
FEDERAL RECEIPTS AND COLLECTIONS

3. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Government's sovereign or governmental powers. The difference between receipts and outlays determines the surplus or deficit.

Growth in receipts.—Total receipts in 1999 are estimated to be \$1,742.7 billion, an increase of \$84.9 billion

or 5.1 percent relative to 1998. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. Receipts are projected to grow at an average annual rate of 3.9 percent between 1999 and 2003, rising to \$2,028.2 billion.

As a share of GDP, receipts are projected to decline from 19.9 percent in 1998 to 19.6 percent in 2003.

Table 3-1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1997 actual	Estimate					
		1998	1999	2000	2001	2002	2003
Individual income taxes	737.5	767.8	791.5	804.6	833.4	877.1	915.5
Corporation income taxes	182.3	190.8	198.0	202.9	209.2	214.7	220.4
Social insurance and retirement receipts	539.4	571.4	595.9	623.0	649.0	677.8	706.5
(On-budget)	(147.4)	(155.4)	(161.8)	(169.1)	(176.3)	(183.5)	(189.9)
(Off-budget)	(392.0)	(416.0)	(434.1)	(453.9)	(472.7)	(494.3)	(516.6)
Excise taxes	56.9	55.5	72.0	69.6	71.6	74.0	74.6
Estate and gift taxes	19.8	20.4	20.5	21.6	22.6	24.4	25.6
Customs duties	17.9	18.4	18.2	19.5	20.4	22.4	24.0
Miscellaneous receipts	25.5	33.5	46.7	52.2	56.4	59.0	61.4
Total receipts	1,579.3	1,657.9	1,742.7	1,793.6	1,862.6	1,949.3	2,028.2
(On-budget)	(1,187.3)	(1,241.9)	(1,308.6)	(1,339.7)	(1,389.9)	(1,455.0)	(1,511.5)
(Off-budget)	(392.0)	(416.0)	(434.1)	(453.9)	(472.7)	(494.3)	(516.6)

Table 3-2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1998	1999	2000	2001	2002	2003
Receipts under tax rates and structure in effect January 1, 1998 ¹	1,657.9	1,728.7	1,774.4	1,837.3	1,918.0	1,991.8
Social security (OASDI) taxable earnings base increases:						
\$68,400 to \$70,800 on Jan. 1, 1999		1.1	3.0	3.3	3.6	3.9
\$70,800 to \$74,100 on Jan. 1, 2000			1.6	4.1	4.5	4.9
\$74,100 to \$76,800 on Jan. 1, 2001				1.3	3.3	3.7
\$76,800 to \$79,800 on Jan. 1, 2002					1.4	3.7
\$79,800 to \$82,800 on Jan. 1, 2003						1.4
Proposals ²	-0.1	12.9	14.7	16.7	18.5	18.7
Total, receipts under existing and proposed legislation	1,657.9	1,742.7	1,793.6	1,862.6	1,949.3	2,028.2

¹ These estimates assume a social security taxable earnings base of \$68,400 through 2003.

² Net of income offsets.

ENACTED LEGISLATION

Several laws were enacted in 1997 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

Airport and Airway Trust Fund Tax Reinstatement Act of 1997.—This Act reinstated, through September 30, 1997, aviation excise taxes that expired on December 31, 1996. The reinstated taxes on commercial air transportation included a 10-percent excise tax on domestic passenger tickets, a \$6-per-person international departure tax, and a 6.5-percent domestic air freight excise tax. The reinstated taxes also included an excise tax on fuels used in general aviation of 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline. In addition, the Act authorized the Treasury Department to transfer to the Airport and Airway Trust Fund any aviation excise taxes collected during the fourth quarter of calendar year 1996 but not remitted to the Federal government during that period.

Taxpayer Relief Act of 1997.—This Act, together with the Balanced Budget Act of 1997, implements the bipartisan budget agreement announced on May 2, 1997. The legislation includes, with certain modifications, the key features of the Administration's proposals to give middle-income families the tax relief they need to help raise their children, save for the future, and pay for postsecondary education. In addition, the provisions of the Act promote a fairer tax system and encourage economic growth, while being fiscally responsible. The major provisions of the Act are described below.

Family Tax Relief

Provide tax credit for dependent children.—A credit is allowed for each dependent child under the age of 17. The credit equals \$400 for 1998 and rises to \$500 for 1999 and subsequent years. The credit is phased out for taxpayers with adjusted gross income (AGI) in excess of the following thresholds: \$110,000 for married taxpayers filing a joint return, \$75,000 for a single taxpayer or head of household, and \$55,000 for married taxpayers filing a separate return. The amount of the credit and the thresholds are not indexed for inflation. The phase-out rate is \$50 for each \$1,000 of modified AGI (or fraction thereof) in excess of the threshold. For low-income families with three or more children, a refundable child credit is available to the extent that their income and employee payroll taxes exceed their earned income tax credit.

Education Tax Incentives

Provide tax credits for higher education tuition expenses.—Taxpayers are allowed to claim a per-student nonrefundable tax credit (Hope Credit) for qualified tuition and fees for enrollment of the taxpayer, the taxpayer's spouse or the taxpayer's dependent in a postsecondary degree or certificate program. To be eligible

for the credit, a student must be enrolled on at least a half-time basis. The Hope Credit is equal to 100 percent of the first \$1,000 of qualified expenses and 50 percent of the next \$1,000 of qualified expenses, for a maximum credit of \$1,500 per student. The maximum credit is indexed for inflation. The Hope Credit is available for expenses paid after December 31, 1997, for education furnished in academic periods beginning after that date, and is available for only the first two years of a student's post-secondary education. Alternatively, taxpayers are allowed a nonrefundable Lifetime Learning Credit for all postsecondary education, including graduate education. The credit is equal to 20 percent of qualified tuition and fees paid during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or the taxpayer's dependent. A maximum credit of \$1,000 per family is provided for expenses paid after June 30, 1998 and before January 1, 2003; the maximum credit increases to \$2,000 per family effective for expenses paid after December 31, 2002. There is no limit on the number of years for which the Lifetime Learning Credit may be claimed. With respect to an eligible student, a taxpayer may elect either the Hope Credit, the Lifetime Learning Credit, or the exclusion from gross income for withdrawals from an education savings account (discussed below), but only one of these preferences may be used in a taxable year. Both credits are phased out for married taxpayers filing a joint return with modified AGI between \$80,000 and \$100,000 and for single taxpayers and heads of households with modified AGI between \$40,000 and \$50,000. The phase-out ranges will be indexed for inflation beginning in 2002.

Provide deduction for student loan interest.—Interest paid on a qualified education loan during the first 60 months that payment is required is deductible for income tax purposes, effective for payments due and paid after December 31, 1997. The maximum allowable deduction is \$1,000 in 1998, \$1,500 in 1999, \$2,000 in 2000 and \$2,500 in 2001 and subsequent years. The maximum amount is not indexed for inflation. In addition, the deduction is phased out ratably for single taxpayers with AGI between \$40,000 and \$55,000 and for married taxpayers filing a joint return with AGI between \$60,000 and \$75,000. The phase-out ranges are indexed for inflation beginning after 2002.

Expand tax preferences provided qualified State tuition programs.—Qualified State tuition programs (programs eligible for tax-exempt status and deferral of tax on earnings) are expanded to include State programs where individuals prepay for room and board, in addition to tuition, fees, books and supplies. This Act also expands the definition of eligible institution, expands the definition of "member of the family" with regard to tax-free rollovers of credits or account balances, and clarifies the estate and gift tax treatment of contributions to such programs. These modifications generally are effective after December 31, 1997.

Provide penalty-free withdrawals from Individual Retirement Accounts (IRAs) for education expenses.—Penalty-free withdrawals are permitted from IRAs for qualified higher education expenses of the taxpayer, the taxpayer's spouse, and the children and grandchildren of the taxpayer and the taxpayer's spouse. The provision applies to distributions made after December 31, 1997 with respect to expenses paid after that date for education furnished in academic periods beginning after that date.

Establish education savings accounts for children under 18.—Effective for taxable years beginning after December 31, 1997, taxpayers may contribute up to \$500 per year, per beneficiary under age 18, to an education savings account. Earnings on contributions accumulate tax-free and distributions are excludable from gross income to the extent that the distribution does not exceed qualified higher education expenses incurred during the year the distribution is made. The earnings portion of a distribution not used to cover qualified education expenses is includable in the gross income of the beneficiary and is generally subject to an additional 10-percent tax. However, prior to the beneficiary reaching age 30, tax-free (and penalty-free) roll-overs of account balances may be made to an education IRA benefitting another family member. The contribution limit is phased out ratably for married couples filing a joint return with AGI between \$150,000 and \$160,000 and for single taxpayers and heads of households with AGI between \$95,000 and \$110,000. If a taxpayer uses tax-free education savings account withdrawals for a student's qualified education expenses in a taxable year, neither the Hope Credit nor the Lifetime Learning Credit may be claimed in that year for the same student's education expenses.

Extend exclusion for employer-provided educational assistance.—Certain amounts paid by an employer for undergraduate educational assistance expenses are excluded from the employee's gross income for income and payroll tax purposes. This exclusion, which was scheduled to expire with respect to undergraduate education beginning after June 30, 1997, is extended to apply to undergraduate education courses beginning before June 1, 2000. The exclusion is limited to \$5,250 of undergraduate educational assistance with respect to an individual during a calendar year.

Modify limit on qualified section 501(c)(3) private activity bonds.—Interest on State and local government bonds generally is excluded from income if the bonds are issued to finance activities carried out and paid for with revenues of these governments. Interest on bonds issued by these governments to finance activities of other persons, e.g., private activity bonds, is taxable unless a specific exception is provided in law. One such exception is for private activity bonds issued by certain tax-exempt organizations (section 501(c)(3) organizations) to finance activities that do not constitute an unrelated trade or business. The \$150 million limit on the amount of outstanding bonds issued by an organization for other than hospital purposes is repealed, effective

for section 501(c)(3) bonds issued after August 5, 1997 that are used to finance capital expenditures incurred after that date.

Enhance deduction for corporate contributions of computer technology and equipment.—Under current law augmented deductions are provided for certain corporate contributions of inventory property and scientific equipment. The amount of augmented deduction available to a corporation making these contributions is equal to its basis in the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold. However, the amount of augmented deduction cannot exceed twice the basis of the donated property. Effective for contributions made in taxable years beginning after 1997 and before January 1, 2000, the list of contributions that qualify for the augmented deduction is expanded to include gifts of computer technology and equipment to be used within the United States for educational purposes in any of grades K-12.

Provide tax credit for holders of qualified zone academy bonds.—Certain financial institutions that hold qualified zone academy bonds are provided a non-refundable tax credit in an amount equal to a credit rate (set by the Department of Treasury) multiplied by the face amount of the bond. The tax credit is includable in the gross income of the holder as interest. A qualified zone academy bond is any bond issued by a State or local government, provided that (1) 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a qualified zone academy and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. A total of \$400 million of qualified zone academy bonds may be issued in each of 1998 and 1999. The bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line; any unused allocation may be carried into subsequent years.

Savings and Investment Incentives

Expand Individual Retirement Accounts (IRAs).—Under prior law, eligibility for a deductible IRA was phased out for a single taxpayer with AGI between \$25,000 and \$35,000 and a married taxpayer filing a joint return with AGI between \$40,000 and \$50,000, if the individual (or the individual's spouse) was an active participant in an employer-sponsored retirement plan. Under this Act, the AGI thresholds and phase-out ranges are doubled over time. For 1998, eligibility is phased out for single taxpayers with AGI between \$30,000 and \$40,000, and for couples filing a joint return with AGI between \$50,000 and \$60,000. For 1999 through 2002, the phase-out ranges are increased by \$1,000 per year. For 2003, eligibility is phased out for single taxpayers with AGI between \$40,000 and

\$50,000, and for couples filing a joint return with AGI between \$60,000 and \$70,000. For 2004 and later years, the phase-out ranges are increased by \$5,000 per year until the phase-out range is \$50,000 to \$60,000 for single taxpayers (2005 and subsequent years) and \$80,000 to \$100,000 for couples filing a joint return (2007 and subsequent years). Spouses of individuals who are active participants in an employer-sponsored retirement plan, but who are not themselves active participants, are permitted to make deductible contributions to an IRA. This spousal deduction is phased out for taxpayers with AGI between \$150,000 and \$160,000.

A new, tax-free nondeductible IRA called the "Roth IRA" is created. Eligibility for participation in these IRAs is phased out for single taxpayers with AGI between \$95,000 and \$110,000 and for married couples filing a joint return with AGI between \$150,000 and \$160,000. Taxpayers with AGI of less than \$100,000 are eligible to roll over or convert an existing IRA to a Roth IRA. Distributions from the Roth IRA generally are tax free if (i) made more than 5 years after an account has been established, and (ii) made after age 59½, upon death or disability, or for first-time homebuyer expenses (up to a \$10,000 lifetime cap). The same exceptions to the 10-percent early withdrawal tax apply to Roth IRAs and deductible IRAs, and these prior law exceptions have been expanded to include withdrawals for qualified first-time homebuyer expenses and qualified education expenses. Annual contributions to all IRAs for an individual may not exceed \$2,000.

Reduce tax rate on capital gains.—The maximum capital gains tax rate for individuals is reduced from 28 percent to 20 percent (10 percent for individuals in the 15-percent tax bracket) effective May 7, 1997. The prior law maximum tax rate of 28 percent is retained for collectibles and, effective July 29, 1997, for assets held between 1 year and 18 months. Real estate depreciation recapture generally is taxed at a maximum rate of 25 percent. Beginning in 2001, assets acquired after December 31, 2000 and held for 5 years will be taxed at favorable rates of 8 percent (those in the 15-percent bracket) and 18 percent (those in other tax brackets). A taxpayer holding a capital asset or an asset used in his/her trade or business on January 1, 2001, may elect to treat the asset as having been sold on that date for its fair market value and as having been reacquired at the market price. Taxes must be paid on any gain realized as a result of the election; losses are disallowed.

Provide capital gains exclusion on sale of principal residence.—Under prior law gains on the sale of a taxpayer's principal residence were subject to the capital gains tax; however, taxes on the gain could be deferred through the purchase of a new home of equal or greater value within a specified period of time. Taxpayers over 55 could elect to take a one-time exclusion of up to \$125,000 of gain from the sale of their home. Effective for sales on or after May 7, 1997, up to \$500,000 of gain from the sale of a taxpayer's principal residence (\$250,000 for a single taxpayer) is excluded from tax.

The exclusion is allowed each time a taxpayer selling or exchanging a principal residence meets the eligibility requirements, but generally no more frequently than once every two years. To be eligible for the exclusion, a taxpayer generally must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange.

Alternative Minimum Tax (AMT) Provisions

Exempt small corporations from the AMT and conform AMT depreciation lives to the regular tax.—For taxable years beginning after December 31, 1997, the corporate AMT is repealed for small businesses. A corporation with average gross receipts of less than \$5 million for three taxable years, the last of which begins after December 31, 1996, is a small business corporation for any taxable year beginning after December 31, 1997. The exemption continues to apply as long as the business has three-year average gross receipts of less than \$7.5 million. In addition, for property placed in service after December 31, 1998, the recovery periods used for purposes of the AMT depreciation adjustment are equal to the recovery periods used for purposes of the regular tax under present law.

Estate, Gift, and Generation-Skipping Tax Provisions

Increase estate and gift tax unified credit.—Under prior law, a unified estate and gift tax credit of \$192,800 was provided, which effectively exempted the first \$600,000 of cumulative taxable transfers from tax. Under this Act, a phased-in increase in the unified credit increases the effective exemption to \$1,000,000 in 2006. The effective exemption is \$625,000 for decedents dying and gifts made in 1998, \$650,000 in 1999, \$675,000 in 2000 and 2001, \$700,000 in 2002 and 2003, \$850,000 in 2004, \$950,000 in 2005, and \$1,000,000 in 2006 and subsequent years.

Provide estate tax exclusion for qualified family-owned businesses, including farms.—If "family-owned business interests" comprise more than 50 percent of a decedent's estate and certain other requirements are met, the first \$1 million in qualified family-owned business interests may be excluded from a decedent's taxable estate. This exclusion, which is effective with respect to decedents dying after December 31, 1997, is in addition to the unified credit; however, the total amount excluded from tax is capped at \$1.3 million.

Reduce estate tax for certain land subject to permanent conservation easement.—A 40-percent estate tax exclusion is provided for the value of any land subject to a qualified conservation easement that meets specified requirements. The maximum allowable exclusion is \$100,000 in 1998, \$200,000 in 1999, \$300,000 in 2000, \$400,000 in 2001 and \$500,000 in 2002 and subsequent years. The exclusion may be taken in addition to the maximum exclusion for qualified family-owned business interests and applies to decedents dying after December 31, 1997.

Prohibit the revaluation of gifts for estate tax purposes after expiration of 3-year statute of limitations.—Estate and gift taxes generally must be assessed within 3 years after the filing of the return. In the past, in order to determine the appropriate tax rate bracket and unified credit for the estate tax, the Courts generally permitted the revaluation of a gift for which the statute of limitation period had expired. Effective for gifts made after August 5, 1997, revaluation of a gift for which the limitations period has expired is no longer permitted.

Expiring Provisions

Extend research and experimentation tax credit.—The 20-percent tax credit for certain incremental research and experimentation expenditures is extended to apply to expenditures paid or incurred during the period June 1, 1997 through June 30, 1998.

Extend orphan drug tax credit.—The 50-percent non-refundable tax credit provided for qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions (generally known as “orphan drugs”) is permanently extended, effective for expenses paid or incurred after May 31, 1997.

Extend deduction for contributions of stock to private foundations.—The deduction for a contribution of property to a private foundation is limited to the adjusted basis of the contributed property. However, prior law allowed a taxpayer who contributed qualified appreciated stock to a private foundation before June 1, 1997 to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock. This Act extends the rule for private foundations through June 30, 1998.

Extend work opportunity tax credit, with modifications.—Under prior law, an employer hiring individuals from one or more of seven targeted groups was allowed a work opportunity tax credit equal to 35 percent of the first \$6,000 in qualified first-year wages paid to a qualified individual beginning work after September 30, 1996 and before October 1, 1997. For wages paid to be eligible for the credit, the qualified individual had to be employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 400 hours (120 hours in the case of a qualified summer youth employee). This Act extends the credit to apply to wages paid to qualified individuals beginning work after September 30, 1997 and before July 1, 1998. In addition, a credit of 25 percent is provided for wages paid to a qualified individual employed at least 120 and fewer than 400 hours, and the credit is increased to 40 percent for wages paid to a qualified individual employed for at least 400 hours. Eligibility is extended to members of families receiving AFDC benefits (or its successor programs) and to SSI beneficiaries.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and

other criteria. This program, which had expired after May 31, 1997, is temporarily extended through June 30, 1998. Refunds of any duty paid between May 31, 1997 and August 5, 1997 are provided upon request of the importer.

Extend unemployment surtax and increase the statutory limit on Federal Unemployment Act (FUTA) trust fund balances.—The temporary unemployment surtax of 0.2 percent imposed on employers, which was scheduled to expire with respect to wages paid after December 31, 1998, is extended through December 31, 2007. In addition, the statutory limit on balances in the Federal Unemployment Account (FUA) of the FUTA trust fund is increased from .25 percent to .50 percent of covered wages.

District of Columbia (D.C.) Tax Incentives

Designate D.C. Enterprise Zone.—Certain economically depressed census tracts within D.C. are designated as the “D.C. Enterprise Zone.” The following tax incentives are available to businesses and individual residents within the zone: (1) a 20-percent wage credit for the first \$15,000 of wages paid to D.C. residents who work in the zone; (2) an additional \$20,000 of expensing under section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities. The D.C. Enterprise Zone designation will remain in effect for the period from January 1, 1998 through December 31, 2002.

