244. Dividends received on certain preferred stock

(a) General rule. -- In the case of a corporation, there shall be allowed as a deduction an amount computed as follows:

(1) First determine the amount received as dividends on the preferred stock of a public utility which is subject to taxation under this chapter and with respect to which the deduction provided in section 247 for dividends paid is allowable.

(2) Then multiply the amount determined under paragraph (1) by the fraction --

(A) the numerator of which is 14 percent, and

(B) the denominator of which is that percentage which equals the highest rate of tax specified in section 11(b).

(3) Finally ascertain the amount which is 70 percent of the excess of --

(A) the amount determined under paragraph (1), over

(B) the amount determined under paragraph (2).

(b) Exception. -- If the dividends described in subsection (a)(1) are qualifying dividends (as defined in section 243(b)(1), but determined without regard to section 243(d)(4)) --

(1) subsection (a) shall be applied separately to such qualifying dividends, and

(2) for purposes of subsection (a)(3), the percentage applicable to such qualifying dividends shall be 100 percent in lieu of 70 percent.

245. Dividends from 10-percent owned foreign corporations. --

(1) In general. -- In the case of dividends received by a corporation from a qualified 10-percent owned foreign corporation, there shall be allowed as a deduction an amount equal to the percent (specified in section 243 for the taxable year) of the U.S.-source portion of such dividends.

(2) Qualified 10-percent owned foreign corporation. -- for purposes of this subsection, the term "qualified 10-percent owned foreign corporation" means any foreign corporation (other than a foreign personal holding company or passive foreign investment company) if at least 10 percent of the stock of such corporation (by vote and value) is owned by the taxpayer.

(3) U.S.-source portion. -- for purposes of this subsection, the U.S.-source portion of any dividend is an amount which bears the same ratio to such dividend as --

(A) the post-1986 undistributed U.S. earnings, bears to

(B) the total post-1986 undistributed earnings.

(4) Post-1986 undistributed earnings. - For purposes of this subsection, the term "post-1986 undistributed earnings" has the meaning given to such term by section 902(c)(1).

(5) Post-1986 undistributed U.S. earnings. -- for purposes of this subsection, the term "post-1986 undistributed U.S. earnings" means the portion of the post-1986 undistributed earnings which is attributable to --

(A) income of the qualified 10-percent owned foreign corporation which is effectively connected with the conduct of a trade or business within the United States and subject to tax under this chapter, or

(B) any dividend received (directly or through a wholly owned foreign corporation) from a domestic corporation at least 80 percent of the stock of which (by vote and value) is owned (directly or through such wholly owned foreign corporation) by the qualified 10-percent owned foreign corporation.

(6) Special rule. -- If the 1st day on which the requirements of paragraph (2) are met with respect to any foreign corporation is in a taxable year of such corporation beginning after December 31, 1986, the post-1986 undistributed earnings and the post-1986 undistributed U.S. earnings of such corporation shall be determined by only taking into account periods beginning on and after the 1st day of the 1st taxable year in which such requirements are met.

(7) Coordination with subsection (b). -- Earnings and profits of any qualified 10-percent owned foreign corporation for any taxable year shall not be taken into account under this subsection if the deduction provided by subsection (b) would be allowable with respect to dividends paid out of such earnings and profits.

(8) Disallowance of foreign tax credit. -- No credit shall be allowed under section 901 for any taxes paid or accrued (or treated as paid or accrued) with respect to the Unite States-source portion of any dividend received by a corporation from a qualified 10-percent-owned foreign corporation.

(9) Coordination with section 904. - For purposes of section 904, the U.S.-source portion of any dividend received by a corporation from a qualified 10-percent owned foreign corporation shall be treated as from sources in the United States.

(10) Coordination with treaties. -- If --

(A) any portion of a dividend received by a corporation from a qualified 10-percent-owned foreign corporation would be treated as from sources in the United States under paragraph (9),

(B) under a treaty obligation of the United States (applied without regard to this subsection), such portion would be treated as arising from sources outside the United States, and

(C) the taxpayer chooses the benefits of this paragraph,

this subsection shall not apply to such dividend (but subsections (a), (b), and (c) of section 904 and sections 902, 907, and 960 shall be applied separately with respect to such portion of such dividend).

(11) Coordination with section 1248. -- for purposes of this subsection, the term "dividend" does not include any amount treated as a dividend under section 1248.

