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 2000 are estimated to be $1,883.0 billion, an increase of $76.7 billion or 4.2 percent relative to 1999. 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 3.6 percent between 2000 and 2004, rising to $2,165.5 billion.

As a share of GDP, receipts are projected to decline from 20.6 percent in 1999 to 20.0 percent in 2004.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1998 actual	Estimate					
		1999	2000	2001	2002	2003	2004
Individual income taxes	828.6	868.9	899.7	912.5	942.8	970.7	1,017.7
Corporation income taxes	188.7	182.2	189.4	196.6	203.4	212.3	221.5
Social insurance and retirement receipts	571.8	608.8	636.5	660.3	686.3	712.0	739.2
(On-budget)	(156.0)	(164.8)	(171.2)	(177.7)	(184.6)	(189.8)	(196.3)
(Off-budget)	(415.8)	(444.0)	(465.3)	(482.6)	(501.8)	(522.2)	(542.9)
Excise taxes	57.7	68.1	69.9	70.8	72.3	73.8	75.4
Estate and gift taxes	24.1	25.9	27.0	28.4	30.5	31.6	33.9
Customs duties	18.3	17.7	18.4	20.0	21.4	23.0	24.9
Miscellaneous receipts	32.7	34.7	42.1	44.9	50.3	51.7	53.0
Total receipts	**1,721.8**	**1,806.3**	**1,883.0**	**1,933.3**	**2,007.1**	**2,075.0**	**2,165.5**
(On-budget)	*(1,306.0)*	*(1,362.3)*	*(1,417.7)*	*(1,450.7)*	*(1,505.3)*	*(1,552.8)*	*(1,622.6)*
(Off-budget)	*(415.8)*	*(444.0)*	*(465.3)*	*(482.6)*	*(501.8)*	*(522.2)*	*(542.9)*

Table 3–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1999	2000	2001	2002	2003	2004
Receipts under tax rates and structure in effect January 1, 1999 [1]	1,806.6	1,870.1	1,918.8	1,988.3	2,052.8	2,139.5
Social security (OASDI) taxable earnings base increases:						
$72,600 to $76,200 on Jan. 1, 2000	....	1.7	4.4	4.8	5.2	5.7
$76,200 to $79,200 on Jan. 1, 2001	....	....	1.4	3.6	3.9	4.3
$79,200 to $81,900 on Jan. 1, 2002	....	....	....	1.3	3.2	3.5
$81,900 to $84,600 on Jan. 1, 2003	....	....	....	....	1.3	3.2
$84,600 to $87,000 on Jan. 1, 2004	....	....	....	....	....	1.1
Proposals [2]	–0.3	11.2	8.7	9.1	8.7	8.2
Total, receipts under existing and proposed legislation	1,806.3	1,883.0	1,933.3	2,007.1	2,075.0	2,165.5

[1] These estimates assume a social security taxable earnings base of $72,600 through 2004.
[2] Net of income offsets.

ENACTED LEGISLATION

Several laws were enacted in 1998 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

Transportation Equity Act for the 21st Century.—This Act, which was signed by President Clinton on June 9, 1998, represents a significant achievement in the Administration's efforts to meet our country's transportation needs in the next century. By building on the initiatives established in the Intermodal Surface Transportation Efficiency Act of 1991, this Act combines the continuation and improvement of current programs with new initiatives to meet the challenges of improving safety as traffic continues to increase, protecting and enhancing communities and the natural environment as we provide transportation, and advancing America's economic growth and competitiveness domestically and internationally through efficient and flexible transportation. The major provisions of the Act affecting receipts are described below:

Extend highway-related taxes.—The excise taxes levied on gasoline (other than aviation gasoline), diesel fuel, and special motor fuels, which were scheduled to fall to 4.4 cents per gallon (or comparable rates in the case of special motor fuels) after September 30, 1999, are extended at their prior law rates (with a 0.1-cent-per-gallon reduction, reflecting the expiration of the LUST Trust Fund tax, on April 1, 2005) through September 30, 2005. Highway Trust Fund excise taxes on heavy truck tires and the sale and the use of heavy trucks, which were scheduled to expire on September 30, 1999, are extended at their prior law rates through September 30, 2005.

Extend and modify ethanol tax benefit.—Under prior law, ethanol fuels were eligible for a tax benefit equal to 54 cents per gallon, which could be claimed through reduced excise taxes paid on motor fuels, as well as through income tax credits. The authority to claim the credit against income taxes was scheduled to expire after December 31, 2000 and the authority to claim the benefit through reduced excise taxes was scheduled to expire after September 30, 2000. This Act extends the authority to claim the credit against income taxes through December 31, 2007; the authority to claim the benefit through reduced excise taxes is extended through September 30, 2007. In addition, the tax benefit is reduced to 53 cents per gallon effective January 1, 2001, 52 cents per gallon effective January 1, 2003, and 51 cents per gallon effective January 1, 2005.

Repeal excise tax on railroad diesel fuel.—The 1.25 cents-per-gallon tax on railroad diesel fuel, which was scheduled to expire after September 30, 1999, is repealed effective November 1, 1998.

Extend and increase transfers of motorboat and small engine fuels taxes to the Aquatic Resources Trust Fund.—Under prior law, 11.5 cents per gallon of the 18.4-cents-per-gallon tax on gasoline and special motor fuels used in motorboats and small engines was transferred to the Aquatic Resources Trust Fund. This Act extends the transfer, which was scheduled to expire after September 30, 1998, through September 30, 2005. In addition, the amount transferred is increased to 13.0 cents per gallon effective October 1, 2001 and to 13.5 cents per gallon effective October 1, 2003.

Modify tax treatment of transportation benefits.—Under prior law, up to $175 per month (for 1998) of employer-provided parking benefits were excludable from an employee's gross income, regardless of whether the benefits were offered in addition to, or in lieu of, any compensation otherwise payable to the employee. In contrast, up to $65 per month (for 1998) of employer-provided transit and vanpool benefits were excludable from an employee's gross income, but only if the benefits were provided in addition to, and not in lieu of, any compensation otherwise payable to the employee. The dollar limits for both benefits were indexed annually for inflation. Under this Act, effective for taxable years beginning after December 31, 1997, employers are allowed to offer employees the option of electing cash compensation in lieu of any qualified transportation benefit, or a combination of any of these benefits. In addition, effective for taxable years beginning after December 31, 2001, the exclusion for transit and vanpool benefits is increased to $100 per month, with annual indexing thereafter. The Act also eliminates the 1999 inflation adjustment to the dollar limit on transportation benefits.

Simplify motor fuels tax refund procedures.—Under prior law, gasoline and diesel fuel excise tax refunds were administered separately, subject to separate quarterly minimum filing thresholds. Effective for claims filed after September 30, 1998, refunds of gasoline and diesel fuel excise taxes may be aggregated, and a claim may be filed once a single $750 minimum is reached (determined on a year-to-date basis).

Internal Revenue Service Restructuring and Reform Act of 1998.—This Act, which was signed by President Clinton on July 22, 1998, sets in motion the most comprehensive overhaul of IRS's internal operations in more than four decades, puts new emphasis on electronic filing, and puts in place new rights and protections for taxpayers when dealing with the IRS. The major provisions of the Act are described below.

Reorganization of Structure and Management of the IRS

Reorganize and revise the mission of the IRS.—The IRS Commissioner is required to replace the existing three-tier geographic structure of the IRS (national, regional, district) with organizational units serving particular groups of taxpayers. The IRS is also required to review and restate its mission to place greater emphasis on serving the public and meeting taxpayer's needs. An independent Appeals function must also be established within the IRS.

Establish IRS Oversight Board.—A nine-member IRS Oversight Board is established within the Treasury Department. The responsibilities of the Board include the following: (1) Review and approval of IRS strategic plans. (2) Review operational functions of the IRS. (3) Recommend candidates for IRS Commissioner and review the selection, evaluation, and compensation of senior managers. (4) Review and approve plans for any major future reorganization of the IRS. (5) Review and approve the Commissioner's IRS budget request to be submitted to the Department of the Treasury. This budget request also will be submitted to Congress concurrent with the President's annual budget request for the IRS. (6) Ensure the proper treatment of taxpayers by IRS employees.

Modify appointment and duties of IRS Commissioner.—The IRS Commissioner is nominated by the President and confirmed by the Senate, as under prior law. However, under this Act the Commissioner is appointed to a five-year term and is required to have a demonstrated ability in management.

Rename and expand the authority of the Taxpayer Advocate.—The Taxpayer Advocate position is renamed the National Taxpayer Advocate. The individual appointed to this position cannot have been an officer or employee of the IRS during the two-year period ending with the individual's appointment, and must agree not to accept employment with the IRS (outside of the Taxpayer Advocate organization) during the five-year period beginning with the date the individual ceases to be the National Taxpayer Advocate. The person in this position is responsible for appointing at least one local taxpayer advocate for each State and has expanded authority to issue taxpayer assistance orders (orders that may be issued when a taxpayer is suffering or is about to suffer from a significant hardship as a result of the manner in which the laws are being administered by IRS). In determining whether to issue a taxpayer assistance order, the National Taxpayer Advocate is 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.

Establish position of Treasury Inspector General for Tax Administration.—The Office of the IRS Chief Inspector is to be terminated and the powers of the IRS Chief Inspector are to be transferred to the new position of Treasury Inspector General (IG) for Tax Administration. The new IG for Tax is given all the powers under the Inspector General Act for matters relating to the IRS, may conduct an audit or investigation of the IRS upon the written request of the Commissioner or the Board, and is required to establish a toll-free telephone number for taxpayers to confidentially register complaints of misconduct by IRS employees.

Prohibit Executive Branch influence over taxpayer audits.—The President, Vice President, and most Cabinet officers, other than the Attorney General, are prohibited from requesting, directly or indirectly, an officer or employee of the IRS to either conduct or terminate an audit or investigation of any particular taxpayer with respect to the tax liability of the taxpayer.

Improve personnel flexibilities.—The modification of employee personnel rules applicable to the IRS will help the IRS recruit and retain the private sector expertise it needs to fill critical technical and senior management positions and will provide important tools that will enable the IRS to accomplish its restructuring efforts.

Electronic Filing

The Act states that it is the policy of the Congress to promote paperless filing, with the long-range goal of having at least 80 percent of all tax returns filed electronically by 2007. Toward that end, the IRS is required to develop a strategic plan concerning electronic filing within 180 days after July 22, 1998, to establish an "electronic commerce advisory group," and to report periodically to Congress on progress toward meeting the 80 percent goal. The Act also requires that the IRS develop procedures to: (1) accept digital or other electronic signatures, (2) accept all forms electronically for periods beginning after December 31, 1999, to the extent practicable, (3) acknowledge electronic filing in a manner similar to certified or registered mail, (4) provide forms and other IRS documents on the Internet, (5) electronically authorize disclosure of return information to the return preparer, (6) allow taxpayers on-line access to account information, subject to suitable safeguards, and (7) implement a fully return-free tax system for certain taxpayers for taxable years beginning after 2007. In addition, the deadline for filing information returns with the IRS is extended from February 28 until March 31 of the year following the tax year to which the return relates, for returns filed electronically. The Secretary of the Treasury is required to study and report to Congress by June 30, 1999, the effect of similarly extending the deadline for providing taxpayers with copies of information returns from January 31 to February 15 of the year following the tax year to which the return relates.

Congressional Accountability for the IRS

The Act consolidates Congressional oversight of the IRS by: (1) expanding the duties of the Joint Committee on Taxation (JCT) to include review and approval of all requests for General Accounting Office (GAO) investigations of the IRS (other than those from a committee chairperson or ranking member, those required by law, and those self-initiated by GAO); (2) requiring one annual joint review of the annual filing season and the progress of the IRS in meeting its objectives under the strategic and business plans, in improving taxpayer service and compliance, and on technology modernization; (3) stating that it is the sense of the Congress that IRS should place a high priority on resolving the century date change; (4) stating that it is the sense of the Congress that the IRS provide the Congress with an independent view of tax administration and that the tax-writing committees should hear from front-line technical experts at the IRS during the legislative process with respect to the administrability of pending amendments to the Internal Revenue Code; and (4) requiring that the IRS report to the House Committee on Ways and Means and the Senate Committee on Finance by March 1 of each year regarding sources of complexity in the administration of the Federal tax laws.

Taxpayer Protection and Rights

Burden of Proof

Shift the burden of proof to the IRS in certain circumstances.—In any court proceeding with respect to a factual issue (applicable to income, estate, gift and generation-skipping transfer taxes), the burden of proof is shifted to the IRS if the taxpayer introduces credible evidence relevant to ascertaining his/her tax liability. The taxpayer has the burden of proving that the following conditions, which are necessary prerequisites to establishing that the burden of proof is on the IRS, have been met: (1) All items at issue must be substantiated by the taxpayer in accordance with the Internal Revenue Code and relevant regulations. (2) All records required by the Internal Revenue Code and regulations must be maintained by the taxpayer. (3) The taxpayer must cooperate with the IRS regarding reasonable requests for witnesses, information, documents, meetings and interviews. (4) Taxpayers other than individuals or estates must meet the net worth limitations (no more than $7 million) that apply to awarding attorney's fees. This provision applies to court proceedings arising in connection with examinations commencing after July 22, 1998, or if there is no examination, to court proceedings arising in connection with taxable periods or events beginning or occurring after July 22, 1998.

Proceedings by Taxpayers

Expand authority to award costs and certain 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 attorney's fees awarded cannot exceed a statutorily limited rate. Under prior law, taxpayers who were represented pro bono, and thus bore no actual attorney's fees and costs, could not recover such amounts. This Act allows the awarding 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 statutorily limited rate is increased from $110 per hour (indexed for inflation) to $125 per hour (indexed for inflation). The Act also clarifies that an award of attorney's fees from the United States is permitted in actions for civil damages for unauthorized inspection or disclosure of taxpayer returns and return information only when the defendant is the United States and the plaintiff is a prevailing party. Other defendants (such as State employees or contractors) may be liable for attorney's fees and costs in cases where the United States is not a party, whenever they are found to have made a wrongful disclosure. Finally, the Act provides that attorney's fees and costs may be recovered if the taxpayer makes a "qualified offer" to the IRS, the IRS rejects the offer, and the ultimate resolution of the case is less favorable to the IRS than the rejected "qualified offer." These provisions are effective for costs incurred and services performed after January 18, 1999.

Expand civil damages for collection actions.—Taxpayers have the 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. Under prior law, actions could only be brought by the injured taxpayer (not by an injured third party) and could not be brought against any officer or employee of the IRS who negligently disregarded any provision of the Internal Revenue Code or any regulation thereunder. In addition, suit could not be brought against any officer or employee of the IRS who willfully violated the automatic stay or discharge provisions of the Bankruptcy Code. Effective for actions occurring after July 22, 1998, this Act expands the ability to sue for civil damages as follows: (1) A taxpayer may sue for up to $100,000 in civil damages caused by an officer or employee of the IRS who negligently disregards provisions of the Internal Revenue Code or any regulation thereunder in connection with the collection of Federal tax from the taxpayer. (2) A taxpayer may sue for up to $1 million in civil damages caused by an officer or employee of the IRS who willfully violates provisions of the Bankruptcy Code relating to automatic stays or discharges. (3) Injured third parties are permitted to sue for civil damages for unauthorized collection actions.

Increase Tax Court's "small case" limit.—Taxpayers may choose to contest many tax disputes in the Tax Court. Under prior law, special "small case procedures" applied to disputes involving $10,000 or less, if the taxpayer chose to utilize these procedures (and the Tax Court concurred). This Act increases the cap for small case treatment in the Tax Court from $10,000 to $50,000, effective for proceedings commencing after July 22, 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. Effective for claims filed after July 22, 1998, this Act grants the courts refund jurisdiction to determine the correct liability of such an estate, so long as the estate has properly elected to pay in installments, all payments are current, the payments due have not been accelerated, there are no suits for declaratory judgment pending, and there are no outstanding deficiency notices against the estate. The Act also includes a number of technical and conforming amendments to implement this change.

Modify appeals process with regard to adverse determinations regarding the tax-exempt status of certain bond issues.—Interest on debt incurred by States or local governments generally is excluded from gross income if the proceeds of the borrowing are used to carry out governmental functions of those entities and the debt is repaid with governmental funds. A jurisdiction that seeks to issue bonds can request a ruling from the IRS regarding the eligibility of such bonds for tax-exemption. The prospective issuer can challenge the IRS's determination (or failure to make a timely determination) in a declaratory judgment proceeding in the Tax Court. Under prior law there was no mechanism that explicitly allowed tax-exempt bond issuers examined by the IRS to appeal adverse examination determinations to the Appeals Division of the IRS as a matter of right. This Act directs the IRS to modify its administrative procedures to allow tax-exempt bond issuers examined by the IRS to appeal adverse examination determinations to the Appeals Division as a matter of right, effective July 22, 1998. These appeals must be heard by senior appeals officers having experience in resolving complex cases.

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. This Act creates administrative and judicial remedies for a third party subject to an erroneous tax lien, effective July 22, 1998. Under this procedure, the owner of property (other than the taxpayer) can obtain a certificate discharging property from the Federal tax lien as a matter of right, provided certain conditions are met. The certificate of discharge enables the property owner to sell the property free and clear of the Federal tax lien in all circumstances. The Act also establishes a judicial cause of action for persons challenging a Federal tax lien.

Relief for Innocent Spouses and Persons with Disabilities

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. Under prior law, relief from liability was available for "innocent spouses" in certain circumstances, but the conditions were frequently hard to meet and the Tax Court did not have jurisdiction to review all denials of innocent spouse relief. This Act generally makes innocent spouse status easier to obtain by eliminating certain applicable dollar thresholds for understatements of tax; requiring that the understatement of tax be attributable to an erroneous item of the other spouse, rather than a grossly erroneous item as required under prior law; giving the IRS the discretion to provide equitable relief; and providing the Tax Court with jurisdiction to review the IRS's denial of innocent spouse relief and to order appropriate relief. The Act also modifies the innocent spouse provision to permit a spouse who is divorced, legally separated, or living apart for 12 months, to elect to limit his/her liability for unpaid taxes on a joint return to his/her separate liability amount. Unless the electing taxpayer had knowledge, when the return was signed, that an item on the return was incorrect, such an electing taxpayer essentially is responsible for any deficiency only to the extent his/her own items contributed to the deficiency. The separate liability election must be made no later than two years after the date on which collection activities have begun with respect to the individual seeking the relief. Except in limited cases, the IRS is not permitted to collect the tax until the Tax Court case is final (although the running of the statute of limitations will be suspended while the Tax Court case is pending). Finally, the Act requires the IRS to develop a separate form with instructions for taxpayers to use in applying for innocent spouse relief by January 18, 1999. These changes apply to liability for tax arising after July 22, 1998, as well as to any liability arising on or before that date that remains unpaid on that date.

