DESCRIPTION OF THE TECHNICAL CORRECTIONS ACT OF 1988 (S. 2238), ADDITIONAL TECHNICAL CORRECTIONS, AND CERTAIN OTHER PROVISIONS

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SENATE COMMITTEE ON FINANCE

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Prepared by the Staff

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of proposals relating to: (1) The Technical Corrections Act of 1988, as introduced (S. 2238); (2) proposed additional technical corrections; (3) additional simplification and clarification provisions; (4) diesel fuel excise tax collection and exemption procedures (similar provision was previously reported by the Committee on Finance in S. 2223);[2] (5) repeal of limitation on Treasury long-term bond authority; (6) House-passed bills (H.R. 2792, relating to tax treatment of Indian fishing rights, and H.R. 2167, relating to railroad unemployment and retirement programs) and a bill referred from another Senate Committee (S. 2611, relating to access to tax information by the Veterans' Administration); and (7) corporate estimated tax payments.

Although some descriptions in this document may correspond to descriptions contained in documents prepared for the House Committee on Ways and Means, committee approval of items described in this document would not necessarily require the use of statutory language used in the Ways and Means Committee legislation (H.R. 4333 as ordered reported on July 14, 1988).

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1 This document may be cited as follows: Joint Committee Taxation, Description of the Technical Corrections Act of 1988 (S. 2238), Additional Technical Corrections, and Certain Other Provisions (JCX-18-88), July 26, 1988.

2 S. Rpt. 100-309, March 29, 1988.

I. TECHNICAL CORRECTIONS ACT OF 1988 (S. 2238)

For a detailed description of S. 2238 as introduced, see Joint Committee on Taxation pamphlet, Description of the Technical Corrections Act of 1988 (H.R. 4333 and S. 2238) (JCS-10-88), March 31, 1988.

II. ADDITIONAL TECHNICAL CORRECTIONS
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TECHNICAL AMENDMENTS TO THE TAX REFORM ACT OF 1986

I. Capital Cost Provisions (Title II of the 1986 Act)

Depreciation and Investment Tax Credit

An error in stating the amount of investment credit eligible for a transitional exception included in the Reform Act for a Spray Cotton Mills facility would be corrected.

Rehabilitation Credit

A transitional exception for a Newport, Rhode Island rehabilitation project would be deleted from the technical corrections bill.

II. Tax Shelters; Interest Expense (Title V of the 1986 Act)

The provision in the bill (sec. 105(c)(11)) which treats pre-1987 investment interest carryovers attributable to net lease property as subject to the passive activity rules rather than as investment interest would apply only if the taxpayer elects.

III. Corporate Tax Provisions (Title VI of the 1986 Act)

A. Special Limitations on Net Operating Loss and Other Carryforwards

1. Value of loss corporation: Special rule in the case of redemption or contraction.--The amendment would provide that the statutory extension of the rules for redemptions to other corporate contractions applies only to ownership changes after June 10, 1987.

2. Built-in gains and losses: Treatment of certain deductions.--The amendment would clarify that any amount allowable as a deduction during the recognition period but attributable to periods before the change date is treated as a recognized built-in loss.

3. Computation of 25-percent threshold for built-in gains and losses.

a. The amendment would provide regulatory authority to take cash items and marketable securities into account for purposes of the threshold computation.

b. For ownership changes occurring on or after June 21, 1988, the amendment would also provide that redemptions or other corporate contractions occurring in connection with an ownership change are taken into account for purposes of the threshold computation only to the extent provided in regulations.

4. Bankruptcy proceedings.--The amendment would clarify that the disallowance of an interest deduction for interest paid to creditors during the three years prior to the year of the ownership change applies for purposes of computing pre-change excess credits, as well as pre-change losses.

B. Recognition of Gain or Loss on Liquidating Sales and Distributions of Property (General Utilities)

1. Tax imposed on certain built-in gains of S corporations.--The amendment would clarify that amounts that are allowable as a deduction during the recognition period but that are attributable to periods before the first S corporation taxable year are treated as recognized built-in losses in the year of the deduction.

2. Certain transfers to foreign corporations.--

a. Effective date.--The amendment would provide that the technical correction relating to transfers of property to a foreign corporation that would otherwise qualify as a tax-free reorganization applies only to transactions occurring after June 10, 1987.

b. Conditions for relief.--The amendment would also modify the conditions under which relief from full immediate tax may be granted. In general, relief would be granted where 5 or fewer U.S. corporations owned at least 80 percent of the stock of the transferor corporation prior to the transaction, subject to certain basis adjustments and other conditions to prevent the removal of corporate appreciation from U.S. taxing jurisdiction.