Provide zero-percent capital gains rate on certain Enterprise Zone property.—A zero-percent capital gains rate is provided for capital gains from the sale of certain qualified assets held for more than five years. To qualify for the zero-percent rate, the asset must be within a census tract within the D.C. Enterprise Zone where the poverty rate is not less than 10 percent.

Provide tax credit to first-time homebuyers.—A tax credit of up to \$5,000 of the purchase price is provided first-time homebuyers of a principal residence in the District of Columbia. The credit phases out for single taxpayers with AGI between \$70,000 and \$90,000 and for married couples filing a joint return with AGI between \$110,000 and \$130,000. The credit is available with respect to property purchased after August 4, 1997 and before January 1, 2001.

Welfare-to-Work Tax Credit

Provide welfare-to-work tax credit.—Employers are provided a tax credit on the first \$20,000 of eligible wages paid to qualified recipients of long-term family assistance (AFDC or its successor program) during the first two years of employment. The credit is 35 percent of the first \$10,000 of eligible wages in the first year of employment and 50 percent of the first \$10,000 of eligible wages in the second year of employment. The credit is effective for wages paid or incurred by the employer for a qualified employee who begins work on or after January 1, 1998 and before May 1, 1999.

Excise Tax Provisions

Repeal excise tax on diesel fuel used in recreational motorboats.—The 24.3-cents-per-gallon excise tax on diesel fuel used in recreational motorboats is repealed. Under prior law, imposition of this tax had been suspended through December 31, 1997.

Transfer 4.3-cents-per-gallon General Fund highway fuels tax to the Highway Trust Fund.—Under prior law 4.3-cents-per-gallon of the excise tax on gasoline, diesel fuel, and special motor fuels used in highway vehicles was transferred to the General Fund of the Treasury. Under this Act, collections from these taxes are deposited in the Highway Trust Fund, with 3.45-cents-per-gallon allocated to the Highway Account and .85-cents-per-gallon allocated to the Mass Transit Account. Conforming amendments ensure that no direct spending increases will occur as a result of this transfer of funds.

Modify deposit rules for excise taxes on highway motor fuels.—The excise taxes imposed on highway motor fuels that would otherwise be required to be deposited with the Treasury after July 31, 1998 and before September 30, 1998 are not required to be deposited until October 5, 1998, resulting in a shift of collections from 1998 to 1999.

Modify and expand excise tax on vaccines.—Under prior law an excise tax was imposed on the following vaccines: DPT (diphtheria, pertussis, tetanus) at \$4.56 per dose; DT (diphtheria, tetanus) at \$0.06 per dose; MMR (measles, mumps, or rubella) at \$4.44 per dose; and polio at \$0.29 per dose. Effective for sales after August 5, 1997, a uniform rate of \$0.75 per dose on any listed vaccine component is imposed on all previously taxed vaccines. In addition, the tax is expanded to apply to HIB (haemophilus influenza type B), Hepatitis B, and varicella (chickenpox) vaccines

Extend and modify excise taxes deposited in the Airport and Airway Trust Fund.—Under prior law, the excise taxes deposited in the Airport and Airway Trust Fund were scheduled to expire after September 30, 1997. These taxes included a 10-percent excise tax on domestic passenger tickets, a \$6-per-person international departure tax, a 6.5-percent domestic air freight excise tax, and an excise tax on fuels used in general aviation of 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline. This Act extends these taxes for 10 years, through September 30, 2007, with the following modifications:

- *Tax on domestic passenger tickets.*—The 10-percent ad valorem tax on domestic passenger tickets is replaced with a combination ad valorem and per-domestic-flight-segment tax. Effective October 1, 1997 the tax is 9 percent of fare plus \$1 per domestic flight segment. The tax changes to 8 percent of fare and \$2 per domestic flight segment effective October 1, 1998; and to 7.5 percent of fare and \$2.25 per domestic flight segment effective October 1, 1999. The ad valorem tax remains at 7.5 percent, but the per-domestic-flight-segment tax increases to \$2.50 effective January 1, 2000, \$2.75 effective January 1, 2001 and \$3 effective

January 1, 2002. The \$3 rate is indexed annually for inflation effective January 1, 2003. The per-domestic-flight-segment tax is not imposed on flight segments to and from qualified rural airports; the ad valorem tax on such flights is 7.5 percent of fare. The 7.5 percent ad valorem tax also applies to payments to air carriers (and related parties) for the right to award air travel benefits.

- *Tax on international departures and arrivals.*—The \$6-per-passenger international departure tax is increased to \$12 per passenger and extended to apply to international arrivals effective October 1, 1997. A \$6-per-passenger rate is applicable to the international airspace component of flights between the 48 contiguous States and Alaska or Hawaii (or flights between Alaska and Hawaii). Both the \$6 and \$12 taxes are indexed annually for inflation effective January 1, 1999.
- *Deposit schedule for certain aviation taxes.*—Deposits of air passenger taxes otherwise due after August 14, 1997 and before October 1, 1997 are due on October 10, 1997. In addition, deposits of air passenger taxes otherwise required after August 14, 1998 and before October 1, 1998 are due on October 5, 1998. Deposits of commercial air cargo and aviation fuels taxes otherwise required to be made after July 31, 1998 and before October 1, 1998 are due on October 5, 1998.
- *Transfer of General Fund taxes.*—The 4.3-cents-per-gallon excise tax on aviation fuels that was deposited in the General Fund of the Treasury under prior law is deposited in the Airport and Airway Trust Fund effective October 1, 1997.

Impose excise taxes on kerosene as diesel fuel.—A 24.3-cents-per-gallon excise tax is imposed on diesel fuel upon removal from a registered terminal storage facility unless the fuel is indelibly dyed and is destined for a nontaxable use. Under prior law, undyed kerosene was not subject to the diesel fuel excise tax when it was removed from a terminal. Undyed kerosene was subject to tax, however, when it was blended with previously taxed diesel fuel. Effective July 1, 1998, kerosene is taxed as diesel fuel when it is removed from a terminal. Exceptions are provided for aviation fuel and, to the extent provided in regulations, for feedstock uses. In addition, special refund rules apply in certain cases of kerosene used for heating purposes.

Reinstate excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—Before January 1, 1996, a 0.1-cent-per-gallon excise tax was levied on gasoline, other motor fuels, methanol and ethanol fuels, aviation fuels, and on fuels used in inland waterways and deposited in the LUST Trust Fund. This Act reinstates those taxes effective October 1, 1997 through March 31, 2005.

Apply communications excise tax to prepaid telephone cards.—A 3-percent excise tax is imposed on amounts paid for local and toll telephone service and teletypewriter exchange service. This Act extends this tax to

apply to amounts paid to communications service providers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate telephone service. The tax is effective for cards sold after October 31, 1997.

Modify treatment of tires under the heavy highway vehicle retail excise tax.—A 12-percent retail excise tax is imposed on certain heavy highway trucks and trailers, and on highway tractors. A separate manufacturer's excise tax is imposed on tires weighing more than 40 pounds. Under prior law, because tires were taxed separately, the value of tires installed on highway vehicles was excluded from the 12-percent retail excise tax on heavy highway vehicles. This Act repeals this exclusion; instead, a credit for the amount of manufacturers' excise tax paid on the tires is allowed. This change is effective after December 31, 1997.

Small Business Provisions

Clarify definition of principal place of business for home office deduction.—The definition of "principal place of business" is expanded to include a home office that is used by the taxpayer to conduct administrative or management activities of the business, provided that there is no other fixed location where the taxpayer conducts substantial administrative or management activities of the business, regardless of whether such activities are performed by others at other locations. As under prior law, deductions are allowed only if the office is exclusively used on a regular basis as a place of business and, in the case of an employee, only if such exclusive use is for the convenience of the employer. The expanded definition applies to taxable years beginning after December 31, 1998.

Increase deduction of health insurance costs for self-employed individuals.—Under prior law self-employed individuals were allowed a deduction for the cost of health insurance for themselves and their spouse and dependents as follows: 40 percent for 1997; 45 percent for 1998 through 2002; 50 percent for 2003; 60 percent for 2004; 70 percent for 2005; and 80 percent for 2006 and subsequent years. This Act increases the allowable deduction to 100 percent as follows: 45 percent for 1998 and 1999; 50 percent for 2000 and 2001; 60 percent for 2002; 80 percent for 2003 through 2005; 90 percent for 2006; and 100 percent for 2007 and subsequent years.

Increase deduction for business meals for certain individuals.—Generally the amount allowable as a deduction for food and beverage is limited to 50 percent of the otherwise deductible amount. Exceptions to this 50-percent rule are provided for food and beverages provided to crew members of certain vessels and offshore oil or gas platforms or drilling rigs. This Act increases the deduction for food and beverages consumed while away from home by an individual during or incident to a period of duty subject to the hours of service limitations of the Department of Transportation. Such individuals include certain air transportation employees, interstate truck operators and bus drivers, certain rail-

road employees and certain merchant mariners. The increase in the deductible percentage is phased in as follows: 55 percent for 1998 and 1999, 60 percent for 2000 and 2001, 65 percent for 2002 and 2003, 70 percent for 2004 and 2005, 75 percent for 2006 and 2007, and 80 percent for 2008 and subsequent years.

Increase standard mileage rate for purposes of computing the charitable deduction.—Effective for taxable years beginning after December 31, 1997, for purposes of computing the charitable deduction, the standard mileage rate for the use of a passenger vehicle is increased from 12 cents per mile to 14 cents per mile.

Incentives for Distressed Areas

Provide tax incentive to clean up environmentally contaminated areas known as brownfields.—A current deduction is allowed for certain costs incurred by businesses to remediate environmentally contaminated land in certain areas. Qualified sites generally are limited to those properties located in or next to census tracts with a poverty rate of 20 percent or more, Federal empowerment zones and enterprise communities, and areas subject to certain Environmental Protection Agency (EPA) Brownfields Pilots. To claim this incentive, taxpayers are required to obtain from the appropriate State or local agency verification that the site satisfies geographic and contamination requirements. The deduction is available for qualified expenses incurred after August 5, 1997 and before January 1, 2001.

Expand and modify Empowerment Zone and Enterprise Community program.—Under the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), certain tax incentives were provided for nine empowerment zones (6 urban and 3 rural) and 95 enterprise communities. The tax incentives were a 20-percent employer wage credit, an additional \$20,000 of section 179 expensing, and a new category of tax-exempt financing. Qualifying businesses in empowerment zones were eligible for all three incentives, while businesses in enterprise communities were eligible only for the tax-exempt financing. This Act authorizes the designation of two additional urban empowerment zones within 180 days of enactment; however, the designations, which generally will remain in effect for 10 years, will not take effect before January 1, 2000. These two additional zones are subject to the same eligibility criteria as the original 6 urban empowerment zones, and, except for a modification of the wage credit, generally enjoy the same tax incentives as the original zones. For these two additional zones the wage credit is modified slightly to provide that the percentage of wages taken into account for purposes of determining the wage credit is 20 percent for 2000 through 2004, 15 percent for 2005, 10 percent for 2006, and 5 percent for 2007; the credit is not available for subsequent years. The Act also authorizes the designation of an additional 20 empowerment zones before 1999. Businesses in these 20 additional zones are not eligible for the wage credit, but are eligible to receive up to \$20,000 of additional section 179 expensing, and special tax-exempt financing benefits. The "brownfields

tax incentive" provided in this Act (see discussion above) is available within all designated empowerment zones.

Financial Product Provisions

Require recognition of gain on certain appreciated positions in personal property.—Gains and losses generally are taken into account for tax purposes when realized. Gains or losses are usually realized with respect to a capital asset at the time the asset is sold or exchanged. However, because of special rules under prior law, many transactions designed to reduce or eliminate risk of loss and opportunity for gain on financial assets generally did not cause realization. For example, taxpayers could lock in gain on securities without recognizing gain for tax purposes by entering into a "short sale against the box," that is, the taxpayer could own securities the same as or substantially identical to the securities borrowed and sold short. This Act requires in some circumstances recognition of gain (but not loss) upon entering into a constructive sale of any appreciated financial position in stock, a debt instrument, or a partnership interest. A constructive sale occurs when the taxpayer enters into one of the following transactions with respect to the same or substantially identical property: (1) a short sale, (2) an offsetting notional principal contract, (3) a futures or forward contract, or (4) to the extent provided in regulations, one or more transactions that have substantially the same effect as one of the described transactions. This provision generally is effective for constructive sales entered into after June 8, 1997.

Permit dealers in commodities and traders in securities and commodities to elect mark-to-market.—This Act permits securities traders and commodities traders and dealers to elect mark-to-market accounting similar to that currently required for securities dealers. All securities held by an electing taxpayer in connection with a trade or business as a securities trader, and all commodities held by an electing taxpayer in connection with a trade or business as a commodities dealer or trader, are subject to mark-to-market treatment. Property not held in connection with an electing taxpayer's trading activity is not subject to the election provided that it is identified by the taxpayer, under rules similar to the present law rules for securities dealers, and the electing taxpayer can demonstrate by clear and convincing evidence that the property bears no relation to its activities as a trader. Gain or loss recognized by an electing taxpayer under the provision is ordinary gain or loss. This provision applies to taxable years ending after August 5, 1997.

Change the treatment of gains and losses on extinguishment.—The tax law distinguishes between the sale of a right or obligation to a third party and the extinguishment or retirement of the right or obligation. A sale to a third party can give rise to capital treatment while an extinguishment produces ordinary income. Under prior law extinguishment treatment was eliminated for all debt instruments except those issued by

natural persons and for most options and other positions in actively traded property. This Act eliminates the remaining portions of the extinguishment doctrine so that gain or loss attributable to the cancellation, lapse, expiration, or other termination of any right or obligation which is (or on acquisition would be) a capital asset in the hands of the taxpayer is treated as gain or loss from the sale or exchange of a capital asset. This change applies to property acquired or positions established 30 days after the date of enactment. In addition, redemptions of debt issued by natural persons and debt issued before July 2, 1982 are treated as an exchange and, accordingly, any gain or loss on that redemption is capital gain or loss effective for debt issued or purchased after June 8, 1997.

Deny interest deduction on certain debt instruments.—If an instrument qualifies as equity, the issuer generally does not receive a deduction for dividends paid. If an instrument qualifies as debt, the issuer may deduct accrued interest, including original issue discount (OID). The Act eliminates the deduction for interest and OID on a debt instrument that is issued by a corporation and that is payable in stock of the issuer or a related party. The Act applies to debt instruments that are mandatorily convertible or convertible at the issuer's option into stock of the issuer or of a related party. The Act does not apply to debt instruments that are convertible at the holder's option unless, at the time the instrument is issued, it is substantially certain that the holder's option will be exercised. This provision generally is effective for instruments issued after June 8, 1997.

Require reasonable payment assumptions for interest accruals on certain debt instruments.—A taxpayer that holds a debt instrument generally accrues interest income over the life of the instrument. Certain debt instruments, such as credit card receivables, do not require the debtors to pay interest if they pay their balances in full by a specified date. The operation of the interest accrual rules of prior law provided that, in such instances, the holder could assume that each debtor would pay its balance by the specified date and, thereby, avoid accruing interest over the life of the debt instrument. In these cases, the holder would not accrue any interest income until the specified date had passed. In the case of a large pool of such debt instruments, the assumption that each debtor will prepay (and thereby avoid a finance charge) is unrealistic and results in the mismeasurement of income. Under the Act, taxpayers that hold large pools of prepayable debt instruments must accrue interest on the pool by making a reasonable assumption regarding the timing of payments on the instruments that make up the pool. The provision is effective for taxable years beginning after August 5, 1997.

Corporate Organizations and Reorganizations

Require gain recognition for certain extraordinary dividends.—A corporate shareholder generally is allowed to deduct a percentage of dividends received from

another domestic corporation. A distribution in redemption of stock may be treated as a dividend if the shareholder's proportionate interest in the distributing corporation has not been meaningfully reduced. In determining if a shareholder's interest has been meaningfully reduced, the ownership of options to purchase stock may be treated as actual stock ownership, rather than as a sale of the stock, if it is essentially equivalent to a dividend. Certain dividends and dividend equivalent transactions are treated as "extraordinary" dividends. Whether a dividend is "extraordinary" is determined, among other things, by reference to the size of the dividend in relation to the adjusted basis of the shareholder's stock. If a corporate shareholder receives an extraordinary dividend, the corporate shareholder must reduce the basis of the stock to which the distribution relates by the amount of the nontaxed portion of the dividend (generally the amount of the dividend that was deducted). Under prior law, if the nontaxed portion of the dividend exceeded the basis of the stock, the excess was deferred and not taxed as gain until the sale or disposition of the stock. Under this Act a corporate shareholder generally is required to recognize gain immediately with respect to any redemption treated as a dividend when the nontaxed portion of the dividend exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership. In addition, immediate gain recognition is required whenever the basis of stock with respect to which any extraordinary dividend is received is reduced below zero. These changes generally are effective for distributions after May 3, 1995, unless made pursuant to the terms of a written binding contract in effect on May 3, 1995 or a tender offer outstanding on May 3, 1995.

Require gain recognition on certain distributions of controlled corporation stock.—A corporation generally is required to recognize gain on a distribution of property (including stock of a controlled corporation) unless the distribution meets certain requirements. Under prior law, if various requirements were met, including restrictions relating to acquisitions and dispositions of stock of the distributing corporation or the controlled corporation, a distribution of the stock of a controlled corporation generally was tax-free to the distributing corporation. This Act adopts additional restrictions on acquisitions and dispositions of the stock of a distributing corporation or controlled corporation. Under this Act, the distributing corporation is required to recognize gain on the distribution of the stock of the controlled corporation if the shareholders of the distributing corporation do not retain 50-percent or more of the stock interest in either the distributing or controlled corporation during the four-year period commencing two years prior to the distribution. In addition, distributions within an affiliated group of corporations, in connection with such a distribution or acquisition transaction, are no longer tax free. These changes generally are effective for distributions after April 16, 1997.

Reform the tax treatment of certain stock transfers.—Certain sales of stock to a related corporation are treated as the payment of a dividend by the purchaser. Such dividends may qualify for the dividends received deduction; in addition, such dividends may bring with them foreign tax credits. For example, if a foreign-controlled domestic corporation sells the stock of a subsidiary to a foreign sister corporation, the domestic corporation may take the position that it is entitled to credit foreign taxes that were paid by the foreign sister corporation. This Act limits the amount treated as a dividend (and the associated foreign tax credits) from the purchaser to the amount of the purchaser's earnings and profits attributable to stock owned by U.S. persons related to the seller. The Act also clarifies that a deemed dividend from a purchaser that is a domestic corporation generally should be treated as an extraordinary dividend requiring a basis reduction and gain recognition to the extent that the nontaxed portion exceeds the basis of the shares transferred. These changes generally are effective for distributions or acquisitions after June 8, 1997, but do not apply to such distributions or acquisitions made pursuant to a written agreement that was binding on that date.

Modify holding period for dividends-received deduction.—The dividends-received deduction is allowed to a corporate shareholder only if the shareholder satisfies a 46-day holding period for the dividend-paying stock or a 91-day period for certain dividends on preferred stock. The 46- or 91-day holding period generally does not include any time in which the shareholder is protected from the risk of loss otherwise inherent in the ownership of an equity interest. However, under prior law, the holding period requirement did not have to be proximate to the time the dividend distribution was made. This Act requires that in order to qualify for the dividends-received deduction, the holding period requirement must be satisfied with respect to that dividend over a period immediately before or immediately after the taxpayer becomes entitled to receive the dividend. This change generally is effective for dividends paid or accrued more than 30 days after August 5, 1997.