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, this Act permits "equitable tolling" of the limitation period on claims for refund for the period of time during which an individual taxpayer is unable to manage his/her financial affairs because of a medically determined physical or mental disability that can be expected to result in death or to last for a continuous period of not less than 12 months. Tolling does 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 provision applies to periods of disability before, on, or after July 22, 1998, but does not apply to any claim for refund or credit that (without regard to the provision) is barred by the operation of any law, including the statute of limitation, as of July 22, 1998.

Provisions Relating to Interest and Penalties

Allow "global" interest netting of underpayments and overpayments of tax.—The rate of interest charged taxpayers on their tax underpayments differs from the rate paid to taxpayers on overpayments. Under prior law, the IRS ameliorated the effect of this interest rate differential by "netting" offsetting underpayments and overpayments in some situations (that is, applying a net interest rate of zero on equivalent amounts of overpayment and underpayment); however, there was no authority to net when either the overpayment or the underpayment had been satisfied already ("global" netting). This Act permits global interest netting for all taxes (not just income taxes), effective for interest applicable to periods beginning after July 22, 1998. It also applies to interest for periods beginning before that date if: (1) as of July 22, 1998, the statute of limitations has not expired with respect to either the underpayment or overpayment; (2) the taxpayer identifies the periods of underpayment and overpayment for which the zero rate applies; and (3) on or before December 31, 1999, the taxpayer asks the Secretary of the Treasury to apply the zero rate.

Increase interest rate applicable to overpayments of tax by noncorporate taxpayers.—Under prior law, interest on overpayments of tax was payable at a rate equal to the Federal short term interest rate (AFR) plus two percentage points. Effective for interest payable on overpayments by noncorporate taxpayers after December 31, 1998, the rate is increased to the AFR plus three percentage points (the same rate applicable to underpayments of tax). The rate remains at AFR plus two percentage points for corporations.

Mitigate failure to pay penalty during installment agreements.—Taxpayers who fail to pay their taxes are subject to a penalty of 0.5 percent per month on the unpaid amount, up to a maximum of 25 percent. Under prior law, taxpayers who made installment payments pursuant to an agreement with the IRS could also be subject to the penalty. Effective for installment agreement payments made after December 31, 1999, the penalty for failure to pay taxes applicable to the unpaid amount is reduced to 0.25 percent per month.

Mitigate failure to deposit penalty.—Under prior law, deposits of payroll taxes were allocated to the earliest period for which such deposit was due. If a taxpayer missed or made an insufficient deposit for a given period, later deposits were first applied to satisfy the shortfall for the earlier period. Cascading penalties often resulted, as payments that would otherwise be sufficient to satisfy current liabilities were applied to satisfy earlier shortfalls. For deposits required to be made after January 18, 1999, this Act allows the taxpayer to designate the period to which each deposit is to be applied. The designation must be made no later than 90 days after the related IRS penalty notice is sent. For deposits required to be made after December 31, 2001, any deposit is to be applied to the most recent period to which the deposit relates, unless the taxpayer explicitly designates otherwise.

Suspend interest and certain penalties if the IRS fails to contact the taxpayer.—In general, interest and penalties accrue during the period for which taxes are unpaid, without regard to whether the taxpayer is aware that tax is due. Effective for taxable years ending after July 22, 1998 and beginning before January 1, 2004, for taxpayers who file a timely return, the accrual of penalties and interest are suspended if the IRS has not sent the taxpayer a notice of deficiency within 18 months following the date which is the later of: (1) the due date of the return (without regard to extensions) or (2) the date on which the individual taxpayer timely filed the return. The provision applies only to individuals and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. The suspension of interest and penalties continues until 21 days after the IRS sends a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability. Effective for taxable years beginning after December 31, 2003, the 18-month period is reduced to one year.

Modify procedural requirements for imposition of penalties.—Under prior law the IRS was not required to show how penalties were computed on the notice of penalty and in some cases, penalties could be imposed without supervisory approval. Effective for notices issued and penalties assessed after December 31, 2000, this Act requires that each notice imposing a penalty include the name of the penalty, the code section imposing the penalty, and a computation of the penalty. In addition, unless excepted, all non-computer-generated penalties require the specific approval of IRS management. The provision does not apply to failure-to-file penalties, failure-to-pay penalties, or to penalties for failure to pay estimated tax.

Permit personal delivery of 100-percent penalty notices.—Any person who willfully fails to collect, truthfully account for, and pay over any tax imposed by the Internal Revenue Code is liable for a penalty equal to the amount of the tax. Before the IRS may assess any such "100-percent penalty" it must mail a written preliminary notice informing the person of the proposed penalty. The mailing of such notice must precede any notice and demand for payment of the penalty by at least 60 days. Effective July 22, 1998, this Act permits personal delivery of such preliminary notices, as an alternative to delivery by mail.

Modify procedural requirements for interest charges.—Effective for all notices issued by the IRS after December 31, 2000 that include an amount of interest required to be paid by the taxpayer, a detailed computation of the interest charges and a citation of the Code section under which such interest is imposed are required.

Abate interest on underpayments of tax by taxpayers in Presidentially declared disaster areas.—Effective for disasters declared after December 31, 1997, with respect to taxable years beginning after December 31, 1997 (a provision of the Taxpayer Relief Act of 1997 had provided the same benefit to disasters declared during 1997), taxpayers located in a Presidentially declared disaster area do not have to pay interest on taxes due for the length of any extension for filing their tax returns granted by the Secretary of the Treasury.

Protections for Taxpayers Subject to Audit or Collection Activities

Establish formal procedures to insure due process in IRS collection actions.—The IRS is entitled to seize a taxpayer's property by levy to pay the taxpayer's tax liability. Effective for collections initiated after January 18, 1999, this Act establishes formal procedures designed to insure due process where the IRS seeks to collect taxes by levy. Under these procedures, the IRS is required to provide the taxpayer with a "Notice of intent to Levy" by personal delivery, by leaving it at the taxpayer's dwelling or usual place of business, or by registered or certified mail, return receipt requested, at least 30 days before the taxpayer's property is seized. During the 30-day period following issuance of the intent to levy, the taxpayer may demand a hearing before an appeals officer who has had no prior involvement with the taxpayer's case. If such a hearing is requested, no levy may occur until a determination by the appeals officer is rendered. The determination of the appeals officer may be appealed to the Tax Court or, where appropriate, the Federal district court. No seizure of a dwelling that is the principal residence of the taxpayer, the taxpayer's spouse, the taxpayer's former spouse, or minor child is allowed without prior judicial approval.

Extend confidentiality privilege to taxpayer communications with federally authorized practitioners.—The attorney-client privilege of confidentiality is extended to communications between taxpayers and individuals (in noncriminal proceedings) who are authorized under Federal law to practice before the IRS. The provision, which is effective with regard to communications made on or after July 22, 1998, does not apply to a written communication between federally authorized tax practitioners and any director, shareholder, officer, employee, agent, or representative of a corporation in connection with the promotion of any tax shelter.

Limit financial status audit techniques.—Effective July 22, 1998, the IRS is prohibited from using financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the IRS has a reasonable indication that there is a likelihood of unreported income.

Establish protections against the disclosure and improper use of computer software and source codes.—In a civil action, the IRS is prohibited from issuing a summons for any portion of any third-party tax-related computer source code unless certain requirements are satisfied. The Act also establishes a number of protections against the disclosure and improper use of trade secrets and computer software and source code that come into possession of the IRS in the course of the examination of a taxpayer's return. These protections generally are effective for summonses issued and computer software and source code acquired after July 22, 1998.

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. Effective July 22, 1998, the IRS is required 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.

Allow taxpayers to quash all third-party summonses.—Under prior law, summonses issued to "third-party recordkeepers" were subject to different procedures than other summonses: notice of the summons was required to be given to the taxpayer, and the taxpayer had an opportunity to bring a court proceeding to quash the summons, during which time the third-party recordkeeper was prohibited from complying with the summons. This Act expands the "third-party recordkeeper" procedures to apply to all summonses issued to persons other than the taxpayer. The provision is effective for summonses served after July 22, 1998.

Permit service of summonses by mail.—This Act permits the IRS to serve summonses by certified or registered mail, as an alternative to the prior law requirement that all summonses be personally served. The provision is effective for summonses served after July 22, 1998.

Provide notice of IRS contact with third party.—Third parties may be contacted by the IRS in connection with the examination of a taxpayer or the collection of the tax liability of the taxpayer. In general, under prior law, the IRS was required to notify the taxpayer of the service of summons on a third party within three days of the date of service. This Act provides that the IRS may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of the taxpayer without providing reasonable notice in advance to the taxpayer that the IRS may contact persons other than the taxpayer. This provision, which is effective with respect to contacts made after January 18, 1999, does not apply to criminal tax matters, if the collection of the tax liability is in jeopardy, if the Secretary determines that disclosure may involve reprisal against any person, or if the taxpayer authorized the contact.

Require supervisory approval for certain liens, levies, and seizures.—Under prior law, supervisory approval of liens, levies or seizures was only required under certain circumstances. This Act requires the IRS to implement an approval process under which any lien, levy or seizure would, when appropriate, be approved by a supervisor, who would review the taxpayer's information, verify that a balance is due, and affirm that a lien, levy or seizure is appropriate under the circumstances. Circumstances to be taken into account include the amount due and the value of the asset. The provision applies to automated collection system actions initiated after December 31, 2000 and to all other collections actions initiated after July 22, 1998.

Modify levy exemption amounts.—IRS may levy on all non-exempt property of the taxpayer. Under prior law, property exempt from levy included up to $2,500 in value of fuel, provisions, furniture, and personal effects in the taxpayer's household and up to $1,250 in value of books and tools necessary for the trade, business or profession of the taxpayer. This Act increases the value of personal effects exempt from levy to $6,250 and the value of books and tools exempt from levy to $3,125. These amounts are indexed annually for inflation and apply to levys issued after July 22, 1998.

Require release of levy upon agreement that amount is uncollectible.—Effective for levys imposed after December 31, 1999, the IRS is required to release a wage levy as soon as practicable upon agreement with the taxpayer that the tax is not collectible.

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). Effective for refund suits brought with respect to taxable years beginning after December 31, 1998, this Act requires the IRS to suspend collection by levy of liabilities that are the subject of a refund suit during the pendency of the litigation. This only applies where refund suits can be brought without the full payment of the tax, i.e., divisible taxes. Collection by levy is suspended unless jeopardy exists or the taxpayer waives the suspension of collection in writing. The statute of limitations on collection is stayed for the period during which collection by levy is prohibited.

Require review of jeopardy and termination assessments and jeopardy levies.—Special procedures allow 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 or termination 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. This Act requires IRS Counsel review and approval before the IRS can make a jeopardy assessment, a termination assessment, or a jeopardy levy. If the Counsel's approval is not obtained, the taxpayer is entitled to obtain abatement of the assessment or release of the levy, and, if the IRS fails to offer such relief, to appeal first to the collections appeals process and then to the U.S. District Court. This provision is effective with respect to taxes assessed and levies made after July 22, 1998.

Increase "superpriority" dollar limits.—A Federal tax lien attaches to all property and rights in property of the taxpayer, if the taxpayer fails to pay the assessed tax liability after notice and demand. However, the Federal tax lien is not valid as to certain "superpriority" interests. Two of these "superpriorities" are subject to dollar limitations. For example, under prior law, purchasers of personal property at a casual sale were protected against a Federal tax lien attached to such property to the extent the sale was for less than $250; protection for mechanics lienors who provide home improvement work for residential real property was $1,000. Effective July 22, 1998, this Act increases these dollar limits, which are indexed for inflation, to $1,000 and $5,000, respectively. Under prior law, superpriorities were granted to banks and building and loan associations that made passbook loans to their customers, provided that those institutions retained the passbooks in their possession until the loan was completely paid off. This Act clarifies the superpriorities law to reflect current banking practices, where a passbook-type loan may be made even though an actual passbook is not used.

Waive early withdrawal penalty for IRS levies on retirement plans.—Early withdrawals from qualified retirement plans and Individual Retirement Accounts (IRAs) that are includible in the gross income of the taxpayer generally are subject to a 10-percent early withdrawal tax, unless an exception to the tax applies. Effective for distributions after December 31, 1999, this Act provides an exception from the 10-percent early withdrawal tax for amounts withdrawn from an employer-sponsored retirement plan or an IRA that are subject to a levy by the IRS. The exception applies only if the plan or IRA is levied; it does not apply if the taxpayer withdraws funds to pay taxes in the absence of a levy, or if the taxpayer withdraws funds in order to release a levy on other interests.

Prohibit sales of seized property at less than minimum bid.—A minimum bid price must be established for seized property offered for sale. Effective for sales after July 22, 1998, the IRS is prohibited from selling seized property for less than the minimum bid price.

Require a written accounting of all sales of seized property.—The IRS is required to provide a written accounting of all sales of seized property to the taxpayer, effective for seizures occurring after July 22, 1998. The accounting must include a receipt for the amount credited to the taxpayer's account.

Implement a uniform asset disposal mechanism.—The IRS must sell property seized by levy either by public auction or by public sale under sealed bids. These sales are often conducted by the revenue officer charged with collecting the tax liability. By July 22, 2000, this Act requires the IRS to implement a uniform asset disposal mechanism for sales of seized property. The disposal mechanism should be designed to remove any participation in the sale by revenue officers and outsourcing of the disposal mechanism may be considered.

Codify administrative procedures for seizures.—The IRS Manual provides general guidelines for seizure actions, requiring that if it is determined that the taxpayer's equity in the seized property is insufficient to yield net proceeds from sale to apply to the unpaid tax, the revenue officer must immediately release the seized property. This Act codifies these administrative procedures effective July 22, 1998.

Establish procedures for seizure of residences and businesses.—Effective July 22, 1998, the following procedures apply with respect to the seizure of residences and businesses: (1) Seizure of any nonrental residential real property to satisfy an unpaid liability of $5,000 or less (including interest and penalties) generally is prohibited. (2) All other payment options must be exhausted before the taxpayer's business assets or principal residence may be seized. (3) Seizure of a principal residence is permitted only if approved in writing by a U.S. District Court. (4) Future income derived from the sale of fish or wildlife under specified State permits or licenses must be taken into account in evaluating other payment options before seizing the taxpayer's business assets.

Require disclosures relating to extension of statute of limitations by agreement.— Under prior law, taxpayers and the IRS could agree in writing to extend statute of limitations on assessment or collection, either for a specified period or for an indefinite period. Under this Act, the statute of limitations on collections may no longer be extended by agreement between the taxpayer and the IRS, except in connection with an installment agreement, but the extension is only for the period for which the installment agreement by its terms extends beyond the end of the otherwise applicable 10-year period plus 90 days. The Act also requires that on each occasion that the taxpayer is requested by the IRS to extend the statue of limitations on assessment, 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 or to a particular time period. These requirements generally apply to requests to extend the statute of limitations made after December 31, 1999.

Expand authority of the IRS to accept 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 owed, or doubt as to the taxpayer's ability to pay the full amount owed. This Act requires 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. This information is to be used to ensure that taxpayers entering into an offer-in-compromise will have adequate means to provide for basic living expenses. The IRS is prohibited from rejecting an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer. The Act also prohibits the IRS from collecting a tax liability by levy during any period that a taxpayer's offer-in-compromise for that liability is being processed, during the 30 days following rejection of an offer, during any period in which an appeal of the rejection of an offer is being considered, and while an installment agreement is pending. The Act also provides that the IRS must implement procedures to review all proposed rejections of taxpayer offers-in-compromise and requests for installment agreements prior to the rejection being communicated to the taxpayer. These changes generally are effective for offers-in-compromise and installment agreements submitted after July 22, 1998. The provision suspending levy is effective with respect to offers-in-compromise pending on or made after December 31, 1999.

Require notice of deficiency to specify Tax Court filing deadlines.—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. This Act requires 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 is treated as timely filed. The provision applies to notices mailed after December 31, 1998.

Refund or credit of overpayments before final determination.—The IRS may not take action to collect a deficiency during the period a taxpayer may petition the Tax Court, or, if the taxpayer petitions the Tax court, until the decision of the Tax Court becomes final. Actions to collect a deficiency attempted during this period may be enjoined, but under prior law, there was no authority for ordering the refund of any amount collected by the IRS during the prohibited period. If a taxpayer contested a deficiency in the Tax Court, no credit or refund of income tax for the contested taxable year generally could be made, except in accordance with a final decision of the Tax Court. Where the Tax Court determined that an overpayment had been made and a refund was due, and a portion of the decision was appealed, there was no provision for the refund of any portion of any overpayment that was not contested in the appeal. Effective July 22, 1998, this Act provides that a proper court may order a refund of any amount that was collected within the period during which collection of the deficiency by levy or other proceeding is prohibited. This Act also allows the refund of any overpayment determined by the Tax Court, to the extent the overpayment is not contested on appeal.

Modify IRS procedures related to appeal of examinations and collections.—Effective July 22, 1998, this Act codifies existing IRS procedures with respect to early referrals to Appeals and the Collections Appeals Process. This Act also codifies the existing Alternative Dispute Resolution procedures, as modified by eliminating the prior law dollar threshold of more than $10 million in dispute.

Codify certain Fair Debt Collection procedures.—Government agencies, including the IRS, are generally exempt from the Fair Debt Collection Practices Act (FDCPA). Effective July 22, 1998, this Act applies to the IRS the FDCPA restrictions relating to communication with the taxpayer/debtor (prohibition on telephone calls outside the hours of 8:00 a.m. to 9:00 p.m. local time) and prohibitions on harassing or abusing a debtor.

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. This Act requires the IRS to enter into an installment agreement (at the taxpayer's option) for liabilities of $10,000 or less, provided certain conditions are met. The provision is effective July 22, 1998.

Prohibit requests to waive rights to bring actions.—Effective July 22, 1998, the government cannot ask a taxpayer to waive the right to sue the United States or one of its employees for actions taken concerning a tax matter, in order to settle another tax matter unless the taxpayer knowingly and voluntarily waives the right or the request is made to an authorized taxpayer representative (such as an attorney).

Disclosures to Taxpayers

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. This Act requires the IRS to establish procedures no later than January 18, 1999, to alert married taxpayers clearly of their joint and several liability on all appropriate publications and instructions.

Provide explanation of taxpayer rights in interviews with the IRS.—The IRS is required to rewrite Publication 1 (*Your Rights as a Taxpayer*) no later than January 18, 1999. The revision must inform taxpayers more clearly of their rights to be represented by a representative, and, if the taxpayer is so represented, that interviews with the IRS may not proceed without the presence of the representative unless the taxpayer consents.