(b) Certain dividends received from wholly owned foreign subsidiaries. --

(1) In general. -- In the case of dividends described in paragraph (2) received from a foreign corporation by a domestic corporation which, for its taxable year in which such dividends are received, owns (directly or indirectly) all of the outstanding stock of such foreign corporation, there shall be allowed as a deduction (in lieu of the deduction provided by subsection (a)) an amount equal to 100 percent of such dividends.

(2) Eligible dividends. -- Paragraph (1) shall apply only to dividends which are paid out of the earnings and profits of a foreign corporation for a taxable year during which --

(A) all of its outstanding stock is owned (directly or indirectly) by the domestic corporation to which such dividends are paid; and

(B) all of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

(3) Exception. -- Paragraph (1) shall not apply to any dividends if an election under section 1562 is effective for either --

(A) the taxable year of the domestic corporation in which such dividends are received, or

(B) the taxable year of the foreign corporation out of the earnings and profits of which such dividends are paid.

(c) Certain dividends received from FSC. --

(1) In general. -- In the case of a domestic corporation, there shall be allowed as a deduction an amount equal to --

(A) 100 percent of any dividend received from another corporation which is distributed out of earnings and profits attributable to foreign trade income for a period during which such other corporation was a FSC, and

(B) 70 percent (80 percent in the case of dividends from a 20-percent owned corporation as defined in section 243(c)(2)) of any dividend received from another corporation which is distributed out of earnings and profits attributable to effectively connected income received or accrued by such other corporation while such other corporation was FSC.

(2) Exception for certain dividends. -- Paragraph (1) shall not apply to any dividend which is distributed out of earnings and profits attributable to foreign trade income which --

(A) is section 923(a)(2) nonexempt income (within the meaning of section 927(d)(6)), or

(B) Effectively connected income. -- The term "effectively connected income" means any income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States and is subject to tax under this chapter. Such term shall not include any foreign trade income.

246. Rules applying to deductions for dividends received

(a) Deduction not allowed for dividends from certain corporations. --

(1) In general. -- The deductions allowed by sections 243, 244, and 245 shall not apply to any dividend from a corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is a corporation exempt from tax under section 501 (relating to certain charitable, etc., organizations) or section 521 (relating to farmers' cooperative associations).

(2) Subsection not to apply to certain dividends of federal home loan banks. --

(A) Dividends out of current earnings and profits. -- In the case of any dividend paid by any FHLB out of earnings and profits of the FHLB for the taxable year in which such dividend

was paid, paragraph (1) shall not apply to that portion of such dividend which bears the same ratio to the total dividend as --

(i) the dividends received by the FHLB from the FHLMC during such taxable year, bears to

(ii) the total earnings and profits of the FHLB for such taxable year.

(B) Dividends out of accumulated earnings and profits. -- In the case of any dividend which is paid out of any accumulated earnings and profits of any FHLB, paragraph (1) shall not apply to that portion of the dividend which bears the same ratio to the total dividend as --

(i) the amount of dividends received by such FHLB from the FHLMC which are out of earnings and profits of the FHLMC --

(I) for taxable years ending after December 31, 1984, and

(II) which were not previously treated as distributed under subparagraph (A) or this subparagraph, bears to

(ii) the total accumulated earnings and profits of the FHLB as of the time such dividend is paid.

For purpose of clause (ii), the accumulated earnings and profits of the FHLB as of January 1, 1985, shall be treated as equal to its retained earnings as of such date.

(C) Coordination with section 243. -- To the extent that paragraph (1) does not apply to any dividend by reason of subparagraph (A) or (B) of this paragraph, the requirement contained in section 243(a) that the corporation paying the dividend be subject to taxation under this chapter shall not apply.

(D) Definitions. -- For purposes of this paragraph --

(i) FHLB. -- The term "FHLB" means any Federal Home Loan Bank.

(ii) FHLMC. -- The term "FHLMC" means the Federal Home Loan Mortgage Corporation.

(iii) Taxable year of FHLB. -- The taxable year of an FHLB shall, except as provided in regulations prescribed by the Secretary, be treated as the calendar year.

(iv) Earnings and profits. -- The earnings and profits of any FHLB for any taxable year shall be treated as equal to the sum of --

(I) any dividends received by the FHLB from the FHLMC during such taxable year, and

(II) the total earnings and profits (determined without regard to dividends described in subclause (I)) of the FHLB as reported in its annual financial statement prepared in accordance with section 20 of the Federal Home Loan Bank Act (12 U.S.C. 1440).