Pension and Employee Benefit Provisions

The Act makes a number of changes affecting pension plans and other employee benefits, including the following:

Change rule relating to involuntary distributions from retirement plans.—In the case of a participant who separates from service with the employer, a qualified retirement plan may cash out the participant's benefits without the participant's consent if the present value of the benefits does not exceed a dollar limit. The Act increases this limit from \$3,500 to \$5,000 effective for plan years beginning after August 5, 1997.

Repeal excess distribution and excess retirement accumulation taxes.—Under prior law, an individual's distributions from qualified retirement plans, tax-sheltered annuities and IRAs, that, in the aggregate, exceeded

\$160,000 in a calendar year (or, if made as a lump sum distribution, five times that amount) were subject to a 15-percent excise tax on "excess" distributions. This excise tax was suspended for distributions received in 1997, 1998, or 1999. An individual's balance in retirement plans was subject to an additional 15-percent estate tax on excess distributions to the extent that the balance exceeded the present value of a benefit that would not be subject to the 15-percent excise tax on excess distributions. The Act repeals both the excise tax on excess distributions (effective for distributions received after 1996) and the estate tax on excess retirement accumulations (effective for decedents dying after 1996).

Treat matching contributions of self-employed individuals as not constituting elective deferrals.—Employees may elect to make tax-deferred elective contributions ("elective deferrals") to a 401(k) plan up to an indexed dollar limit (\$10,000 for 1998). Employers may make matching contributions based on the employees' elective deferrals. Similarly, under a SIMPLE retirement plan, employees may make elective deferrals (of up to \$6,000 per year), and employers may make matching contributions. Under prior law, matching contributions that were made for a self-employed individual generally were treated as elective deferrals and were counted against the dollar limit on elective deferrals, as well as in the nondiscrimination test applicable to elective deferrals under a 401(k) plan (the ADP test). The Act changes this treatment of matching contributions for self-employed individuals. Instead of subjecting those contributions to the limits on elective deferrals and to the ADP test, the Act generally treats them like matching contributions made for employees. This change is effective for years beginning after 1997 in the case of 401(k) plans and for years beginning after 1996 in the case of SIMPLE plans.

Change rules affecting State and local government and church plans.—The Act makes a number of changes affecting retirement plans maintained by State and local governments and churches, including permanently exempting governmental plans from the nondiscrimination and minimum participation rules that otherwise apply to qualified plans. Those rules generally prohibit plans from discriminating in favor of highly compensated employees with respect to contributions or benefits, participation, coverage and compensation counted under the plan. The exemption generally is effective for taxable years beginning on or after August 5, 1997.

Increase pension plan full funding limit.—Contributions to a defined benefit pension plan are subject to a maximum "full funding" limit. Under prior law, the full funding limit generally was the lesser of the plan's accrued liability (based on projected benefits) or 150 percent of its current liability (based on benefits accrued to date). The Act increases the 150-percent-of-current-liability component of the full funding limit to 155 percent for plan years beginning in 1999 or 2000, 160 percent for plan years beginning in 2001 or 2002,

165 percent for plan years beginning in 2003 or 2004, and 170 percent for plan years beginning thereafter. The Act also extends the amortization period, from ten to twenty years, for amounts that could not be contributed because of the 150-percent-of-current-liability limit. This change is effective for plan years beginning after December 31, 1998.

Require increased diversification of 401(k) investments.—The Employee Retirement Income Security Act of 1974, as amended (ERISA), generally permits only up to 10 percent of the fair market value of the assets of a retirement plan to be invested in employer securities or real property leased to the employer that sponsors the plan. Prior law contained an exception to this rule permitting defined contribution plans, including section 401(k) plans, to invest more than 10 percent of their assets in employer securities or employer real property if the plan authorized such investments. The Act generally provides that a plan is not permitted to require that an employee's elective deferrals be invested in employer securities or employer real property if the employee's elective deferrals are in excess of one percent of the employee's eligible compensation and if employer securities and employer real property exceed 10 percent of the plan's assets. The provision does not apply to employee stock ownership plans or if the value of assets of all defined contribution plans of the employer does not exceed 10 percent of the value of assets of all pension plans maintained by the employer. The provision is effective for elective deferrals for plan years beginning after December 31, 1998.

Tax Exempt Organization Provisions

Repeal grandfather rule with respect to pension business of certain insurers.—Under prior law, that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund (TIAA-CREF) or of Mutual of America that was attributable to pension business was exempt from tax. Effective for taxable years beginning after December 31, 1997, TIAA-CREF and Mutual of America are treated for Federal tax purposes as life insurance companies; that portion of their business attributable to pension business is no longer exempt from tax.

Foreign Provisions

Place further restrictions on like-kind exchanges involving personal property.—An exchange of property, like a sale, is generally a taxable transaction. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like kind that is to be held for productive use in a trade or business or for investment. In general, any kind of real estate is treated as of a like kind with other real property; however, real property located in the United States and real property located outside the United States are not of a like kind. Under prior law, for personal property, property of a "like class" was treated as being of a like kind; no restrictions applied with regard to location

in or outside the United States. To conform the limitations on exchanges of personal property to the limitations on exchanges of real property, this Act provides that personal property predominantly used within the United States and personal property predominantly used outside the United States are not "like-kind" properties. This change generally is effective for exchanges after June 8, 1997, unless the exchange is pursuant to a binding contract in effect on such date.

Impose holding period requirement for claiming foreign tax credits with respect to dividends.—Under prior law, U.S. persons that received dividends from a regulated investment company (RIC), generally were entitled to an indirect credit for foreign taxes paid by the RIC, regardless of the shareholder's holding period for the RIC stock. A U.S. corporation that received a dividend from a foreign corporation in which it had a 10-percent or greater voting interest generally was entitled to an indirect credit for foreign taxes paid by the foreign corporation, also regardless of the shareholder's holding period. This Act generally disallows the foreign tax credits available with respect to a dividend from a corporation or RIC if the shareholder holds the stock for less than 16 days in the case of common stock and 46 days in the case of preferred stock. This provision is effective for dividends paid or accrued more than 30 days after August 5, 1997.

Allow Foreign Sales Corporation (FSC) benefits for computer software licenses.—The FSC provisions provide a limited exemption from U.S. tax for income arising in certain export transactions; under prior law, the exemption was not available for most exports of intangible property, including computer software copyrights. This Act extends FSC benefits to licenses of computer software for reproduction abroad. The provision applies to gross receipts from computer software licenses attributable to periods after December 31, 1997. In the case of a multi-year license, the provision applies to gross receipts attributable to the period of such license that is after December 31, 1997.

Increase dollar limitation on exclusion for foreign earned income.—U.S. citizens generally are subject to U.S. income tax on all their income, whether derived in the United States or elsewhere. U.S. citizens living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income. In order to qualify for this exclusion, a U.S. citizen must be either (1) a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year, or (2) present overseas for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country. Under prior law, the maximum exclusion for foreign earned income for a taxable year was \$70,000. This Act increases the maximum exclusion to \$80,000 in increments of \$2,000 each year beginning in 1998. The limitation on the exclusion is indexed for inflation beginning in 2008.

Other Corporate Provisions

Require registration of certain corporate tax shelters.—Under prior law promoters of a corporate tax shelter were required to register such shelters with the Internal Revenue Service (IRS). This Act generally requires a promoter of a corporate tax shelter to register the shelter with the Secretary of the Treasury no later than the next business day after the day when the shelter is first offered to potential users. This Act also increases the penalty for failing to register in a timely manner a corporate tax shelter and modifies the substantial understatement penalty. The tax shelter registration provision applies to any tax shelter offered to potential participants after the date the Treasury Department issues guidance with respect to the filing requirements. The modifications to the substantial understatement penalty apply to items with respect to transactions entered into after August 5, 1997.

Treat certain preferred stock as "boot."—Under prior law, in reorganization transactions, no gain or loss was recognized except to the extent "other property" (boot) was received; that is, property other than certain stock, including preferred stock. Upon the receipt of "other property," gain but not loss was recognized. This Act requires certain preferred stock that is received in otherwise tax-free transactions to be treated as "other property." This change generally is effective for transactions after June 8, 1997 but does not apply to such transactions made pursuant to a written agreement that was binding on that date.

Administrative Provisions

Require tax reporting for payments to attorneys.—Treasury regulations require a payor to report payments of attorney's fees if the payments are made in the course of a trade or business. However, under prior law a payor generally was not required to report payments made to corporations. In addition, if a payment to an attorney was a gross amount and it could not be determined what portion was the attorney's fee (as in the case of lump-sum judgments or settlements made jointly payable to a lawyer and a plaintiff), then no reporting was required. This Act requires the reporting of gross proceeds on all payments made to attorneys by a trade or business in the course of the trade or business. In addition, the prior law exception for reporting payments to corporations no longer applies to payments made to attorneys. The provision is effective for payments made after December 31, 1997.

Require reporting of payments to corporations rendering services to Federal agencies.—All persons engaged in a trade or business and making payments of \$600 or more to another person in remuneration for services generally must report those payments to the IRS and to the recipient. No reporting is required if the recipient is a corporation, unless the payment is made to an attorney (see previous provision). To ensure that corporations that do business with the Federal Government appropriately report as income their payments from the Federal Government, this Act requires execu-

tive agencies to report payments of \$600 or more made to corporations for services rendered. An exception is provided for certain classified or confidential contracts. The provision is effective for returns the due date of which is more than 90 days after August 5, 1997.

Establish IRS continuous levy and improve debt collection.—Under this Act a continuous levy is applicable to non-means-tested recurring Federal payments, such as Federal salaries and pensions, received by individuals who owe delinquent tax debt. In addition, this Act provides that the levy attach up to 15 percent of any specified payment due the taxpayer. A continuous levy of up to 15 percent also applies to unemployment benefits and means-tested public assistance. The Act also permits the disclosure of otherwise confidential tax return information to the Treasury Department's Financial Management Service only for the purpose of, and to the extent necessary, in implementing these levies. The provision is effective for levies issued after August 5, 1997.

Earned Income Tax Credit (EITC) Compliance Provisions

Deny EITC eligibility for prior acts of recklessness or fraud.—A taxpayer who fraudulently claims the EITC is denied eligibility for the subsequent 10 years. A taxpayer who erroneously claims the EITC due to reckless or intentional disregard of rules or regulations is denied eligibility for the subsequent 2 years. These sanctions are in addition to any other penalties imposed by current law and are effective for taxable years beginning after December 31, 1996.

Require recertification for eligibility if past eligibility was denied as a result of deficiency procedures.—A taxpayer who has been denied the EITC as a result of deficiency procedures is denied eligibility in subsequent years unless evidence of eligibility for the credit is provided. To demonstrate current eligibility the taxpayer is required to meet evidentiary requirements established by the Secretary of the Treasury. Failure to provide this information is treated as a mathematical or clerical error. A taxpayer who has been recertified as eligible for the EITC does not have to resubmit this information in the future unless the IRS again denies the EITC as a result of a deficiency procedure. The provision is effective for taxable years beginning after December 31, 1996.

Require tax preparers to fulfill certain due diligence requirements.—Effective for taxable years beginning after December 31, 1996, tax return preparers are required to fulfill certain due diligence requirements with respect to returns they prepare claiming the EITC. The penalty for failure to meet these requirements, which is in addition to any other penalties assessed under current law, is \$100 for each failure.

Modify the definition of AGI used to phaseout the EITC.—The EITC is phased out for individuals with earned income (or AGI, if greater) in excess of certain amounts. Under prior law, the definition of AGI used for the phase out of the earned income credit dis-

regarded the following losses: (1) net capital losses (if greater than zero); (2) net losses from trusts or estates; (3) net losses from nonbusiness rents and royalties; and (4) 50 percent of the net losses from business, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses. This Act modifies the definition of AGI used for phasing out the credit by adding two sources of nontaxable income: (1) tax-exempt interest and (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements. The Act also increases to 75 percent the percentage of net losses from business disregarded from the definition of AGI used for the phase out of the EITC. These changes are effective for taxable years beginning after December 31, 1997.

Use Federal case registry of child support orders for tax enforcement purposes.—The Personal Responsibility and Work Opportunity Reconciliation Act of 1997 mandated the creation of a Federal Case Registry of Child Support Orders (the FCR) by October 1, 1998. The FCR is required to include the names, and the State case identification numbers of individuals who are owed or who owe child support or for whom paternity is being established. It may also include the social security numbers (SSNs) of these individuals. Under the Taxpayer Relief Act, the Secretary of the Treasury is provided access to the FCR not later than October 1, 1998. Also, by October 1, 1999, the data elements on the State Case Registry will include the SSNs of children covered by cases in the Registry, and the States will provide the SSNs of these children to the FCR.

Expand Social Security Administration (SSA) records for tax enforcement.—Effective February 1, 1998, SSA is required to obtain SSNs of both parents on minor children's applications for SSNs. The SSA will provide this information to the IRS as part of the Data Master File. This information will enable the IRS to identify questionable claims for the earned income credit, the dependent exemption, and other tax benefits before tax refunds are paid.

Other Revenue-Increase Provisions

Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting.—Under the Revenue Act of 1987, family farm corporations were required to change to the accrual method of accounting if their gross receipts exceeded \$25 million in any taxable year beginning after 1985. However, in lieu of including in gross income the entire amount of the adjustment attributable to the change in accounting method, a family farm corporation could establish a suspense account. The amount of the suspense account was to be included in gross income if the corporation ceased to be a family corporation or to the extent the gross receipts of the corporation from farming declined. This Act repeals the ability of family farm corporations to establish such a suspense account and also repeals the requirement to include a portion of a suspense account in income based on a decrease in the

gross receipts of the corporation. Any taxpayer required to change to the accrual method of accounting may take the adjustment attributable to the change in accounting method into account ratably over a ten-year period, beginning with the year of change. Any existing suspense accounts are to be restored to income ratably over a twenty-year period, subject to the existing law requirement to restore such accounts more rapidly. This provision is effective for taxable years ending after June 8, 1997, except that the first year in the twenty-year period for restoring existing suspense accounts to income is the first taxable year beginning after June 8, 1997.

Modify loss carryback and carryforward rules.—Under prior law, net operating losses (NOLs) generally could be used to offset taxable income from the prior three taxable years (carrybacks) and the succeeding 15 taxable years (carryforwards). This Act generally limits carrybacks of NOLs to 2 years and extends carryforwards to 20 years, effective for NOLs arising in taxable years beginning after the date of enactment. The 3-year carryback for NOLs of farmers and small businesses attributable to losses incurred in Presidentially declared disaster areas is preserved.

Modify general business credit carryback and carryforward rules.—A qualified taxpayer is allowed to claim a number of tax credits (collectively, known as general business credits) provided under current law (rehabilitation credit, energy credit, alcohol fuels credit, orphan drug credit, etc.), subject to certain limitations based on tax liability for the year. Under prior law, unused general business credits generally could be carried back three years and carried forward 15 years to offset tax liability of such years. This Act limits the carryback period for general business credits to one year and extends the carryforward period to 20 years. The change is effective for taxable years beginning after December 31, 1997.

Expand the limitations on deductibility of premiums and interest with respect to life insurance, endowment and annuity contracts.—The prior law premium deduction limitation is expanded to provide that no deduction is permitted for premiums paid on any life insurance, endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the contract. In addition, generally no deduction is allowed for interest paid or accrued on any indebtedness with respect to a life insurance policy or endowment or annuity contract covering the life of any individual. In the case of a taxpayer other than a natural person, no deduction is allowed for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash surrender values with respect to any life insurance policy or annuity or endowment contract issued after June 8, 1997. These limitations apply to contracts issued after June 8, 1997. For this purpose, a material increase in the death benefit or other material change in the contract generally causes the contract to be treated as a new contract.

Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party.—Gain realized by taxpayers from certain involuntary conversions is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified period of time. C corporations (and partnerships with one or more corporate partners that own more than 50 percent of the capital or profits interest in the partnership) generally are not entitled to defer gain if the replacement property is purchased from a related person. This Act extends the denial of deferral to any other taxpayer, including an individual, that acquires replacement property from a related person, unless the taxpayer has an aggregate realized gain of \$100,000 or less during the year as a result of involuntary conversions. In the case of a partnership or S corporation, the \$100,000 annual limitation applies to the entity and each partner or shareholder. The provision applies to involuntary conversions occurring after June 8, 1997.

Miscellaneous Tax Provisions

Provide income-averaging for farmers.—Effective for taxable years beginning after December 31, 1997 and before January 1, 2001, an individual taxpayer generally is allowed to elect to compute his or her current year regular tax liability by averaging, over the three-year period, all or a portion of his or her taxable income from farming.

Allow carryback of existing net operating losses of the National Railroad Passenger Corporation (Amtrak).—Amtrak is allowed to carryback its net operating losses against the aggregate of the net tax liability of Amtrak's railroad predecessors. The maximum allowable refund payable to Amtrak, which is to be divided equally between the first two taxable years ending after the date of enactment, is \$2.323 billion. The availability of the refund was conditioned on enactment of Federal legislation authorizing reform; such legislation has been enacted.

Modify estimated tax requirements of individuals.—An individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax. An individual generally does not have an underpayment of estimated tax if timely estimated tax payments are made at least equal to: (1) 100 percent of the tax shown on the return of the individual for the preceding tax year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year. Under prior law the 100 percent of last year's safe harbor was modified to be a 110 percent of last year's liability safe harbor for any individual with an AGI of more than \$150,000 as shown on the return for the preceding taxable year. This Act modifies the safe harbor for individuals with AGI of more than \$150,000 as follows: for taxable years beginning in 1998, the safe harbor is 100 percent; for taxable years beginning in 1999, 2000, and 2001 the safe harbor is 105 percent; for taxable years beginning in 2002, the safe harbor is 112 percent. In addition, for any

period before January 1, 1998, for any estimated payment due before January 16, 1998, no estimated tax penalties will be imposed on an underpayment created or increased by a provision of the Taxpayer Relief Act of 1997.

Balanced Budget Act of 1997.—This Act, together with the Taxpayer Relief Act of 1997, implements the historic bipartisan budget agreement that will benefit generations of Americans. While this Act is primarily a balanced package of spending provisions that includes targeted program cuts while it invests in America's future, it also includes several revenue provisions. The major provisions of the Act affecting receipts are described below.

Increase excise taxes on tobacco products.—The excise tax on small cigarettes is increased from 24 cents per pack to 34 cents per pack effective January 1, 2000 and to 39 cents per pack effective January 1, 2002. The taxes on other tobacco products (large cigarettes, cigars, cigarette papers, cigarette tubes, chewing tobacco, snuff, and pipe tobacco) are increased proportionately. In addition, the tax on roll-your-own tobacco is imposed at the same rate as pipe tobacco.

Increase employee contributions to the Civil Service Retirement System (CSRS) and the Federal Employees

Retirement System (FERS).—Employee contributions to CSRS and FERS are increased by 0.5 percent of base pay in three steps. Contributions increase by 0.25 percent of base pay on January 1, 1999, another 0.15 percent on January 1, 2000 and a final 0.10 percent on January 1, 2001. These higher contribution rates are effective through 2002; on January 1, 2003, contribution rates return to the levels in effect on December 31, 1998.

Authorize appropriation of funds for enforcement initiatives related to the EITC.—In addition to any other funds available for this purpose, the following amounts are authorized to be appropriated to the Secretary of the Treasury for improved application of the earned income tax credit: not more than \$138 million for 1998, \$143 million for 1999, \$144 million for 2000, \$145 million for 2001 and \$146 million for 2002.

Adjust payments to the Universal Service Fund.—Payments to the Universal Service Fund by telecommunications carriers and other providers of interstate telecommunications are adjusted so that \$3 million in payments otherwise due in fiscal year 2001 are deferred until October 1, 2001. This shift in payments was subsequently repealed during the FY 1998 appropriations process.