Require disclosure of criteria for examination selection.—This Act requires that the IRS add to Publication 1 (*Your Rights as a Taxpayer*) a statement setting forth, in simple and nontechnical terms, the criteria and procedures for selecting taxpayers for examination. The statement must not include any information that would be detrimental to law enforcement, and must specify the general procedures used by the IRS, including whether taxpayers are selected for examination on the basis of information in the media or from informants. These additions to Publication 1 must be made no later than January 18, 1999.

Provide explanation of appeals and collection process.—The IRS is required to provide to taxpayers a description of the entire appeals and collection process, from examination through collection, including the assistance available to taxpayers from the Taxpayer Advocate at various points in the process. This information must be provided with the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals, beginnng no later than January 18, 1999.

Provide explanation of reason for refund disallowance.—Effective January 18, 1999, the IRS is required to notify the taxpayer of the specific reasons for the disallowance (or partial disallowance) of a refund claim.

Provide statements regarding installment agreements.—Effective July 1, 2000, the IRS is required to send every taxpayer in an installment agreement an annual statement of the initial balance owed, the payments made during the year, and the remaining balance.

Provide notification of change in tax matters partner.—In general, the tax treatment of items of partnership income, loss, deductions and credits are determined at the partnership level in a unified partnership proceeding rather than in separate proceedings with each partner. In providing notice to taxpayers with respect to partnership proceedings, the IRS relies on information furnished by a party designated as the tax matters partner (TMP) of the partnership. The TMP is required to keep each partner informed of all administrative and judicial proceedings with respect to the partnership. Under certain circumstances, the IRS may require the resignation of the incumbent TMP and designate another partner as the TMP of the partnership. Effective for selections of TMPs made by the IRS after July 22, 1998, this Act requires the IRS to notify all partners of any resignation of the TMP that is required by the IRS, and to notify the partners of any successor TMP.

Provide description of conditions under which taxpayer returns may be disclosed.—Effective July 22, 1998, this Act requires that instruction booklets for general tax forms include a description of conditions under which tax return information may be disclosed outside the IRS (including to States).

Provide procedure for disclosure of Chief Counsel advice.—This Act establishes a structured process by which the IRS will make certain work products, designated as "Chief Counsel Advice," open to public inspection on an ongoing basis. The provision, which applies to Chief Counsel Advice issued after October 20, 1998, is designed to protect taxpayer privacy while allowing the public inspection of public documents in a manner generally consistent with the mechanism for the public inspection of written determinations.

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 Secretary of the Treasury is authorized to provide up to $6 million per year in matching grants (no more than $100,000 per year per eligible clinic) to certain low-income taxpayer clinics, effective July 22, 1998. To be eligible, a clinic may charge no more than a nominal fee to either represent low-income taxpayers in controversies with the IRS or to provide tax information to individuals for whom English is a second language.

Require cataloging of complaints.—Beginning in 1997, the IRS is required to make an annual report to Congress regarding allegations of misconduct by IRS employees. Effective January 1, 2000, the IRS is required to maintain records of taxpayer complaints of misconduct by IRS employees, on an individual employee basis, although individual records are not to be listed in the report to Congress.

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. Under prior law, there was no exception authorizing the disclosure of return information to NARA. This Act provides 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 U.S. 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 apply to NARA. The provision is effective for requests made by the Archivist after July 22, 1998.

Modify payment of taxes.—The Secretary of the Treasury is authorized to accept payments by checks or money orders, as provided in regulations. Under prior law, checks or money orders were made payable to the "Internal Revenue Service." Under this Act the Secretary of the Treasury or his delegate is required to amend the rules, regulations, and procedures to allow payment of taxes by check or money order to be made payable to the "United States Treasury," effective July 22, 1998.

Clarify authority to prescribe manner of making elections.—Except as otherwise provided by statute, prior law provided that elections under the Internal Revenue Code must be made in such manner as the Secretary of the Treasury "shall by regulations or forms prescribe." This Act clarifies that, except as otherwise provided, the Secretary may prescribe the manner of making any election by any reasonable means. This change is effective July 22, 1998.

Additional Provisions

Eliminate 18-month holding period for capital gains.—Under the Taxpayer Relief Act of 1997 (TRA97), the maximum capital gains tax rate for individuals generally was 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 was retained for collectibles and, effective July 29, 1997, for assets held between 1 year and 18 months. In addition, TRA97 provided a maximum rate of 25 percent for the long-term capital gain attributable to depreciation from real estate held more than 18 months. Under this Act, effective January 1, 1998, property held by an individual for more than one year (rather than 18 months) is eligible for the lower maximum capital gains tax rates (10, 20, and 25 percent) provided in TRA97.

Modify tax treatment of meals provided for the convenience of the employer.—Under prior law, meals provided on the business premises to employees were excluded from the employees' income and fully deductible to the employer if substantially all of the employees (interpreted to be approximately 90 percent) were provided such meals for the convenience of the employer. Effective for taxable years beginning before, on, or after July 22, 1998, all meals furnished to employees at a place of business are excluded from the employees' income and fully deductible to the employer if more than one-half of the employees are provided such meals for the convenience of the employer.

Revenue Offsets

Overrule Schmidt Baking with respect to vacation and severance pay.—Any method or arrangement that has the effect of deferring the receipt of compensation or other benefits for employees is treated as a deferred compensation plan. In general, contributions under a deferred compensation plan (other than certain pension, profit-sharing and similar plans) are deductible to the employer in the taxable year in which an amount attributable to the contribution is includible in the income of the employee. Temporary Treasury regulations provide that a plan, method, or arrangement that defers the receipt of compensation or benefits by the employee more than 2½ months after the end of the employer's taxable year in which the services creating the right to such compensation or benefits are performed, is to be treated as a deferred compensation plan. The Tax Court recently addressed the issue of when vacation pay and severance pay are considered deferred compensation in *Schmidt Baking Co., Inc.*,. In that case the taxpayer, who was an accrual basis taxpayer with a fiscal year that ended December 28, 1991, funded its accrued vacation and severance pay liabilities for 1991 by purchasing an irrevocable letter of credit on March 13, 1992. The parties stipulated that the letter of credit represented a transfer of substantially vested interest in property to employees and that the fair market value of such interest was includible in the employees' gross incomes for 1992 as a result of the transfer.

The Tax Court held that the purchase of the letter of credit, and the resulting income inclusion, constituted payment of the vacation and severance pay within the 2½ month period, thus the vacation and severance pay were not treated as deferred compensation. This ruling allowed the employer to deduct the cost in 1991, and the employees to pay the taxes on the benefits in 1992. This Act overrules *Schmidt Baking Co., Inc.*, by providing that for purposes of determining whether an item of compensation (including vacation pay and severance pay), is deferred compensation, the compensation is not considered to be paid or received until actually received by the employee. Actual receipt does not include an amount transferred as a loan, refundable deposit, or contingent payment. Also, amounts set aside in a trust for employees are not considered to be actually received by the employee. This change is effective for taxable years ending after July 22, 1998.

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. This Act limits the ability of grandfathered stapled REITs to grow and actively manage certain types of properties within the stapled structure. Specifically, for purposes of determining whether any grandfathered entity is a REIT, the stapled entities (and certain subsidiary entities) are treated as one entity with respect to properties acquired on or after March 26, 1998 and with respect to activities or services relating to such properties that are undertaken or performed by one of the entities on or after such date.

Preclude certain taxpayers from prematurely claiming losses from receivables.—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"). Under prior law, significant numbers of taxpayers whose principal activities are selling nonfinancial goods or providing nonfinancial services (such as retailers and utilities) were making the customer paper election as a means of restoring bad debt reserves. The customer paper election was also being used inappropriately to mark-to-market trade receivables that bear little or no interest in order to recognize loss. Under this Act, certain trade receivables are no longer eligible for mark-to-market treatment. Specifically, generally effective for taxable years ending after July 22, 1998, sellers of nonfinancial goods and services may not mark-to-market receivables generated on the sale of goods or services sold on credit when such receivables are retained by the seller or a related person.

Disregard minimum distributions in determining adjusted gross income (AGI) for conversions to a Roth Individual Retirement Account (IRA)—Under current law, uniform minimum distribution rules generally apply to all types of tax-favored retirement vehicles, including qualified retirement plans and annuities, IRAs (other than Roth IRAs), and tax-sheltered annuities. Distributions are required to begin no later than the individual's required beginning date. In the case of an IRA, the required beginning date is April 1 of the calendar year following the calendar year in which the IRA owner attains age 70½. Extensive regulations have been issued for purposes of calculating minimum distributions, which generally are includible in the taxpayer's gross income in the year of distribution. A 50-percent excise tax applies to the extent a minimum distribution is not made. Under current law, taxpayers with AGI of less than $100,000 are eligible to roll over or convert an existing IRA to a Roth IRA. Effective for taxable years beginning after December 31, 2004, minimum required distributions from IRAs will be excluded from the definition of AGI, solely for purposes of determining eligibility to convert from an IRA to a Roth IRA. As under present law, the required minimum distribution will not be eligible for conversion and will be includible in gross income.

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999.—This Act, which was signed by President Clinton on October 21, 1998, represents a significant step forward for America, helping to protect the surplus until Social Security is reformed, forging a bipartisan agreement on funding the International Monetary Fund and putting in place critical investments in education and training. This Act also extends several business and trade tax provisions that had expired or were about to expire, provides tax breaks for farmers and ranchers, and includes several other tax changes. The major provisions of the Act affecting receipts are described below.

Emergency Tax Relief for Farmers

Extend permanently income-averaging for farmers.—Under prior law, effective for taxable years beginning after December 31, 1997 and before January 1, 2001, an electing individual taxpayer generally was 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. This Act permanently extends this provision, effective for taxable years beginning after December 31, 2000.

Modify taxation of farm production flexibility contract payments.—A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless such amount properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. Under production flexibility contracts entered into between certain eligible owners and producers and the Secretary of Agriculture (as provided in the Federal Agriculture Improvement and Reform Act of 1996), annual payments are made at specific times during the Federal government's fiscal year. One-half of each annual payment is to be made on either December 15 or January 15 of the fiscal year, at the option of the recipient; the remaining one-half is to be paid no later than September 30 of the fiscal year. The option to receive the payment on December 15 potentially results in the constructive receipt (and thus potential inclusion in income) of one-half of the annual payment at that time, even if the option to receive the amount on January 15 is elected. For fiscal year 1999, as provided under The Emergency Farm Financial Relief Act of 1998, all payments are to be paid at such time or times during the fiscal year as the recipient may specify. This option to receive all of the 1999 payment in calendar year 1998 potentially results in constructive receipt (and thus potential inclusion in income) in that year, whether or not the amounts are actually received. Under this Act, effective for production flexibility contract payments made in taxable years ending after December 31, 1995, the time a production flexibility contract payment is to be included in income is to be determined without regard to the options granted for payment.

Extend the net operating loss carryback period for farmers.—A net operating loss (NOL) is, generally, the amount by which business deductions of a taxpayer exceed business gross income. Generally, an NOL may be carried back two years and carried forward 20 years to offset taxable income in those years. One exception provides that, in the case of an NOL attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business, the NOL can be carried back three years, as provided under prior law. Under this provision, a special five-year carryback period is provided for a farming loss, regardless of whether the loss is incurred in a Presidentially declared disaster area; the carryforward period remains at 20 years. The provision is effective for such NOLs arising in taxable years beginning after December 31, 1997.

Extension of Expiring Tax and Trade Provisions

Extend research and experimentation tax credit.—The 20-percent tax credit for certain incremental research and experimentation expenditures is extended to apply to qualifying expenditures paid or incurred during the period July 1, 1998 through June 30, 1999.

Extend the work opportunity tax credit.—The work opportunity tax credit, which provides an incentive for employers to hire individuals from certain targeted groups, is extended to apply to individuals who begin work on or after July 1, 1998 and before July 1, 1999.

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. This credit is extended to apply to individuals who begin work after April 30, 1999 and before July 1, 1999.

Extend permanently the 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 July 1, 1998 to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock. This Act permanently extends the rule for private foundations effective for contributions of qualified appreciated stock made on or after July 1, 1998.

Extend and modify exceptions provided under subpart F for certain active financing income.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes "foreign personal holding company income" and insurance income. The U.S. 10-percent shareholders of a CFC also are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (income derived from services performed for a related person outside the country in which the CFC is organized). Under prior law, certain income derived in the active conduct of a banking, financing, insurance, or similar business (only for taxable years beginning in 1998) was excepted from the Subpart F rules regarding the taxation of foreign personal holding company income and foreign base company services income. This Act extends the exception for one year, with modifications, to apply to such income derived in taxable year 1999.

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 June 30, 1998, is temporarily extended through June 30, 1999. Refunds of any duty paid between June 30, 1998 and October 21, 1998 are provided upon request of the importer.

Other Provisions

Allow personal tax credits fully against regular tax liability.—Certain nonrefundable personal tax credits (dependent care credit, credit for the elderly and disabled, adoption credit, child tax credit, credit for interest on certain home mortgages, HOPE Scholarship and Lifetime Learning credit, and the D.C. homebuyer's credit) are provided under current law. Generally, these credits are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax. An additional child tax credit is provided under current law to families with three or more qualifying children. This credit, which may be offset against social security payroll tax liability (provided that liability exceeds the amount of the earned income credit), is reduced by the amount of the individual's minimum tax liability (that is, the amount by which the individual's tentative minimum tax exceeds the individual's regular tax liability). For taxable year 1998, this Act allows nonrefundable personal tax credits to offset regular income tax liability in full (as opposed to only the amount by which the regular tax liability exceeds the tentative minimum tax). In addition, for taxable year 1998, the additional child credit provided to families with three or more qualifying children is not reduced by the amount of the individual's minimum tax liability.

Accelerate 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: 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. This Act increases the allowable deduction to 100 percent as follows: 60 percent for 1999 through 2001; 70 percent for 2002; and 100 percent for 2003 and subsequent years.

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. For any individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year, the 100 percent of last year's safe harbor generally is modified to be a 110 percent of last year's liability safe harbor. However, under prior law, the 110 percent of last year's liability safe harbor for individuals with AGI of more than $150,000 was modified for taxable years beginning in 1999 through 2002, as follows: for taxable years beginning in 1999, 2000, and 2001 the safe harbor is 105 percent; and for taxable years beginning in 2002, the safe harbor is 112 percent. Under this Act the estimated tax safe harbor for individuals with AGI of more than $150,000 is modified as follows: for taxable years beginning in 2000 and 2001 the safe harbor is 106 percent.

Increase State volume limits on private activity tax-exempt bonds.—Interest on bonds issued by States and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of tax-exempt private activity bonds that State and local governments may issue in each calendar year is limited by State-wide volume limits. Under prior law, the annual volume limit for any State was equal to the greater of $50 per resident of the State or $150 million. Under this Act the annual private activity bond volume limit is increased to the greater of $75 per resident or $225 million for 2007 and subsequent years. The increase is phased-in annually, beginning in 2003, as follows: for 2003, the greater of $55 per resident or $165 million; for 2004, the greater of $60 per resident or $180 million; for 2005, the greater of $65 per resident or $195 million; and for 2006, the greater of $70 per resident or $210 million.

Allow States a limited period of time to exempt student employees from social security.—The Social Security Amendments of 1972 provided an opportunity for States to obtain exemptions from social security coverage for student employees of public schools, colleges, and universities. Three States chose not to seek an exemption from social security coverage for these employees. Under this Act States are allowed a limited window of time (January 1 through March 31, 1999), to modify existing State agreements to exempt such students from social security coverage effective with respect to wages earned after June 30, 2000.

Revenue Offset Provisions

Modify treatment of certain deductible liquidating distributions of real estate investment trusts (REITs) and regulated investment companies (RICs).—REITs and RICs are allowed a deduction for dividends paid to their shareholders. The deduction for dividends paid includes amounts distributed in liquidation that are properly chargeable to earnings and profits. In addition, in the case of a complete liquidation occurring within 24 months after the adoption of a plan of complete liquidation, any distribution made pursuant to such plan is deductible to the extent of earnings and profits. Rules that govern the receipt of dividends from REITs and RICs generally provide for including the amount of the dividend in the income of the shareholder receiving the dividend that was deducted by the REIT or RIC. However, in the case of a liquidating distribution by a REIT or RIC to a corporation owning at least 80 percent of its stock, a separate rule under prior law generally provided that the distribution was tax-free to the parent corporation. As a result, a liquidating REIT or RIC was able to deduct amounts paid to its parent corporation without the parent corporation including corresponding amounts in its income. Effective for distributions on or after May 22, 1998 (regardless of when the plan of liquidation was adopted), any amount that a liquidating REIT or RIC takes as a deduction for dividends paid with respect to an 80-percent corporate owner is includible in the income of the recipient corporation. As under prior law, the liquidating corporation may designate the amount distributed as a capital gain dividend or, in the case of a RIC, a dividend eligible for the 70-percent dividends-received deduction or an exempt interest dividend.

Expand list of taxable vaccines.—Under prior law an excise tax of $.75 per dose is levied on the following vaccines: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, and varicella (chickenpox). This Act adds any vaccine against rotavirus gastroenteritis to the list of taxable vaccines, effective for vaccines sold by a manufacturer or importer after October 21, 1998.

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. This Act provides 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 TIN" used on a tax return is defined as the TIN assigned to such individual by the Social Security Administration (SSA), or in certain limited cases, the IRS. Second, the IRS is 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 include the individual's name, age or date of birth, and Social Security number. Third, the IRS is authorized to use math error procedures to deny eligibility for those tax benefits 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 that the IRS determines, using data from SSA, does not meet the statutory age restrictions. These changes are effective for taxable years ending after October 21, 1998.

Restrict special net operating loss carryback rules for specified liability losses.— 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. This Act modifies the specified liability loss provisions to provide that only a limited class of liabilities qualifies as a specified liability loss. Effective for liability losses arising in taxable years ending after October 21, 1998, specified liability losses 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.

Modify taxation of prizes and awards.—A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless the item properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. Under prior law, the winner of a contest who was given the option of receiving either a lump-sum distribution or an annuity was considered to be in constructive receipt of the award on becoming entitled to the award, and was required to include the value of the award in gross income, even if the annuity option was exercised. Under this Act the existence of a "qualified prize option" is disregarded in determining the taxable year for which any portion of a qualified prize is to be included in income. A qualified prize option is an option that entitles a person to receive a single cash payment in lieu of a qualified prize (or portion thereof), provided such option is exercisable not later than 60 days after the prize winner becomes entitled to the prize. Thus, a qualified prize winner who is provided the option to choose either cash or an annuity is not required to include amounts in gross income immediately if the annuity option is exercised. This change applies to any qualified prize to which a person first becomes entitled after October 21, 1998. In order to give previous prize winners a one-time option to alter previous payment arrangements, the change also applies to any qualifed prize to which a person became entitled on or before October 21, 1998 if the person has an option to receive a lump-sum cash payment only during some portion of the 18-month period beginning on July 1, 1999.