(b) Limitation on aggregate amount of deductions. --

(1) General rule. -- Except as provided in paragraph (2), the aggregate amount of the deductions allowed by sections 243 (a)(1), 244(a), and subsection (a) or (b) of section 245 shall not exceed the percentage determined under paragraph (3) of the taxable income computed without regard to the deductions allowed by sections 172, 243(a)(1), 244(a), subsection (a) or (b) of section 245, and 247, without regard to any adjustment under section 1059, and without regard to any capital loss carryback to the taxable year under section 1212(a)(1).

(2) Effect of net operating loss. -- Paragraph (1) shall be applied --

(A) first separately with respect to dividends from 20-percent owned corporations (as defined in section 243(c)(2)) and the percentage determined under this paragraph shall be 80 percent, and

(B) then separately with respect to dividends not from 20-percent owned corporations and the percentage determined under this paragraph shall be 70 percent and the taxable income shall be reduced by the aggregate amount of dividends from 20-percent owned corporations (as so defined).

(c) exclusion of certain dividends. --

(1) In general. -- No deduction shall be allowed under section 243, 244, or 245, in respect of any dividend on any share of stock --

(A) Which is held by the taxpayer for 45 days or less, or

(B) to the extent that the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(2) 90-day rule in the case of certain preference dividends. -- In the case of any stock having preference in dividends, the holding period specified in paragraph (1)(A) shall be 90 days in lieu of 45 days if the taxpayer receives dividends with respect to such stock which are attributable to a period or periods aggregating in excess of 366 days.

(3) Determination of holding periods. -- For purposes of this section, in determining the period for which the taxpayer has held any share of stock --

(A) the day of disposition, but not the day of acquisition, shall be taken into account,

(B) there shall not be taken into account any day which is more than 45 days (or 90 days in the case of stock to which paragraph (2) applies) after the date on which such share becomes ex-dividend, and

(C) paragraph (4) of section 1223 shall not apply.

(4) Holding period reduced for periods where risk of loss diminished. -- The holding periods determined for purposes of this subsection shall be appropriately reduced (in the manner provided in regulations prescribed by the Secretary) for any period (during such periods) in which --

(A) the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities,

(B) the taxpayer is the grantor of an option to buy substantially identical stock or securities, or

(C) under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

The preceding sentence shall not apply in the case of any qualified covered call (as defined in section 1092(c)(4) but without regard to the requirement that gain or loss with respect to the option not be ordinary income or loss).

(d) Dividends from a DISC or former DISC. -- No deduction shall be allowed under section 243 in respect of a dividend from a corporation which is a DISC or former DISC (as defined in section 992(a)) to the extent such dividend is paid out of the corporations's accumulated DISC income or previously taxed income, or is a deemed distribution pursuant to section 995(b)(1).

(e) Certain distributions to satisfy requirements. -- No deduction shall be allowed under section 243(a) with respect to a dividend received pursuant to a distribution described in section 936(h)(4).

(f) Cross reference. --

246A. Dividends received deduction reduced where portfolio stock is debt financed

(a) General rule. -- In the case of any dividend on debt-financed portfolio stock, there shall be substituted for the percentage which (but for this subsection) would be used in determining the amount of the deduction allowable under section 243, 244, or 245(a) a percentage equal to the product of --

(1) 70 percent (80 percent in the case of any dividend from a 20-percent owned corporation as defined in section 243(c)(2)), and

(2) 100 percent minus the average indebtedness percentage.

(b) Section not to apply to dividends for which 100 percent dividends received deduction allowable. -- Subsection (a) shall not apply to --

(1) qualifying dividends (as defined in section 243(b) without regard to section 243(c)(4)), and

(2) dividends received by a small business investment company operating under the Small Business Investment Act of 1958.

(c) Debt financed portfolio stock. -- For purposes of this section --

(1) In general. -- The term "debt financed portfolio stock" means any portfolio stock if at some time during the base period there is portfolio indebtedness with respect to such stock.

(2) Portfolio stock. -- The term "portfolio stock" means any stock of a corporation unless --

(A) as of the beginning of the ex-dividend date, the taxpayer owns stock of such corporation --

(i) possessing at least 50 percent of the total voting power of the stock of such corporation, and

(ii) having a value equal to at least 50 percent of the total value of the stock of such corporation, or

(B) as of the beginning of the ex-dividend date --

(i) the taxpayer owns stock of such corporation which would meet the requirements of subparagraph (A) if "20 percent" were substituted for "50 percent" each place it appears in such subparagraph, and

(ii) stock meeting the requirements of subparagraph (A) is owned by 5 or fewer corporate shareholders.