ADMINISTRATION PROPOSALS

PROVIDE TAX RELIEF AND EXTEND EXPIRING PROVISIONS

The President's plan targets tax relief to provide child-care assistance to working families. It also includes new initiatives to promote energy efficiency and environmental objectives and new incentives to promote retirement savings, as well as education incentives and extensions of certain expiring tax provisions. In addition, the President's plan contains provisions to simplify the tax laws and to enhance taxpayers' rights.

Make Child Care More Affordable

Increase and simplify child and dependent care tax credit.—Under current law, taxpayers may receive a nonrefundable tax credit for a percentage of certain child care expenses they pay in order to work. The credit rate is phased down from 30 percent of expenses (for taxpayers with adjusted gross incomes of \$10,000 or less) to 20 percent (for taxpayers with adjusted gross incomes above \$28,000). The Administration proposes to increase the maximum credit rate from 30 percent to 50 percent and to extend eligibility for the maximum credit rate to taxpayers with adjusted gross incomes of \$30,000 or less. The credit rate would be phased down gradually for taxpayers with adjusted gross incomes between \$30,000 and \$59,000. The credit rate would be 20 percent for taxpayers with adjusted gross incomes over \$59,000. Eligibility for the credit would be simplified by elimination of a complicated household maintenance test. Certain credit parameters would be

indexed. The proposal would be effective for taxable years beginning after December 31, 1998.

Establish tax credit for employer-provided child care.—The Administration proposes to provide taxpayers a credit equal to 25 percent of expenses incurred to build or acquire a child care facility for employee use, or to provide child care services to children of employees directly or through a third party. Taxpayers also would be entitled to a credit equal to 10 percent of expenses incurred to provide employees with child care resource and referral services. A taxpayer's credit could not exceed \$150,000 in a single year. Any deduction the taxpayer would otherwise be entitled to take for the expenses would be reduced by the amount of the credit. Similarly, the taxpayer's basis in a facility would be reduced to the extent that a credit is claimed for expenses of constructing or acquiring the facility. The credit would be effective for taxable years beginning after December 31, 1998.

Promote Energy Efficiency and Improve the Environment Buildings

Provide tax credit for energy-efficient building equipment.—No income tax credit is provided currently for investment in energy-efficient building equipment. The Administration proposes to provide a new tax credit for the purchase of certain highly efficient building equipment technologies, including fuel cells, electric heat pump water heaters, natural gas heat

pumps, residential size electric heat pumps, natural gas water heaters, and advanced central air conditioners. The credit would equal 20 percent of the amount of qualified investment, subject to a cap. The credit generally would be available for equipment purchased over the five-year period beginning January 1, 1999 and ending December 31, 2003.

Provide tax credit for the purchase of new energy-efficient homes.—No income tax credit is provided currently for investment in energy-efficient homes. The Administration proposes to provide a tax credit to taxpayers who purchase, as a principal residence, certain newly constructed homes that are highly energy efficient. The credit would equal one percent of the purchase price of the home, up to a maximum of \$2,000. The full credit would be available for homes purchased between January 1, 1999 and December 31, 2003. A credit of up to \$1,000 would be available for homes purchased between January 1, 2004 and December 31, 2005.

Transportation

Provide tax credit for high-fuel-economy vehicles.—No income tax credit is provided currently for purchases of highly fuel-efficient vehicles. The Administration proposes to provide a credit of \$4,000 for each vehicle that gets three times the base fuel economy for its class. The \$4,000 credit would be available for purchases of qualifying vehicles after December 31, 2002. This credit would phase down beginning in 2007 and phase out in 2010. A \$3,000 credit would also be provided for purchases of vehicles achieving two times the base fuel economy for their class. The \$3,000 credit would be available for purchases of qualifying vehicles after December 31, 1999. This credit would phase down beginning in 2004 and phase out in 2006.

Equalize treatment of parking and transit benefits.—Under current law, employer-provided transit and vanpool benefits are only excluded from income if such benefits are in addition to, not in lieu of, other compensation. Under the Taxpayer Relief Act of 1997, however, parking benefits are excluded from income even if offered in lieu of other compensation. The Administration proposes to allow employers to offer their employees transit and vanpool benefits in lieu of compensation, beginning January 1, 1999, thus granting transit and vanpool benefits the same treatment as parking benefits. Also under current law, up to \$155 per month (in 1993 dollars) in employer-provided parking benefits and \$60 per month (in 1993 dollars) in employer-provided transit and vanpool benefits are excludable from income. The Administration proposes to raise the monthly limit on employer-provided transit and vanpool benefits excludable from income to be the same as the limit on parking.

Industry

Provide investment tax credit for combined heat and power (CHP) systems.—Combined heat and power (CHP) assets are used in the production of electricity and process heat and/or mechanical power from the same primary energy source. No tax credits are currently available for investment in CHP property. The Administration proposes to establish a 10-percent investment credit for CHP systems in order to encourage and accelerate investment in such equipment. The credit would apply to property placed in service in the United States after December 31, 1998, and before January 1, 2004.

Provide tax credit for replacement of certain circuitbreaker equipment.—The chlorofluorocarbon substitute sulfur hexafluoride (SF₆), an extremely harmful greenhouse gas, is used in some large power circuit breakers used in the transmission and distribution of electric power. The Administration proposes to make a tax credit available for the installation of new power circuit breaker equipment to replace certain circuit breakers that are prone to leak SF₆. The credit would be equal to 10 percent of qualified investment. To be eligible for the credit, the replaced power circuit breakers must be dual pressure circuit breakers with a capacity of at least 115kV, contain SF₆, and have been installed prior to December 31, 1985. The replaced equipment must be destroyed so as to prevent further use. The credit would apply only to new equipment placed in service in the five-year period beginning January 1, 1999 and ending December 31, 2003.

Provide tax credit for certain perfluorocompound (PFC) and hydrofluorocompound (HFC) recycling equipment.—Under current law, semiconductor manufacturers who install equipment to recover or recycle PFC and HFC gases used in the production of semiconductors may depreciate the cost of that equipment, but no tax credit is provided for the purchase of such equipment. PFCs and certain HFCs are among the most potent greenhouse gases because of their extreme stability in the atmosphere and strong absorption of radiation, and they are used extensively in the semiconductor manufacturing industry. The Administration proposes to provide a 10 percent tax credit for the installation of qualified PFC/HFC recovery or recycling equipment to recover gases used in the production of semiconductors. Equipment would qualify for the credit only if it recovers at least 99 percent of the PFCs and HFCs and the equipment is placed in service in the five-year period beginning January 1, 1999 and ending December 31, 2003.

Renewables

Provide tax credit for rooftop solar equipment.—Current law provides a 10 percent business energy investment tax credit for qualifying equipment that uses

solar energy to generate electricity, to heat or cool, to provide hot water for use in a structure, or to provide solar process heat. The Administration proposes to make a new tax credit available for purchasers of rooftop photovoltaic systems and solar water heating systems located on or adjacent to the building for uses other than heating swimming pools. (Taxpayers would have to choose between the proposed credit and the current-law tax credit for each investment.) The proposed credit would be equal to 15 percent of qualified investment up to a maximum of \$1,000 for solar water heating systems and \$2,000 for rooftop photovoltaic systems. It would apply only to equipment placed in service after December 31, 1998 and before January 1, 2004 for solar water heating systems and after December 31, 1998 and before January 1, 2006 for rooftop photovoltaic systems.

Extend wind and biomass tax credit.—Current law provides taxpayers a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind or “closed-loop” biomass. The electricity must be sold to an unrelated third party and the credit applies to the first 10 years of production. The current credit applies only to facilities placed in service before July 1, 1999, after which it expires. The Administration proposes to extend the current credit for five years, to facilities placed in service before July 1, 2004.

Promote Expanded Retirement Savings

Building on recent legislation, the Administration proposes further expansions of retirement savings incentives, including three new initiatives that would expand the availability of retirement plans and other workplace-based savings opportunities, particularly for moderate- and lower-income workers not currently covered by employer-sponsored plans. Two of the proposals are designed to expand pension coverage for employees of small businesses, a group that currently has low pension coverage. The Administration also seeks to improve existing retirement plans for employers of all sizes by promoting portability, expanding workers’ and spouses’ rights to know about their retirement benefits, and simplifying the pension rules. These provisions generally are effective beginning in 1999.

Promote Individual Retirement Account (IRA) contributions through payroll deduction.—Employers could offer employees the opportunity to make IRA contributions on a pre-tax basis through payroll deduction. Providing employees an exclusion from income (in lieu of a deduction) is designed to increase savings among workers in businesses that do not offer a retirement plan. Signing up for payroll deduction is easy for an employee. In addition, saving is facilitated because it becomes automatic as salary reduction contributions continue each paycheck after an employee’s initial election. Peer-group participation may also encourage employees to save more. Finally, the favorable

tax treatment of payroll deductions would encourage participation.

Provide tax credit for new plans.—Effective in the year of enactment, the Administration proposes a new three-year tax credit for the administrative and retirement-education expenses of any small business that sets up a new qualified defined benefit or defined contribution plan (including a 401(k) plan), savings incentive match plan for employees (SIMPLE), simplified employee pension (SEP), or payroll deduction IRA arrangement. The credit would cover 50 percent of the first \$2,000 in administrative and retirement-education expenses for the plan or arrangement for the first year of the plan and 50 percent of the first \$1,000 of such expenses for each of the second and third years. The tax credit would help promote new plan sponsorship by targeting a tax benefit to employers adopting new plans or payroll deduction IRA arrangements, providing a marketing tool to financial institutions and advisors promoting new plan adoption, and increasing awareness of retirement savings options.

Establish new small business pension plan.—The Administration is proposing a new small business defined benefit-type plan that combines certain key features of defined benefit plans and defined contribution plans: guaranteed minimum retirement benefits, an option for payments over the course of an employee’s retirement years, and Pension Benefit Guaranty Corporation insurance, together with individual account balances that can benefit from favorable investment returns and have enhanced portability.

Enhance portability and disclosure; simplify pensions.—The Administration is also proposing accelerated vesting of employer matching contributions under 401(k) plans (and other qualified plans). This would increase pension portability, which is important given the mobility of today’s workforce, particularly of working women. Matching contributions would be required to be fully vested after an employee has completed three years of service (or would vest in annual 20 percent increments beginning after two years of service). The Administration’s proposal also would enhance workers’ and spouses’ rights to know about their pension benefits—among other things, requiring that the same explanation of a pension plan’s survivor benefits that is provided to a participant be provided to the participant’s spouse, and that participants in 401(k) safe harbor plans receive timely notification of plan rules governing contributions and employer matching. Improved benefits for nonhighly compensated employees under the 401(k) safe harbors, a simplified definition of highly compensated employee, and simplification of rules for multiemployer plans are also being proposed.

Expand Education Incentives

Provide incentives for public school construction.—The Taxpayer Relief Act of 1997 enacted a provi-

sion that allows certain public schools to issue “qualified zone academy bonds,” the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds can be used for a number of purposes, including teacher training, purchases of equipment, curricular development, and rehabilitation and repair of the school facilities. The Administration proposes to institute a new program of Federal tax assistance for public school construction. Under the proposal, State and local governments would be able to issue up to \$9.7 billion of “qualified school construction bonds” in each of 1999 and 2000. Holders of these bonds would receive annual federal income tax credits, set according to market interest rates by the Treasury Department, in lieu of interest. At least 95 percent of the bond proceeds of a qualified school construction bond must be used to finance public school construction or rehabilitation. The Administration also proposes to expand the amount of qualified zone academy bonds that can be issued in 1999 from \$400 million to \$1.4 billion and to authorize an additional \$1.4 billion of qualified zone academy bonds in 2000, and to allow the proceeds of these bonds to be used for school construction.

Extend and expand exclusion for employer-provided educational assistance.—Certain amounts paid by an employer for educational assistance provided to an employee currently are excluded from the employee’s gross income for income and payroll tax purposes. The exclusion is limited to \$5,250 of educational assistance with respect to an individual during a calendar year and applies whether or not the education is job-related. The exclusion currently is limited to undergraduate courses beginning before June 1, 2000. The Administration proposes to extend the current law exclusion by one year to apply to undergraduate courses beginning before June 1, 2001. In addition, the exclusion would be expanded to cover graduate courses beginning after June 30, 1998 and before June 1, 2001.

Eliminate tax when forgiving student loans subject to income contingent repayment.—Students who borrow money to pay for postsecondary education through the Federal government’s Direct Loan program may elect income contingent repayment of the loan. If they elect this option, their loan repayments are adjusted in accordance with their income. If after the borrower makes repayments for a twenty-five year period any loan balance remains, it is forgiven. The Administration proposes to eliminate any Federal income tax the borrower may otherwise owe as a result of the forgiveness of the loan balance. The proposal would be effective for loan cancellations after December 31, 1998.

Increase Low-Income Housing Tax Credit

Increase low-income housing tax credit per capita cap.—Low-income housing tax credits provide an incentive to build and make available rental housing

units to households with incomes significantly below area medians. The amount of first-year credits that can be awarded in each State is currently limited by annual allocations of \$1.25 per capita. The \$1.25 per capita limitation was established in 1986. The Administration proposes to increase the annual State housing credit limitation to \$1.75 per capita effective for calendar years beginning after 1998. The proposed increase in this cap will permit additional new and rehabilitated low-income housing to be provided while still encouraging State housing agencies to award the credits to projects that meet specific needs.

Extend Expiring Provisions

Extend the work opportunity tax credit.—The work opportunity tax credit provides an incentive for employers to hire individuals from certain targeted groups. The credit equals a percentage of qualified wages paid during the first year of the individual’s employment with the employer. The credit percentage is 25 percent for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit expires with respect to employees who begin work after June 30, 1998. The Administration proposes to extend the work opportunity tax credit so that the credit would be effective for individuals who begin work before May 1, 2000.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit enables employers to claim a tax credit on the first \$20,000 of eligible wages paid to certain long-term family assistance recipients. The credit is 35 percent of the first \$10,000 of eligible wages in the first year of employment and 50 percent of the first \$10,000 of eligible wages in the second year of employment. The credit is effective for individuals who begin work before May 1, 1999. The Administration proposes to extend the welfare-to-work tax credit for one year, so that the credit would be effective for individuals who begin work before May 1, 2000.

Extend the R&E tax credit.—The Administration proposes to extend the tax credit provided for certain research and experimentation expenditures, which is scheduled to expire after June 30, 1998, for one year through June 30, 1999.

Extend the deduction provided for contributions of appreciated stock to private foundations.—The special rule that allows a taxpayer to deduct the full fair market value of qualified stock donated to a private foundation expires with respect to contributions made after June 30, 1998. The Administration proposes to extend the provision to apply to contributions made during the period July 1, 1998 through June 30, 1999.

Make permanent the expensing of brownfields remediation costs.—Under the Taxpayer Relief Act of 1997, taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year

paid or incurred. The provision does not apply to expenditures paid or incurred after December 31, 2000. The Administration proposes that the provision be made permanent.

Modify International Trade Provisions

Extend the Generalized System of Preferences (GSP) and modify other trade provisions.—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. The Administration proposes to extend the program, which expires after June 30, 1998, through September 30, 2001. The Administration is proposing new enhanced trade benefits for Sub-Saharan African countries undertaking strong economic reforms. The Administration also proposes to provide, through September 30, 2001, expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria to prepare for a future free trade agreement with the United States. The Administration also proposes to implement the OECD Shipbuilding Agreement.

Extend and modify Puerto Rico economic-activity tax credit (section 30A).—Although the Puerto Rico and possessions tax credit generally was repealed in 1996, both the income-based option and the economic-activity option under the credit remain available for existing business operations through 2005, subject to base-period caps. To provide a more efficient and effective tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity credit that was begun in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), the Administration proposes to modify the economic-activity credit for Puerto Rico by (1) extending it indefinitely, (2) making newly established business operations eligible for the credit, effective for taxable years beginning after December 31, 1998, and (3) removing the base-period cap.

Levy tariff on certain textiles and apparel products produced in the Commonwealth of the Northern Mariana Islands (CNMI).—The Administration has proposed a tariff on textile and apparel products produced in the CNMI without certain percentages of workers who are U.S. citizens, nationals or permanent residents or citizens of the Pacific island nations freely associated with the U.S.

Expand Virgin Island tariff credits.—The Administration proposes the expansion of authorized but currently unused tariff credits for wages paid in the production of watches in the Virgin Islands to be available for the production of fine jewelry.

Provide Other Tax Incentives

Expand tax incentives for specialized small business investment companies (SSBICs).—Current law

provides certain tax incentives for investment in SSBICs. The Administration proposes to enhance the tax incentives for SSBICs. First, the existing provision allowing a tax-free rollover of the proceeds of a sale of publicly-traded securities into an investment in a SSBIC would be modified to extend the rollover period to 180 days, to allow investment in the preferred stock of a SSBIC, to eliminate the annual caps on the SSBIC rollover gain exclusion, and to increase the lifetime caps to \$750,000 per individual and \$2,000,000 per corporation. Second, the proposal would allow a SSBIC to convert from a corporation to a partnership within 180 days of enactment without giving rise to tax at either the corporate or shareholder level, but the partnership would remain subject to an entity-level tax at any time that it later disposed of assets that it holds at the time of conversion on the amount of “built-in” gains inherent in such assets at the time of conversion. Finally, in the case of a direct or indirect sale of SSBIC stock that qualifies for treatment under section 1202, the proposal would raise the exclusion of gain from 50 percent to 60 percent. The tax-free rollover and section 1202 provisions would be effective for sales occurring after the date of enactment.

Accelerate and expand incentives available to two new Empowerment Zones (EZs).—OBRA 93 authorized a Federal demonstration project in which nine EZs and 95 empowerment communities would be designated in a competitive application process. Among other benefits, businesses located in the nine original EZs are eligible for three Federal tax incentives: an employment and training credit; an additional \$20,000 per year of section 179 expensing; and a new category of tax-exempt private activity bonds. The Taxpayer Relief Act of 1997 authorized the designation of two additional EZs located in urban areas, which generally are eligible for the same tax incentives as are available within the EZs authorized by OBRA 93. The two additional EZs will be designated in early 1998, but the tax incentives provided for them do not take effect until January 1, 2000. The incentives generally remain in effect for 10 years. The wage credit, however, is phased down beginning in 2005 and expires after 2007. The Administration proposes to accelerate the start-up date of the incentives for the two additional EZs to January 1, 1999. In addition, the proposal would provide that the wage credit would remain in effect for 10 years from that date and would be phased down using the same percentages that apply to the original empowerment zones designated under OBRA 93.

Make first \$2,000 of severance pay exempt from income tax.—Under current law, payments made to a terminated employee are taxable as compensation. The Administration proposes to allow an individual to exclude up to \$2,000 of severance pay from income when certain conditions are met. First, the severance must result from a reduction in force by the employer. Second, the individual must not obtain a job within six months of separation with compensation at least

equal to 95 percent of his or her prior compensation. Third, the total severance payments received by the employee must not exceed \$125,000. The exclusion would be effective for severance pay received in taxable years beginning after December 31, 1998 and before January 1, 2004.

Simplify The Tax Laws

Provide for optional Self-employment Contributions Act (SECA) computations.—Self-employed individuals currently may elect to increase their self-employment income for purposes of obtaining social security coverage. Current law provides more liberal treatment for farmers as compared to other self-employed individuals. The Administration proposes to extend the favorable treatment currently accorded to farmers to other self-employed individuals. The proposal would be effective for taxable years beginning after December 31, 1998.