ADMINISTRATION PROPOSALS

The President's plan targets tax relief to provide child-care assistance to working families and support to Americans with long-term care needs. The President's plan also provides several incentives to promote education, including a school construction and modernization proposal. In addition, the President's plan includes initiatives to promote energy efficiency and environmental objectives and incentives to promote retirement savings, as well as extensions of certain expiring tax provisions.

Make Health Care More Affordable

Provide tax relief for long-term care needs.—Current law provides a tax deduction for certain long-term care expenses. However, the deduction does not assist with all long-term care expenses, especially the costs of informal family caregiving. The Administration proposes to provide a new long-term care tax credit of $1,000. The credit could be claimed by a taxpayer for himself or herself or for a spouse or dependent with long-term care needs. To qualify for the credit, an individual with long-term care needs must be certified by a licensed physician as being unable for at least six months to perform at least three activities of daily living without substantial assistance from another individual due to loss of functional capacity. An individual may also qualify if he or she requires substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and has difficulty with one or more activities of daily living or certain other age-appropriate activities. For purposes of the proposed credit, the current-law dependency tests would be liberalized, raising the gross income limit and allowing taxpayers to use a residency test rather than a support test. The credit would be phased out—in combination with the child credit and the disabled worker credit—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 proposal would be effective for taxable years beginning after December 31, 1999.

Provide tax relief for workers with disabilities.—Under current law, disabled taxpayers may claim an itemized deduction for impairment-related work expenses. The Administration proposes to allow disabled workers to claim a $1,000 credit. This credit would help compensate people with disabilities for both formal and informal costs associated with work (e.g., personal assistance to get ready for work or special transportation). In order to be considered a worker with disabilities, a taxpayer must submit a licensed physician's certification that the taxpayer has been unable for at least 12 months to perform at least one activity of daily living without substantial assistance from another individual. A severely disabled worker could potentially qualify for both the long-term care and disabled workers tax credits. The credit would be phased out—in combination with the child credit and the disabled worker credit—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 proposal would be effective for taxable years beginning after December 31, 1999.

Provide tax relief to encourage small business health plans.—Small businesses generally face higher costs than do larger employers in setting up and operating health plans in the current insurance market. Health benefit purchasing coalitions provide an opportunity for small businesses to purchase health insurance for their workers at reduced cost and to offer a greater choice of health plans. However, the formation of health benefit purchasing coalitions has been hindered by their limited access to capital. To facilitate the formation of these coalitions, the Administration proposes to establish a temporary, special rule that would facilitate private foundation grants and loans to fund the initial operating expenses of qualified health benefit purchasing coalitions (i.e., those certified by a Federal or State agency as meeting specified criteria) by treating such grants and loans as made for exclusively charitable purposes. In addition, to encourage use of qualified health benefit purchasing coalitions by small businesses, the Administration proposes a temporary tax credit for qualifying small employers that currently do not provide health insurance to their workforces. The credit would be equal to 10 percent of employer contributions to employee health plans purchased through a qualified coalition. The maximum credit amount would be $200 per year for individual coverage and $500 per year for family coverage (to be reduced proportionately if coverage is provided for less than 12 months during the employer's taxable year). The credit would be allowed to a qualifying small employer only with respect to contributions made during the first 24 months that the employer purchases health insurance through a qualified coalition, and would be subject to the overall limitations of the general business credit. The proposal would be effective for taxable years beginning after December 31, 1999, for health plans established before January 1, 2004. The special foundation rule would apply to grants and loans made prior to January 1, 2004 for initial operating expenses incurred prior to January 1, 2006.

Expand Education Initiatives

Provide incentives for public school construction and modernization.—The Taxpayer Relief Act of 1997 enacted a provision 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 elementary and secondary school construction and modernization. Under the proposal, State and local governments (including U.S. possessions) would be able to issue up to $22 billion of "qualified school modernization bonds" ($11 billion in each of 2000 and 2001). In addition, $400 million of bonds ($200 million in each of 2000 and 2001) would be allocated for the construction and renovation of Bureau of Indian Affairs funded schools. 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. Issuers would be responsible for repayment of principal. At least 95 percent of the bond proceeds of a qualified school modernization bond must be used to finance public school construction or rehabilitation. The Administration also proposes to authorize the issuance of additional qualified zone academy bonds in 2000 and 2001 of $1.0 billion and $1.4 billion, respectively, and to allow the proceeds of these bonds to be used for school construction.

Extend employer-provided educational assistance and include graduate education.—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 for eighteen months to apply to undergraduate courses beginning before January 1, 2002. In addition, the exclusion would be expanded to cover graduate expenses beginning after June 30, 1999 and before January 1, 2002.

Provide tax credit for workplace literacy and basic education programs.—Given the increased reliance on technology in the workplace, workers with low levels of education face greater risk of unemployment than their more educated coworkers. Although the costs of providing workplace literacy and basic education programs to employees are generally deductible to employers under current law, no tax credits are allowed for any employer-provided education. As a result, employers lack sufficient incentive to provide basic education and literacy programs, the benefits of which are more difficult for employers to capture through increased productivity than the benefits of job-specific education. The Administration proposes to allow employers who provide certain workplace literacy, English literacy, or basic education programs for their eligible employees to claim a credit against Federal income taxes equal to 10 percent of the employer's qualified expenses, up to a maximum credit of $525 per participating employee. Qualified education would be limited to basic instruction at or below the level of a high school degree and to English literacy instruction. Eligible employees in basic education programs generally would not have received a high school degree or its equivalent. Instruction would be provided either by the employer, with curriculum approved by the State adult education authority, or by local education agencies or other providers certified by the Department of Education. The credit would be available for taxable years beginning after December 31, 1999.

Encourage sponsorship of qualified zone academies.—Under current law, State and local governments can issue qualified zone academy bonds to fund improvements in certain "qualified zone academies" which provide elementary or secondary education. To encourage corporations to become sponsors of such academies, a credit against Federal income tax would be provided equal to 50 percent of the amount of corporate sponsorship payments made to a qualified zone academy located in (or adjacent to) a designated empowerment zone or enterprise community. The credit would be available only if a credit allocation has been made with respect to the corporate sponsorship payment by the local governmental agency with responsibility for implementing the strategic plan of the empowerment zone or enterprise community. Up to $4 million of credits could be allocated with respect to each of the 31 designed empowerment zones; and up to $1 million of credits could be allocated with respect to each of the 95 designated enterprise communities. The credit would be subject to present law general business credit rules, and would be effective for sponsorship payments made after December 31, 1999.

Eliminate 60-month limit on student loan interest deduction.—Current law provides an income tax deduction for certain interest paid on a qualified education loan during the first 60 months that interest payments are required, effective for interest due and paid after December 31, 1997. The maximum deduction available is $2,500 for years after 2000 (for years 1998, 1999 and 2000, the limits are $1,000, $1,500 and $2,000, respectively) and the deduction is phased-out for taxpayers with adjusted gross income between $40,000 and $55,000 (between $60,000 and $75,000 for joint filers). The 60-month limitation under current law adds significant complexity and administrative burdens for taxpayers, lenders, loan servicing agencies, and the IRS. Thus, to simplify the calculation of deductible interest payments, reduce administrative burdens, and provide longer-term relief to low-and middle-income taxpayers with large educational debt, the Administration proposes to eliminate the 60-month limitation. This proposal would be effective for interest due and paid on qualified education loans after December 31, 1999.

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, 1999.

Provide tax relief for participants in certain Federal education programs.—Present law provides tax-free treatment for certain scholarship and fellowship grants used to pay qualified tuition and related expenses, but not to the extent that any grant represents compensation for services. In addition, tax-free treatment is provided for certain discharges of student loans on condition that the individual works for a certain period of time in certain professions for any of a broad class of employers. To extend tax-free treatment to education awards under certain Federal programs, the Administration proposes to amend current law to provide that any amounts received by an individual under the National Health Service Corps (NHSC) Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program are "qualified scholarships" excludable from income, without regard to the recipient's future service obligation. In addition, the proposal also would provide an exclusion from income for any repayment or cancellation of a student loan under the NHSC Scholarship Program, the Americorps Education Award Program, or the Armed Forces Health Professions Loan Repayment Program. The exclusion would apply only to the extent that the student incurred qualified tuition and related expenses for which no education credit was claimed during academic periods when the student loans were incurred. The proposals would be effective for awards received after December 31, 1999.

Make Child Care More Affordable

Increase, expand, 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 believes that the maximum credit rate is too low. Moreover, because it phases down at a very low threshold of adjusted gross income, many families who have significant child care costs and relatively low incomes are not eligible for the maximum credit. To alleviate the burden of child care costs for these families, 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.

Under current law, no additional tax assistance under the child and dependent care tax credit is provided to families with infants, who require intense and sustained care. Furthermore, parents who themselves care for their infants, instead of incurring out-of-pocket child care expenses, receive no benefit under the child and dependent care tax credit. In order to provide assistance to these families, the Administration proposes to supplement the credit for all taxpayers with children under the age of one, whether or not they incur out-of-pocket child care expenses. The amount of additional credit would be the applicable credit rate multiplied by $500 for a child under the age of one ($1,000 for two or more children under the age of one).

The Administration also proposes to simplify eligibility for the credit by eliminating a complicated household maintenance test. Certain credit parameters would be indexed. The proposal would be effective for taxable years beginning after December 31, 1999.

Provide tax incentives for employer-provided child-care facilities.—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, 1999.

Provide Incentives to Revitalize Communities

Increase low-income housing tax credit per capita cap to $1.75.—Low-income housing tax credits provide an incentive to build and make available affordable rental housing units to households with low incomes. The amount of first-year credits that can be awarded in each State is currently limited to $1.25 per capita. That limit has been unchanged since it 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 1999. 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.

Provide Better America Bonds to improve the environment.—Under current law, State and local governments may issue tax-exempt bonds to finance purely public environmental projects. Certain other environmental projects may also be financed with tax-exempt bonds, but are subject to an overall cap on private-purpose tax-exempt bonds. The subsidy provided with tax-exempt bonds may not provide a deep enough subsidy to induce State and local governments to undertake beneficial environmental infrastructure projects. The Administration proposes to allow State and local governments (including U.S. possessions and Native American tribal governments) to issue tax credit bonds (similar to existing Qualified Zone Academy Bonds) to finance projects to protect open spaces or to otherwise improve the environment. Significant public benefits would be provided by creating more livable urban and rural environments; creating forest preserves near urban areas; protecting water quality; rehabilitating land that has been degraded by toxic or other wastes or destruction of its ground cover; and improving parks and reestablishing wetlands. The Environmental Protection Agency will allocate $1.9 billion in annual bond authority for five years starting in 2000 based on competitive applications. The bonds would have a maximum maturity of 15 years and the bond issuer effectively would receive an interest-free loan for the term of the bonds. During that interval, bond holders receive Federal income tax credits in lieu of interest.

Provide New Markets Tax Credit.—Businesses located in low-income urban and rural communities often lack access to sufficient equity capital. To help attract new capital to these businesses, taxpayers would be allowed a credit against Federal income taxes for certain investments made to acquire stock or other equity interests in a community development investment entity selected by the Treasury Department to receive a credit allocation. Selected community development investment entities generally would be required to use the investment proceeds to provide capital to businesses located in low-income communities. During the period 2000–2004, the Treasury Department would authorize selected community development investment entities to issue $6 billion of new stock or equity interests with respect to which credits could be claimed. The credit would be allowed for each year during the five-year period after the stock or equity interest is acquired from the selected community development investment entity, and the credit amount that could be claimed for each of the five years would equal six percent of the amount paid to acquire the stock or equity interest from the community development investment entity. The credit would be subject to current-law general business credit rules, and would be available for qualified investments made after December 31, 1999.

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 upon ceasing activity as a SSBIC or at any time that it disposes 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. Third, the proposal would make it easier for a SSBIC to meet the qualifying income, distribution of income, and diversification of assets tests to qualify as a tax-favored regulated investment company. 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. The regulated investment company provisions would be effective for taxable years beginning on or after the date of enactment.

Extend wage credit for 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 were 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 that the wage credit for the two additional EZs would remain in effect until January 1, 2010, and would be phased down using the same percentages that apply to the original empowerment zones designated under OBRA 93.

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 10 or 20 percent of the amount of qualified investment depending upon the energy efficiency of the qualified item, subject to a cap. The 10-percent credit generally would be available for equipment purchased during the two-year period beginning January 1, 2000 and ending December 31, 2001. The 20-percent credit would be available for equipment purchased during the four-year period beginning January 1, 2000 and ending December 31, 2003.

Provide tax credit for 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 $1,000, $1,500 or $2,000 depending upon the home's energy efficiency. The $1,000 credit would be available for homes purchased between January 1, 2000 and December 31, 2001 that are at least 30 percent more energy efficient than the standard under the 1998 International Energy Conservation Code (IECC). The $1,500 credit would be available for homes purchased between January 1, 2000 and December 31, 2002 that are at least 40 percent more energy efficient than the IECC standard. The $2,000 credit would be available for homes purchased between January 1, 2000 and December 31, 2004 that are at least 50 percent more energy efficient than the IECC standard.

Transportation

Extend the electric vehicle tax credit; provide tax credit for fuel-efficient vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2002. The credit begins to phase down in 2002 and is not available after 2004. The Administration proposes to extend the present $4,000 credit through 2006 and to allow the full amount of the credit to be available for qualified electric vehicles through 2006. The Administration also proposes to provide a tax credit for the purchase of certain fuel-efficient hybrid vehicles. The credit would be: (a) $1,000 for each vehicle that is one-third more fuel efficient than a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2002 and before January 1, 2005; (b) $2,000 for each vehicle that is two-thirds more fuel efficient than a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2002 and before January 1, 2007; (c) $3,000 for each vehicle that is twice as fuel efficient as a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2003 and before January 1, 2007; and (d) $4,000 for each vehicle that is three times as fuel efficient as a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2003 and before January 1, 2007.

Industry

Provide investment tax credit for combined heat and power (CHP) systems.—Combined heat and power (CHP) assets are used to produce electricity (and/or mechanical power) and usable heat from the same primary energy source. No tax credits are currently available for investment in CHP property. The Administration proposes to establish an eight-percent investment credit for qualifying CHP systems in order to encourage more efficient energy usage. The credit would apply to property placed in service in the United States after December 31, 1999 and before January 1, 2003.

Renewables

Provide tax credit for rooftop solar systems.—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 a new tax credit for purchasers of roof-top 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, 1999 and before January 1, 2005 for solar water heating systems and after December 31, 1999 and before January 1, 2007 for rooftop photovoltaic systems.

Extend wind and biomass tax credit and expand eligible biomass sources.—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 and to expand eligible biomass to include certain biomass from forest-related resources, and agricultural and other sources. A 1.0 cent-per-kilowatt-hour tax credit would also be allowed for cofiring biomass in coal plants.

Promote Expanded Retirement Savings, Security, and Portability

Building on recent legislation, the Administration proposes further expansions of retirement savings incentives, including 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. Other 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 increasing retirement security for women, expanding workers' and spouses' rights to know about their retirement benefits, and simplifying the pension rules. Finally, the Administration proposes to increase the portability of pension coverage, which will enhance retirement savings opportunities when employees change jobs. These provisions generally are effective beginning in 2000, except as provided below.

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 for 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 small business 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. 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 IRAs.

Create simplified pension plan for small business.—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 at a reduced premium, together with individual account balances that can benefit from favorable investment returns and have enhanced portability.

Provide faster vesting of employer matching contributions.—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).

Count Family and Medical Leave Act leave for vesting and eligibility purposes.—Under the Family and Medical Leave Act (FMLA), eligible workers are entitled to up to 12 weeks of unpaid leave to care for a new child, to care for a family member who has a serious health condition, or because the worker has a serious health condition. Under the Administration's proposal, workers who take time off under the FMLA could count that time toward retirement plan vesting and eligibility to participate. This would ensure that workers do not lose retirement benefits they have earned because they take time off under FMLA.

Require joint and 75-percent annuity option for pension plans.—Current law requires certain pension plans to offer to pay pension benefits as a joint and survivor annuity; frequently, the benefit for the employee's surviving spouse is reduced to 50 percent of the monthly benefit paid when both spouses were alive. Under the proposal, plans that are subject to the joint and survivor annuity rules would be required to offer an option that pays a survivor benefit equal to at least 75 percent of the benefit the couple received while both were alive. This option would be especially helpful to women because they tend to live longer than men and because many aged widows have incomes below the poverty level.

Improve disclosure; simplify pensions.—The Administration proposes to enhance workers' and spouses' rights to know about their pension benefits by, 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 adequate notification and have timely election periods 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.

Allow immediate participation in the Thrift Savings Plan (TSP) by new Federal employees.—Current law requires a newly-hired Federal employee to wait six to twelve months after being hired before contributing to the TSP. Rehired employees wait up to six months. Under the Administration's proposal, all waiting periods for employee elective contributions to the TSP would be eliminated for new hires and rehires.

Allow rollovers from private plans to TSP.—Current law limits employee contributions to a TSP account to salary reduction amounts, as opposed to rollover contributions from a qualified trust. The Administration proposes to allow an employee to roll over an "eligible rollover distribution" from a qualified trust sponsored by a previous employer to the employee's TSP account.

Allow rollovers between qualified retirement plans and 403(b) tax-sheltered annuities.—Under current law, rollovers are not allowed between qualified retirement plans and section 403(b) tax-sheltered annuities. The Administration proposes that eligible rollover distributions from a qualified retirement plan could be rolled over to a section 403(b) tax-sheltered annuity and vice versa.

Allow rollovers from regular IRAs to qualified plans or 403(b) tax-sheltered annuities.—The Administration's proposal would allow individuals to consolidate their IRA funds and their workplace retirement savings in a single place. Under current law, individuals may roll over only amounts in "conduit" IRAs (IRAs containing only amounts rolled over from workplace retirement plans) to their qualified retirement plans or section 403(b) tax-sheltered annuities. Under the Administration's proposal, individuals who have IRAs with deductible IRA contributions will be offered the opportunity to transfer funds from their IRAs into their qualified defined contribution retirement plan or 403(b) tax-sheltered annuity—provided that the retirement plan trustee meets the same standards as an IRA trustee.

Allow rollovers of after-tax contributions.—While pre-tax contributions to retirement plans are perhaps the most common form of employee contribution, some plans also allow participants to make after-tax contributions. Under current law, these after-tax contributions cannot be rolled over when employees switch jobs. The proposal would allow individuals to roll over their after-tax contributions to their new employer's defined contribution plan or to an IRA if the plan or IRA provider agrees to track and report the after-tax portion of the rollover for the individual.