3. Certain liquidating distributions of installment obligations by S corporations.--The amendment would clarify that no gain or loss with respect to a liquidating distribution of an installment obligation will be recognized by a distributing S corporation except for purposes of any tax imposed by subchapter S.

4. Certain distributions.--For transfers on or after June 21, 1988, the amendment would clarify that the transfer of property by a corporation to its shareholder in a transaction under section 351(b) (certain corporate contributions) is taxed as a nonliquidating distribution.

C. Amortizable Bond Premium

1. Basis reduction.--The amendment would clarify that basis reduction is required for amounts of amortizable bond premium applied to reduce interest payments under the provision.

D. Regulated Investment Companies (RICs)

1. Time certain dividends taken into account.--The provision treating certain dividends declared in October, November and December as paid in the year of declaration would be effective for dividends declared on or after January 1, 1988.

E. Real Estate Investment Trusts (REITs)

1. Time certain dividends taken into account.--The provision treating certain dividends declared in October, November and December as paid in the year of declaration would be effective for dividends declared on or after January 1, 1988.

2. Treatment of amounts based on income or profit as interest.--Gain from the sale of property would be excluded in determining whether substantially all the gross income with respect to property is derived from the leasing of such property for purposes of determining whether payments under the lease are interest for purposes of the 75 and 95 percent tests.

F. Real Estate Mortgage Investment Conduits (REMICs)

1. Disqualified organization.--An organization will not be treated as an instrumentality of the United States or of any State or political subdivision thereof if all its activities are subject to tax, and, with the exception of the Federal Home Loan Mortgage Corporation, a majority of its board of directors is not selected by such governmental unit.

2. Tax on pass-through entities.--An entity would be relieved of liability for the tax imposed on pass-through entities with respect to an interest in such entity if the holder of record of the interest furnishes an affidavit that it is not a disqualified organization and during the period the pass-through entity lacks knowledge that the affidavit is false.

3. Effective date of tax on pass-through entities.--The tax on pass-thru entities would not be imposed on regulated investment companies, real estate investment trusts, common trust funds, or publicly traded partnerships for taxable years beginning before January 1, 1989. For taxable years beginning on or after January 1, 1989, such entities would be taxed to the same extent as other

pass-through entities.

4. Reporting.--The bill would clarify that amounts includible with respect to regular interests would be reported when accrued.

5. Determination of net operating loss.--Excess inclusions would be disregarded in determining net operating losses, net operating loss carryforwards and net operating loss carrybacks.

IV. Accounting Provisions (Title VIII of the 1986 Act)

1. Limitation on the use of the cash method of accounting.--Clarification would be provided that an S corporation is not treated as a tax shelter under the public offering test by reason of being required to file a notice of exemption from registration with a State agency if all corporations that offer securities for sale in the State are required to register or file a notice of exemption from registration.

2. Capitalization rules: simplified method for certain tangible personal property.--Because the Treasury Department has provided simplified rules for deducting business expenses of individuals who are mainly responsible for the creation of a work of art, the grant of regulatory authority contained in the introduced bill would be removed.

3. Taxable years of common trust funds.--The effective date of the change requiring common trust funds to adopt a calendar year would be postponed one year (i.e., the change would apply to taxable years beginning after December 31, 1987).

4. Repeal of installment method for revolving credit installment obligations.--The contraction rule for revolving credit installment obligations would be applied by treating obligations that are disposed of to an unrelated party on or before October 26, 1987, as not outstanding as of the close of the taxpayer's last taxable year beginning before January 1, 1987. For this purpose, obligations disposed of pursuant to a written contract that was binding on October 26, 1987, and at all times thereafter until the date of disposition shall be considered disposed of on or before October 26, 1987.

V. Insurance Provisions (Title X of the 1986 Act)

1. Structured settlements.--The amendment would provide an exception to the required distribution rules for annuity contracts that are qualified funding assets under structured settlement agreements without regard to whether a qualified

assignment has occurred.

2. Market discount bonds.--The committee report to the bill would provide rules for taking into account capital losses in determining the amount of gain that is subject to tax at a rate of 31.6 percent.

