect to shareholders.

#### 534. Burden of proof

(a) General rule. -- In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall --

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) Notification by Secretary. -- Before mailing the notice of deficiency referred to in subsection (a), the Secretary may send by certified mail or registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531.

(c) Statement by taxpayer. -- Within such time (but not less than 30 days) after the mailing of the notification described in subsection (b) as the Secretary may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies

to establish that all or part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

(d) Jeopardy assessment. -- If pursuant to section 6861(a) a jeopardy assessment is made before the mailing of the notice of deficiency referred to in subsection (a), for purposes of this section such notice of deficiency shall, to the extent that it informs the taxpayer that such deficiency includes the accumulated earnings tax imposed by section 531, constitute the notification described in section (b), and in that event the statement described in subsection (c) may be included in the taxpayer's petition to the Tax Court.

### 535. Accumulated taxable income

(a) Definition. -- For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

(b) Adjustments to taxable income. -- For purposes of subsection (a), taxable income shall be adjusted as follows:

(1) Taxes. -- There shall be allowed as a deduction Federal income and excess profits taxes and income, war profits, and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4)), accrued during the taxable year or deemed to be paid by a domestic corporation under section 902(a) or 960(a)(1) for the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law.

(2) Charitable contributions. -- The deduction for charitable contributions provided under section 170 shall be allowed without regard to section 170(b)(2).

(3) Special deductions disallowed. -- The special deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

(4) Net operating loss. -- The net operating loss deduction provided in section 172 shall not be allowed.

(5) Capital losses. --

(A) In general. -- Except as provided in subparagraph (B), there shall be allowed as a deduction an amount equal to the net capital loss for the taxable year (determined without regard to paragraph (7)(A)).

(B) Recapture of previous deductions for capital gains. -- The aggregate amount allowable as a deduction under subparagraph (A) for any taxable year shall be reduced by the lesser of --

(i) the nonrecaptured capital gains deductions, or

(ii) the amount of the accumulated earnings and profits of the corporation as of the close of the preceding taxable year.

(C) Nonrecaptured capital gains deductions. -- For purposes of subparagraph (B), the term "nonrecaptured capital gains deductions" means the excess of --

(i) the aggregate amount allowable as a deduction under paragraph (6) for preceding taxable years beginning after July 18, 1984, over

(ii) the aggregate of the reductions under subparagraph (B) for preceding taxable years.

(6) Net capital gains. --

(A) In general. -- There shall be allowed as a deduction --

(i) the net capital gain for the taxable year (determined with the application of paragraph (7)), reduced by

(ii) the taxes attributable to such net capital gain.

(B) Attributable taxes. -- For purposes of subparagraph (A), the taxes attributable to the net capital gain shall be an amount equal to the difference between --

(i) the taxes imposed by this subtitle (except the tax imposed by this part) for the taxable year, and

(ii) such taxes computed for such year without including in taxable income the net capital gain for the taxable year (determined without the application of paragraph (7)).

(7) Capital loss carryovers. --

(A) Unlimited carryforward. -- The net capital loss for any taxable year shall be treated as short-term capital loss in the next taxable year.

(B) Section 1212 inapplicable. -- No allowance shall be made for the capital loss carryback or carryforward provided in section 1212.

(8) Special rules for mere holding or investment companies. -- In the case of a mere holding or investment company --

(A) Capital loss deduction, etc., not allowed. -- Paragraphs (5) and (7)(A) shall not apply.

(B) Deduction for certain offsets. -- There shall be allowed as a deduction the net short-term capital gain for the taxable year to the extent such gain does not exceed the amount of any capital loss carryover to such taxable year under section 1212 (determined without regard to paragraph (7)(B)).

(C) Earnings and profits. -- For purposes of subchapter C, the accumulated earnings and profits at any time shall not be less than they would be if this subsection had applied to the computation of earnings and profits for all taxable years beginning after July 18, 1984.

(9) Special rule for capital gains and losses of foreign corporations. -- In the case of a foreign corporation, paragraph (6) shall be applied by taking into account only gains and losses which are effectively connected with the conduct of a trade or business within the United States and are not exempt from tax under treaty.