Allow rollovers of contributions from governmental 457 plans to an IRA.—Generally, amounts held under qualified retirement plans or section 403(b) tax-sheltered annuities plans may be rolled over to an IRA. However, under current law, amounts held under nonqualified deferred compensation plans of State or local governments (governmental section 457 plans) may not be rolled over into an IRA and are taxable upon distribution. The Administration's proposal would allow individuals to roll over the money they have saved in a governmental section 457 plan to an IRA.

Facilitate the purchase of service credits in governmental defined benefit plans.—Employees of State and local governments, particularly teachers, often move between States and school districts in the course of their careers. Under State law, they often can purchase service credits in their State defined benefit pension plans for time spent in another State or district and earn a pension reflecting a full career of employment in the State in which they conclude their career. Under current law, these employees cannot make a tax-free transfer of the money they have saved in their 403(b) plan or governmental section 457 plan to purchase these credits and often lack other resources to use for this purpose. Under the proposal, State and local government employees will be able to use funds from these retirement savings plans to purchase service credits on a tax-free basis, i.e., through a direct transfer without first having to take a taxable distribution of these amounts.

Extend Expiring Provisions

Allow personal tax credits against the alternative minimum tax (AMT).—The Administration is concerned that the individual alternative minimum tax (AMT) may impose financial and compliance burdens upon taxpayers that have few tax preference items and were not the originally intended targets of the AMT. In particular, the Administration is concerned that the individual AMT may act to erode the benefits of nonrefundable tax credits (such as the education credits, the child credit, adoption credit, and the child and dependent care credit) that are intended to provide tax relief for middle-income taxpayers. In response, the Administration proposes to extend, for two years, the provision enacted in 1998 that allows an individual to offset his or her regular tax liability by nonrefundable tax credits regardless of the amount of the individual's tentative minimum tax. The Administration hopes to work with Congress to develop a longer-term solution to the individual AMT problem.

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, 1999. The Administration proposes to extend the work opportunity tax credit so that the credit would be effective for individuals who begin work before July 1, 2000. The proposal also clarifies the interaction of the work opportunity tax credit and the welfare-to-work tax credit. This proposed clarification would be effective for taxable years beginning on or after the date of first committee action.

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 July 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 July 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, 1999, for one year through June 30, 2000.

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.

Extend tax credit for first-time D.C. homebuyers.—The Administration proposes to extend the tax credit provided for the first-time purchase of a principal residence in the District of Columbia, which is scheduled to expire after December 31, 2000, for one year through December 31, 2001.

Simplify The Tax Laws

Provide optional Self-employment Contributions Act (SECA) computations.—Self-employed individuals currently may elect to increase their self-employment income for puposes 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, 1999.

Provide statutory hedging and other rules to ensure business property is treated as ordinary property.—Under current law, there is an 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 the 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 and provide more equitable timing of losses under the straddle rules. 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 (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 the application of the foreign tax credit limitation significantly 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, 1998.

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.

Expand declaratory judgment remedy for noncharitable organizations seeking determinations of tax-exempt status. —Under current law, organizations seeking tax-exempt status as charities under section 501(c)(3) are allowed to seek a declaratory judgment as to their tax status if their application is denied or delayed by the IRS. A noncharity (an organization not described in section 501(c)(3)) that applies to the IRS for recognition of its tax-exempt status faces potential tax liability if its application ultimately is denied by the IRS. This creates uncertainty for the noncharity, particularly when the IRS determination is delayed for a significant period of time. To reduce this uncertainty, the declaratory judgment procedure available to charities under current-law section 7428 would be expanded, so that if the application of any organization seeking tax-exempt status under section 501(c) is pending with the IRS for more than 270 days, and the organization has exhausted all administrative remedies available within the IRS, then the organization could seek a declaratory judgment as to its tax-exempt status from the United States Tax Court. The proposal would be effective for applications for recognition of tax-exempt status filed after December 31, 1999.

Simplify the active trade or business requirement for tax-free spin-offs.—In order to satisfy the active trade or business requirement for tax-free spin-offs, split-offs, and split-ups, the distributing corporation and the controlled corporation both must be engaged in the active conduct of a trade or business. If a corporation is not itself active, it may satisfy the active trade or business test indirectly, but only if substantially all of its assets consist of stock and securities of a controlled corporation that is engaged in an active trade or business. Because the substantially all standard is much higher than that required if the corporation is active itself, a taxpayer often must engage in predistribution restructurings that it otherwise would not have undertaken. There is no clear policy reason that the standards for meeting the active trade or business requirement should differ depending upon whether a corporation is considered to be active on a direct or indirect basis. Therefore, the Administration proposes to simplify the requirement by removing the substantially all test and generally allowing an affiliated group to satisfy the active trade or business requirement as long as the affiliated group, taken as a whole, is considered active. This proposal would be effective for transactions after the date of enactment.

Miscellaneous Provisions

Make first $2,000 of severance pay exempt from income tax.—Under current law, payments received by 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 $75,000. The exclusion would be effective for severance pay received in taxable years beginning after December 31, 1999 and before January 1, 2003.

Allow steel companies to carryback net operating losses (NOLs) up to five years.—Under current law, a net operating loss of a taxpayer generally may be carried back two years and forward 20 years. The Administration proposes to provide an immediate cash flow benefit to troubled companies in the steel industry by extending the carryback period for the NOLs of a steel company to five years. The proposal would be effective for taxable years ending after the date of enactment, regardless of when the NOL arose, and would sunset after five years.

Electricity Restructuring

Revise tax-exempt bond rules for electric power facilities.—As part of Federal legislation to encourage restructuring the nation's electric power industry so that consumers benefit from competition, rules relating to the use of tax-exempt bonds to finance electric power facilities would be modified. To encourage public power systems to implement retail competition, outstanding bonds issued to finance transmission facilities would continue their tax-exempt status even if private use resulted from allowing nondiscriminatory open access to those facilities. Similarly, outstanding bonds issued to finance generation or distribution facilities would continue their tax-exempt status even if the issuer implements retail competition. To support fair competition within the restructured industry, interest on bonds to finance electric generation or transmission facilities issued after enactment of such legislation would not be exempt. Distribution facilities could continue to be financed with tax-exempt bonds. These changes would be effective upon enactment.

Modify taxation of contributions to nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal the limitation for taxable years beginning after December 31, 1999. As under current law, deductible contributions would not be permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's decommissioning costs.

Modify International Trade Provisions

Extend and modify Puerto Rico economic-activity tax credit.—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 conducted in taxable years beginning before January 1, 2006, subject to base-period caps. To provide a more efficient tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity-based credit that was begun in the 1993 Act, the budget would modify the phase-out of the economic-activity-based credit for Puerto Rico (under section 30A of the Code) by (1) opening it to newly established business operations during the phase-out period, effective for taxable years beginning after December 31, 1998, and (2) extending the phase-out period through taxable years beginning before January 1, 2009.

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, 1999, through June 30, 2000. The Administration is proposing permanent enhanced trade benefits for subsaharan African countries undertaking strong economic reforms. The Administration also proposes to provide, through June 30, 2001, expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria. These benefits will help Caribbean Basin countries prepare for a future free trade agreement with the United States and respond to the effects of Hurricanes George and Mitch. The Administration also proposes to implement the OECD Shipbuilding Agreement.

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.

ELIMINATE UNWARRANTED BENEFITS AND ADOPT OTHER REVENUE MEASURES

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

Limit Benefits of Corporate Tax Shelter Transactions

The Administration is concerned about the proliferation of corporate tax shelters and their effect upon both the corporate tax base and the integrity of the tax system as a whole. The primary goals of corporate tax shelters are to manufacture tax benefits that can be used to offset unrelated income of the taxpayer or to create tax-favored or tax-exempt economic income.

Corporate tax shelters may take several forms but often share certain common characteristics. Corporate tax shelter schemes are often marketed by their designers or promoters to multiple corporate taxpayers. The transactions typically involve arrangements among corporate taxpayers and persons not subject to U.S. tax. Shelters are also often associated with high transactions costs, contingent or refundable fees, unwind clauses, financial accounting treatment that is significantly more favorable than the corresponding tax treatment, and property or transactions unrelated to the corporate participant's core business.

The Administration proposes several general remedies to curb the growth of corporate tax shelters. In addition, the Administration proposes to modify the treatment of certain specific transactions that provide sheltering potential. No inference is intended as to the treatment of any of these trnsactions under current law.

Modify substantial understatement penalty for corporate tax shelters.—The current 20-percent substantial understatement penalty imposed on corporate tax shelter items can be avoided if the corporate taxpayer had reasonable cause for the tax treatment of the item and good faith. The Administration proposes to increase the substantial understatement penalty on corporate tax shelter items to 40 percent. The penalty will be reduced to 20 percent if the corporate taxpayer discloses to the National Office of the Internal Revenue Service within 30 days of the closing of the transaction appropriate documents describing the corporate tax shelter and files a statement with, and provides adequate disclosure on, its tax return. The penalty could not be avoided by a showing of reasonable cause and good faith. The proposal is effective for transactions entered into after the date of first committee action.

Deny certain tax benefits in corporate tax shelters.—Under curent law, if a person acquires control of a corporation or a corporation acquires carryover basis property of a corporation not controlled by the acquiring corporation or its shareholders, and the principal purpose for such acquisition is evasion or avoidance of Federal income tax by securing certain tax benefits, the Secretary may disallow such benefits to the extent necessary to eliminate such evasion or avoidance of tax. However, this current rule has been interpreted narrowly. The Administration proposes to expand the current rules to authorize the Secretary to disallow a deduction, credit, exclusion, or other allowance obtained in a corporate tax shelter. The proposal would apply to transactions entered into on or after the date of first committee action.

Deny deductions for certain tax advice and impose an excise tax on certain fees received.—Buyers of corporate tax shelter advice may deduct the fees paid for such advice. The proposal would deny a deduction for fees paid or accrued in connection with the promotion of corporate tax shelters and the rendering of certain tax advice related to corporate tax shelters. The proposal would also impose a 25-percent excise tax on fees received in connection with the promotion of corporate tax shelters and the rendering of certain tax advice related to corporate tax shelters. The proposal would be effective for payments made on or after the date of first committee action.

Impose excise tax on certain rescission provisions and provisions guaranteeing tax benefits.—Because taxpayers entering into corporate tax shelter transactions know that such transactions are risky, particularly because the expected tax benefits are not justified economically, purchasers of corporate tax shelters often require the seller or a counterparty to enter into a tax benefit protection arrangement. The Administration proposes to impose on the purchaser of a corporate tax shelter an excise tax of 25 percent on the maximum payment to be made under the arrangement. For this purpose, a tax benefit protection arrangement would include certain rescission clauses, guarantee of tax benefits arrangement or any other arrangement that has the same economic effect (e.g., insurance purchased with respect to the transaction). The proposal would apply to arrangements entered into on or after the date of first committee action.

Preclude taxpayers from taking tax positions inconsistent with the form of their transactions.—Under current law, if a taxpayer enters into a transaction in which the economic substance and the legal form are different, the taxpayer may take the position that, notwithstanding the form of the transaction, the substance is controlling for Federal income tax purposes. Many taxpayers enter into such transactions in order to arbitrage tax and regulatory laws. Under the proposal, except to the extent the taxpayer discloses the inconsistent position on its tax return, a corporate taxpayer, but not the Internal Revenue Service, would be precluded from taking any position (on a tax return or otherwise) that the Federal income tax treatment of a transaction is different from that dictated by its form, if a tax indifferent person has a direct or indirect interest in such transaction. No inference is intended regarding the tax treatment of transactions not covered by the proposal. The proposal would be effective for transactions entered into on or after the date of first committee action.

Tax income from corporate tax shelters involving tax-indifferent parties.—The Federal income tax system has many participants who are indifferent to tax consequences (e.g., foreign persons, tax-exempt organizations, and Native American tribal organizations). Many corporate tax shelters have tax-indifferent participants who absorb taxable income generated by the shelters so that corresponding losses or deductions can be allocated to taxable participants. The proposal would provide that any income received by a tax-indifferent person with respect to a corporate tax shelter would be taxable. The proposal would be effective for transactions entered into on or after the date of first committee action.

Require accrual of income on forward sale of corporate stock.—There is little substantive difference between a corporate issuer's current sale of its stock for a deferred payment and an issuer's forward sale of the same stock. In both cases, a portion of the deferred payment compensates the issuer for the time-value of money during the term of the contract. Under current law, the issuer must recognize the time-value element of the deferred payment as interest if the transaction is a current sale for deferred payment but not if the transaction is a forward contract. Under the proposal, the issuer would be required to recognize the time-value element of the forward contract as well. The proposal would be effective for forward contracts entered into on or after the date of first committee action.

Modify treatment of built-in losses and other attribute trafficking.—Under current law, a taxpayer that becomes subject to U.S. taxation may take the position that it determines its beginning bases in its assets under U.S. tax principles as if the taxpayer had historically been subject to U.S. tax. Other tax attributes are computed similarly. A taxpayer may thus "import" built-in losses or other favorable tax attributes incurred outside U.S. taxing jurisdiction (e.g., from foreign or tax-exempt parties) to offset income or gain that would otherwise be subject to U.S. tax. The proposal would prevent the importation of attributes by eliminating tax attributes (including built-in items) and marking to market bases when an entity or an asset becomes relevant for U.S. tax purposes. The proposal would be effective for transactions in which assets or entities become relevant for U.S. tax purposes on or after the date of enactment.

Modify treatment of ESOP as S corporation shareholder.—Pursuant to provisions enacted in 1996 and 1997, an employee stock ownership plan (ESOP) may be a shareholder of an S corporation and the ESOP's share of the income of the S corporation is not subject to tax until distributed to the plan beneficiaries. The Administration proposes to require an ESOP to pay tax on S corporation income (including capital gains on the sale of stock) as the income is earned and to allow the ESOP a deduction for distributions of such income to plan beneficiaries. The deduction would only apply to the extent distributions exceed all prior undistributed amounts that were previously not subject to unrelated business income tax. The proposal would be effective for taxable years beginning on or after the date of first committee action. In addition, the proposal would be effective for acquisitions of S corporation stock by an ESOP after such date and for S corporation elections made on or after such date.

Prevent serial liquidation of U.S. subsidiaries of foreign corporations.—When a domestic corporation distributes a dividend to a foreign corporation, it is subject to U.S. withholding tax. In contrast, if a domestic corporation distributes earnings in a subsidiary liquidation under section 332, the foreign shareholder generally is not subject to any withholding tax. Relying on section 332, some foreign corporations establish U.S. holding companies to receive tax-free dividends from operating subsidiaries, and then liquidate the holding companies, thereby avoiding the withholding tax. Subsequently, they re-establish the holding companies to receive future dividends. The proposal would impose withholding tax on any distribution made to a foreign corporation in complete liquidation of a U.S. holding company if the holding company was in existence for less than five years. The proposal would also achieve a similar result with respect to serial terminations of U.S. branches. The proposal would be effective for liquidations and terminations occurring on or after the date of first committee action.

Prevent capital gains avoidance through basis shift transactions involving foreign shareholders.—A distribution in redemption of stock generally is treated as a dividend if it does not result in a meaningful reduction in the shareholder's proportionate interest in the distributing corporation, measured with reference to certain constructive ownership rules, including option attribution. If an amount received in redemption of stock is treated as a distribution of a dividend, the basis of the remaining stock generally is increased to reflect the basis of the redeemed stock. The basis of the remaining stock is not increased, however, to the extent that the basis of the redeemed stock was reduced or eliminated pursuant to the extraordinary dividend rules. In certain circumstances, these rules require a corporate shareholder to reduce the basis of stock with respect to which a dividend is received by the nontaxed portion of the dividend, which generally equals the amount of the dividend that is offset by the dividends received deduction. To prevent taxpayers from attempting to offset capital gains by generating artificial capital losses through basis shift transactions involving foreign shareholders, the Administration proposes to treat the portion of a dividend that is not subject to current U.S. tax as a nontaxed portion. Similar rules would apply in the event that the foreign shareholder is not a corporation. The proposal is effective for distributions on or after the date of first committee action.

Limit inappropriate tax benefits for lessors of tax-exempt use property.—Under current law, certain property leased to governments, tax-exempt organizations, or foreign persons is considered to be "tax-exempt use property." There are a number of restrictions on the ability of lessors of tax-exempt use property to claim tax benefits from transactions related to the tax-exempt use property. The Administration is concerned that certain structures involving tax-exempt use property are being used to generate inappropriate tax benefits for lessors. The proposal would deny a lessor the ability to recognize a net loss from a leasing transaction involving tax-exempt use property during the lease term. A lessor would be able to carry forward a net loss from a leasing transaction and use it to offset net gains from the transaction in subsequent years. The proposal would be effective for leasing transactions entered into on or after the date of enactment.

Prevent mismatching of deductions and income inclusions in transactions with related foreign persons.—Current law provides that if any debt instrument having original issue discount (OID) is held by a related foreign person, any portion of such OID shall not be allowable as a deduction to the issuer until paid. Section 267 and the regulations thereunder apply similar rules to other expenses and interest owed to related foreign persons. These general rules are modified, however, so that a deduction is allowed when the OID is includible in the income of a foreign personal holding company (FPHC), controlled foreign corporation (CFC) or passive foreign investment company (PFIC). The Treasury has learned of certain structured transactions (involving both U.S. payors and U.S.-owned foreign payors) designed to allow taxpayers inappropriately to take advantage of the current rules by accruing deductions to related FPHCs, CFCs or PFICs, without the U.S. owners of such related entities taking into account for U.S. tax purposes an amount of income appropriate to the accrual. This results in an improper mismatch of deductions and income. The proposal would provide that deductions for amounts accrued but unpaid to related foreign CFCs, PFICs or FPHCs would be allowable only to the extent the amounts accrued by the payor are, for U.S. tax purposes, reflected in the income of the direct or indirect U.S. owners of the related foreign person. The proposal would contain an exception for certain short term transactions entered into in the ordinary course of business. The Secretary would be granted regulatory authority to provide exceptions from these rules. The proposal would be effective for amounts accrued on or after the date of first committee action.