(3) Special rule for stock in a bank or bank holding company. --

(A) In general. -- If, as of the beginning of the ex-

dividend date, the taxpayer owns stock of any bank or bank holding company having a value equal to at least 80 percent of the total value of the stock of such bank or bank holding company, for purposes of paragraph (2)(A)(i), the taxpayer shall be treated as owning any stock of such bank or bank holding company which the taxpayer has an option to acquire.

(B) Definitions. -- For purposes of subparagraph (A) --

(i) Bank. -- the term "bank" has the meaning given such term by section 581.

(ii) Bank holding company. -- The term "bank holding company" means a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956).

(4) Treatment of certain preferred stock. -- for purposes of determining whether the requirements of subparagraph (A) or (B) of paragraph (2) or of subparagraph (A) of paragraph (3) are met, stock described in section 1504(a)(4) shall not be taken into account.

(d) Average indebtedness percentage. -- For purposes of this section --

(1) In general. -- Except as provided in paragraph (2), the term "average indebtedness percentage" means the percentage obtained by dividing --

(A) the average amount (determined under regulations prescribed by the Secretary) of the portfolio indebtedness with respect to the stock during the base period, by

(B) the average amount (determined under regulations prescribed by the Secretary) of the adjusted basis of the stock during the base period.

(2) Special rule where stock held throughout base period. -- In the case of any stock which was not held by the taxpayer throughout the base period, paragraph (1) shall be applied as if the base period consisted only of that portion of the base period during which the stock was held by the taxpayer.

(3) Portfolio indebtedness. --

(A) In general. -- The term "portfolio indebtedness" means any indebtedness directly attributable to investment in the portfolio stock.

(B) Certain amounts received from short sale treated as indebtedness. -- for purposes of subparagraph (A), any amount received from a short sale shall be treated as indebtedness for the period beginning on the day on which such amount is received and ending on the day the short sale is closed.

(4) Base period. -- The term "base period" means, with respect to any dividend, the shorter of --

(A) the period beginning on the ex-dividend date for the most recent previous dividend on the stock and ending on the day before the ex-dividend date for the dividend involve, or

(B) the 1-year period ending on the day before the ex-dividend date for the dividend involved.

(e) Reduction in dividends received deduction not to exceed allocable interest. -- Under regulations prescribed by the Secretary, any reduction under this section in the amount allowable as a deduction under section 243, 244, or 245 with respect to any dividend shall not exceed the amount of any

interest deduction (including any deductible short sale expense) allocable to such dividend.

(f) Regulations. -- The regulations prescribed for purposes of this section under section 7701(f) shall include regulations providing for the disallowance of interest deduction or other appropriate treatment (in lieu of reducing the dividend received deduction) where the obligor of the indebtedness is a person other than the person receiving the dividend.

247. Dividends paid on certain preferred stock of public utilities

(a) Amount of deduction. -- In the case of a public utility, there shall be allowed as a deduction an amount computed as follows:

(1) First determine the amount which is the lesser of --

(A) the amount of dividends paid during the taxable year on its preferred stock, or

(B) the taxable income for the taxable year (computed without the deduction allowed by this section).

(2) Then multiply the amount determined under paragraph (1) by the fraction --

(A) the numerator of which is 14 percent, and

(B) the denominator of which is that percentage which equal the highest rate of tax specified in section 11(b).

For purposes of the deduction provided in this section, the amount of dividends paid shall not include any amount distributed in the current taxable year with respect to dividends unpaid and accumulated in any taxable year ending before October 1, 1942. Amounts distributed in the current taxable year with respect to dividends unpaid and accumulated for a prior taxable year shall for purposes of this subsection be deemed to be distributed with respect to the earliest year or years for which there are dividends unpaid and accumulated.

(b) Definitions. -- For purposes of this section and section 244 --

(1) Public utility. -- The term "public utility" means a corporation engaged in the furnishing of telephone service or in the sale of electrical energy, gas, or water, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

(2) Preferred stock. --

(A) In general. -- The term "preferred stock" means stock issued before October 1, 1942, which during the whole of the taxable year (or the part of the taxable year after its issue) was stock the dividends in respect of which were cumulative, limited to the same amount, and payable in preference to the payment of dividends on other stock.

(B) Certain stock issued on or after October 1, 1942. -- Stock issued on or after October 1, 1942, shall be deemed for purposes of this paragraph to have been issued before October 1, 1942, if it was issued to refund or replace bonds or debentures

issued before October 1, 1942, or to refund or replace other preferred stock (including stock which is preferred stock by reason of this subparagraph or), but only the extent that the par or stated value of the new stock does not exceed the par, stated, or face value of the bonds or debentures issued before October 1, 1942, or the other preferred stock, which such new stock is issued to refund or replace.