(c) Accumulated earnings credit. --

(1) General rule. -- For purposes of subsection (1), in the case of a corporation other than a mere holding or investment company the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b)(6). For purposes of this paragraph, the amount of the earnings and profits for the taxable year which are retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction (as defined in section 561) for such year.

(2) Minimum credit. --

(A) In general. -- The credit allowable under paragraph (1) shall in no case be less than the amount by which \$250,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

(B) Certain service corporations. -- In the case of a corporation the principal function of which is the performance of services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, subparagraph (A) shall be applied by substituting "\$150,000" for "\$250,000".

(3) Holding and investment companies. -- In the case of a corporation which is a mereholding or investment company, the accumulated earnings credit is the amount (if any) by which \$250,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

(4) Accumulated earnings and profits. -- For purposes of paragraphs (2) and (3), the accumulated earnings and profits at the close of the preceding taxable year shall be reduced by the dividends which under section 563(a) (relating to dividends paid after the close of the taxable year) are considered as paid during such taxable year.

(5) Cross reference. --

For denial of credit provided in paragraph (2) or (3) where multiple corporations are formed to avoid tax, see section 1551, and for limitation on such credit in the case of certain controlled corporations, see section 1561.

(d) Income distributed to United States-owned foreign corporation retains United States connection. --

(1) In general. -- For purposes of this part, if 10 percent or more of the earnings and profits of any foreign corporation for any taxable year --

(A) is derived from sources within the United States, or

(B) is effectively connected with the conduct of a trade or business within the United States, any distribution out of such earnings and profits (and any interest payment) received (directly or through 1 or more other entities) by a United States-owned foreign corporation shall be treated as derived by such corporation from sources within the United States.

(2) United States-owned foreign corporation. -- The term "United States-owned foreign corporation" has the meaning given to such term by section 904(g)(6).

#### 536. Income not placed on annual basis

Section 443(b) (relating to computation of tax on change of annual accounting period) shall not apply in the computation of the accumulated earnings tax imposed by section 531.

#### 537. Reasonable needs of the business

(a) General rule. -- For purposes of this part, the term "reasonable needs of the business" includes --

(1) the reasonably anticipated needs of the business,

(2) the section 303 redemption needs of the business, and

(3) the excess business holdings redemption needs of the business.

(b) Special rules. -- For purposes of subsection (a) --

(1) Section 303 redemption needs. -- The term "section 303 redemption needs" means, with respect to the taxable year of the corporation in which a shareholder of the corporation died or any taxable year thereafter, the amount needed (or reasonably anticipated to be needed) to make a redemption of stock included in the gross estate of the decedent (but not in excess of the maximum amount of stock to which section 303(a) may apply).

(2) Excess business holdings redemption needs. -- The term "excess business holdings redemption needs" means the amount needed (or reasonably anticipated to be needed) to redeem from a private foundation stock which --

(A) such foundation held on May 26, 1969 (or which was received by such foundation pursuant to a will or irrevocable trust to which section 4943(c)(5) applies), and

(B) constituted excess business holdings on May 26, 1969, or would have constituted excess business holdings as of such date if there were taken into account (i) stock received pursuant to a will or trust described in subparagraph (A), and (ii) the reduction in the total outstanding stock of the corporation which would have resulted solely from the redemption of stock held by the private foundation.

(3) Obligations incurred to make redemptions. -- In applying paragraphs (1) and (2), the discharge of any obligation incurred to make a redemption described in such paragraphs shall be treated as the making of such redemption.

(4) Product liability loss reserves. -- The accumulation of reasonable amounts for the payment of reasonably anticipated product liability losses (as defined in section 172(i)), as determined under regulations prescribed by the Secretary, shall be treated as accumulated for the reasonably anticipated needs of the business.

(5) No inference as to prior taxable years. -- The application of this part to any taxable year before the first taxable year specified in paragraph (1) shall be made without regard to the fact that distributions in redemption coming within the terms of such paragraphs were subsequently made.

#### 541. Imposition of personal holding company tax

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the undistributed personal holding company income (as defined in section 545) of every personal holding company (as defined in section 542) a personal holding company tax equal to 28 percent of the undistributed personal holding company income.