Restrict basis creation through section 357(c).—A transferor generally is required to recognize gain on a transfer of property in certain tax-free exchanges to the extent that the sum of the liabilities assumed, plus those to which the transferred property is subject, exceeds the basis in the property. This gain recognition to the transferor generally increases the basis of the transferred property in the hands of the transferee. If a recourse liability is secured by multiple assets, it is unclear under current 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 generally would be eliminated. Generally, a recourse liability would be treated as assumed to the extent that the transferee has agreed and is expected to satisfy the liability (whether or not the transferor has been relieved of the liability). A nonrecourse liability would be treated as assumed by the transferee of any asset subject to the liability, but the amount of nonrecourse liability treated as assumed would be reduced by the amount of the liability which an owner of other assets not transferred to the transferee and also subject to the liability has agreed with the transferee and is expected to satisfy, up to the fair market value of such other assets. The transferor's recognition of gain as a result of assumption of liability would not increase the transferee's basis in the transferred asset to an amount in excess of its fair market value. Moreover, if no person is subject to U.S. tax on gain recognized as the result of the assumption of a nonrecourse liability, then the transferee's basis in the transferred assets would be increased only to the extent such basis would be increased if the transferee had assumed only a ratable portion of the liability, based on the relative fair market values of all assets subject to such nonrecourse liability. The Treasury Department would have the authority to prescribe regulations necessary to carry out the purposes of the proposal, and to apply the treatment set forth in this proposal where appropriate elsewhere in the Code.

Modify anti-abuse rule related to assumption of liabilities.—The assumption of a liability in an otherwise tax-free transaction is treated as boot to the transferor if the principal purpose of having the transferee assume the liability was the avoidance of tax on the exchange. The current language is inadequate to address the avoidance concerns that underlie the provision. The Administration proposes to modify the anti-abuse rule by deleting the limitation that it only applies to tax avoidance on the exchange itself, and changing "the principal purpose" standard to "a principal purpose." Additional conforming changes would be made. This proposal would be effective for assumptions of liabilities on or after the date of first committee action.

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 on contracts insuring certain classes of individuals. 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 life insurance contracts to the 20-percent owner exception in the COLI proration rules. The proposal would be effective for taxable years beginning after the date of enactment.

Other Proposals

Require banks to accrue interest on short-term obligations.—Under current law, a bank (regardless of its accounting method) must accrue as ordinary income interest, including original issue discount, on short-term obligations. Recent court cases have held that banks that use the cash receipts and disbursements method of accounting do not have to accrue stated interest and original issue discount on short-term loans made in the ordinary course of the bank's business. The Administration believes it is inappropriate to treat these short-term loans differently than other short-term obligations held by the bank. The Administration's proposal would clarify that banks must accrue interest and original issue discount on all short-term obligations, including loans made in the ordinary course of the bank's business, regardless of the banks' overall accounting method. The proposal would be effective for obligations acquired (including originated) on or after the date of enactment. No inference is intended regarding the current-law treatment of these transactions.

Require current accrual of market discount by accrual method taxpayers.—Under current law, a taxpayer that holds a debt instrument with market discount is not required to include the discount in income as it accrues, even if the taxpayer uses an accrual method of accounting. Under the proposal, a taxpayer that uses an accrual method of accounting would be required to include market discount in income as it accrues. The proposal also would cap the amount of market discount on distressed debt instruments, because a portion of such discount, if realized, may be more in the nature of capital gain than interest. The proposal would be effective for debt instruments acquired on or after the date of enactment.

Limit conversion of character of income from constructive ownership transactions with respect to partnership interests.—Under current law, a taxpayer can enter into a derivatives transaction that is designed to give the taxpayer the economic equivalent of an ownership interest in a partnership but that is not itself a current ownership interest in the partnership. These so-called "constructive ownership" transactions purportedly allow taxpayers to defer income and to convert ordinary income and short-term capital gain into long-term capital gain. The proposal would treat long-term capital gain recognized from a constructive ownership transaction as ordinary income to the extent the long-term capital gain recognized from the transaction exceeds the long-term capital gain that could have been recognized had the taxpayer invested in the partnership interest directly. In addition, the proposal would impose an interest charge on these transactions to compensate for their inherent deferral and would allow taxpayers to elect mark-to-market treatment in lieu of applying the gain recharacterization and interest charge rule. The proposal would be effective for gains recognized on or after the date of first committee action.

Modify rules for debt-financed portfolio stock.—Under current law, a corporation must reduce its dividends-received deduction with respect to dividends paid on portfolio stock to the extent the portfolio stock is debt financed. For the portfolio stock to be debt financed, the indebtedness must be "directly attributable to investment in the portfolio stock." This "directly attributable" standard is too easily avoided. Under the proposal, the percentage of portfolio stock considered to be debt financed would be equal to the sum of (1) the percentage of stock that is directly financed, and (2) the percentage of remaining stock that is indirectly financed. The proposal would be effective for portfolio stock acquired on or after the date of enactment.

Modify and clarify certain rules relating to debt-for-debt exchanges.—Under current law, an issuer can inappropriately accelerate interest deductions by refinancing a debt instrument in a debt-for-debt exchange at a time when the issuer's cost of borrowing has declined. The proposal would spread the issuer's net deduction for bond repurchase premium in a debt-for-debt exchange over the term of the new debt instrument using constant yield principles. In addition, the proposal would modify the measurement of the net income or deduction in debt-for-debt exchanges involving contingent payment debt instruments. Finally, the proposal would modify the measurement of taxable boot to the holder in debt-for-debt exchanges that are part of corporate reorganizations. The proposal would apply to debt-for-debt exchanges occurring on or after the date of enactment.

Modify and clarify the straddle rules.—A "straddle" is the holding of two or more offsetting positions with respect to actively-traded personal property. An exception from the definition is provided for certain offsetting positions with respect to actively-traded stock. If a taxpayer enters into a straddle, the taxpayer must defer the recognition of loss from the "loss leg" of the straddle until the taxpayer recognizes the offsetting gain from the "gain leg" of the straddle. Further, the taxpayer must capitalize the net interest and carrying charges properly attributable to the straddle. The proposal would clarify that net interest expense and carrying charges arising from structured financial products that contain a leg of a straddle must be capitalized. In addition, the proposal would repeal the current-law exception for certain straddles of actively-traded stock. The proposal would be effective for straddles entered into on or after the date of enactment.

Conform control test for tax-free incorporations, distributions, and reorganizations.—For tax-free incorporations, tax-free distributions, and reorganizations, "control" is defined as the ownership of 80 percent of the voting stock and 80 percent of the number of shares of all other classes of stock of the corporation. This test is easily manipulated by allocating voting power among the shares of a corporation, allowing corporations to retain control of a corporation but sell a significant amount of the value of the corporation. In contrast, the necessary "ownership" for tax-free liquidations, qualified stock purchases, and affiliation is at least 80 percent of the total voting power of the corporation's stock and at least 80 percent of the total value of the corporation's stock. The Administration proposes to conform the control requirement for tax-free incorporations, distributions, and reorganizations with that used for determining affiliation. This proposal is effective for transactions on or after the date of enactment.

Tax issuance of tracking stock.—"Tracking stock" is an economic interest that is intended to relate to and track the economic performance of one or more separate assets of the issuer, and gives its holder a right to share in the earnings or value of less than all of the corporate issuer's earnings or assets. The use of tracking stock is clearly outside the contemplation of subchapter C and other sections of the Code. As a result, a principal consequence of treating such a stock interest as stock of the issuer is the potential avoidance of these provisions. The Administration proposes to define "tracking stock" as stock that is linked to the performance of assets of the issuing corporation with one or more identified characteristics and provide that gain will be recognized on the issuance of tracking stock. Under this proposal, the Secretary would have authority to treat tracking stock as nonstock (e.g., debt, a notional principal contract, etc.) or as stock of another entity as appropriate to prevent avoidance. No inference is intended regarding the tax treatment of tracking stock under current law. This proposal is effective for tracking stock issued on or after the date of enactment.

Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions.—No gain or loss will be recognized if one or more persons transfer property to a controlled corporation (or partnership) solely in exchange for stock in the corporation (or a partnership interest). Where there is a transfer of less than "all substantial rights" to use property, the Internal Revenue Service's position is that such transfer will not qualify as a tax-free exchange. However, the Claims Court rejected the Service's position in *E.I. Du Pont de Nemours and Co. v. U.S.*, holding that any transfer of something of value could be a "transfer" of "property." The inconsistency between the positions has resulted in whipsaw of the government. The Administration proposes to provide that the transfer of an interest in intangible property constituting less than all of the substantial rights of the transferor in the property is a transfer of property entitled to tax-free treatment, and the transferor must allocate the basis of the intangible between the retained rights and the transferred rights based upon respective fair market values. Consistent reporting by the transferor and the transferee would be required. This proposal is effective for transfers on or after the date of enactment.

Modify tax treatment of downstream mergers.—If a target corporation owns stock in an acquiring corporation and wants to combine with the acquiring corporation in a downstream transaction, the target corporation transfers its assets to the acquiring corporation, and the shareholders of the target corporation receive stock of the acquiring corporation in exchange for their target corporation stock. Downstream transactions have been held to qualify as tax-free reorganizations. In substance, however, this transaction is a distribution by the target corporation of its acquiring corporation stock to its shareholders, which otherwise would result in gain recognized by the target corporation. Under the proposal, where a target corporation holds less than 80 percent of the stock of an acquiring corporation, and the target corporation combines with the acquiring corporation in a reorganization in which the acquiring corporation is the survivor, the target corporation must recognize gain, but not loss, as if it distributed the acquiring corporation stock that it held immediately prior to the reorganization. Nonrecognition treatment would continue to apply to other assets transferred by the target corporation and to the target corporation shareholders. The proposal would apply to similar transactions: for example, where stock of the target corporation is acquired by the acquiring corporation in a transaction qualifying as a reorganization, and the target corporation is liquidated pursuant to a plan of liquidation adopted not more than two years after the acquisition date. This proposal applies to transactions that occur on or after the date of enactment.

Provide mandatory basis adjustments with respect to partnership distributions.—The basis of partnership property is not adjusted upon a distribution of property to a partner unless a special election is in effect. If such an election is in effect, a partnership must increase the basis of partnership property in certain circumstances and decrease its basis in partnership property in other situations. The electivity of these adjustments provides substantial opportunities for taxpayer abuse. Accordingly, the Administration proposes that basis adjustments in connection with partnership distributions be made mandatory. In addition, unlike current law, the basis adjustment would be measured by reference to the difference between the basis of the distributed property and the amount by which the distributee partner's proportionate share of the adjusted basis of partnership property is reduced by the distribution. This proposal would apply to partnership distributions made on or after the date of enactment.

Modify rules for allocation of basis adjustments for partnership distributions.—Under current law, a partner's basis in distributed property is allocated first to unrealized receivables and inventory items in an amount equal to the adjusted basis of each such property to the partnership, with any remaining basis being allocated among the other distributed property. This basis allocation scheme is intended to prevent partners from shifting basis from capital assets to ordinary income assets. While generally accomplishing this goal, the allocation scheme still allows for a shifting of basis from non-depreciable assets to depreciable assets. The proposal would modify the rule for basis allocations in the event of a liquidation of a partner's interest to include three asset classes: (1) inventory, unrealized receivables and other inventory assets, (2) depreciable assets, and (3) non-depreciable assets. Basis would be allocated in the first two categories up to the partnership's basis in such assets. Residual basis would be allocated to the third category of assets. The partnership's inside asset basis adjustments made in connection with partnership distributions would be determined in the same manner. Basis adjustments relating to transfers of partnership interests would not be affected by this proposal. This proposal would apply to partnership distributions made on or after the date of enactment.

Modify rules for partial liquidations of a partnership.—A partner recognizes gain or loss upon a distribution from a partnership in certain limited circumstances. The basis of property distributed to a partner other than in liquidation of the partner's interest generally is its adjusted basis to the partnership, while the basis of property distributed to a partner in liquidation of the partner's interest is equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction. These rules provide for an inappropriate deferral of gain with respect to certain partnership distributions and also allow for a misallocation of basis in many instances. The Administration proposes to treat a partial liquidation of a partner's interest in a partnership as a complete liquidation of that portion of the partner's interest. A partial liquidation would be a reduction in a partner's percentage share of capital, and the percentage that is reduced would be treated as a separate interest that was completely liquidated in the distribution. This proposal would apply to partnership distributions made on or after the date of enactment.

Repeal rules relating to distributions treated as sales or exchanges with respect to unrealized receivables and inventory items.—Under current law, to the extent that a partner receives (1) unrealized receivables or substantially appreciated inventory in exchange for all or part of its interest in other partnership property, or (2) partnership property other than unrealized receivables or substantially appreciated inventory in exchange for all or part of its interest in partnership property that is unrealized receivables or substantially appreciated inventory, such transactions are, under regulations, treated as a sale or exchange of such property between the distributee and the partnership. This rule, which often has been criticized as being overly complex, was designed to prevent taxpayers from converting ordinary income to capital gains through partnership distributions where the distributee partner essentially transferred his share of ordinary income assets to the partnership in exchange for capital gain assets or vice versa. The proposals discussed above would prevent positive basis adjustments from being made to ordinary income assets, which would greatly reduce the ability to carry out such abuses. Accordingly, the Administration proposes that this rule be repealed. This proposal would apply to partnership distributions made on or after the date of enactment.

Require basis adjustments when a partnership distributes certain stock to a corporate partner.—The basis of property distributed to a partner in liquidation of the partner's interest is equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction. Generally, no gain or loss is recognized on the receipt by a corporation of property distributed in complete liquidation of an 80-percent-owned subsidiary corporation. The basis of property received by the distributee in such a corporate liquidation is the same as it was in the hands of the transferor. These corporate liquidation rules provide taxpayers with the ability to negate the effect of downward basis adjustments by having a partnership contribute property to a corporation prior to a liquidating distribution to a corporate partner. The proposal would require that if stock of a corporation is distributed to a corporate partner that, as a result of the distribution and related transactions, owns 80 percent or more of the stock of such corporation, then the distributed corporation must reduce the basis of its assets by an amount equal to the amount by which the stock basis is reduced as a result of the distribution. The basis must be reduced using the same methodology as is used in the partnership liquidation rules, determined as if the corporation's assets were being distributed. This proposal would apply to partnership distributions made on or after the date of enactment.

Deny change in method treatment to tax-free formations.—Generally, a taxpayer that desires to change its method of accounting must obtain the consent of the Commissioner. In addition, in a transaction to which section 381 applies, a corporation acquiring assets generally is required to use the method of accounting used for those assets by the distributor or transferor corporation. Under current law, section 381 does not apply to tax-free contributions to a corporation or to a partnership. Consequently, taxpayers who transfer assets to a subsidiary or a partnership in a transaction to which section 351 or section 721 applies may avail themselves of a new method of accounting without obtaining the consent of the Commissioner. The Administration proposes to expand the transactions to which the carryover of method of accounting rules in section 381 and the regulations thereunder apply to include tax-free contributions to corporations or partnerships effective for transfers on or after the date of enactment.

Repeal installment method for accrual basis taxpayers.—Generally, an accrual method requires a taxpayer to recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. The installment method of accounting provides an exception to these general recognition principles by allowing a taxpayer to defer recognition of income from the disposition of certain property until payment is received. To the extent that an installment obligation is pledged as security for any indebtedness, the net proceeds of the secured indebtedness are treated as a payment on such obligation, thereby triggering the recognition of income. The installment method is inconsistent with an accrual method of accounting and effectively allows an accrual method taxpayer to recognize income from certain property using the cash receipts and disbursements method. Consequently, the method fails to reflect the economic results of a taxpayer's business during the taxable year. In addition, the pledging rules, which are designed to require the recognition of income when the taxpayer receives cash related to an installment obligation, are inadequate. The Administration proposes to repeal the installment method of accounting for accrual method taxpayers and to eliminate the inadequacies in the pledging rules for installment sales entered into on or after the date of enactment.

Deny deduction for punitive damages.—The current deductibility of most punitive damage payments undermines the role of such damages in discouraging and penalizing certain undesirable actions or activities. The Administration proposes to disallow any deduction for punitive damages paid or incurred by the taxpayer, whether upon a judgment or in settlement of a claim.

Where the liability for punitive damages is covered by insurance, such damages paid or incurred by the insurer would be included in the gross income of the insured person. The insurer would be required to report such payments to the insured person and to the Internal Revenue Service. The proposal would apply to damages paid or incurred on or after the date of enactment.

Apply uniform capitalization rules to tollers.—The uniform capitalization rules require the capitalization of the direct costs, and an allocable portion of the indirect costs, of real or tangible personal property produced by a taxpayer or of real or personal property that is acquired by a taxpayer for resale. Costs attributable to producing or acquiring property generally must be capitalized by charging such costs to basis or, in the case of property which is inventory in the hands of the taxpayer, by including such costs in inventory. In general, a toller charges a fee (known as a toll) to perform certain manufacturing or processing operations on property which is provided by its customers. Since the toller does not take title to the property, it contends that it does not produce property or acquire property for resale. As a result, a toller does not capitalize certain direct and indirect costs attributable to its tolling activities. The Administration believes that the disparate treatment between tollers and manufacturers based on ownership of the raw materials leads to inequitable results. Thus, the uniform capitalization rules would be modified to require tollers to capitalize both their direct costs, and a portion of their indirect costs, allocable to property tolled. An exception would be provided for small businesses. The proposal would be effective for taxable years beginning on or after the date of enactment.

Provide consistent amortization periods for intangibles.—Under current law, start-up and organizational expenditures are amortized at the election of the taxpayer over a period of not less than 5 years. Current law requires certain acquired intangible assets (goodwill, trademarks, franchises, patents, etc.) to be amortized over 15 years. The Administration believes that, to encourage the formation of new businesses, a fixed amount of start-up and organizational expenditures should be currently deductible. Thus, the proposal would allow a taxpayer to elect to deduct up to $5,000 each of start-up or organizational expenditures. However, for each taxpayer, the $5,000 amount is reduced (but not below zero) by the amount by which the cumulative cost of start-up or organizational expenditures exceeds $50,000. Start-up and organizational expenditures not currently deductible would be amortized over a 15-year period consistent with the amortization period for acquired intangible assets. The proposal generally would be effective for start-up and organizational expenditures incurred in taxable years beginning on or after the date of enactment.

Clarify recovery period of utility grading costs.—A taxpayer is allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property that is used in a trade or business or held for the production of income. For most tangible property placed in service after 1986, the amount of the depreciation deduction is determined under the modified accelerated cost recovery system (MACRS) using a statutorily prescribed depreciation method, recovery period, and placed in service convention. The recovery period may be determined by reference to the statutory recovery period or to the list of class lives provided by the Treasury Department. Electric and gas utility clearing and grading costs incurred to extend distribution lines and pipelines have not been assigned a class life. By default, such assets have a seven-year recovery period under MACRS. The Administration believes that the recovery period used for electric and gas utility clearing and grading costs does not reflect the economic useful life of such costs. For example, the electric utility transmission and distribution lines and the gas utility trunk pipelines benefitted by the clearing and grading costs have MACRS recovery periods of 20 years and 15 years, respectively. The proposal would assign depreciable electric and gas utility clearing and grading costs incurred to locate transmission and distribution lines and pipelines to the class life assigned to the benefitted assets, giving these costs a recovery period of 20 years and 15 years, respectively. The proposal would be effective for electric and gas utility clearing and grading costs incurred on or after the date of enactment.