(C) Determination under regulations. -- The determination of whether stock was issued to refund or replace bonds or debentures issued before October 1, 1942, or to refund or replace other preferred stock, shall be made under regulations prescribed by the Secretary.

(D) Issuance of stock. -- For purposes of subparagraph (B) , issuance of stock includes issuance either by the same or another corporation in a transaction which is a reorganization (as defined in section (368(a)), or a transaction subject to part VI of subchapter O (relating to exchanges in SEC obedience orders), or the respectively corresponding provisions of the Internal Revenue Code of 1939.

248. Organizational expenditures

(a) Election to amortize. -- The organizational expenditures of a corporation may, at the election of the corporation (made in accordance with regulation prescribed by the Secretary), be treated as deferred expenses. In computing taxable income, such deferred expenses shall be allowed as a deduction ratably over such period of not less than 60 months as may be selected by the corporation (beginning with the month in which the corporation begins business).

(b) Organizational expenditures defined. -- The term "organizational expenditures" means any expenditure which --

(1) is incident to the creation of the corporation;

(2) is chargeable to capital account; and

(3) is of a character which, if expended incident to the creation of a corporation having a limited life, would be amortizable over such life.

(c) Time for and scope of election. -- The election provided by subsection (a) may be made for any taxable year beginning after December 31, 1953, but only if made not later than the time prescribed bylaw for filing the return for such taxable year (including extensions thereof). the period so elected shall be adhered to in computing the taxable income of the corporation for the taxable year for which the election is made and all subsequent taxable years. The election shall apply only with respect to expenditures paid or incurred on or after August 16, 1954.

249. Limitation on deduction of bond premium on repurchase

(a) General rule. -- No deduction shall be allowed to the issuing corporation for any premium paid or incurred upon the repurchase of a bond, debenture, note, or certificate or other evidence of indebtedness which is convertible into the stock of the issuing corporation, or a corporation in control of, or controlled by, the issuing corporation, to the extent the repurchase price exceeds an amount equal to the adjusted issue

price plus a normal call premium on bonds or other evidences of indebtedness which are not convertible. the preceding sentence shall apply to the extent that the corporation can demonstrate to the satisfaction of the Secretary that such excess is attributable to the cost of borrowing and is not attributable to the conversion feature.

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

(1) Adjusted issued price. -- The adjusted issue price is the issued price (as defined in sections 1273(b) and 1274) increased by any amount of discount deducted before repurchase, or, in the case of bonds or other evidences of indebtedness issued after February 28, 1913, decreased by any amount of premium included in gross income before repurchase by the issuing corporation.

(2) Control. -- The term "control" has the meaning assigned to such term by section 368(c).

250. Certain payments to the National Railroad Passenger Corporation

(a) General rule. -- If --

(1) any corporation which is a rail carrier (as defined in section 10102(20) of title 49) makes a payment in cash, rail passenger equipment, or services to the National Railroad Passenger Corporation (hereinafter in this section referred to as the "Passenger Corporation") pursuant to a contract entered into under section 401(a) of the Rail Passenger Service Act, and

(2) no stock in the Passenger Corporation is issued at any time to such corporation in connection with any contract entered into under such section 401(a).

then the amount of such payment shall (subject to subsection (c)) be allowed as a deduction for the taxable year in which it is made.

(b) When payment is made. -- Under regulations prescribed by the Secretary, a payment in rail passenger equipment shall be treated as made when title to the equipment is transferred, and a payment in services shall be treated as made when the services are rendered.

(c) Effect of certain subsequent acquisitions of stock. --

(1) Disallowance of deductions. -- If any deduction has been allowed under subsection (a) to a corporation and such corporation (or a successor corporation) acquires any stock in the Passenger Corporation (other than in a transaction described in section 374 or 381) before the close of the 36-month period which begins with the day on which the last payment is made to the Passenger Corporation pursuant to the contract entered into under such section 401(a), then such deduction shall be disallowed (as of the close of the taxable year for which it was allowed under subsection (a)).

(2) Collection of deficiency. -- If any deduction is disallowed by reason of paragraph (1), then the periods of limitation provided in sections 6501 and 6502 on the making of an assessment and the collection by levy or a proceeding in court shall, with respect to any deficiency (including interest and additions to the tax) resulting from such a disallowance, include one year following the date on which the person acquiring the

stock which results in the disallowance (in accordance with regulations prescribed by the Secretary) notifies the Secretary of such acquisition; and such assessment and collection may be made notwithstanding any provision of law or rule of law which otherwise would prevent such assessment and collection.