3. Election of small property and casualty companies to be taxed on investment income.--The amendment would clarify that a small property and casualty insurance company that elects to be taxed on its taxable investment income is subject to current tax on amounts subtracted from a protection against loss account.

VI. Pensions; Employee Benefits (Title XI of the 1986 Act)

1. Qualified plan coverage.--The amendment would clarify that an employee who has satisfied a qualified plan's age and service requirements but who has not attained the plan's entry date (sec. 410(a)(4)) is not taken into account for testing discrimination under section 410(b).

2. Dependent care assistance.--Under the amendment, the $5,000 limit on dependent care assistance under section 129 would apply on an accrual basis. The requirement that the employer report to an employee the dependent care assistance provided to the employee would be similarly modified to apply on an accrual basis. The reporting requirement would be further modified by requiring that the reporting be to the IRS in addition to the employee.

3. Distributions from eligible deferred compensation plans.--The bill provides that the rule permitting certain elections with respect to benefits not in excess of $3,500 does not permit in-service distributions from an eligible deferred compensation plan. Under the amendment, this provision of the bill would apply to years beginning after December 31, 1988.

4. Interest rate relating to minimum participation rule.--The bill establishes certain permissible interest rates that apply for certain purposes in the case of a termination, asset transfer, or asset distribution with respect to a plan that would have failed to satisfy the requirements of the minimum participation rule (sec. 401(a)(26)) had the effective date of such rule been August 16, 1986. In determining such permissible rates, the bill disregards certain retroactive plan amendments with respect to nonhighly compensated employees. Under the amendment, such retroactive amendments would only be disregarded if adopted after October 26, 1987.

5. Health care continuation: maximum period.--Under the amendment, if an individual obtains health care continuation rights by virtue of a reduction of hours, and then separates from service within 18 months, his or her health care continuation rights with respect to the separation from service would exist for no more than 18 months (rather than 36 months under present law) from the date of reduction of hours.

6. Application of section 457 to vacation, sick, etc., plans.--The position of the IRS in Notice 88-68 would be codified, confirming that section 457 would not apply to bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, and death benefit plans.

7. Clarification of grandfather rule for tax-exempt organizations maintaining 401(k) plans.--The legislative history would clarify that any organization that maintained a section 401(k) plan on May 6, 1986, and that subsequently becomes a tax-exempt organization, continues to qualify for the grandfather rule in the 1986 Act for tax-exempt organizations maintaining section 401(k) plans.

8. Class-year vesting.--The amendment would limit the provision in the introduced bill requiring that certain employees be deemed covered by the employer's former class-year vesting schedule or by the employer's vesting schedule required under the 1986 Act, whichever yields the higher vesting percentage for the year. Under the amendment, this treatment would not be required with respect to former employees who were rehired by the employer on or after the effective date and who had incurred at least a 5-year break in service as of the date of rehire.

9. Partial interest exclusion for loans to ESOPs.--The amendment would provide that the partial interest exclusion for loans to an ESOP (sec. 133) is available with respect to a refinanced loan that would qualify for the exclusion but for the fact that the loan it is refinancing is a loan between corporations that are members of the same controlled group.

10. Diversification rules for ESOPs.--Under the introduced bill, the first diversification election would generally be required in 1988, whereas under the 1986 Act, the first diversification election would generally be required in 1989. The amendment would incorporate into the statute the provision in the legislative history to the introduced bill that permits the first diversification election to be provided either in 1988 or 1989.

VII. Foreign Tax Provisions (Title XII of the 1986 Act)

A. Foreign Tax Credit

1. Application of the separate foreign tax credit limitation for financial services income to de minimis amounts of foreign base company or subpart F insurance income.--The amendment would clarify that income that would be treated as financial services income but for the de minimis subpart F income exception will be financial services income for purposes of applying the separate foreign tax credit limitations.

2. Noncontrolled section 902 corporation.--The amendment would modify the previously introduced technical correction, which treats a dividend from a controlled foreign corporation, out of earnings for periods during which the recipient was not a U.S. shareholder with respect to the controlled foreign corporation, as a dividend subject to the separate foreign tax credit limitation for dividends from noncontrolled section 902 corporations. Under the amendment, this previously introduced technical correction would be operative with respect to dividend recipients who are less-than-50 percent shareholders only if so provided by regulations.