Provide statutory hedging and other rules to ensure business property is treated as ordinary property.—Under current law, there is a significant issue of whether income from hedging transactions is capital or ordinary. The rules under which assets are treated as ordinary assets and under which hedging transactions are accounted for need to be modernized. In addition, the current-law rules that allow taxpayers to defer loss when a taxpayer holds a position or positions that reduce the risk of loss on certain capital assets, the so-called straddle rules, are punitive and sometimes result in a total disallowance of losses. The proposal would generally codify the hedging rules previously promulgated by Treasury Department and make some modifications to help clarify the rules. The proposal would clarify that certain assets are ordinary assets for Federal income tax purposes, provide more equitable timing of losses under the straddle rules, and eliminate an exception to the straddle rules for positions in corporate stock. The proposal generally would be effective after the date of enactment, and would give the Treasury Department authority to issue regulations similar to the hedging provisions governing hedging transactions entered into prior to the effective date.

Clarify rules relating to certain disclaimers.—Under current law, if a person refuses to accept (i.e., disclaims) a gift or bequest prior to accepting the transfer (or any of its benefits), the transfer to the disclaiming person generally is ignored for Federal transfer tax purposes. Current law is unclear as to whether certain transfer-type disclaimers benefit from rules applicable to other disclaimers under the estate and gift tax. Current law is also silent as to the income tax consequences of a disclaimer. The Administration proposes to extend to transfer-type disclaimers the rule permitting disclaimer of an undivided interest in property as well as the rule permitting a spouse to disclaim an interest that will pass to a trust for the spouse's benefit. The proposal also clarifies that disclaimers are effective

for income tax purposes. The proposal would apply to disclaimers made after the date of enactment.

Simplify the foreign tax credit limitation for dividends from 10/50 companies.—The Taxpayer Relief Act of 1997 modified the regime applicable to indirect foreign tax credits generated by dividends from so-called 10/50 companies. Specifically, the Act retained the prior law “separate basket” approach with respect to pre-2003 distributions by such companies, adopted a “single basket” approach with respect to post-2002 distributions by such companies of their pre-2003 earnings, and adopted a “look-through” approach with respect to post-2002 distributions by such companies of their post-2002 earnings. The application of the three approaches results in significant additional complexity. The proposal would simplify significantly the application of the foreign tax credit limitation by applying a look-through approach immediately to dividends paid by 10/50 companies, regardless of the year in which the earnings and profits out of which the dividends are paid were accumulated (including pre-2003 years). The proposal would be effective for taxable years beginning after December 31, 1997.

Provide interest treatment for certain payments from regulated investment companies to foreign persons.—Under current law, foreign investors in U.S. bond and money-market mutual funds are effectively subject to withholding tax on interest income and short term capital gains derived through such funds. Foreign investors that hold U.S. debt obligations directly generally are not subject to U.S. taxation on such interest income and gains. This proposal would eliminate the discrepancy between these two classes of foreign investors by eliminating the U.S. withholding tax on distributions from U.S. mutual funds that hold substantially all of their assets in cash or U.S. debt securities (or foreign debt securities that are not subject to withholding tax under foreign law). The proposal is designed to enhance the ability of U.S. mutual funds to attract foreign investors and to eliminate needless complications now associated with the structuring of vehicles for foreign investment in U.S. debt securities. The proposal would be effective for mutual fund taxable years beginning after the date of enactment.

Enhance Taxpayers' Rights Collection

Suspend collection by levy during refund suit.—Generally, full payment of the tax at issue is a prerequisite to a refund suit (*Flora v. United States*), but this rule does not apply in the case of “divisible” taxes (such as employment taxes or the “100 percent penalty” under section 6672). The Administration proposes to require the IRS to suspend collection by levy of liabilities that are the subject of a refund suit during the pendency of the litigation. This would only apply where refund suits can be brought without the full payment of the tax, i.e., divisible taxes. Collection by levy would

be suspended unless jeopardy exists or the taxpayer waives the suspension of collection in writing. This proposal would not affect the IRS's ability to collect other assessments that are not the subject of the refund suit, to offset refunds or to file a notice of federal tax lien. The statute of limitations on collection would be stayed for the period during which collection by levy is prohibited. The proposal would be effective for refund suits brought with respect to taxable years beginning after December 31, 1998.

Suspend collection by levy while offer in compromise is pending.—The Administration proposes to bar the IRS from collecting a tax liability by levy during any period that a taxpayer's offer in compromise of that liability is being processed, during the 30 days following rejection of an offer, and for any period during which an appeal of a rejected offer is being considered. Levy would not be precluded if the IRS determines that collection is in jeopardy or that the offer is submitted solely to delay collection. This proposal would not affect liabilities or assessments that are not the subject of the offer in compromise, the IRS's ability to offset refund, or its ability to file a notice of Federal tax lien. The proposal would not require the IRS to stop any levy action that was initiated, or withdraw any lien that was filed, prior to the taxpayer's making an offer in compromise. The statute of limitations on collection would be stayed for the period during which collection by levy is barred. The proposal would be effective with respect to taxes assessed 60 days after the date of enactment.

Suspend collection to permit resolution of disputes as to liability.—The Administration proposes to permit an individual taxpayer to request that collection be suspended temporarily with regard to an income tax liability that is assessed based upon a statutory notice of deficiency that the taxpayer failed to receive or to which the taxpayer failed to respond. The IRS would suspend collection for a 60-day period, during which the taxpayer may dispute the merits of the underlying assessment. The 60-day period would be extended in appropriate cases where progress is being made in resolving the liability. Collection by refund offset and jeopardy levies would be exempted. The proposal would not affect the IRS's ability to file a notice of Federal tax lien. The statutory collection period would be stayed while the taxpayer's claim is pending. The proposal would be effective for taxes assessed with respect to taxable years beginning after December 31, 1998.

Require District Counsel approval of certain third party collection activities.—The Administration proposes to require IRS District Counsel approval before a notice of Federal tax lien can be filed or levy is made in connection with property held by a nominee, transferee, or alter ego of the taxpayer. Counsel approval would also be required before the IRS seizes property encumbered by a Federal tax lien if the prop-

erty is presently neither owned nor titled in the name of the taxpayer. The only exception would be in jeopardy situations. If District Counsel's approval was not obtained, the property-owner would be entitled to obtain release of the lien or levy, and, if the IRS failed to make such release, to appeal first to the Collections Appeals process and then to the U.S. District Court. The proposal would be effective with respect to taxes assessed after the date of enactment.

Require management approval of levies on certain assets.—The Administration proposes to require the personal approval of an IRS District Director or Assistant District Director of any levy made against non-Federal pensions or the cash value of life insurance policies. The proposal would thus place these assets in the same class as principal residences pursuant to section 6334(e). The only exception would be in jeopardy situations. If the District Director's approval was not obtained, the taxpayer would be entitled to obtain release of the levy, and, if the IRS failed to make such release, to appeal first to the Collections Appeals process and then to the U.S. District Court. The proposal would be effective with respect to taxes assessed after the date of enactment.

Require District Counsel review and approval of jeopardy and termination assessments and jeopardy levies.—Current law provides special procedures allowing the IRS to make jeopardy assessments or termination assessments in certain extraordinary circumstances, for instance, if the taxpayer is leaving or removing property from the United States or if assessment or collection would be jeopardized by delay. In jeopardy situations, a levy may also be made without the 30-day notice of intent to levy that is ordinarily required. Jeopardy and termination assessments and jeopardy levies often involve difficult legal issues, and the government bears the burden of proof with respect to the reasonableness of a jeopardy or termination assessment or a jeopardy levy. The Administration proposes to require IRS District Counsel review and approval before the IRS could make a jeopardy assessment, a termination assessment, or a jeopardy levy. If District Counsel's approval was not obtained, the taxpayer would be entitled to obtain abatement of the assessment or release of the levy, and, if the IRS failed to offer such relief, to appeal first to the Collections Appeals process and then to the U.S. District Court. The proposal would be effective with respect to taxes assessed after the date of enactment.

Require management approval of sales of perishable goods.—Because of the nature of the property at issue, special accelerated procedures apply to the sale of perishable property that has been seized to satisfy a tax liability. The Administration proposes to require approval by an IRS District Director or Assistant District Director before perishable goods are sold. The proposal would also clarify what a "perishable" item is for these purposes. The proposal would be effective

with respect to taxes assessed after the date of enactment.

Codify certain Fair Debt Collection procedures.—Government agencies, including the IRS, are generally exempt from the Fair Debt Collection Practices Act (FDCPA). In the past, appropriations legislation funding the IRS has required IRS officers and employees to comply with certain provisions of the FDCPA. Placing these requirements in the Internal Revenue Code would ensure that both taxpayers and employees of the IRS are fully aware of these requirements. Therefore, the Administration proposes to add to the Internal Revenue Code two provisions of the FDCPA concerning communications in connection with debt collection and the prohibition on harassment or abuse. The proposal would be effective on the date of enactment.

Modify payment of taxes.—The Secretary of the Treasury is authorized to accept payments by stamps, check, or money orders, as provided in regulations. Checks or money orders currently are made payable to the “Internal Revenue Service.” The proposal would require amending the rules, regulations, and procedures to allow payment of taxes by check or money order to be made payable to the order of “United States Treasury.” This would make it clearer to taxpayers that their tax payments support the entire Federal Government, not just the IRS. The proposal would be effective on the date of enactment.

Require disclosures relating to extension of statutes of limitation by agreement.—Taxpayers and the IRS may agree in writing to extend the statutory period of limitations on assessment or collection, either for a specified period or for an indefinite period. The Administration proposes to require that, on each occasion that the taxpayer is requested by the IRS to extend the statute of limitations, the IRS must notify the taxpayer of the taxpayer’s right to refuse to extend the statute of limitations or to limit the extension to particular issues. The proposal would apply to requests to extend the statute of limitations made after the date of enactment.

Publish living allowance schedules relating to offers in compromise.—The IRS is authorized to compromise a taxpayer’s tax liability for less than the full amount due. In general, there are two grounds on which an offer in compromise can be made: doubt as to the taxpayer’s liability for the full amount, or doubt as to the taxpayer’s ability to pay in full the amount owed. The proposal would require the IRS to develop and publish schedules of national and local living allowances, taking into account variations in the cost of living in different areas. The IRS would use this information in evaluating the sufficiency of offers in compromise. The schedules would be required to be published no later than 180 days after the date of enactment.

Ensure availability of installment agreements.—The IRS is authorized to enter agreements permitting taxpayers to pay taxes in installments if such an agreement will “facilitate collection” of the liability. The IRS has discretion to determine when an installment agreement is appropriate. The Administration proposes to codify the IRS’s current practice of requiring an installment agreement (at the taxpayer’s option) for liabilities of \$10,000 or less, provided certain conditions are met. The proposal would be effective on the date of enactment.

Increase “superpriority” dollar limits.—Current law provides protection to certain property interests even though a Notice of Federal Tax Lien has been properly filed before the interests arise. Such “superpriorities” are subject to certain dollar limitations, however. The proposal would increase the current dollar limit for purchasers at a casual sale from \$250 to \$1,000, and it would increase the current dollar limit from \$1,000 to \$5,000 for mechanics lienors who provide home improvement work for residential real property. The proposal would also clarify current law to reflect current banking practices, where a “passbook”-type loan may be made even though an actual “passbook” is not used. The proposal would be effective on the date of enactment.

Permit personal delivery of 100 percent penalty notices.—The proposal would permit personal delivery, in addition to the Internal Revenue Code’s current requirement of mail delivery, of a preliminary notice that the IRS intends to assess a 100 percent penalty under section 6672 against the taxpayer. The proposal would be effective on the date of enactment.

Examination

Allow taxpayers to quash all third party summonses.—Summonses issued to “third party recordkeepers” are subject to different procedures than other summonses: notice of the summons must be given to the taxpayer, and the taxpayer has an opportunity to bring a court proceeding to quash the summons, during which time collection action is stayed and the third party recordkeeper is prohibited from complying with the summonses. The Administration proposes generally to expand the “third party recordkeeper” procedures to apply to all summonses issued to third parties other than the taxpayer. This would have the beneficial effect of giving taxpayers notice and an opportunity to contest any summons issued to a third party in connection with the determination of their liability. The provision would be effective for summonses served after the date of enactment.

Require disclosure of criteria for examination selection.—The IRS examines Federal tax returns to determine the correct liability of taxpayers. Returns are selected for examination in a number of ways, such as through “matching” of returns and information returns or through the use of a computerized classifica-

tion system (the discriminant function (DIF) system). Taxpayers should better understand the reasons why they may be selected for examination. Therefore, the Administration proposes to require that within 180 days the IRS add to Publication 1 (*Your Rights as a Taxpayer*) a statement setting forth, in simple and non-technical terms, the criteria and procedures for selecting taxpayers for examination. The statement would not include any information that would be detrimental to law enforcement, and drafts of the statement would be required to be submitted to the congressional tax-writing committees prior to publication.

Prohibit threat of audit to coerce tip reporting alternative commitment agreements.—Restaurants may enter into Tip Reporting Alternative Commitment (TRAC) agreements. A restaurant entering into a TRAC agreement is obligated to educate its employees on their tip reporting obligations, to institute formal tip reporting procedures, to fulfill all filing and record keeping requirements, and to pay and deposit taxes. In return, the IRS agrees to base the restaurant's liability for employment taxes solely on reported tips and any unreported tips discovered during an IRS audit of an employee. The proposal would require the IRS to instruct its employees that they may not threaten to audit any taxpayer in an attempt to coerce the taxpayer to enter into a TRAC agreement. The provision would be effective on the date of enactment.

Permit service of summonses by mail.—This proposal would permit the IRS to serve summonses by mail, in addition to the present law requirement that all summonses be personally served. Most summonses are served on financial institutions, where personal service can disrupt the working environment. Further, notice to the taxpayer that a summons has been served on a third party recordkeeper can already be given by mail, and the proposal would thus bring the service of the actual summons into line with the notice requirements. The provision would be effective for summonses served after the date of enactment.

New Remedies

Allow suits for damages if IRS violates certain bankruptcy procedures.—No remedy exists under the Internal Revenue Code if the IRS willfully violates the automatic stay or discharge provisions of the Bankruptcy Code. The Administration proposes to provide for payment of damages, plus attorneys fees' and costs, for willful violations by officers or employees of the IRS of either the automatic stay provision or the discharge injunction under the Bankruptcy Code. Jurisdiction over such cases would lie with the Bankruptcy Court, but the claimant would be required to exhaust administrative remedies to the same extent as for other damage claims. The provision would be effective with respect to violations occurring after the date of enactment.

Increase Tax Court's "small case" limit.—Taxpayers may choose to contest many tax disputes in the Tax Court. Under current law, special "small case procedures" apply to disputes involving \$10,000 or less, if the taxpayer chooses to utilize these procedures (and the Tax Court concurs). The Administration proposes to increase the cap for small case treatment in the Tax Court from \$10,000 to \$25,000. The proposal would apply to proceedings commenced after the date of enactment.

Provide equitable tolling.—A refund claim that is not filed within certain specified time periods is rejected as untimely. The Supreme Court recently held (*United States v. Brockamp*) that these limitations periods cannot be extended, or "tolled," for equitable reasons. This may lead to harsh results for some taxpayers, particularly when they fail to seek a refund because of a well-documented disability or similar compelling circumstance that prevents them from doing so. Consequently, the Administration proposes to permit "equitable tolling" of the limitation period on claims for refund for the period of time during which an individual taxpayer is under a sufficient medically determined physical or mental disability as to be unable to manage his or her financial affairs. Tolling would not apply during periods in which the taxpayer's spouse or another person is authorized to act on the taxpayer's behalf in financial matters. The proposal would apply with respect to taxable years ending after the date of enactment.

Require notice of deficiency to specify Tax Court filing deadlines.—Under current law, taxpayers must file a petition with the Tax Court within 90 days after the notice of deficiency is mailed (150 days if the person is outside the United States). Because timely filing in Tax Court is a jurisdictional prerequisite, the IRS cannot extend the filing period, nor can the Tax Court hear the case of a taxpayer who relies on erroneous information from the IRS and files too late. The Administration proposes to require the IRS to include on each notice of deficiency the date it determines is the last day on which the taxpayer may file a Tax Court petition (including the last day for a taxpayer who is outside the United States). Any petition filed by the later of the statutory date or the date shown on the notice would be timely. The provision would apply to notices mailed after December 31, 1998.

Allow actions for refund with respect to certain estates that have elected the installment method of payment.—Under the Internal Revenue Code, a taxpayer may bring a refund suit only if full payment of the assessed tax liability has been made. However, under certain conditions, the executor of an estate may pay the estate tax attributable to certain closely-held businesses over a 14-year period. These two rules can be in conflict, preventing electing estates from obtaining full relief in a refund jurisdiction. The Administration proposes to grant courts refund jurisdiction to deter-

mine the correct liability of such an estate, so long as the estate had properly elected to pay in installments and was current on all payments. The proposal also would make a number of technical and conforming amendments to implement this change. The proposal would be effective for claims for refunds filed after the date of enactment.

Expand authority to award costs and fees.—Any person who substantially prevails in a dispute related to taxes, interest, or penalties may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding. Individuals can receive an award of litigation and administrative costs only if their net worth does not exceed \$2 million. Awards cannot exceed amounts actually paid or incurred, and cannot exceed a statutorily limited rate (\$110 per hour, indexed for inflation). Taxpayers who are represented pro bono, and thus bear no actual attorney's fees and costs, cannot recover such amounts. The Administration proposes to allow the award of attorney's fees (in amounts up to the statutory limit) to persons who represent such taxpayers for no more than a nominal fee. The proposal would be effective with respect to costs incurred and services performed after the date of enactment.

Expand authority to issue taxpayer assistance orders.—Under current law, taxpayers can request that the Taxpayer Advocate issue a taxpayer assistance order (TAO) to require the IRS to release property of the taxpayer that has been levied upon, or to cease any action, take any action as permitted by law, or refrain from taking any action with respect to the taxpayer. A TAO may be issued if the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the laws are being administered by IRS. The Administration proposes to provide that, in determining whether to issue a TAO, the Taxpayer Advocate will also be authorized to consider, among other factors, the following: unreasonable delays in resolving the taxpayer's account problems; immediate threats of substantial adverse action (such as the seizure of a residence to pay overdue taxes); the likelihood of irreparable harm if relief is not granted; whether the taxpayer will have to pay significant professional fees if relief is not granted; and the possibility of long-term adverse impact on the taxpayer. The proposal would be effective on the date of enactment.

Provide new remedy for third parties who claim that the IRS has filed an erroneous lien.—The Supreme Court held (*Williams v. United States*) that a third party who paid another person's tax under protest to remove a lien on the third party's property could bring a refund suit, because she had no other adequate administrative or judicial remedy. However, the Court left many important questions unresolved. The Administration proposes to create administrative and judicial remedies for a third party in that situation. Under this procedure, the owner of property (other than the tax-

payer) could obtain a certificate discharging property from the Federal tax lien as a matter of right, provided certain conditions were met. The certificate of discharge would enable the property owner to sell the property free and clear of the Federal tax lien in all circumstances. The proposal would also establish a judicial cause of action for persons challenging a Federal tax lien that is similar to the wrongful levy remedy already in the Internal Revenue Code. The proposal would be effective on the date of enactment.

Allow damage suits by persons other than the taxpayer.—Under current law, taxpayers have a right to sue for damages if, in connection with any collection of Federal tax, any officer or employee of the IRS recklessly or intentionally disregards any provision of the Internal Revenue Code or any regulation thereunder. Recoverable damages are the lesser of actual, direct economic damages sustained, plus attorneys' fees, or \$1 million. Actions under this provision may only be brought by an injured taxpayer, however, and not by an injured third party. The Administration proposes that persons other than the taxpayer from whom collection is sought be granted a right to sue for damages. The current law limitations on awards for damages would apply to third party plaintiffs, as well. The proposal would be effective with respect to collection actions taken after the date of enactment.