Require recapture of policyholder surplus accounts.—Between 1959 and 1984, stock life insurance companies deferred tax on a portion of their profits. These untaxed profits were added to a policyholders surplus account (PSA). In 1984, Congress precluded life insurance companies from continuing to defer tax on future profits through PSAs. However, companies were permitted to continue to defer tax on their existing PSAs, and to pay tax on the previously untaxed profits in the PSAs only in certain circumstances. There is no remaining justification for allowing these companies to continue to defer tax on profits they earned between 1959 and 1984. Most pre-1984 policies have terminated, because pre-1984 policyholders have surrendered their pre-1984 contracts for cash, ceased paying premiums on those contracts, or died. The Administration proposes that companies generally would be required to include in their gross income over ten years their PSA balances as of the beginning of the first taxable year starting on or after the date of enactment.

Modify rules for capitalizing policy acquisition costs of life insurance companies.—Under current law, insurance companies capitalize varying percentages of their net premiums for certain types of insurance contracts, and generally amortize these amounts over 10 years (five years for small companies). These capitalized amounts are intended to serve as proxies for each company's actual commissions and other policy acquisition expenses. However, data reported by insurance companies to State insurance regulators each year indicates that the insurance industry is capitalizing less than half of its policy acquisition costs, which results in a mismatch of income and deductions. The Administration proposes that insurance companies be required to capitalize modified percentages of their net premiums for certain lines of business. The percentages would be modified once in the first taxable year beginning after the date of enactment, and a second time in the sixth taxable year beginning after the date of enactment. The final modified percentages would more accurately reflect the ratio of actual policy acquisition expenses to net premiums and the typical useful lives of the contracts. To ensure that companies are not required to capitalize more under this proxy approach than they would capitalize under normal tax accounting rules, companies that have low policy acquisition costs generally would be permitted to capitalize their actual policy acquisition costs.

Subject investment income of trade associations to tax.—Trade associations described in section 501(c)(6) generally are exempt from Federal income tax, but are subject to tax on their unrelated business income. Under the proposal, trade associations that have net investment income in excess of $10,000 for any taxable year would be subject to the unrelated business income tax on their excess net investment income. As under current-law section 512(a)(3), investment income would not be subject to tax under the proposal to the extent that it is set aside for a charitable purpose specified in section 170(c)(4). In addition, any gain from the sale of property used directly in the performance of the trade association's exempt function would not be subject to tax under the proposal to the extent that the sale proceeds are used to purchase replacement exempt-function property. The proposal would be effective for taxable years beginning on or after the date of enactment.

Restore phaseout of unified credit for large estates.—Prior to the Taxpayer Relief Act of 1997, the benefit of both the estate tax graduated rate brackets below fifty-five percent and the unified credit were phased out by imposing a five-percent surtax on estates with a value above $10 million. When the Taxpayer Relief Act of 1997 increased the unified credit amount, the phase out of the unified credit was inadvertently omitted. The Administration proposes to restore the surtax in order to phase out the benefits of the unified credit as well as the graduated estate tax brackets. The proposal would be effective for decedents dying after the date of enactment.

Require consistent valuation for estate and income tax purposes.—The basis of property acquired from a decedent generally is its fair market value on the date of death. Property included in the gross estate of a decedent is valued also at its fair market value on the date of death. Recipients of lifetime gifts generally take a carryover basis in the property received. The Administration proposes to impose a duty of consistency on heirs receiving property from a decedent, requiring such heirs to use the value as reported on the estate tax return as the basis for the property for income tax purposes. Estates would be required to notify heirs (and the IRS) of such values. In addition, donors making lifetime gifts would be required to notify the recipients of such gifts (and the IRS) of the donor's basis in the property at the time of the gift, as well as any gift tax paid with respect to the gift. This proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

Require basis allocation for part sale/part gift transactions.—In a part gift, part sale transaction, the donee/purchaser takes a basis equal to the greater of the amount paid by the donee or the donor's adjusted basis at the time of the transfer. The donor/seller uses adjusted cost basis in computing the gain or loss on the sale portion of the transaction. The Administration proposes to rationalize basis allocation in a part gift, part sale transaction by requiring the basis of the property to be allocated ratably between the gift portion and the sale portion based on the fair market value of the property on the date of transfer and the consideration paid. This proposal would be effective for transactions entered into on or after the date of enactment.

Conform treatment of surviving spouses in community property States.—If joint property is owned by spouses in a non-community property state, a surviving spouse receives a stepped-up basis only in the half of the property owned by the deceased spouse. In contrast, when a spouse dies owning community property, the surviving spouse is entitled to a stepped-up basis not only in the half of the property owned by the deceased spouse, but also in the half of the property already owned by the surviving spouse prior to the decedent's death. The Administration proposes to eliminate the stepped-up basis in the part of the community property owned by the surviving spouse prior to the deceased spouse's death. The half of the community property owned by the deceased spouse would continue to be entitled to a stepped-up basis upon death. This treatment will be consistent with the treatment of joint property owned by spouses in a non-community property State. This proposal would be effective for decedents dying after the date of enactment.

Expand section 864(c)(4)(B) to interest and dividend equivalents.—Under U.S. domestic law, a foreign person is subject to taxation in the United States on a net income basis with respect to income that is effectively connected with a U.S. trade or business (ECI). The test for determining whether income is effectively connected to a U.S. trade or business differs depending on whether the income at issue is U.S. source or foreign source. Only enumerated types of foreign source income—rents, royalties, dividends, interest, gains from the sale of inventory property, and insurance income—constitute ECI, and only in certain circumstances. The proposal would expand the categories of foreign-source income that could constitute ECI to include interest equivalents (including letter of credit fees) and dividend equivalents in order to eliminate arbitrary distinctions between economically equivalent transactions.

Recapture overall foreign losses when CFC stock is disposed.—Under the interest allocation rules of section 864(e), the value of stock in a controlled foreign corporation (CFC) is added to the value of directly-owned foreign assets, and then compared to the value of domestic assets of a corporation (or a group of affiliated U.S. corporations) for purposes of determining how much of the corporation's interest deductions should be allocated against foreign income and how much against domestic income. If these deductions against foreign income result in (or increase) an overall foreign loss which is then set against U.S. income, section 904(f) has recapture rules that require subsequent foreign income or gain to be recharacterized as domestic. Recapture can take place when directly-owned foreign assets, for example, are disposed of. However, there may be no recapture when stock in a CFC is disposed of. The proposal would correct that asymmetry by providing that property subject to the recapture rules upon disposition under section 904(f)(3) would include stock in a CFC.

Increase elective withholding rate for nonperiodic distributions from deferred compensation plans.—The Administration proposes to increase the current 10-percent elective withholding rate for nonperiodic distributions (such as certain lump sums) from pensions, IRAs and annuities to 15 percent, which more closely approximates the taxpayer's income tax liability for the distribution effective for distributions after 1999. The withholding would not apply to eligible rollover distributions.

Increase section 4973 excise tax for excess IRA contributons.—Excess IRA contributions are currently subject to an annual six-percent excise tax. With high investment returns, this annual six-percent rate may be insufficient to discourage contributions in excess of the current limits for IRAs. The Administration proposes to increase from six percent to 10 percent the excise tax on excess contributions to traditional and Roth IRAs for taxable years after the year the excess contribution is made. Thus, the six-percent rate would continue to apply for the year of the excess contribution and a higher annual rate would apply if excess amounts remain in the IRA. This increase would be effective for taxable years beginning after 1999.

Limit pre-funding of welfare benefits for 10 or more employer plans.—Current law generally limits the ability of employers to claim a deduction for amounts used to prefund welfare benefits. An exception is provided for certain arrangements where 10 or more employers participate because it is believed that such relationships involve risk-sharing similar to insurance which will effectively eliminate any incentive for participating employers to prefund benefits. However, as a practical matter, it has proven difficult to enforce the risk-sharing requirements in the context of certain arrangements. The Administration proposes to limit the 10 or more employer plan funding exception to medical, disability, and group-term life insurance benefits because these benefits do not present the same risk of prefunding abuse. Thus, effective for contributions paid on or after the date of enactment, the existing deduction rules would apply to prevent an employer who contributes to a 10 or more employer plan from claiming a current deduction for supplemental unemployment benefits, severance pay or life insurance (other than group-term life insurance) benefits to be paid in future years.

Subject signing bonuses to employment taxes.—Bonuses paid to individuals for signing a first contract of employment are ordinary income in the year received. The Administration proposes to clarify that these amounts are treated as wages for purposes of income tax withholding and FICA taxes effective after the date of enactment. No inference is intended with respect to the application of prior law withholding rules to signing bonuses.

Expand reporting of cancellation of indebtedness income.—Under current law, gross income generally includes income from the discharge of indebtedness. If a bank, thrift institution, or credit union discharges $600 or more of any indebtedness of a debtor, the institution must report such discharge to the debtor and the IRS. The proposal would extend these reporting requirements to additional entities involved in the trade or business of lending for discharges of indebtedness occurring on or after the date of enactment.

Require taxpayers to include rental income of residence in income without regard to the period of rental.—Under current law, rental income is generally includable in income and the deductibility of expenses attributable to the rental property is subject to certain limitations. An exception to this general treatment applies if a dwelling is used by the taxpayer as a residence and is rented for less than 15 days during the taxable year. The income from such a rental is not included in gross income and no expenses arising from the rental are deductible. The Administration proposes to repeal this 15-day exception. The proposal would apply to taxable years beginning after December 31, 1999.

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 or 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 similar 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.

Defer interest deduction and original issue discount (OID) on certain 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.

Modify deposit requirement for Federal Unemployment Act (FUTA).—Beginning in 2005, 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.

Reinstate Oil Spill Liability Trust Fund 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, 2009. 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.

Deny 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 dividends-received deduction for dividends on nonqualified preferred stock (as defined in section 351(g)), except in the case of "qualifying dividends." This proposal is effective for nonqualified preferred stock issued after the date of first committee action.

Disallow interest on debt allocable to tax-exempt obligations.—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.

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.

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.

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.

Require withholding on certain gambling winnings —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.

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, 1999.

Replace sales-source rules with activity-based rules.—If inventory is manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of the income from such sales is treated as earned by production activities and 50 percent by sales activities. The income from the production activities is sourced on the basis of the location of assets held or used to produce the income. The income from the sales activity (the remaining 50 percent) is sourced based on where title to the inventory transfers. If inventory is purchased in the United States and sold abroad, 100 percent of the sales income generally is deemed to be foreign source. These rules generally produce more foreign source income for United States tax purposes than is subject to foreign tax. Thus, the rules generally increase the U.S exporters' foreign tax credit limitation and thereby allow U.S. exporters that operate in high-tax foreign countries to credit tax in excess of the U.S. rate against their U.S. tax liability. The proposal would require that the allocation between production activities and sales activities be based on actual economic activity. 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.—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, 2000 and to acquisitions of a C corporation by an S corporation made after December 31, 1999.

Eliminate the income recognition exception for accrual method service providers.—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 beginning after the date of enactment.

Modify structure of businesses indirectly conducted by REITs.—REITs generally are restricted to owning passive investments in real estate and certain securities. No single corporation can account for more than five percent of the total value of a REIT's assets, and a REIT cannot own more than 10 percent of the outstanding voting securities of any issuer. Through the use of non-voting preferred stock and multiple subsidiaries, up to 25 percent of the value of a REIT's assets can consist of subsidiaries that conduct otherwise impermissible activities. Under the proposal, the 10-percent vote test would be changed to a "vote or value" test. This would prevent REITs from undertaking impermissible activities through preferred stock subsidiaries. However, the proposal also would provide an exception to the five- and 10-percent asset tests so that REITs could have "taxable REIT subsidiaries" that would be allowed to perform non-customary and other currently prohibited services with respect to REIT tenants and other customers. Under the proposal, there would be two types of taxable REIT subsidiaries, a "qualified independent contractor subsidiary" and a "qualified business subsidiary." A qualified business subsidiary would be allowed to undertake non-tenant related activities that currently generate bad income for a REIT. A qualified independent contractor subsidiary would be allowed to perform non-customary and other currently prohibited services with respect to REIT tenants as well as activities that could be performed by a qualified business subsidiary. All taxable REIT subsidiaries owned by a REIT could not represent more than 15 percent of the value of the REIT's total assets, and within that 15-percent limitation, no more than five percent of the total value of a REIT's assets could consist of qualified independent contractor subsidiaries. A number of additional constraints would be imposed on a taxable REIT subsidiary to ensure that the taxable REIT subsidiary pays a corporate level tax on its earnings. This proposal would be effective after the date of enactment. REITs would be allowed to combine and convert preferred stock subsidiaries into taxable REIT subsidiaries tax-free prior to a certain date.

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 50 percent or more of the total combined voting power of all classes of voting stock or 50 percent or more of the total value of all 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.

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 40-percent excise tax on the difference between the amount paid by the purchaser to the injured person and the undiscounted value of the purchased payment stream 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 on or 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.

Amend 80/20 company rules.—Interest or 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 on or after 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 nonresident'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 of section 883.—Under section 887, a foreign corporation is subject to a four-percent tax on its United States source gross transportation income. Under section 883, however, the tax will not apply 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 to current U.S. 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. Residents of non-exemption countries, however, 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 four-percent U.S. tax. The proposal would stop that abuse. It would be effective for taxable years beginning on or 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.

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 non-business assets. The proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

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 trust 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.

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 companies 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, banks and brokerage firms, 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 deductible 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 25 percent.

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 taxable years beginning after December 31, 1998 and before January 1, 2010.

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, 2009. These taxes expired on December 31, 1995.

Convert a portion of the excise taxes deposited in the Airport and Airway Trust Fund to cost-based user fees assessed for Federal Aviation Administration (FAA) services.—The excise taxes that are levied on domestic air passenger tickets and flight segments, international departures and arrivals, and domestic air cargo are proposed to be reduced over time as more efficient, cost-based user fees for air traffic services are phased in beginning in fiscal year 2000. The excise taxes are proposed to be reduced as necessary to ensure that the amount collected each year from the new user fees and the excise taxes together is equal to the total budget resources requested for the FAA in each succeeding year.

Receipts from tobacco legislation.—The Administration includes receipts from tobacco legislation in the 2000 budget. These receipts, which total approximately $34 billion for the five years 2000 through 2004, would provide reimbursements for tobacco-related health care costs.

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.

Restore premiums for the United Mine Workers of America Combined Benefit Fund.—The Administration proposes legislation to restore the previous calculation of premiums charged to coal companies that employed the retired miners that have been assigned to them. By reversing the court decision of *National Coal v. Chater*, this legislation will restore a premium calculation that supports medical cost containment.

Assess mortgage transaction fees for flood hazard determination.—The Administration proposes to establish a $15 fee on mortgage originations and refinancings to support a multi-year program to update and modernize FEMA's inventory of floodplain maps (100,000 maps). Accurate and easy to use flood hazard maps are essential in determining if a property is located in a floodplain. The maps allow lenders to meet their statutory obligation of requiring risk-prone homes with a mortgage to carry flood insurance, and allow homeowners to assess their risk of flood damage. These maps are the basis for developing appropriate risk-based flood insurance premium charges, and improved maps will result in a more actuarially sound insurance program.

Replace Harbor Maintenance Tax with the Harbor Services User Fee (receipt effect).—The Administration proposes to replace the ad valorem Harbor Maintenance Tax with a cost-based user fee, the Harbor Services User Fee. The user fee will finance harbor construction, operation, and maintenance activities performed by the Army Corps of Engineers, the costs of operating and maintaining the Saint Lawrence Seaway, and the costs of administering the fee. The fee will raise an average of $980 million annually through FY 2004, which is less than would have been raised by the Harbor Maintenance Tax before the Supreme Court decision that the ad valorem tax on exports was unconstitutional.

Allow members of the clergy to revoke exemption from Social Security and Medicare coverage.—Under current law, ministers of a church who are opposed to participating in the Social Security and Medicare programs on religious principles may reject coverage by filing with the Internal Revenue Service before the tax filing date for their second year of work in the ministry. This proposal would provide an opportunity for members of the clergy to revoke their exemptions from Social Security and Medicare coverage.