B. Source Rules

1. Definition of intangible.--Under the amendment, the definition of intangible property, for purposes of applying the 1986 Act source rules applicable to income from the sale of an intangible, would be modified to include franchises.

C. Subpart F

1. Coordination of related person exceptions and the chain deficit rule.--Under the amendment, interest, rent, and royalty payments from a related person organized or created under the laws of the same country as the recipient would not qualify for the "same-country" exception from subpart F income to the extent that such payments may reduce subpart F income of either the payor or, because of the chain deficit rule, another entity.

2. Use of pre-1987 deficits for foreign base company oil related income.--The amendment would allow post-1982, pre-1987 accumulated deficits attributable to foreign base company oil related activities to be carried forward for purposes of applying the deficit rules of subpart F.

D. U.S. Taxpayers

1. PFIC inclusions.--Under the amendment, a U.S.

shareholder in a PFIC that is both a controlled foreign corporation and a qualified electing fund would not include in income U.S. source effectively connected earnings, unless those earnings were exempt from U.S. tax or subject to a reduced rate of U.S. tax under a treaty.

2. Coordination of PFIC and charitable lead trust rules.--The amendment would provide that if PFIC stock is held by a charitable lead trust (or other trust with respect to which a charitable deduction is allowable with respect to an interest (other than a remainder interest) in the trust), then under regulations the income from PFIC stock distributions and gains upon which deferred tax amounts are computed may be adjusted to take into account the charitable obligations of the trust.

3. Termination of election to defer tax payment.--In the case of a taxpayer who elects to defer the payment of an undistributed PFIC earnings tax liability with respect to the taxpayer's stock in a PFIC that is a qualified electing fund, the amendment would provide that under regulations the election may continue in effect in the event that the taxpayer disposes of the PFIC stock in certain nonrecognition transactions.

4. Coordination of PFIC and pooled income fund rules.--If the governing instrument of a pooled income fund allows no portion of any gain from a disposition of PFIC stock owned by the fund to be allocated to income beneficiaries of the fund, then under the amendment the fund would not be taxed on undistributed PFIC earnings under the rules governing PFICs that are qualified electing funds; and gains realized by the pooled income fund on the disposition of PFIC stock would not be subject to the interest charge rules applicable to PFICs that are not qualified electing funds.

5. Reduction of deferred tax amount by foreign tax credits.--The amendment would specify the method by which foreign taxes paid or deemed paid with respect to an excess distribution from a PFIC, or a sale or exchange of PFIC stock to which section 1248 would otherwise apply, will reduce the deferred tax amount due on the distribution or gain.

E. Foreign Taxpayers

1. Treaty reductions or exceptions to the branch profits tax.--The amendment would clarify that only provisions of income tax treaties can serve as the basis for a treaty-based reduction or elimination of branch profits tax.

2. Exclusion of international organizations from branch tax.--The amendment would clarify that international

organizations, as defined in the Code, are not subject to either the branch level interest tax or the branch profits tax.

3. Withholding tax on foreign partners' share of effectively connected taxable income of a partnership.--The amendment would clarify that for purposes of the withholding tax provision, "effectively connected taxable income" is computed without taking into account items of income, gain, loss, or deduction to the extent such items are allocable under section 704 to any partner who is not a foreign partner.

F. Miscellaneous Foreign Provisions

1. Residual treaty override.--In lieu of the previously introduced technical providing for a "residual" treaty override applicable to provisions of the 1986 Act, the amendment would codify, on a permanent basis, that a statute and a treaty are to be construed in the same manner as two statutes. The amendment would require disclosure of any treaty-based return position that modifies the operation of a later-enacted statute.

2. Applicability of dividends received deduction to FSC distributions.--The amendment would provide that dividends from a foreign sales corporation (FSC) out of the FSC's investment income would qualify only for the 70/80 percent dividends received deduction, and not the 100 percent deduction.

G. 1984 Act Technical

1. Recognition of gain or loss upon transfers to nonresident aliens incident to divorce.--The amendment would expand the present law exception from the rule generally providing for nonrecognition of gain or loss on a transfer of property, incident to a divorce, from an individual to his or her current or former spouse. Under the amendment, nonrecognition would be denied on a transfer to a former spouse who is a nonresident alien. Under present law, nonrecognition is already denied in the case of a transfer to a current spouse who is a nonresident alien.