Joint Returns

Suspend collection in certain joint liability cases.—When a married couple's joint return is the subject of a Tax Court proceeding, the Administration proposes to require the IRS to withhold collection by levy against a nonpetitioning spouse while a Tax Court proceeding involving the other spouse is pending. This would treat the nonpetitioning spouse the same as the petitioning spouse in most situations. Certain exceptions would be provided, including in jeopardy situations; when the taxpayer waives this protection (i.e., agrees to the collection action); other, limited but automatic kinds of collection activity, such as automatic refund offset; filing of protective notices of Federal tax lien, etc.; or certain other situations. The statute of limitations on assessment and collection would be stayed for the period during which collection by levy is barred. If there is a final decision that reduces the proposed assessment against the petitioning spouse, the assessment against the nonpetitioning spouse would likewise be reduced. The proposal would not affect the IRS's ability to collect other liabilities or assessments that are not the subject of the Tax Court proceeding. The proposal would be effective for taxes assessed with respect to taxable years beginning after December 31, 1998.

Require explanation of joint and several liability.—In general, spouses who file a joint tax return are jointly and severally liable for the tax due. Thus each is fully responsible for the accuracy of the return

and the full amount of the liability, even if only one spouse earned the wages or income that is shown on the return. Married taxpayers need to better understand the legal implications of signing a joint return. Therefore, the Administration proposes to require the IRS to establish procedures to alert married taxpayers clearly of their joint and several liability on appropriate tax publications and instructions. The proposal would require that such procedures be established no later than 180 days after the date of enactment.

Relieve innocent spouse of liability in certain cases.—Spouses who file a joint tax return are each fully responsible for the accuracy of the return and for the full tax liability, even if only one spouse earned the wages or income shown on the return. Relief from liability is available for “innocent spouses” in certain circumstances, but the conditions are frequently hard to meet and the Tax Court may not have jurisdiction to review all denials of innocent spouse relief. The Administration proposes to generally make innocent spouse status easier to obtain. It would first eliminate certain applicable dollar thresholds for understatements of tax. Second, the proposal would specifically provide the Tax Court with jurisdiction to review the IRS’s denial of innocent spouse relief and to order appropriate relief. Except in limited cases, the IRS could not collect the tax until the Tax Court case is final (although the statute of limitations would be extended while the Tax Court case is pending). Finally, the proposal would require the IRS to develop a separate form with instructions for taxpayers to use in applying for innocent spouse relief within 180 days from the date of enactment. The proposal would be effective for understatements in years beginning after the date of enactment and for overpayments assessed within the previous two years.

Miscellaneous

Allow “global” interest netting of under- and over-payments.—The rate of interest charged taxpayers on their tax underpayments differs from the rate paid to taxpayers on overpayments. Although the IRS ameliorates the effect of this interest rate differential by “netting” offsetting underpayments and overpayments in some situations, there is no authority to net when either the overpayment or the underpayment has been satisfied already (“global” netting). Global interest netting for income taxes would be implemented under this proposal. The proposal would be effective for calendar quarters with periods of overlapping mutual indebtedness after the date of enactment.

Facilitate archiving of IRS records.—The IRS, like all other Federal agencies, must create, maintain, and preserve agency records, and must transfer significant and historical records to the National Archives and Records Administration (NARA) for retention or disposal. However, tax returns and return information are confidential and can be disclosed only pursuant to

limited exceptions. There is no exception authorizing the disclosure of return information to NARA. The Administration proposes to provide an exception to the disclosure rules, authorizing the IRS to disclose tax returns and return information to officers or employees of NARA, upon written request from the Archivist, for purposes of the appraisal of such records for destruction or retention. The prohibitions on, and penalties for, unauthorized re-disclosure of such information would apply. The proposal would be effective for requests made by the Archivist after the date of enactment.

Clarify authority to prescribe manner of making elections.—Except as otherwise provided by statute, elections under the Internal Revenue Code must be made in such manner as the Secretary of the Treasury “shall by regulations or forms prescribe.” The question has arisen whether the Secretary can prescribe the manner of required elections other than by regulations or forms, for instance in revenue rulings or revenue procedures. The proposal would clarify that, except as otherwise provided, the Secretary may prescribe the manner of making any election by any reasonable means. The proposal would be effective on the date of enactment.

Grant IRS broad authority to enter into cooperative agreements with State taxing agencies.—Taxpayers currently must file returns with both their State taxing agency and the IRS, and frequently must resolve issues with the agencies at different times. If appropriate statutory authority were enacted, taxpayers could file only one return for both State and Federal taxes. Then, pursuant to a cooperative agreement between the IRS and the State, the information could be processed by one tax administrator and shared between the two, substantially simplifying filing requirements and reducing taxpayer burden. The Administration proposes to allow the IRS to enter such agreements with the States to provide for joint filing and processing of returns, joint collection of taxes (other than Federal income taxes), and such other provisions as may enhance joint tax administration. It would further amend the Internal Revenue Code’s confidentiality provisions to permit sharing of common tax data, would address the effect of joint agreements in a number of situations, and would include a thorough list of conforming amendments. The provision would be effective on the date of enactment.

Provide clinics for low-income taxpayers.—Low-income individuals frequently have difficulty complying with their tax obligations or resolving disputes over their tax liabilities. Providing tax services to such individuals through clinics that offer such services for a nominal fee would improve compliance with the tax laws and should be encouraged. The Administration proposes that the Legal Services Corporation be authorized to make up to \$3,000,000 in grants for the development, expansion, or continuation of certain low-income

taxpayer clinics. The provision would be effective on the date of enactment.

Provide procedures for release of field service memoranda.—The Administration proposes to clarify that Field Service Advice Memoranda (FSAs) are return information that is protected under the Internal Revenue Code and cannot be disclosed without authorization. It would also, however, make the non-confidential information in such documents public, subject to a redaction process in which the taxpayer whose liability is the subject of the FSA would be allowed to participate. The proposal would be effective on the date of enactment, but it would include a schedule of time over which the IRS would make past FSAs available under the redaction procedure.

ELIMINATE UNWARRANTED BENEFITS AND ADOPT OTHER REVENUE MEASURES

The President's plan curtails unwarranted corporate tax subsidies, closes tax loopholes, improves tax compliance and adopts other revenue measures.

Defer deduction for interest and original issue discount (OID) on convertible debt.—The accrued but unpaid interest and OID on a convertible debt instrument generally is deductible, even if the instrument is converted into the stock of the issuer or a related party before the issuer pays any interest or OID. The Administration proposes to defer the deduction for all interest, including OID, on convertible debt until payment. The proposal would be effective for convertible debt issued on or after the date of first committee action.

Eliminate dividends-received deduction for certain preferred stock.—A corporate holder of stock generally is entitled to a deduction for dividends received on stock in the following amounts: 70 percent if the recipient owns less than 20 percent of the stock of the payor, 80 percent if the recipient owns 20 percent or more of the stock, and 100 percent of qualifying dividends received from members of the same affiliated group. The Administration proposes to eliminate the 70- and 80-percent dividends-received deduction for dividends on certain limited-term preferred stock, effective for stock issued after the date of enactment.

Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands.—Taxpayers are allowed to deduct a reasonable allowance for depletion relating to certain mineral deposits. The depletion deduction for any taxable year is calculated under either the cost depletion method or the percentage depletion method, whichever results in the greater allowance for depletion for the year. The percentage depletion method is viewed as an incentive for mineral production rather than as a normative rule for recovering the taxpayer's investment in the property. This incentive is excessive with respect to minerals mined on Federal and formerly Federal lands

under the 1872 mining act, in light of the minimal costs of acquiring the mining rights (\$5.00 or less per acre). The Administration proposes to repeal percentage depletion for non-fuel minerals mined on Federal lands where the mining rights were originally acquired under the 1872 law, and on private lands acquired under the 1872 law. The proposal would be effective for taxable years beginning after the date of enactment.

Repeal tax-free conversions of large C corporations to S corporations (section 1374).—A corporation can avoid the existing two-tier tax by electing to be treated as an S corporation or by converting to a partnership. Converting to a partnership is a taxable event that generally requires the corporation to recognize any built-in gain on its assets and requires the shareholders to recognize any built-in gain on their stock. By contrast, the conversion to an S corporation is generally tax-free, except that the S corporation generally must recognize the built-in gain on assets held at the time of conversion if the assets are sold within ten years. The Administration proposes that the conversion of a C corporation with a value of more than \$5 million into an S corporation would be treated as a liquidation of the C corporation, followed by a contribution of the assets to an S corporation by the recipient shareholders. Thus, the proposal would require immediate gain recognition by both the corporation (with respect to its appreciated assets) and its shareholders (with respect to their stock). This proposal would make the tax treatment of conversions to an S corporation generally consistent with conversions to a partnership. The proposal would apply to elections that are first effective for a taxable year beginning after January 1, 1999 and to acquisitions of a C corporation by an S corporation made after December 31, 1998.

Replace sales-source rules with activity-based rules.—The foreign tax credit generally reduces U.S. tax on foreign source income, but does not reduce U.S. tax on U.S. source income. When products are manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of such income generally is treated as earned in production activities, and sourced on the basis of the location of assets held or used to produce income from the sale. The remaining 50 percent of the income is treated as earned in sales activities and sourced based on where title to the inventory transfers. Thus, if a U.S. manufacturer sells inventory abroad, half of the income generally is treated as derived from domestic sources, and half of the income generally is treated as derived from foreign sources. However, the taxpayer may use a more favorable method if it can establish to the satisfaction of the IRS that more than half of its economic activity occurred in a foreign country. This 50/50 rule provides a benefit to U.S. exporters that operate in high-tax foreign countries. Thus, U.S. multinational exporters have a competitive advantage over U.S. exporters that conduct all their business activities in the U.S. Because export benefits should be targeted equally to all export-

ers, the Administration proposes to reduce the amount of export sales income that such corporations may treat as derived from foreign sources by requiring that the allocation be based on actual economic activity. The proposal would be effective for taxable years beginning after the date of enactment.

Modify rules relating to foreign oil and gas extraction income.—To be eligible for the U.S. foreign tax credit, a foreign levy must be the substantial equivalent of an income tax in the U.S. sense, regardless of the label the foreign government attaches to it. Under regulations, a foreign levy is a tax if it is a compulsory payment under the authority of a foreign government to levy taxes and is not compensation for a specific economic benefit provided by the foreign country. Taxpayers that are subject to a foreign levy and that also receive (directly or indirectly) a specific economic benefit from the levying country are referred to as “dual capacity” taxpayers and may not claim a credit for that portion of the foreign levy paid as compensation for the specific economic benefit received. The Administration proposes to treat as taxes payments by a dual-capacity taxpayer to a foreign country that would otherwise qualify as income taxes or “in lieu of” taxes, only if there is a “generally applicable income tax” in that country. For this purpose, a generally applicable income tax is an income tax (or a series of income taxes) that applies to trade or business income from sources in that country, so long as the levy has substantial application both to non-dual-capacity taxpayers and to persons who are citizens or residents of that country. Where the foreign country does generally impose an income tax, as under present law, credits would be allowed up to the level of taxation that would be imposed under that general tax, so long as the tax satisfies the new statutory definition of a “generally applicable income tax.” The proposal also would create a new foreign tax credit basket within section 904 for foreign oil and gas income. The proposal would be effective for taxable years beginning after the date of enactment. The proposal would yield to U.S. treaty obligations that allow a credit for taxes paid or accrued on certain oil or gas income.

Repeal lower-of-cost-or-market inventory accounting method.—Taxpayers required to maintain inventories are permitted to use a variety of methods to determine the cost of their ending inventories, including the last-in, first-out (LIFO) method, the first-in, first-out (FIFO) method, and the retail method. Taxpayers not using a LIFO method may determine the carrying values of their inventories by applying the lower-of-cost-or-market (LCM) method and by writing down the cost of goods that are unsalable at normal prices or unusable in the normal way because of damage, imperfection or other causes (subnormal goods method). The allowance of write-downs under the LCM and subnormal goods methods is essentially a one-way mark-to-market method that understates taxable income. The Administration proposes to repeal the LCM

and subnormal goods methods effective for taxable years beginning after the date of enactment.

Increase penalties for failure to file correct information returns.—Any person who fails to file required information returns in a timely manner or incorrectly reports such information is subject to penalties. For taxpayers filing large volumes of information returns or reporting significant payments, existing penalties (\$15 per return, not to exceed \$75,000 if corrected within 30 days; \$30 per return, not to exceed \$150,000 if corrected by August 1; and \$50 per return, not to exceed \$250,000 if not corrected at all) may not be sufficient to encourage timely and accurate reporting. The Administration proposes to increase the general penalty amount, subject to the overall dollar limitations, to the greater of \$50 per return or 5 percent of the total amount required to be reported. The increased penalty would not apply if the aggregate amount actually reported by the taxpayer on all returns filed for that calendar year was at least 97 percent of the amount required to be reported. The increased penalty would be effective for returns the due date for which is more than 90 days after the date of enactment.

Tighten the substantial understatement penalty for large corporations.—Currently taxpayers may be penalized for erroneous, but non-negligent, return positions if the amount of the understatement is “substantial” and the taxpayer did not disclose the position in a statement with the return. “Substantial” is defined as 10 percent of the taxpayer’s total current tax liability, but this can be a very large amount. This has led some large corporations to take aggressive reporting positions where huge amounts of potential tax liability are at stake—in effect playing the audit lottery—without any downside risk of penalties if they are caught, because the potential tax still would not exceed 10 percent of the company’s total tax liability. To discourage such aggressive tax planning, the Administration proposes that any deficiency greater than \$10 million be considered “substantial” for purposes of the substantial understatement penalty, whether or not it exceeds 10 percent of the taxpayer’s liability. The proposal, which would be effective for taxable years beginning after the date of enactment, would affect only taxpayers that have tax liabilities greater than or equal to \$100 million.

Repeal exemption for withholding on gambling winnings from bingo and keno in excess of \$5,000.—Proceeds of most wagers with odds of less than 300 to 1 are exempt from withholding, as are all bingo and keno winnings. The Administration proposes to impose withholding on proceeds of bingo or keno in excess of \$5,000 at a rate of 28 percent, regardless of the odds of the wager, effective for payments made after the start of the first calendar quarter that is at least 30 days after the date of enactment.

Reinstate oil spill excise tax.—Before January 1, 1995, a five-cents-per-barrel excise tax was imposed on domestic crude oil and imported oil and petroleum products. The tax was dedicated to the Oil Spill Liability Trust Fund to finance the cleanup of oil spills and was not imposed for a calendar quarter if the unobligated balance in the Trust Fund exceeded \$1 billion at the close of the preceding quarter. The Administration proposes to reinstate this tax for the period after the date of enactment and before October 1, 2008. The tax would be suspended for a given calendar quarter if the unobligated Trust Fund balance at the end of the preceding quarter exceeded \$5 billion.

Modify Federal Unemployment Act (FUTA) provisions.—Beginning in 2004, the Administration proposes to require an employer to pay Federal and State unemployment taxes monthly (instead of quarterly) in a given year, if the employer's FUTA tax liability in the immediately preceding year was \$1,100 or more.

Extend pro rata disallowance of tax-exempt interest expense that applies to banks to all financial intermediaries.—No income tax deduction is allowed for interest on debt used directly or indirectly to acquire or hold investments that produce tax-exempt income. The determination of whether debt is used to acquire or hold tax-exempt investments differs depending on the holder of the instrument. For banks and a limited class of other financial institutions, debt generally is treated as financing all of the taxpayer's assets proportionately. Securities dealers are not included in the definition of "financial institution," and under a special rule are subject to a disallowance of a much smaller portion of their interest deduction. For other financial intermediaries, such as finance companies, that are also not included in the narrow definition of "financial institutions," deductions are disallowed only when indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt investments. These taxpayers are therefore able to reduce their tax liabilities inappropriately through the double Federal tax benefits of interest expense deductions and tax-exempt interest income, notwithstanding that they operate similarly to banks. Effective for taxable years beginning after the date of enactment, with respect to obligations acquired on or after the date of first committee action, the Administration proposes that all financial intermediaries, other than insurance companies (which are subject to a separate regime), be treated the same as banks are treated under current law with regard to deductions for interest on debt used directly or indirectly to acquire or hold tax-exempt obligations.

Increase the proration percentage for property casualty (P&C) insurance companies.—In computing their underwriting income, P&C insurance companies deduct reserves for losses and loss expenses incurred. These loss reserves are funded in part with the company's investment income. In 1986, Congress reduced the reserve deductions of P&C insurance com-

panies by 15 percent of the tax-exempt interest or the deductible portion of certain dividends received. In 1997, Congress expanded the 15-percent proration rule to apply to the inside buildup on certain insurance contracts. The existing 15-percent proration rule still enables P&C insurance companies to fund a substantial portion of their deductible reserves with tax-exempt or tax-deferred income. Other financial intermediaries, such as life insurance companies and banks, are subject to more stringent proration rules that substantially reduce or eliminate their ability to use tax-exempt or tax-deferred investments to fund currently deductible reserves or to deduct interest expense. Effective for taxable years beginning after the date of enactment, with respect to investments acquired on or after the date of first committee action, the Administration proposes to increase the proration percentage to 30 percent.

Preclude certain taxpayers from prematurely claiming losses from receivables.—An accrual method taxpayer generally must recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. In the event that a receivable arising in the ordinary course of the taxpayer's trade or business becomes uncollectible, the accrual method taxpayer may deduct the account receivable as a business bad debt in the year in which it becomes wholly or partially worthless. Accrual method service providers, however, are provided a special exception to these general rules. Under the exception, a taxpayer using an accrual method with respect to amounts to be received for the performance of services is not required to accrue any portion of such amounts that (on the basis of experience) will not be collected. This special exception permits an accrual method service provider to reduce current taxable income by an estimate of its future bad debt losses. This method of estimation results in a mismeasurement of a taxpayer's economic income and, because this tax benefit only applies to amounts to be received for the performance of services, promotes controversy over whether a taxpayer's receivables represent amounts to be received for the performance of services or for the provision of goods. The Administration proposes to repeal the special exception for accrual method service providers effective for taxable years ending after the date of enactment.

In general, dealers in securities are required to use a mark-to-market method of accounting. Under this method, securities that are inventory in the hands of the dealer must be included in inventory at fair market value. A taxpayer that is otherwise not a dealer in securities may elect to be treated as such for this purpose if the taxpayer purchases and sells debt instruments that, at the time of purchase or sale, are customer paper with respect to either the taxpayer or a corporation that is a member of the same consolidated group as the taxpayer (the "customer paper election"). Significant numbers of taxpayers whose principal activities are selling nonfinancial goods or providing nonfinancial services are making the customer paper elec-

tion as a means of restoring bad debt reserves. The customer paper election is also being used inappropriately to mark-to-market trade receivables that bear little or no interest in order to recognize loss. Under the proposal, certain customer receivables would not be allowed to be marked to market. The proposal would be effective for taxable years ending after the date of enactment.

Restrict special net operating loss carryback rules for specified liability losses.—Under current law, the portion of a net operating loss that qualifies as a specified liability loss may be carried back 10 years rather than being limited to the general two-year carryback period. A specified liability loss includes amounts allowable as a deduction with respect to product liability, and also certain liabilities that arise under Federal or State law or out of any tort of the taxpayer. The proper interpretation of the specified liability loss provisions as they apply to liabilities arising under Federal or State law or out of any tort of the taxpayer has been the subject of manipulation and significant controversy. Accordingly, the Administration proposes to modify the specified liability loss provisions to provide that only a limited class of liabilities qualifies as a specified liability loss. Under the proposal, specified liability losses would include (in addition to product liability losses) any amount allowable as a deduction that is attributable to a liability under Federal or State law for reclamation of land, decommissioning of a nuclear power plant (or any unit thereof), dismantlement of an offshore oil drilling platform, remediation of environmental contamination, or payments under a workers' compensation statute. The proposal would be effective for taxable years beginning after the date of enactment.