#### 542. Definition of personal holding company

(a) General rule. -- For purposes of this subtitle, the term "personal holding company" means any corporation (other than a corporation described in subsection (c)) if --

(1) Adjusted ordinary gross income requirement. -- At least 60 percent of its adjusted ordinary gross income (as defined in section 543(b)(2)) for the taxable year is personal holding company income (as defined in section 543(a)), and

(2) Stock ownership requirement. -- At any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals. For purposes of this paragraph, an organization described in section 401(a), 501(c)(17), or 509(a) or a portion of a trust permanently described in section 642(c) or a corresponding provision of a prior income tax law shall be considered an individual.

(b) Corporations filing consolidated returns. --

(1) General rule. -- In the case of an affiliated group of corporations filing or required to file a consolidated return under section 1501 for any taxable year, the adjusted ordinary gross income requirement of subsection (a)(1) of this section shall, except as provided in paragraphs (2) and (3), be applied for such year with respect to the consolidated adjusted ordinary gross income and the consolidated personal holding company income of the affiliated group. No member of such an affiliated group shall be considered to meet such adjusted ordinary gross income requirement unless the affiliated group meets such requirement.

(2) Ineligible affiliated group. -- Paragraph (1) shall not apply to an affiliated group of corporations if --

(A) any member of the affiliated group of corporations (including the common parent corporation) derived 10 percent or more of its adjusted ordinary gross income for the taxable year from sources outside the affiliated group, and

(B) 80 percent or more of the amount described in subparagraph (A) consists of personal holding company income (as defined in section 543).

For purposes of this paragraph, section 543 shall be applied as if the amount described in subparagraph (A) were the adjusted ordinary gross income of the corporation.

(3) Excluded corporations. -- Paragraph (1) shall not apply to an affiliated group of corporations if any member of the affiliated group (including the common parent corporation) is a corporation excluded from the definition of personal holding company under subsection (c).

(4) Certain dividend income received by a common parent. --

In applying paragraph (2)(A) and (B), personal holding company income and adjusted ordinary gross income shall not include dividends received by a common parent corporation from another corporation if --

(A) the common parent corporation owns, directly or indirectly, more than 50 percent of the outstanding voting stock of such other corporation, and

(B) such other corporation is not a personal holding company for the taxable year in which the dividends are paid.

(5) Certain dividend income received from a nonincludible life insurance company. -- In the case of an affiliated group of corporations filing or required to file a consolidated return under section 1501 for any taxable year, there shall be excluded from consolidated personal holding company income and consolidated adjusted ordinary gross income for purposes of this part dividends received by a member of the affiliated group from a life insurance company taxable under section 801 that is not a member of the affiliated group solely by reason of the application of paragraph (2) of subsection (b) of section 1504.

(c) Exceptions. -- The term "personal holding company" as defined in subsection (a) does not include --

(1) a corporation exempt from tax under subchapter F (sec. 501 and following);

(2) a bank as defined in section 581, or a domestic building and loan association within the meaning of section 7701(a)(19); (3) a life insurance company;

(4) a surety company;

(5) a foreign personal holding company as defined in section 552;

(6) a lending or finance company if --

(A) 60 percent or more of its ordinary gross income (as defined in section 543(b)(1)) is derived from the active and regular conduct of a lending or finance business;

(B) the personal holding company income for the taxable year (computed without regard to income described in subsection (d)(3) and income derived directly from the active and regular conduct of a lending or finance business, and computed by including as personal holding company income the entire amount of the gross income from rents, royalties, produced film rents, and compensation for use of corporate property by shareholders) is not more than 20 percent of the ordinary gross income;

(C) the sum of the deductions which are directly allocable to the active and regular conduct of its lending or finance business equals or exceeds the sum or --

(i) 15 percent of so much of the ordinary gross income derived therefrom as does not exceed \$500,000, plus

(ii) 5 percent of so much of the ordinary gross income derived therefrom as exceeds \$500,000; and

(D) the loans to a person who is a shareholder in such company during the taxable year by or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by members of his family as defined in section 544(a)(2)), outstanding at any time during such year do not exceed \$5,000 in principal amount;

(7) a foreign corporation (other than a corporation which has income to which section 543(a)(7) applies for the taxable year), if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;

(8) A 1 small business investment company which is licensed by the Small Business Administration and operating under the Small Business Investment Act of 1958 (15 U.S.C. 661 and following) and which is actively engaged in the business of providing funds to small business concerns under that Act. This paragraph shall not apply if any shareholder of the small business investment company owns at any time during the taxable year directly or indirectly (including, in the case of an individual, ownership by the members of his family as defined in section 544(a)(2)) a 5 percentum or more proprietary interest in a small business concern to which funds are provided by the investment company or 5 per centum or more in value of the outstanding stock of such concern;

(9) a corporation which is subject to the jurisdiction of the court in a title 11 or similar case (within the meaning of section 368(a)(3)(A)) unless a major purpose of instituting or continuing such case is the avoidance of the tax imposed by section 541; and

(10) a passive foreign investment company (as defined in section 1296).