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 millions of dollars)

	Estimate						
	1999	2000	2001	2002	2003	2004	2000–2004
Provide tax relief and extend expiring provisions:							
Make health care more affordable:							
Provide tax relief for long-term care needs	....	–52	–1,107	–1,144	–1,312	–1,408	–5,023
Provide tax relief for workers with disabilities	....	–21	–151	–169	–187	–196	–724
Provide tax relief to encourage small business health plans	....	–1	–5	–10	–15	–13	–44
Subtotal, make health care more affordable	....	–74	–1,263	–1,323	–1,514	–1,617	–5,791
Expand education initiatives:							
Provide incentives for public school construction and modernization	....	–146	–570	–939	–1,035	–1,045	–3,735
Extend employer-provided educational assistance and include graduate education	–72	–267	–719	–236	....	....	–1,222
Provide tax credit for workplace literacy and basic education programs	....	–3	–18	–25	–38	–55	–139
Encourage sponsorship of qualified zone academies	....	–22	–43	–55	–24	....	–144
Eliminate 60-month limit on student loan interest deduction	....	–18	–61	–62	–67	–73	–281
Eliminate tax when forgiving student loans subject to income contingent repayment	....	....	....	....	....	....	....
Provide tax relief for participants in certain Federal education programs	....	–3	–7	–7	–7	–6	–30
Subtotal, expand education initiatives	–72	–459	–1,418	–1,324	–1,171	–1,179	–5,551
Make child care more affordable:							
Increase, expand, and simplify child and dependent care tax credit	....	–338	–1,585	–1,426	–1,471	–1,503	–6,323
Provide tax incentives for employer-provided child-care facilities	....	–40	–84	–114	–131	–140	–509
Subtotal, make child care more affordable	....	–378	–1,669	–1,540	–1,602	–1,643	–6,832

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	1999	2000	2001	2002	2003	2004	2000–2004
				Estimate			
Provide incentives to revitalize communities:							
Increase low-income housing tax credit per capita cap	....	–46	–186	–330	–474	–620	–1,656
Provide Better America Bonds to improve the environment	....	–8	–49	–127	–205	–284	–673
Provide New Markets Tax Credit	....	–12	–88	–207	–297	–376	–980
Expand tax incentives for SSBICs	–*	–*	–*	–*	–*	–*	–*
Extend wage credit for two new EZs	....	....	....	....	....	....	....
Subtotal, provide incentives to revitalize communities	....	–66	–323	–664	–976	–1,280	–3,309
Promote energy efficiency and improve the environment:							
Provide tax credit for energy-efficient building equipment	....	–230	–407	–376	–393	–127	–1,533
Provide tax credit for new energy-efficient homes	....	–60	–109	–92	–72	–96	–429
Extend electric vehicle tax credit; provide tax credit for fuel-efficient vehicles	....	....	....	–4	–178	–712	–894
Provide investment tax credit for CHP systems	–1	–64	–99	–110	–52	–7	–332
Provide tax credit for rooftop solar systems	....	–9	–19	–25	–34	–45	–132
Extend wind and biomass tax credit and expand eligible biomass sources	....	–20	–48	–73	–88	–94	–323
Subtotal, promote energy efficiency and improve the environment	–1	–383	–682	–680	–817	–1,081	–3,643
Promote expanded retirement savings, security and portability	–27	–144	–204	–218	–213	–218	–997
Extend expiring provisions:							
Allow personal tax credits against the AMT	–67	–679	–707	....	....	....	–1,386
Extend work opportunity tax credit	–23	–116	–164	–81	–38	–16	–415
Extend welfare-to-work tax credit	–3	–19	–36	–21	–9	–2	–87
Extend R&E tax credit	–311	–933	–656	–281	–133	–53	–2,056
Make permanent the expensing of brownfields remediation costs	....	....	–106	–170	–168	–167	–611
Extend tax credit for first-time DC homebuyers	1	–1	–10	–1	....	....	–12
Subtotal, extend expiring provisions	–403	–1,748	–1,679	–554	–348	–238	–4,567
Simplify the tax laws	–64	–141	–159	–154	–104	–41	–599
Miscellaneous provisions:							
Make first $2,000 of severance pay exempt from income tax	....	–42	–168	–173	–133	....	–516
Allow steel companies to carryback NOLs up to five years	–19	–190	–28	–30	–24	–20	–292
Subtotal, miscellaneous provisions	–19	–232	–196	–203	–157	–20	–808
Electricity restructuring:							
Deny tax-exempt status for new electric utility bonds except for distribution related expenses; repeal cost of service limitation for determining deductible contributions to nuclear decommissioning funds	....	4	11	20	30	41	106
Subtotal, electricity restructuring	....	4	11	20	30	41	106
Modify international trade provisions:							
Extend and modify Puerto Rico economic-activity tax credit	....	–24	–46	–71	–106	–141	–388
Extend GSP and modify other trade provisions [1]	–84	–484	–223	–93	–96	–99	–995
Levy tariff on certain textiles/apparel produced in the CNMI [1]	....	....	187	187	187	187	748
Expand Virgin Island tariff credits [1]	....	....	–*	–*	–2	–1	–3
Subtotal, modify international trade provisions	–84	–508	–82	23	–17	–54	–638
Subtotal, provide tax relief and extend expiring provisions	**–670**	**–4,129**	**–7,664**	**–6,617**	**–6,889**	**–7,330**	**–32,629**
Eliminate unwarranted benefits and adopt other revenue measures:							
Limit benefits of corporate tax shelter transactions:							
Deny tax benefits resulting from non-economic transactions; modify substantial understatement penalty for corporate tax shelters; deny deductions for certain tax advice and impose excise taxes on certain fees, rescission provisions and provisions guaranteeing tax benefits	....	11	76	162	194	214	657
Preclude taxpayers from taking tax positions inconsistent with the form of their transactions	5	50	52	55	58	62	277
Tax income from corporate tax shelters involving tax-indifferent parties	15	150	155	165	175	185	830
Require accrual of income on forward sale of corporate stock	1	4	9	13	21	31	78
Modify treatment of built-in losses and other attribute trafficking	9	113	185	192	200	208	898
Modify treatment of ESOP as S corporation shareholder	17	64	102	145	183	202	696
Prevent serial liquidation of U.S. subsidiaries of foreign corporations	....	12	20	19	19	19	89
Prevent capital gains avoidance through basis shift transactions involving foreign shareholders	65	301	114	64	45	27	551
Limit inappropriate tax benefits for lessors of tax-exempt use property	1	35	79	119	147	163	543
Prevent mismatching of deductions and income exclusions in transactions with related foreign persons	....	60	104	108	112	117	501

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	Estimate						
	1999	2000	2001	2002	2003	2004	2000–2004
Restrict basis creation through Section 357(c)	3	9	19	28	39	50	145
Modify anti-abuse rule related to assumption of liabilities	1	2	4	5	7	9	27
Modify COLI rules	....	240	366	398	427	451	1,882
Subtotal, limit benefits of corporate tax shelter transactions	117	1,051	1,285	1,473	1,627	1,738	7,174
Other proposals:							
Require banks to accrue interest on short-term obligations	....	72	2	3	4	4	85
Require current accrual of market discount by accrual method taxpayers	3	7	11	15	20	25	78
Limit conversion of character of income from constructive ownership transactions with respect to partnership interests	19	30	37	32	32	35	166
Modify rules for debt-financed portfolio stock	1	5	9	14	20	26	74
Modify and clarify certain rules relating to debt-for-debt exchanges	15	76	109	108	107	106	506
Modify and clarify straddle rules	16	40	50	48	47	49	234
Conform control test for tax-free incorporations, distributions, and reorganizations	7	18	22	22	21	21	104
Tax issuance of tracking stock	40	105	128	127	127	127	614
Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions	2	66	83	86	90	95	420
Modify tax treatment of downstream mergers	14	42	55	59	63	67	286
Modify partnership distribution rules	–28	131	162	173	162	147	775
Deny change in method treatment to tax-free formations	6	94	64	65	67	70	360
Repeal installment method for accrual basis taxpayers	....	685	757	438	114	16	2,010
Deny deduction for punitive damages	16	88	124	130	137	143	622
Apply uniform capitalization rules to tollers	....	25	39	40	42	21	167
Provide consistent amortization periods for intangibles	....	–219	–189	48	255	435	330
Clarify recovery period of utility grading costs	9	30	49	61	69	75	284
Require recapture of policyholder surplus accounts	....	134	222	219	217	215	1,007
Modify rules for capitalizing policy acquisition costs of life insurance companies	....	379	977	946	914	880	4,096
Subject investment income of trade associations to tax	....	172	294	309	325	341	1,441
Restore phaseout of unified credit for large estates	....	27	61	66	72	76	302
Require consistent valuation for estate and income tax purposes	....	3	8	13	17	22	63
Require basis allocation for part sale/part gift transactions	....	2	3	4	5	6	20
Conform treatment of surviving spouses in community property States	3	15	33	46	59	72	225
Expand section 864(c)(4)(B) to interest and dividend equivalents	....	9	15	16	16	17	73
Recapture overall foreign losses when CFC stock is disposed	....	6	6	6	6	7	31
Increase elective withholding rate for nonperiodic distributions from deferred compensation plans	....	42	2	2	2	2	50
Increase section 4973 excise tax for excess IRA contributions	....	1	12	12	13	14	52
Limit pre-funding of welfare benefits for 10 or more employer plans	....	92	156	159	150	149	706
Subject signing bonuses to employment taxes	....	5	3	3	3	3	17
Expand reporting of cancellation of indebtedness income	....	7	7	7	7	7	35
Require taxpayers to include rental income of residence in income without regard to the period of rental	....	4	11	11	12	12	50
Repeal lower-of-cost-or-market inventory accounting method	18	422	525	431	433	201	2,012
Defer interest deduction and OID on certain convertible debt	2	9	20	32	44	55	160
Modify deposit requirement for FUTA	....	....	....	....	....	....	....
Reinstate Oil Spill Liability Trust Fund tax [1]	26	254	256	257	261	264	1,292
Deny DRD for certain preferred stock	4	13	26	38	52	66	195
Disallow interest on debt allocable to tax-exempt obligations	4	11	17	23	28	33	112
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	....	92	94	96	97	99	478
Modify rules relating to foreign oil and gas extraction income	....	5	65	107	112	118	407
Increase penalties for failure to file correct information returns	....	6	12	15	19	13	65
Tighten the substantial understatement penalty for large corporations	....	....	25	42	43	37	147
Require withholding on certain gambling winnings	....	17	4	1	1	1	24
Simplify foster child definition under EITC	....	....	6	7	7	7	27
Replace sales-source rules with activity-based rules	....	310	540	570	600	630	2,650
Repeal tax-free conversions of large C corporations into S corporations	....	10	32	46	56	68	212
Eliminate the income recognition exception for accrual method service providers	1	32	44	46	48	50	220
Modify structure of businesses indirectly conducted by REITs	4	27	27	27	28	28	137
Modify treatment of closely held REITs	....	24	10	12	14	15	75
Impose excise tax on purchase of structured settlements	6	8	6	3	1	–2	16
Amend 80/20 company rules	28	48	49	51	52	53	253
Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office	1	7	10	10	11	11	49
Stop abuse of CFC exception to ownership requirements of section 883	....	4	9	7	5	5	30
Include QTIP trust assets in surviving spouse's estate	....	....	2	2	2	2	8
Eliminate non-business valuation discounts	....	206	425	443	477	494	2,045

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	1999	Estimate 2000	2001	2002	2003	2004	2000–2004
Eliminate gift tax exemption for personal residence trusts	....	–1	–1	–1	3	12	12
Increase proration percentage for P&C insurance companies	....	–4	49	64	87	107	303
Subtotal, other proposals	217	3,693	5,574	5,617	5,676	5,652	26,212
Subtotal, eliminate unwarranted benefits and adopt other revenue measures [1]	**334**	**4,744**	**6,859**	**7,090**	**7,303**	**7,390**	**33,386**
Other provisions that affect receipts:							
Reinstate environmental tax on corporate taxable income [2]	....	794	460	463	476	481	2,674
Reinstate Superfund excise taxes [1]	109	738	747	756	766	778	3,785
Convert Airport and Airway Trust Fund taxes to a cost-based user fee system [1]	....	1,122	1,184	1,091	1,007	910	5,314
Receipts from tobacco legislation [1]	–77	7,987	7,105	6,589	6,418	6,400	34,499
Assess fees for examination of bank holding companies and State-chartered member banks (receipt effect) [1]	....	82	86	90	94	98	450
Restore premiums for United Mine Workers of America Combined Benefit Fund	8	15	14	13	12	12	66
Assess mortgage transaction fees for flood hazard determination [1]	....	58	59	62	65	68	312
Replace Harbor Maintenance tax with the Harbor Services User Fee (receipt effect) [1]	....	–472	–505	–541	–578	–619	–2,715
Allow members of the clergy to revoke exemption from Social Security and Medicare coverage	....	5	8	10	10	11	44
Create solvency incentive for State unemployment trust fund accounts [1]	....	224	312	96	....	....	632
Subtotal, other provisions that affect receipts [1]	**40**	**10,553**	**9,470**	**8,629**	**8,270**	**8,139**	**45,061**
Total effect of proposals [1]	**–296**	**11,168**	**8,665**	**9,102**	**8,684**	**8,199**	**45,818**

* $500,000 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	1998 Actual	Estimate 1999	2000	2001	2002	2003	2004
Individual income taxes (federal funds):							
Existing law	828,586	869,160	902,059	918,399	947,596	975,721	1,022,940
Proposed Legislation (PAYGO)	....	–144	–1,484	–5,181	–4,277	–4,516	–4,727
Legislative proposal, discretionary offset	....	–71	–834	–741	–569	–502	–478
Total individual income taxes	**828,586**	**868,945**	**899,741**	**912,477**	**942,750**	**970,703**	**1,017,735**
Corporation income taxes:							
Federal funds:							
Existing law	188,598	182,346	186,496	192,604	199,217	207,884	217,189
Proposed Legislation (PAYGO)	....	–123	2,056	3,452	3,679	3,837	3,662
Legislative proposal, discretionary offset	....	–13	–418	–208	–171	–151	–138
Total Federal funds corporation income taxes	188,598	182,210	188,134	195,848	202,725	211,570	220,713
Trust funds:							
Hazardous substance superfund	79	....	....	....	....	....	....
Legislative proposal, discretionary offset	....	....	1,222	707	713	732	740
Total corporation income taxes	**188,677**	**182,210**	**189,356**	**196,555**	**203,438**	**212,302**	**221,453**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	358,784	383,176	398,777	412,564	428,922	446,411	464,104
Proposed Legislation (non-PAYGO)	....	....	3	6	8	8	9
Disability insurance (Off-budget)	57,015	60,860	66,534	70,065	72,833	75,804	78,813
Proposed Legislation (non-PAYGO)	....	....	....	1	1	1	1
Hospital insurance	119,863	127,363	131,982	136,933	142,483	148,429	154,624
Proposed Legislation (PAYGO)	....	....	2	2	2	2	2
Railroad retirement:							
Social Security equivalent account	1,769	1,685	1,720	1,749	1,769	1,792	1,813
Rail pension and supplemental annuity	2,583	2,656	2,693	2,750	2,789	2,824	2,848
Total employment and general retirement	540,014	575,740	601,711	624,070	648,807	675,271	702,214
On-budget	124,215	131,704	136,397	141,434	147,043	153,047	159,287
Off-budget	415,799	444,036	465,314	482,636	501,764	522,224	542,927
Unemployment insurance:							
Deposits by States [1]	21,047	22,208	23,464	24,689	26,165	25,934	26,371
Proposed Legislation (PAYGO)	....	....	280	390	120	....	....
Federal unemployment receipts [1]	6,369	6,446	6,536	6,557	6,650	6,699	6,773
Proposed Legislation (PAYGO)	....	....	....	....	....	....	....
Railroad unemployment receipts [1]	68	111	77	37	70	124	130
Total unemployment insurance	27,484	28,765	30,357	31,673	33,005	32,757	33,274
Other retirement:							
Federal employees' retirement—employee share	4,259	4,248	4,396	4,493	4,482	3,912	3,659
Non-Federal employees retirement [2]	74	71	65	60	54	44	39
Total other retirement	4,333	4,319	4,461	4,553	4,536	3,956	3,698
Total social insurance and retirement receipts	**571,831**	**608,824**	**636,529**	**660,296**	**686,348**	**711,984**	**739,186**
On-budget	156,032	164,788	171,215	177,660	184,584	189,760	196,259
Off-budget	415,799	444,036	465,314	482,636	501,764	522,224	542,927
Excise taxes:							
Federal funds:							
Alcohol taxes	7,215	7,240	7,249	7,251	7,235	7,220	7,207
Tobacco taxes	5,657	5,028	6,264	6,705	7,370	7,575	7,553
Legislative proposal, discretionary offset	....	185	1,441	906	217	....	....
Transportation fuels tax	589	811	717	735	720	739	746
Telephone and teletype services	4,910	5,213	5,489	5,780	6,097	6,439	6,801
Ozone depleting chemicals and products	98	52	26	13	3	....	....
Other Federal fund excise taxes	3,196	–564	1,766	1,721	1,686	1,606	1,607

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1998 Actual	Estimate 1999	2000	2001	2002	2003	2004
Proposed Legislation (PAYGO)		8	13	15	16	18	19
Legislative proposal, discretionary offset		–381	381				
Total Federal fund excise taxes	21,665	17,592	23,346	23,126	23,344	23,597	23,933
Trust funds:							
Highway	26,628	38,464	33,097	33,642	34,252	34,890	35,539
Airport and airway	8,111	10,397	9,251	9,693	10,441	11,060	11,736
Legislative proposal, discretionary offset			1,496	1,579	1,455	1,341	1,214
Aquatic resources	290	376	334	340	377	381	398
Black lung disability insurance	636	638	656	674	690	705	720
Inland waterway	91	102	105	107	109	111	113
Hazardous substance superfund							
Legislative proposal, discretionary offset		147	985	996	1,008	1,022	1,037
Oil spill liability							
Proposed Legislation (PAYGO)		35	339	341	344	348	351
Vaccine injury compensation	116	112	113	114	116	116	117
Leaking underground storage tank	136	212	180	183	187	190	194
Total trust funds excise taxes	36,008	50,483	46,556	47,669	48,979	50,164	51,419
Total excise taxes	**57,673**	**68,075**	**69,902**	**70,795**	**72,323**	**73,761**	**75,352**
Estate and gift taxes:							
Federal funds	24,076	25,932	26,740	27,880	29,979	31,046	33,318
Proposed Legislation (PAYGO)			232	487	510	554	584
Total estate and gift taxes	**24,076**	**25,932**	**26,972**	**28,367**	**30,489**	**31,600**	**33,902**
Customs duties:							
Federal funds	17,585	17,110	18,941	19,953	21,219	22,767	24,663
Proposed Legislation (PAYGO)		–112	–645	–48	125	119	115
Trust funds	712	656	697	744	792	844	901
Legislative proposal, discretionary offset			–629	–674	–721	–771	–825
Total customs duties	**18,297**	**17,654**	**18,364**	**19,975**	**21,415**	**22,959**	**24,854**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	112	120	123	126	128	131	134
Receipts from tobacco legislation (discretionary offset)		165	6,525	6,426	6,426	6,418	6,400
United Mine Workers of America combined benefit fund	340	281	291	282	275	270	263
Proposed Legislation (PAYGO)		8	15	14	13	12	12
Deposit of earnings, Federal Reserve System	24,540	26,354	25,121	26,008	26,941	27,973	28,896
Proposed Legislation (PAYGO)			110	115	120	125	130
Defense cooperation		6	6	6	6	6	6
Fees for permits and regulatory and judicial services	5,560	5,629	7,752	9,713	14,244	14,620	15,033
Proposed Legislation (PAYGO)			78	80	83	87	91
Fines, penalties, and forfeitures	1,925	1,962	1,963	1,984	1,968	1,977	1,988
Gifts and contributions	222	206	181	134	128	131	129
Refunds and recoveries	–41	–37	–37	–37	–37	–37	–37
Total miscellaneous receipts	**32,658**	**34,694**	**42,128**	**44,851**	**50,295**	**51,713**	**53,045**
Total budget receipts	**1,721,798**	**1,806,334**	**1,882,992**	**1,933,316**	**2,007,058**	**2,075,022**	**2,165,527**
On-budget	1,305,999	1,362,298	1,417,678	1,450,680	1,505,294	1,552,798	1,622,600
Off-budget	415,799	444,036	465,314	482,636	501,764	522,224	542,927
MEMORANDUM							
Federal funds	1,113,467	1,146,637	1,200,714	1,224,894	1,271,291	1,312,435	1,374,499
Trust funds	385,631	413,274	426,370	443,257	461,895	479,001	496,908
Interfund transactions	–193,099	–197,613	–209,406	–217,471	–227,892	–238,638	–248,807
Total on-budget	**1,305,999**	**1,362,298**	**1,417,678**	**1,450,680**	**1,505,294**	**1,552,798**	**1,622,600**
Off-budget (trust funds)	**415,799**	**444,036**	**465,314**	**482,636**	**501,764**	**522,224**	**542,927**

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
Total	**1,721,798**	**1,806,334**	**1,882,992**	**1,933,316**	**2,007,058**	**2,075,022**	**2,165,527**

[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 adminstrative 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.