Freeze grandfather status of stapled (or "paired-share") Real Estate Investment Trusts (REITs).—REITs generally are limited to owning passive investments in real estate and certain securities. Prior to 1984, certain "stapled" REITs were paired with subchapter C corporations and traded in tandem as a single unit. This effectively allowed these stapled REITs to circumvent the restrictions on operating active businesses. In the Deficit Reduction Act of 1984, Congress restricted REITs' ability to avoid these investment limitations by providing that stapled entities must be treated as one entity for purposes of determining qualification under the REIT rules. However, Congress grandfathered the existing stapled REITs indefinitely. The Administration proposes to limit the grandfather status of the existing stapled REITs. Under the proposal, for purposes of determining whether any grandfathered entity is a REIT, the stapled entities would be treated as one entity with respect to properties acquired on or after the date of the first committee action and with respect to activities or services relating to such properties (i.e., properties acquired after the effective date) that are undertaken or performed by one of the stapled entities on or after such date.

Restrict impermissible business indirectly conducted by REITs.—REITs generally are restricted to owning passive investments in real estate and certain securities. To prevent indirect ownership of impermissible businesses, current law restricts a REIT from owning more than 10 percent of the outstanding voting securities of any issuer. Nonetheless, a REIT can essentially conduct an impermissible business through a subsidiary by holding a significant amount of non-voting stock in a corporation. Through the retention of non-voting stock and debt, the REIT is able to retain most, if not all, of the income generated by the impermissible business and to circumvent the restrictions on operating active businesses. The Administration proposes to restrict this ability by prohibiting REITs from holding stock possessing more than 10 percent of the vote or value of all classes of stock of a corporation. In general, the proposal would be effective with respect to stock acquired on or after the date of first committee action.

Modify treatment of closely held REITs.—When originally enacted, the REIT legislation was intended to provide a tax-favored vehicle through which small investors could invest in a professionally managed real estate portfolio. REITs are intended to be widely held entities, and certain requirements of the REIT rules are designed to ensure this result. Among other requirements, in order for an entity to qualify for REIT status, the beneficial ownership of the entity must be held by 100 or more persons. In addition, a REIT cannot be closely held, which generally means that no more than 50 percent of the value of the REIT's stock can be owned by five or fewer individuals during the last half of the taxable year. Certain attribution rules apply in making this determination. The Administration has become aware of a number of tax avoidance transactions involving the use of closely held REITs. In order to meet the 100 or more shareholder requirement, the REIT generally issues common stock, which is held by one shareholder, and a separate class of non-voting preferred stock with a relatively nominal value, which is held by 99 "friendly" shareholders. The closely held limitation does not disqualify the REITs that are utilizing this ownership structure because the majority shareholders of these REITs are not individuals. The Administration proposes to impose as an additional requirement for REIT qualification that no person can own stock of a REIT possessing more than 50 percent of the total combined voting power of all classes of voting stock or more than 50 percent of the total value of shares of all classes of stock. For purposes of determining a person's stock ownership, rules similar to the attribution rules contained in section 856(d)(5) would apply. The proposal would be effective for entities electing REIT status for taxable years beginning on or after the date of first committee action.

Modify depreciation method for tax-exempt use property.—Current law requires tax-exempt use property (property owned by a U.S. person but leased to a foreign or tax-exempt person) to be depreciated using

the straight-line method over a period equal to the greater of (1) the property's class life; or (2) 125 percent of the lease term. This rule has led to manipulations designed to create a shortened recovery period. The Administration proposes to lengthen the recovery period for "tax-exempt use property" to 150 percent of its class life. This will prevent the U.S. tax system from providing tax benefits in the form of accelerated depreciation for the use of property that is not connected with U.S. business activities. The proposal generally would be effective for property placed in service after December 31, 1998.

Impose excise tax on purchase of structured settlements.—Current law facilitates the use of structured personal injury settlements because recipients of annuities under these settlements are less likely than recipients of lump sum awards to consume their awards too quickly and require public assistance. Consistent with that policy, this favorable treatment is conditional upon a requirement that the periodic payments cannot be accelerated, deferred, increased or decreased by the injured person. Nonetheless, certain factoring companies are able to purchase a portion of the annuities from the recipients for heavily discounted lump sums. These purchases are inconsistent with the policy underlying favorable tax treatment of structured settlements. Accordingly, the Administration proposes to impose on any person who purchases (or otherwise acquires for consideration) a structured settlement payment stream, a 20-percent excise tax on the purchase price unless such purchase is pursuant to a court order finding that the extraordinary and unanticipated needs of the original intended recipient render such a transaction desirable. The proposal would apply to purchases occurring after the date of enactment. No inference is intended as to the contractual validity of the purchase or the effect of the purchase transaction on the tax treatment of any party other than the purchaser.

Clarify and expand math error procedures.—If the IRS determines that a taxpayer has failed to provide a correct taxpayer identification number (TIN) that is required by statute, the IRS may, in certain cases, use the streamlined procedures for mathematical and clerical errors ("math error procedures") to expedite the assessment of tax. The Administration proposes the following clarifications to the math error procedures applicable to the child tax credit, the child and dependent care tax credit, the personal exemption for dependents, the Hope and Lifetime Learning tax credits, and the earned income tax credit. First, the term "correct taxpayer identification number" used on a tax return would be defined as the TIN assigned to such individual by the Social Security Administration (SSA), or in certain limited cases, the IRS. Second, the IRS would be authorized to use data obtained from SSA to verify that the TIN provided on the return corresponds to the individual for whom the TIN was assigned. Such data would include the individual's name, age or date of birth, and Social Security number. Third, the IRS

would be authorized to use math error procedures to deny eligibility for those tax benefits subject to the math error procedures that impose a statutory age restriction (i.e., the child tax credit, the child and dependent care tax credit and the earned income tax credit) if the taxpayer provides a TIN for either the taxpayer or qualifying child that the IRS determines, using data from SSA, does not meet the statutory age restrictions. The proposal would be effective for taxable years ending after the date of enactment.

Clarify the meaning of "subject to" liabilities under section 357(c).—A transferor generally is required to recognize gain on a transfer of property in an otherwise tax-free section 351 exchange to the extent the sum of the liabilities assumed, plus those to which the transferred property is subject, exceeds the basis in the property. If a recourse liability is secured by multiple assets, it is unclear under present law whether a transfer of one asset where the transferor remains liable is a transfer of property "subject to the liability." Similar issues exist with respect to nonrecourse liabilities. Under the Administration's proposal, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability would be eliminated. Instead, the extent to which a liability (including a nonrecourse liability) is treated as assumed for Federal income tax purposes in connection with a transfer of property would be determined on the basis of all the facts and circumstances. In general, if nonrecourse indebtedness is secured by more than one asset, and any assets securing the indebtedness are transferred subject to the indebtedness without any indemnity agreements, then for all Federal income tax purposes the transferee would be treated as assuming an allocable portion of the liability based upon the relative fair market values (determined without regard to section 7701(g)) of the assets securing the liability. The proposal would be effective for transfers after the date of first committee action. No inference regarding the tax treatment under current law is intended.

Simplify foster child definition under EITC.—In order to simplify the EITC rules, the Administration proposes to clarify the definition of foster child for purposes of claiming the EITC. Under the proposal, the foster child must be the taxpayer's sibling (or a descendant of the taxpayer's sibling), or be placed in the taxpayer's home by an agency of a State or one of its political subdivisions or a tax-exempt child placement agency licensed by a State. The proposal would be effective for taxable years beginning after December 31, 1998.

Clarify tie-breaker rule under EITC.—The earned income tax credit tie-breaker rule prevents a lower-income individual from claiming the credit with respect to a particular child who could also be a qualifying child with respect to a higher-income individual. The Administration proposes to clarify that the requirement that a taxpayer identify on his or her tax return any

child with respect to whom the taxpayer is claiming the EITC is a requirement for claiming the credit, rather than an element of the definition of "qualifying child." Thus, under the EITC tie-breaker rule, the child would be a qualifying child with respect to the higher-income individual, regardless of whether the higher-income individual actually identifies the child on his or her return. A similar change would be made to the definition of "eligible individual." The proposal is effective with respect to taxable years ending after the date of enactment. No inference is intended as to the operation of the tie-breaker rule under current law.

Eliminate non-business valuation discounts.—Under current law, taxpayers are claiming large discounts on the valuation of gifts and bequests of interests in entities holding marketable assets. Because these discounts are inappropriate, the Administration proposes to eliminate valuation discounts except as they apply to active businesses. Interests in entities generally would be required to be valued for gift and estate tax purposes at a proportional share of the net asset value of the entity to the extent that the entity holds readily marketable assets. The proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

Eliminate "Crummey" rule.—Currently, gifts of present interests of up to \$10,000 (in 1998) per donor per donee each year are excepted from the gift tax. The decision in *Crummey v. Commissioner* held that a transfer in trust is a transfer of a present interest if the beneficiary has a right to withdraw the property from the trust for a limited period of time. The Administration proposes to overrule this decision so that only outright gifts of present interests would be counted for purposes of the \$10,000 gift exception. The proposal would be effective for gifts completed after December 31, 1998.

Eliminate gift tax exemption for personal residence trusts.—Current law excepts transfers of personal residences in trust from the special valuation rules applicable when a grantor retains an interest in a trust. The Administration proposes to repeal this personal residence exception. Thereafter, if a residence is to be used to fund a grantor retained interest trust, the trust would be required to pay out the required annuity or unitrust amount or else the grantor's retained interest would be valued at zero for gift tax purposes. This proposal would be effective for transfers in trust after the date of enactment.

Include qualified terminable interest property (QTIP) trust assets in surviving spouse's estate.—A marital deduction is allowed for qualified terminable interest property (QTIP) passing to a qualifying trust for a spouse either by gift or by bequest. The value of the recipient spouse's estate includes the value of any such property in which the decedent had a qualifying income interest for life and a deduction was allowed

under the gift or estate tax. In some cases, taxpayers have attempted to whipsaw the government by claiming the deduction in the first estate and then arguing against inclusion in the second estate due to some technical flaw in the QTIP election. The Administration proposes that, if a deduction is allowed under the QTIP provisions, inclusion is required in the beneficiary spouse's estate. The proposal would be effective for decedents dying after the date of enactment.

Apply 7.7 percent capitalization rate to credit life insurance premiums.—Under current law, a company that issues group credit life insurance contracts is required to capitalize 2.05 percent of its net premiums for such contracts. However, commissions and other policy acquisition expenses on credit life insurance contracts generally are higher than policy acquisition expenses for individual life insurance contracts, to which a 7.7 percent capitalization rate applies. Thus, the statutory proxy rate for policy acquisition costs on credit life insurance contracts does not accurately reflect the level of commissions and other policy acquisition expenses for credit life insurance. Under the Administration's proposal, insurance companies would be required to capitalize 7.7 percent of their net premiums for a taxable year with respect to all credit life insurance contracts. The proposal would be effective for taxable years beginning after the date of enactment.

Modify corporate-owned life insurance (COLI) rules.—In general, interest on policy loans or other indebtedness with respect to life insurance, endowment or annuity contracts is not deductible unless the insurance contract insures the life of a "key person" of a business. In addition, the interest deductions of a business generally are reduced under a proration rule if the business owns or is a direct or indirect beneficiary with respect to certain insurance contracts. The COLI proration rules generally do not apply if the contract covers an individual who is a 20 percent owner of the business or is an officer, director, or employee of such business. These exceptions under current law still permit leveraged businesses to fund significant amounts of deductible interest and other expenses with tax-exempt or tax-deferred inside buildup. The Administration proposes to repeal the exception under the COLI proration rules for contracts insuring employees, officers or directors (other than 20 percent owners) of the business. The proposal also would conform the key person exception for disallowed interest deductions attributable to policy loans and other indebtedness with respect to insurance contracts to the 20 percent owner exception in the COLI proration rules. The proposal would be effective for taxable years beginning after date of enactment.

Modify reserve rules for annuity contracts.—Under current law, a life insurance company that issues an annuity contract claims a reserve deduction equal to the greater of the net surrender value of the contract and an amount that is based on the Commissioner's

Annuities Reserve Valuation Method (CARVM) in effect on the date that the annuity contract is issued, subject to a cap equal to the annual statement reserve for the contract. In 1997, the National Association of Insurance Commissioners adopted new actuarial guidelines interpreting CARVM. The guidelines generally require life insurance companies to compute CARVM reserves by determining the greatest possible present value of all guaranteed benefits, using a number of worst case or "conservative" assumptions. The guidelines are effective on December 31, 1998, and apply to all contracts issued on or after January 1, 1981. Because these new guidelines would be inappropriate for calculating tax reserves, the Administration proposes that tax reserves for all annuity contracts with cash surrender values would be set at the contract's net cash surrender value plus a specified percentage of the contract's net cash surrender value that would be phased out over a portion of the contract period. The proposal would be effective for taxable years ending on or after the date of enactment.

Tax certain exchanges of insurance contracts and reallocations of assets within variable insurance contracts.—Generally, investors are taxed upon the sale or exchange of assets. However, certain exchanges of life insurance, endowment and annuity contracts are not taxed. Also, the holder of a variable contract who liquidates part or all of his investment in one fund, and reallocates the proceeds to a different fund within a variable contract, is not taxed. The Administration proposes that all exchanges of an insurance contract for a variable contract would be taxable. Exchanges of variable contracts for any type of life insurance, endowment or annuity contract would be taxable. Each variable contract investment in a separate account mutual fund or in the insurance company's general account would be treated as a separate contract. In addition, the investment in the contract would be net of mortality and expense charges. These rules would apply to contracts issued after the date of first committee action. A material change in an existing contract would be treated as the issuance of a new contract.

Reduce "investment in the contract" for mortality and expense charges on certain insurance contracts.—For purposes of computing the amount of taxable investment income under section 72 of the Internal Revenue Code from distributions under cash value life insurance, endowment, or annuity contracts, the holder's tax basis includes premiums used to pay mortality and expense charges. These charges are used to pay for annual term life insurance coverage, other types of insurance coverage, and options to buy life annuities at specified rates guaranteed in a deferred annuity contract. As a result, these rules overstate basis and thus understate the amount of tax-deferred income under these contracts when they are surrendered for cash or the holder receives other distributions under the contract. The Administration proposes to modify the com-

putation of basis under section 72 by subtracting mortality and expense charges. This proposal would apply to contracts issued after the date of first committee action.

Amend 80/20 company rules.—Dividends paid by a so-called "80/20 company" generally are partially or fully exempt from U.S. withholding tax. A U.S. corporation is treated as an 80/20 company if at least 80 percent of the gross income of the corporation for the three-year period preceding the year of a dividend is foreign source income attributable to the active conduct of a foreign trade or business (or the foreign business of a subsidiary). Certain foreign multinationals improperly seek to exploit the rules applicable to 80/20 companies in order to avoid U.S. withholding tax liability on earnings of U.S. subsidiaries that are distributed abroad. The proposal would prevent taxpayers from avoiding withholding tax through manipulations of these rules. The proposal would apply to interest or dividends paid or accrued after the date of enactment.

Prescribe regulatory directive to address tax avoidance involving foreign built-in losses.—Certain taxpayers are engaging in tax avoidance transactions that inappropriately use losses generated outside the United States to offset income that otherwise would be subject to U.S. tax. The provision would direct the Secretary of Treasury to prescribe regulations, as may be necessary or appropriate to prevent the avoidance of tax, to determine (1) the basis of assets held directly or indirectly by a person other than a United States person, and (2) the amount of built-in deductions of a person other than a U.S. person, or an entity held directly or indirectly by such a person. The proposal would be effective on the date of enactment.

Prescribe regulatory directive to address tax avoidance through use of hybrids.—Certain persons are entering into tax avoidance transactions that utilize hybrid entities, securities and transactions to achieve tax results that are inconsistent with the purposes of the provisions of U.S. law (including treaties) that are relied on for such results. Other transactions involving hybrids do not achieve tax results that are inconsistent with the purposes of U.S. law. The consequences of these transactions should be described in the form of promptly issued administrative guidance both to prevent inappropriate results and to provide taxpayers with greater certainty. The proposal would direct the Secretary of Treasury to prescribe regulations to prevent the avoidance of tax through the use of hybrid entities, securities and transactions that achieve results inconsistent with the purposes of U.S. law (including treaties). The proposal would be effective on the date of enactment.

Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office.—In the case of a sale of inventory property that is attributable to a non-

resident's office or other fixed place of business within the United States, the sales income is generally U.S. source. The income is foreign source, however, if the inventory is sold for use, disposition, or consumption outside the United States and the nonresident's foreign office or other fixed place of business materially participates in the sale. The proposal would provide that the foreign source exception shall apply only if an income tax equal to at least 10 percent of the income from the sale is actually paid to a foreign country with respect to such income. The proposal thereby ensures that the United States does not cede its jurisdiction to tax such sales unless the income from the sale is actually taxed by a foreign country at some minimal level. The proposal would be effective for transactions occurring on or after the date of enactment.

Stop abuse of controlled foreign corporation (CFC) exception to ownership requirements.—Under section 887 of the Internal Revenue Code, a foreign corporation is subject to a four-percent tax on its United States source gross transportation income. The tax does not apply, however, if the corporation is organized in a country (an "exemption country") that grants an equivalent tax exemption to U.S. shipping companies. The exemption from the four-percent tax is subject to an anti-abuse rule that requires at least 50 percent of the stock of the corporation be owned by individual residents of an exemption country. Thus residents of a non-exemption country cannot secure the exemption simply by forming their shipping corporation in an exemption country. The anti-abuse rule requiring exemption country ownership does not apply, however, if the corporation is a controlled foreign corporation (the "CFC exception"). The premise for the CFC exception is that the U.S. shareholders of a CFC will be subject under U.S. tax law to current income taxation on their share of the foreign corporation's shipping income and thus the four-percent tax should not apply if the corporation is organized in an exemption country. However, residents of non-exemption countries can achieve CFC status for their shipping companies simply by owning the corporations through U.S. partnerships. Non-exemption country individuals can thereby avoid the anti-abuse rule requiring exemption country ownership and illegitimately secure the exemption from the U.S. four-percent tax. The proposal would stop that abuse. It would be effective for taxable years beginning after the date of enactment.

OTHER PROVISIONS THAT AFFECT RECEIPTS

Reinstate environmental tax imposed on corporate taxable income and deposited in the Hazardous Substance Superfund Trust Fund.—Under prior law a tax equal to 0.12 percent of alternative minimum taxable income (with certain modifications) in excess of \$2 million was levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. The Administration proposes to reinstate this tax, which expired on December 31, 1995, for tax-

able years beginning after December 31, 1997 and before January 1, 2009.

Reinstate excise taxes deposited in the Hazardous Substance Superfund Trust Fund.—The excise taxes that were levied on petroleum, chemicals, and imported substances and deposited in the Hazardous Substance Superfund Trust Fund, are proposed to be reinstated for the period after the date of enactment and before October 1, 2008. These taxes expired on December 31, 1995.

Extend excise taxes on gasoline, diesel fuel, and special motor fuels.—Excise taxes are imposed on gasoline (other than aviation gasoline) at a rate of 18.4 cents per gallon, diesel fuel at a rate of 24.4 cents per gallon, and special motor fuels at varying rates. The tax rates are scheduled to fall to 4.4 cents per gallon (or comparable rates in the case of special motor fuels) on September 30, 1999. The Administration proposes to extend the current rates of tax on nonaviation gasoline, diesel fuel and special motor fuels (with a 0.1-cent-per-gallon reduction, reflecting the expiration of the LUST Trust Fund tax on April 1, 2005).