(d) Special rules for applying subsection (c)(6). --

(1) Lending or finance business defined. --

(A) In general. -- Except as provided in subparagraph (B), for purposes of subsection (c)(6), the term "lending or finance business" means a business of --

(i) making loans,

(ii) purchasing or discounting accounts receivable, notes, or installment obligations,

(iii) rendering services or making facilities available in connection with activities described in clauses (i) and (ii) carried on by the corporation rendering services or making facilities available, or

(iv) rendering services or making facilities available to another corporation which is engaged in the lending or finance business (within the meaning of this paragraph), if such services or facilities are related to the lending or finance business (within such meaning) of such other corporation and such other corporation and the corporation rendering services or making facilities available are members of the same affiliated group (as defined in section 1504).

(B) Exceptions. -- For purposes of subparagraph (A), the term "lending or finance business" does not

include the business of --

(i) making loans, or purchasing or discounting accounts receivable, notes, or installment obligations, if (at the time of the loan, purchase, or discount) the remaining maturity exceeds 144 months; unless --

(I) the loans, notes, or installment obligations are evidenced or secured by contracts of conditional sale, chattel mortgages, or chattel lease agreements arising out of the sale of goods or services in the course of the borrower's or transferor's trade or business, or

(II) the loans, notes, or installment obligations are made or acquired by the taxpayer and meet the requirements of subparagraph (C), or

(ii) making loans evidenced by, or purchasing, certificates of indebtedness issued in a series, under a trust indenture, and in registered form or with interest coupons attached.

For purposes of clause (i), the remaining maturity shall be treated as including any period for which there may be a renewal or extension under the terms of an option exercisable by the borrower.

(C) Indefinite maturity credit transactions. -- For purposes of subparagraph (B)(i), a loan, note, or installment obligation meets the requirements of this subparagraph if it is made under an agreement --

(i) under which the creditor agrees to make loans or advances (not in excess of an agreed upon maximum amount) from time to time to or for the account of the debtor upon request, and

(ii) under which the debtor may repay the loan or advance in full or in installments.

(2) Business deductions. -- For purposes of subsection (c)(6)(C), the deductions which may be taken into account shall include only --

(A) deductions which are allowable only by reason of section 162 or section 404, except there shall not be included any such deduction in respect of compensation for personal services rendered by shareholders (including members of the shareholder's family as described in section 544(a)(2)), and

(B) deductions allowable under section 167, and deductions allowable under section 164 for real property taxes, but in either case only to the extent that the property with respect to which such deductions are allowable is used directly in the active and regular conduct of the lending or finance business.

(3) Income received from certain affiliated corporations. --

For purposes of subsection (c)(6)(B), in the case of a lending or finance company which meets the requirements of subsection (c)(6)(A), there shall not be treated as personal holding company income the lawful income received from a corporation which meets the requirements of subsection (c)(6) and which is a member of the same affiliated group (as defined in section 1504) of which such company is a member.

#### 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 section 511 or 607 of the Merchant Marine Act, 1936 (46 U.S.C.App. 1161 or 1177),

(C) active business computer software royalties (within the meaning of subsection (d)), and

(D) 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(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 subparagraph (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 perform, 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,

(B) all gains (other than those referred to in subparagraph (A)) from the sale or other disposition of property described in section 1231(b), and

(C) in the case of a foreign corporation all of the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), all items of income which would, but for this subparagraph, constitute personal holding company income under any paragraph of subsection (a) other than paragraph (7) thereof:

(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 royalties or such gross income from working interests in oil or gas well. 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 interest 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 831(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 91) 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, and 195 for the taxable year which are properly allocable to the trade or business described in paragraph 92) 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.