(d) Members of controlled group. -- Under regulations prescribed by the Secretary, if a corporation is a member of a controlled group of corporations (within the meaning of section 1563), subsections (a)(2) and (c) shall be applied by treating all members of such controlled group as one corporation.

261. General rule for disallowance of deductions

In computing taxable income no deduction shall in any case be allowed in respect of the items specified in this part.

262. Personal, living, and family expenses

(a) General rule. -- Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

(b) Treatment of certain phone expenses. -- For purposes of subsetion (a), in the case of an individual, any charge (including taxes thereon) for basic local telephone service with respect to the 1st telephone line provided to any residence of the taxpayer shall be treated as a personal expense.

263. Capital expenditures

(a) General rule. -- No deduction shall be allowed for --

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to --

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180,

(E) expenditures for removal of architectural and transportation barriers to the handicapped and elderly which the taxpayer elects to deduct under section 190,

(F) expenditures for tertiary injectant with respect to which a deduction is allowed under section 193 or

(G) expenditures for which a deduction is allowed under section 179.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

(b) Repealed.

(c) Intangible drilling and development costs in the case of oil and gas wells and geothermal wells. -- Notwithstanding subsection (a), and except as provided in subsection (i), regulations shall be prescribed by the Secretary under this subtitle corresponding to the regulations which granted the option to deduct as expenses intangible drilling and development

costs in the case of oil and gas wells and which were recognized and approved by the congress in House Concurrent Resolution 50, Seventy-ninth Congress. such regulations shall also grant the option to deduct as expenses intangible drilling and development costs in the case of wells drilled for any geothermal deposit (as defined in section 613(e)(3)) to the same extent and in the same manner as such expenses are deductible in the case of oil and gas wells. This subsection shall not apply with respect to any costs to which any deduction is allowed under section 59(d) or 291.

(d) Expenditures in connection with certain railroad rolling stock. -- In the case of expenditures in connection with rehabilitation of a unit of railroad rolling stock (except a locomotive) used by a domestic common carrier by railroad which would, but for this subsection, be properly chargeable to capital account, such expenditures, if during any 12-mont period they do not exceed an amount equal to 20 percent of the basis of such unit in the hands of the taxpayer, shall, at the election of the taxpayer, be treated (notwithstanding subsection (a)) as deductible repairs under section 162 or 212. An election under this subsection shall be made for any taxable year at such time and in such manner as the Secretary prescribes by regulations. an election may not be made under this subsection for any taxable year to which an election under subsection for any taxable year to which an electing under subsection (e) applies to railroad rolling stock (other than locomotives).

(e) Repealed.

(f) Railroad ties. -- In the case of a domestic common carrier by rail (including a railroad switching or terminal company) which uses the retirement-replacement method of accounting for depreciation of its railroad track, expenditures for acquiring and installing replacement ties of any material (and fastenings related to such ties) shall be accorded the same tax accounting treatment as expenditures for replacement ties of wood (and fastenings related to such ties).

(g) Certain interest and carrying costs in the case of straddles.

(1) General rule. -- No deduction shall be allowed for interest and carrying charges properly allocable to personal property which is part of a straddle (as defined in section 1092 (c)). Any amount not allowed as a deduction by reason of the preceding sentence shall be chargeable to the capital account with respect to the personal property to which such amount relates.

(2) Interest and carrying charges defined. -- for purposes of paragraph (1), the term "interest and carrying charges" means the excess of --

(A) the sum of --

(i) interest on indebtedness incurred or continued to purchase or carry the personal property, and

(ii) all other amounts (including charges to insure, store, or transport the personal property) paid or incurred to carry the personal property, over

(B) the sum of --

(i) the amount of interest (including original issue discount)

includible in gross income for the taxable year with respect to the property described in subparagraph (A),

(ii) any amount treated as ordinary income under section 1271(a)(3)(A), 1278, or 1281(a) with respect to such property for the taxable year,

(iii) the excess of any dividends includible in gross income with respect to such property for the taxable year over the amount of any deduction allowable with respect to such dividends under section 243, 244, or 245, and

(iv) any amount which is a payment with respect to a security loan (within the meaning of section 512(a)(5)) includible in gross income with respect to such property for the taxable year.

For purposes of subparagraph (A), the term "interest" includes any amount paid or incurred in connection with personal property used in a short sale.