Convert excise taxes deposited in the Airport and Airway Trust Fund to cost-based user fees assessed for Federal Aviation Administration (FAA) services.—Beginning in 2000, the excise taxes that are levied on domestic air passenger tickets and flight segments, international departures and arrivals, domestic air cargo, and aviation fuels are proposed to be phased out over a five-year period, and replaced with more efficient, cost-based user fees charged for FAA services. As part of a continuing effort to create a more business-like FAA, the Administration will propose legislation by which the FAA would be entirely funded by cost-based user fees by 2003.

Receipts from tobacco legislation.—The Administration includes receipts from tobacco legislation in the 1999 budget. These receipts, which total approximately \$65 billion for the five years 1999 through 2003, would support tobacco-related public health and other activities at the State and Federal level.

Assess fees for examination of bank holding companies and State-chartered member banks (receipt effect).—The Administration proposes to require the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) to assess fees for the examination of bank holding companies and State-chartered banks. The Federal Reserve currently funds the costs of such examinations from earnings; therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, will increase by the amount of the fees.

Transfer retirees and certain active employees of the FDIC and the Board of Governors of the Federal Reserve to the Federal Employee Health

Benefits Program (FEHBP) (receipt effect).—The Administration supports the transfer of health coverage for retirees and certain active employees of the FDIC and the Board of Governors of the Federal Reserve, who are now covered by in-house health care plans, to the FEHBP administered by the Office of Personnel Management (OPM). The current plans are becoming more expensive because of the small size and age of the insured group. FEHBP coverage would be more cost effective. This proposal will reduce the administrative costs of the Federal Reserve, thereby increasing deposits of earnings by the Federal Reserve, which are classified as governmental receipts.

Repeal Federal Employees Retirement System (FERS) open season (receipt effect).—The Administration proposes, in a supplemental, to repeal section 642 of the Treasury and General Government App-

ropriation Act, 1998. That section provides an “open season” from July 1, 1998 through December 31, 1998 during which time Federal and Postal Service employees covered by the Civil Service Retirement System (CSRS) could switch to FERS. Repealing section 642 would increase employee payments to the Civil Service Retirement and Disability Fund.

Create solvency incentive for State Unemployment Trust Fund accounts.—The Administration proposes to create an incentive for States to improve the solvency of their State accounts in the Federal Unemployment Trust Fund. This is intended to improve the ability of States to continue paying benefits in the event of a recession. The incentive consists of tying a portion of the projected distributions to the States under the Reed Act to demonstrated improvements in solvency.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In billions of dollars)

	Estimate						
	1998	1999	2000	2001	2002	2003	1999–2003
Provide tax relief and extend expiring provisions:							
Make child care more affordable:							
Increase and simplify child and dependent care tax credit		-0.3	-1.3	-1.1	-1.2	-1.2	-5.1
Establish tax credit for employer-provided child care		-*	-0.1	-0.1	-0.1	-0.1	-0.5
Subtotal, make child care more affordable		-0.3	-1.3	-1.3	-1.3	-1.4	-5.6
Promote energy efficiency and improve the environment:							
Provide tax credit for energy-efficient building equipment		-0.1	-0.2	-0.3	-0.3	-0.4	-1.4
Provide tax credit for purchase of new energy-efficient homes		-*	-*	-*	-0.1	-0.1	-0.2
Provide tax credit for high-fuel-economy vehicles				-0.1	-0.2	-0.4	-0.7
Equalize treatment of parking and transit benefits		-*	-*	-*	-*	-*	-0.1
Provide investment tax credit for CHP systems	*	-0.3	-0.3	-0.1	-0.1	-0.2	-0.9
Provide tax credit for replacement of certain circuitbreaker equipment		-*	-*	-*	-*	-*	-*
Provide tax credit for certain PFC and HFC recycling equipment		-*	-*	-*	-*	-*	-*
Provide tax credit for rooftop solar equipment		-*	-*	-*	-*	-*	-0.1
Extend wind and biomass tax credit		-*	-*	-*	-0.1	-0.1	-0.2
Subtotal, promote energy efficiency and improve the environment	*	-0.4	-0.6	-0.6	-0.8	-1.2	-3.6
Promote expanded retirement savings	-*	-0.1	-0.2	-0.2	-0.2	-0.2	-0.9
Expand education incentives:							
Provide incentives for public school construction		-0.2	-0.9	-1.3	-1.3	-1.3	-5.0
Extend and expand exclusion for employer-provided educational assistance	-*	-0.2	-0.3	-0.4	-0.1		-1.0
Eliminate tax when forgiving student loans subject to income contingent repayment							
Subtotal, expand education incentives	-*	-0.4	-1.2	-1.7	-1.4	-1.3	-6.0
Increase low-income housing tax credit per capita cap		-*	-0.2	-0.3	-0.4	-0.6	-1.6
Extend expiring provisions:							
Extend work opportunity tax credit	-*	-0.2	-0.3	-0.2	-0.1	-*	-0.8
Extend welfare-to-work tax credit		-*	-0.1	-0.1	-*	-*	-0.2
Extend R&E tax credit	-0.4	-0.8	-0.6	-0.3	-0.1	-*	-1.8
Extend deduction provided for contributions of appreciated stock to private foundations		-*	-*				-0.1
Make permanent the expensing of brownfields remediation costs				-0.1	-0.2	-0.2	-0.5
Subtotal, extend expiring provisions	-0.4	-1.1	-1.0	-0.6	-0.4	-0.3	-3.4
Modify international trade provisions:							
Extend GSP and modify other trade provisions ¹		-0.5	-0.5	-0.5	-*	-*	-1.5
Extend and modify Puerto Rico economic-activity tax credit		-*	-0.1	-0.1	-0.2	-0.2	-0.6
Levy tariff on certain textiles and apparel products produced in the CNMI ¹			0.2	0.2	0.2	0.2	0.7
Expand Virgin Island tariff credits ¹			-*	-*	-*	-*	-*
Subtotal, modify international trade provisions ¹		-0.6	-0.4	-0.4	*	-*	-1.4

Table 3-3. EFFECT OF PROPOSALS ON RECEIPTS—Continued
(In billions of dollars)

	Estimate						
	1998	1999	2000	2001	2002	2003	1999-2003
Provide other tax incentives:							
Expand tax incentives for SSBICs	—*	—*	—*	—*	—*	—*	—*
Accelerate and expand incentives available to two new empowerment zones	—*	—*	—*	—*	—*	—*	—0.1
Make first \$2,000 of severance pay exempt from income tax		—*	—0.2	—0.2	—0.2	—0.2	—0.8
Subtotal, provide other tax incentives	—*	—0.1	—0.2	—0.2	—0.2	—0.2	—0.8
Simplify the tax laws	—*	—0.1	—0.1	—0.1	—0.1	—0.1	—0.6
Enhance taxpayers' rights	—*	—*	—*	—*	—0.1	—0.1	—0.2
Subtotal, provide tax relief and extend expiring provisions¹	—0.5	—3.2	—5.1	—5.5	—5.0	—5.4	—24.2
Eliminate unwarranted benefits and adopt other revenue measures:							
Defer deduction for interest and OID on convertible debt	*	*	*	*	*	0.1	0.2
Eliminate dividends-received deduction for certain preferred stock	*	*	*	*	*	0.1	0.2
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands		0.1	0.1	0.1	0.1	0.1	0.5
Repeal tax-free conversions of large C corporations to S corporations		*	*	*	*	0.1	0.1
Replace sales-source rules with activity-based rules		0.6	1.4	1.5	1.5	1.6	6.6
Modify rules relating to foreign oil and gas extraction income		*	0.1	0.1	0.1	0.1	0.4
Repeal lower-of-cost-or-market inventory accounting method		*	0.4	0.5	0.4	0.1	1.6
Increase penalties for failure to file correct information returns		*	*	*	*	*	0.1
Tighten the substantial understatement penalty for large corporations			*	*	*	*	0.1
Repeal exemption for withholding on gambling winnings from bingo and keno in excess of \$5,000		*	*	*	*	*	*
Reinstate oil spill excise tax ¹	*	0.2	0.2	0.2	0.2	0.3	1.2
Modify Federal Unemployment Act provisions							
Extend pro-rata disallowance of tax-exempt interest expense that applies to banks to all financial intermediaries	*	*	*	*	*	*	0.1
Increase proration percentage for P&C insurance companies	—*	*	0.1	0.1	0.1	0.1	0.4
Preclude certain taxpayers from prematurely claiming losses from receivables		0.4	0.1	0.1	0.1	0.1	0.7
Restrict special net operating loss carryback rules for specified liability losses		*	*	*	*	*	0.1
Freeze grandfather status of stapled (or "paired-share") REITs	*	*	*	*	*	*	0.1
Restrict impermissible business indirectly conducted by REITs		*	*	*	*	*	*
Modify treatment of closely held REITs		*	*	*	*	*	0.1
Modify depreciation method for tax-exempt use property		*	*	*	*	*	0.1
Impose excise tax on purchase of structured settlements ¹		*	*	*	*	*	0.1
Clarify and expand math-error procedures		*	0.1	0.1	0.1	0.1	0.3
Clarify the meaning of "subject to" liabilities under section 357(c)	*	*	*	*	*	*	0.1
Simplify foster child definition under EITC			*	*	*	*	*
Clarify tie-breaker rule under EITC		*	*	*	*	*	*
Eliminate non-business valuation discounts			0.2	0.2	0.3	0.3	1.0
Eliminate "Crummey" rule			*	*	*	*	0.1
Eliminate gift tax exemption for personal residence trusts		—*	—*	*	*	*	*
Include QTIP trust assets in surviving spouse's estate			*	*	*	*	*
Apply 7.7% capitalization rate to credit life insurance premiums		*	*	*	*	*	0.1
Modify corporate-owned life insurance (COLI) rules	0.3	0.4	0.4	0.4	0.5	0.5	2.2
Modify reserve rules for annuity contracts		1.8	0.7	0.8	0.6	0.7	4.6
Tax certain exchanges of insurance contracts and reallocations of assets within variable insurance contracts	*	*	0.1	0.2	0.3	0.4	0.9
Reduce "investment in the contract" for mortality and expense charges on certain insurance contracts		*	*	*	*	0.1	0.1
Amend 80/20 company rules	*	*	*	*	0.1	0.1	0.2
Prescribe regulatory directive to address tax avoidance involving foreign built-in losses		*	0.1	0.1	0.1	0.1	0.2
Prescribe regulatory directive to address tax avoidance through use of hybrids		*	0.1	0.1	*	*	0.2
Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office	*	*	*	*	*	*	*
Stop abuse of CFC exception to ownership requirements		*	*	*	*	*	*
Subtotal, eliminate unwarranted benefits and adopt other revenue measures¹	0.3	4.3	4.3	4.7	4.7	5.0	23.0
Other provisions that affect receipts:							
Reinstate environmental tax imposed on corporate taxable income ²		1.1	0.7	0.7	0.7	0.7	3.8
Reinstate Superfund excise taxes ¹	0.1	0.7	0.7	0.7	0.7	0.7	3.6
Extend excise taxes on gasoline, diesel fuel and special motor fuels ¹			0.4	0.4	0.4	0.4	1.5
Convert airport and airway trust fund taxes to a cost-based user fee system ¹			1.7	1.7	1.7	0.8	6.0
Receipts from tobacco legislation		9.8	11.8	13.3	14.5	16.1	65.5
Assess fees for examination of bank holding companies and State-chartered member banks (receipt effect) ¹		0.1	0.1	0.1	0.1	0.1	0.4
Transfer retirees and certain active employees of the FDIC and Board of Governors of the Federal Reserve to FEHBP (receipt effect)		*	*	*	*	*	*

Table 3-3. EFFECT OF PROPOSALS ON RECEIPTS—Continued
(In billions of dollars)

	Estimate						
	1998	1999	2000	2001	2002	2003	1999-2003
Repeal FERS open season (receipt effect)	*	0.2	0.2	0.2	0.2	0.2	1.0
Create solvency incentive for State unemployment trust fund accounts ¹	0.4	0.4	0.8
Subtotal, other provisions that affect receipts¹	0.1	11.8	15.5	17.4	18.8	19.1	82.6
Total effect of proposals¹	-0.1	12.9	14.7	16.7	18.5	18.7	81.5

* \$50 million or less.

¹ Net of income offsets.

² Net of deductibility for income tax purposes.

Table 3-4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1997 actual	1998 estimate	1999 estimate	2000 estimate	2001 estimate	2002 estimate	2003 estimate
Individual income taxes (Federal funds):							
Existing law	737,466	767,874	792,739	808,471	837,867	881,538	919,874
Proposed Legislation (PAYGO)		-106	-1,285	-3,907	-4,503	-4,485	-4,341
Total individual income taxes	737,466	767,768	791,454	804,564	833,364	877,053	915,533
Corporation income taxes:							
Federal funds:							
Existing law	182,289	190,944	194,412	200,388	206,033	211,741	217,427
Proposed Legislation (PAYGO)		-102	2,210	1,671	2,255	2,080	2,145
Total Federal funds corporation income taxes	182,289	190,842	196,622	202,059	208,288	213,821	219,572
Trust funds:							
Hazardous substance superfund	4						
Proposed Legislation (PAYGO)			1,343	870	863	863	864
Total corporation income taxes	182,293	190,842	197,965	202,929	209,151	214,684	220,436
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	336,729	358,949	374,612	388,988	404,101	422,586	441,648
Disability insurance (Off-budget)	55,261	57,042	59,516	64,915	68,630	71,756	74,995
Hospital insurance	110,710	118,029	122,626	128,479	134,081	140,430	146,899
Railroad retirement:							
Social Security equivalent account	1,611	1,611	1,619	1,624	1,636	1,648	1,651
Rail pension and supplemental annuity	2,440	2,493	2,495	2,507	2,521	2,536	2,548
Total employment and general retirement	506,751	538,124	560,868	586,513	610,969	638,956	667,741
On-budget	114,761	122,133	126,740	132,610	138,238	144,614	151,098
Off-budget	391,990	415,991	434,128	453,903	472,731	494,342	516,643
Unemployment insurance:							
Deposits by States ¹	22,071	22,658	24,175	25,456	26,319	27,175	28,075
Proposed Legislation (PAYGO)					450	490	
Federal unemployment receipts ¹	6,103	6,196	6,254	6,345	6,359	6,449	6,495
Railroad unemployment receipts ¹	28	68	104	97	78	78	95
Total unemployment insurance	28,202	28,922	30,533	31,898	33,206	34,192	34,665
Other retirement:							
Federal employees' retirement—employee share	4,344	4,245	4,247	4,361	4,601	4,382	3,838
Proposed Legislation (non-PAYGO)		6	167	201	212	224	232
Non-Federal employees retirement ²	74	77	71	65	60	54	44
Total other retirement	4,418	4,328	4,485	4,627	4,873	4,660	4,114
Total social insurance and retirement receipts	539,371	571,374	595,886	623,038	649,048	677,808	706,520
On-budget	147,381	155,383	161,758	169,135	176,317	183,466	189,877
Off-budget	391,990	415,991	434,128	453,903	472,731	494,342	516,643
Excise taxes:							
Federal funds:							
Alcohol taxes	7,257	7,251	7,254	7,250	7,236	7,223	7,211
Tobacco taxes	5,873	5,926	5,900	7,495	8,083	8,686	8,895
Transportation fuels tax	7,107	442	682	88	89	90	92
Telephone and teletype services	4,543	4,864	5,129	5,394	5,691	6,015	6,356
Ozone depleting chemicals and products	130	55	30	10			
Other Federal fund excise taxes	2,921	1,529	1,613	1,430	1,373	1,338	1,263
Proposed Legislation (PAYGO)			12	515	531	550	568
Total Federal fund excise taxes	27,831	20,067	20,620	22,182	23,003	23,902	24,385
Trust funds:							
Highway	23,867	26,063	38,614	33,201	33,812	34,448	35,107
Airport and airway	4,007	7,975	10,038	9,273	9,793	10,525	11,095

Table 3-4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1997 actual	1998 estimate	1999 estimate	2000 estimate	2001 estimate	2002 estimate	2003 estimate
Proposed Legislation (PAYGO)				2,267	2,267	2,267	1,133
Aquatic resources	316	281	379	339	345	353	359
Black lung disability insurance	614	640	662	684	703	718	733
Inland waterway	96	116	120	123	126	131	135
Hazardous substance superfund	71						
Proposed Legislation (PAYGO)		101	934	949	960	976	990
Oil spill liability	1						
Proposed Legislation (PAYGO)		46	317	321	325	330	336
Vaccine injury compensation	123	111	111	111	111	111	111
Leaking underground storage tank	-2	140	214	182	186	189	193
Total trust funds excise taxes	29,093	35,473	51,389	47,450	48,628	50,048	50,192
Total excise taxes	56,924	55,540	72,009	69,632	71,631	73,950	74,577
Estate and gift taxes:							
Existing law	19,845	20,436	20,542	21,389	22,353	24,156	25,300
Proposed Legislation (PAYGO)			-1	253	266	291	319
Total estate and gift taxes	19,845	20,436	20,541	21,642	22,619	24,447	25,619
Customs duties:							
Federal funds	17,131	17,515	17,928	18,890	19,691	21,053	22,655
Proposed Legislation (PAYGO)			-658	-323	-333	225	224
Trust funds	797	848	905	964	1,029	1,097	1,171
Total customs duties	17,928	18,363	18,175	19,531	20,387	22,375	24,050
MISCELLANEOUS RECEIPTS:³							
Miscellaneous taxes	107	113	115	118	120	123	126
Receipts from tobacco legislation (PAYGO)			9,795	11,787	13,283	14,544	16,085
United Mine Workers of America combined benefit fund	339	323	282	273	266	258	251
Deposit of earnings, Federal Reserve System	19,636	24,991	24,544	24,950	25,501	26,121	26,786
Proposed Legislation (PAYGO)			98	102	106	111	116
Defense cooperation		12	6				
Fees for permits and regulatory and judicial services	3,222	5,778	9,605	12,888	15,097	15,843	16,074
Fines, penalties, and forfeitures	1,994	2,140	2,100	1,991	1,899	1,877	1,877
Gifts and contributions	184	194	177	147	126	121	123
Refunds and recoveries	-17	-16	-16	-16	-16	-16	-16
Total miscellaneous receipts	25,465	33,535	46,706	52,240	56,382	58,982	61,422
Total budget receipts	1,579,292	1,657,858	1,742,736	1,793,576	1,862,582	1,949,299	2,028,157
On-budget	1,187,302	1,241,867	1,308,608	1,339,673	1,389,851	1,454,957	1,511,514
Off-budget	391,990	415,991	434,128	453,903	472,731	494,342	516,643
MEMORANDUM							
Federal funds	1,010,315	1,050,472	1,093,576	1,121,674	1,163,467	1,219,949	1,269,885
Trust funds	365,248	383,120	412,247	423,654	441,874	461,621	480,193
Interfund transactions	-188,261	-191,725	-197,215	-205,655	-215,490	-226,613	-238,564
Total on-budget	1,187,302	1,241,867	1,308,608	1,339,673	1,389,851	1,454,957	1,511,514
Off-budget (trust funds)	391,990	415,991	434,128	453,903	472,731	494,342	516,643
Total	1,579,292	1,657,858	1,742,736	1,793,576	1,862,582	1,949,299	2,028,157

¹ Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and administrative costs of the program for the railroads.

² Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

³ Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are 1997: \$746 million; 1998: \$740 million; 1999: \$683 million; 2000: \$649 million; 2001: \$639 million; 2002: \$647 million; and 2003: \$662 million.