(3) Exception for hedging transactions. -- this subsection shall not apply in the case of any hedging transaction (as defined in section 1256(e)).

(4) Application with other provisions. --

(A) Subsection (c). -- In the case of any shortsale, this subsection shall be applied after subsection (h).

(B) Section 1277 or 1282. -- In the case of any obligation to which section 1277 or 1282 applies, this subsection shall be applied after section 1277 or 1282.

(h) Payments in lieu of dividends in connection with short sales. --

(1) In general. -- If --

(A) a taxpayer makes any payment with respect to any stock used by such taxpayer in short sale and such payment is in lieu of a dividend payment on such stock, and

(B) the closing of such short sale occurs on or before the 45th day after the date of such short sale.

then no deduction shall be allowed for such payment. The basis of the stock used to close the short sale shall be increased by the amount not allowed as a deduction by reason of the preceding sentence.

(2) Longer period in case of extraordinary dividends. -- If the payment described in paragraph (1)(A) is in respect of an extraordinary dividend, paragraph (1)(B) shall be applied by substituting "the day 1 year after the date of such short sale" for "the 45th day after the date of such short sale".

(3) Extraordinary dividend. -- for purposes of this subsection, the term "extraordinary dividend" has the meaning given to such term by section 1059(c); except that such section shall be applied by treating the amount realized by the taxpayer in the short sale as his adjusted basis in the stock.

(4) Special rule where risk of loss diminished. -- The running of any period of time applicable under paragraph (1)(B) (as modified by paragraph (2)) shall be suspended during any period in which --

(A) the taxpayer holds, has an option to buy, or is under a contractual obligation to buy, substantially identical stock or securities, or

(B) under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

(5) Deduction allowable to extent of ordinary income from amounts paid by lending broker for use of collateral. --

(A) In general. -- Paragraph (1) shall apply only to the extent that the payments or distributions with respect to any short sale exceed the amount which --

(i) is treated as ordinary income by the taxpayer, and

(ii) is received by the taxpayer as compensation for the use of any collateral with respect to any stock used in such short sale.

(B) Exception not to apply to extraordinary dividends. -- Subparagraph (A) shall not apply if one or more payments or distributions is in respect of an ordinary dividend.

(6) Application of this subsection with subsection (g). -- In the case of any short sale, this subsection shall be applied before subsection (g).

(i) Special rules for intangible drilling and development costs incurred outside the United States. -- In the case of intangible drilling and development costs paid or incurred with respect to an oil, gas, or geothermal well located outside the United States --

(1) subsection (c) shall not apply, and

(2) such costs shall --

(A) at the election of the taxpayer, be included in adjusted basis for purposes of computing the amount of any deduction allowable under section 611 (determined without regard to section 613), or

(B) if subparagraph (A) does not apply, be allowed as a deduction ratably over the 10-taxable year period beginning with the taxable year in which such costs were paid or incurred.

This subsection shall not apply to costs paid or incurred with respect to a nonproductive well.

263A. Capitalization and inclusion in inventory costs of certain expenses

(a) Nondeductibility of certain direct and indirect costs. --

(1) In general. -- In the case of any property to which this section applies, any costs described in paragraph (2) --

(A) in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and

(B) in the case of any other property, shall be capitalized.

(2) Allocable costs. -- The costs described in this paragraph with respect to any property are --

(A) the direct costs of such property, and

(B) such property's proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.

(b) Property to which section applies. -- Except as otherwise provided in this section, this section shall apply to --

(1) Property produced by taxpayer. -- Real or tangible personal property produced by the taxpayer.

(2) Property acquired for resale. --

(A) In general. -- Real or personal property described in section 1221(1) which is acquired by the taxpayer for resale.

(B) Exception for taxpayer with gross receipts of $10,000,000 or less. -- Subparagraph (A) shall not apply to any personal property acquired during any taxable year by the taxpayer for resale if the average annual gross receipts of the taxpayer (or any predecessor) for the 3-taxable year period ending with the taxable year preceding such taxable year do not exceed $10,000,000.

(C) Aggregation rules, etc. -- For purposes of subparagraph (B), rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply.

For purposes of paragraph (1), the term "tangible personal property" shall include a film, sound recording, video tape, book, or similar property.

(c) General exceptions. --

(1) Personal use property. -- This section shall not apply to any property produced by the taxpayer for use by the taxpayer other than in a trade or business or an activity conducted for profit.

(2) Research and experimental expenditures. -- This section shall not apply to any amount allowable as a deduction under section 174.

(3) Certain development and other costs of oil and gas wells or other mineral property. -- This section shall not apply to any cost allowable as a deduction under section 263(c), 263(i), 291(b)(2), 616, or 617.

(4) Coordination with long-term contract rules. -- This section shall not apply to any property produced by the taxpayer pursuant to a long-term contract.

(5) Timer and certain ornamental trees. -- This scion shall not apply to --

(A) trees raised, harvested, or grown by the taxpayer other than trees described in clause (ii) of subsection (e)(4)(B) (after application of the last sentence thereof), and

(B) any real property underlying such trees.

(6) Coordination with section 59(e). -- Paragraphs (2) and (3) shall apply to any amount allowable as a deduction under section 59(e) for qualified expenditures described in subparagraphs (B), (C), (D), and (E) of paragraph (2) thereof.

(d) Exception for farming businesses. --

(1) Section not to apply to certain property. --

(A) In general. -- This section shall not apply to any of the following which is produced by the taxpayer in a farming business:

(i) Any animal.

(ii) Any plant which has a reproductive period of 2 years or less.

(B) Exception for taxpayers required to use accrual method. -- Subparagraph (A) shall not apply to any corporation, partnership, or tax shelter required to use an accrual method of accounting under section 447 or 448(a)(3).

(2) Treatment of certain plants lost by reason of casualty. --

(A) In general. -- If plants bearing an edible crop for human consumption were lost or damaged (while in the hands of the taxpayer) by reason of freezing temperatures, disease, drought, pests, or casualty, this section shall not apply to any costs of the taxpayer of replanting plants bearing the same type of crop (whether on the same parcel of land on which such lost or damaged plants were located or any other parcel of land of the same acreage in the United States).

(B) Special rules for person with minority interest who materially participates. -- Subparagraph (A) shall apply to amounts paid or incurred by a person (other than the taxpayer described in subparagraph (A)) if-

(i) the taxpayer described in subparagraph (A) has an equity interest of more than 50 percent in the plants described in subparagraph (A) at all times during the taxable year in which such amounts were paid or incurred, and

(ii) such other person holds any part of the remaining equity interest and materially participates in the planting, maintenance, cultivation, or development of the plants described in subparagraph (A) during the taxable year in which such amounts were paid or incurred.

The determination of whether an individual materially participates in any activity shall be made in a manner similar to the manner in which such determination is made under section 2032A(d)(6).

(3) Election to have this section not apply. --

(A) In general. -- If a taxpayer makes an election under this paragraph, this section shall not apply to any plant produced in any farming business carried on by such taxpayer.

(B) Certain persons not eligible. -- No election may be made under this paragraph by a corporation, partnership, or tax shelter, if such corporation, partnership, or tax shelter is required to use an accrual method of accounting under section 447 or 448(a)(3).

(C) Special rule for citrus and almond growers. -- An election under this paragraph shall not apply with respect to any item which is attributable to the planting, cultivation, maintenance, or development of any citrus or almond grove (or part thereof) and which is incurred before the close of the 4th taxable year beginning with the taxable year in which the trees were planted. for purposes of the preceding sentence, the portion of a citrus or almond grove planted in 1 taxable year shall be treated separately from the portion of such grove planted in another taxable year.

(D) Election. -- Unless the Secretary otherwise consents, an election under this paragraph may be made only for the taxpayer's 1st taxable year which begins after December 31, 1986, and during which the taxpayer engages in a farming business. any

such election, once made, may be revoked only with the consent of the Secretary.

(e) Definitions and special rules for purposes of subsection (d). --

(1) Recapture of expense amounts on disposition. --

(A) In general. -- In the case of any plant with respect to which amounts would have been capitalized under subsection (a) but for an election under subsection (d)(3) --

(i) such plant (if not otherwise section 1245 property) shall be treated as section 1245 property, and

(ii) for purposes of section 1245, the recapture amount shall be treated as a deduction allowed for depreciation with respect to such property.

(B) Recapture amount. -- For purposes of subparagraph (A), the term "recapture amount" means any amount allowable as a deduction to the taxpayer which, but for an election under subsection (d)(3), would have been capitalized with respect to the plant.

(2) Effects of election on depreciation. --

(A) In general. -- If the taxpayer (or any related person) makes an election under subsection (d)(3), the provisions of section 168(g)(2) (relating to alternative depreciation) shall apply to all property of the taxpayer used predominantly in the farming business and placed in service in any taxable year during which any such election is in effect.

(B) Related person. -- For purposes of subparagraph (A), the term "related person" means --