VIII. Tax-Exempt Bonds (Title XIII of the 1986 Act)

The amount of bonds eligible for a transitional exception included in the Reform Act for renovation of a District of Columbia stadium would be reduced to the originally intended amount.

IX. Trusts and Estates; Minor Children; Generation-Skipping Transfer Tax (Title XIV of the 1986 Act)

A. Taxation of Unearned Income of Minor Children

1. Different taxable years.--Except as provided in Treasury regulations, if a parent and child have different taxable years, the child's tax would be computed by reference to the parent's taxable year ending with or within the child's taxable year.

B. Generation-Skipping Transfer Tax

1. Taxable termination not to include direct skip.--The language in the bill providing that a taxable termination does not also include a transfer which is a direct skip would be deleted as unnecessary.

2. Special rules for certain inter vivos transfers.--The Treasury would be granted regulatory authority to provide exceptions to the rule treating a reference to an individual as a reference to his spouse.

3. Effective date for GST allocations made to property transferred as a result of death.--Any allocation of GST exemption to property transferred as a result of the transferor's death would be effective on and after the date of death.

4. Valuation date where GST exemption allocated after death.--The value of property not transferred as a result of death would be determined as of the date the GST allocation with respect to such property is filed.

5. Nontaxable gifts.--The rules governing certain direct skips which are nontaxable gifts would apply to transfers made after March 31, 1988.

6. Treatment of grandfathered portion.--The provision in the bill treating the grandfathered portions of a trust as separate trusts would be deleted as unnecessary.

7. $2 million exemption.--The distribution requirement for the $2 million exception would be met if income from the trust is distributed for the benefit of, as well as directly to, the grandchild after age 21.

X. Miscellaneous Provisions (Title XVIII of the 1986 Act)

1. Controlled group of corporations.--The definition of a parent-subsidiary controlled group of corporations (sec.

1563) would be amended to provide for the attribution of stock held by partnerships, estates and trusts. The amendment would apply to taxable years beginning after date of enactment of the bill.

2. Effective date of technical amendments on title holding companies.--The effective date of the provisions of the Technical Corrections Bill relating to indirect interests in real property and the flow-through of the character of debt-financed income of title holding companies is postponed until transactions entered into after June 10, 1987.

TECHNICAL AMENDMENTS TO OTHER TAX LEGISLATION

I. Technical Amendments to the Revenue Act of 1987

A. Employee Benefit Provisions

1. Cafeteria plans.--Under the amendment, cafeteria plan participants who, prior to the enactment of the Revenue Act of 1987 (which disallowed overnight camp expenses as dependent care expenses), elected dependent care assistance for a period after 1987 would be entitled to receive reimbursement pursuant to such election for overnight camp expenses without disqualifying the cafeteria plan (even though such reimbursements are taxable).

2. Treatment of plan spin-offs, transfers, etc.--The amendment would provide that, in the case of plan spin-offs and similar transactions (within a controlled group) involving defined benefit plans, assets in excess of the benefits that would have been provided immediately before the transaction (if the plan then terminated) are allocated on a proportional basis.

B. Accounting Provisions

1. Nondealer real property installment obligations.--Clarification would be provided that in computing the interest charge on the deferred tax all persons treated as a single employer under section 52 would be treated as one person, except as otherwise provided in Treasury regulations.

2. Refunds of required payments made by electing partnerships or S corporations.--Under the amendment, if a partnership or S corporation that elected a taxable year other than the required taxable year is entitled to a refund of a required payment for any applicable election year because the amount on deposit with the Internal Revenue Service exceeds the amount required to be on deposit, the amount of the refund would be payable on the later of (1) April 15 of the calendar year following the calendar year in which the applicable election year begins, or (2) the date that is 90 days after the day on which a claim for refund is filed with the Internal Revenue Service.

C. Partnership Provisions

1. Treatment of certain partnership allocations for unrelated business tax.--The amendment would delete the redundant provision governing allocations to partners other than qualified tax-exempt partners (sec. 514(c)(9)(E)(i)(I)).

Thus, allocations exclusively among partners other than qualified tax-exempt partners would be treated as permitted allocations so long as such allocations have substantial economic effect, and do not give rise to a violation of the rules limiting allocations between qualified tax-exempt partners and other partners (sec. 514(c)(9)(E)).

2. Definition of qualifying passive-type income for publicly traded partnerships.--The definition of real property rents would be amended to provide a 5 percent de minimis rule for attribution of holdings to or from partnerships. The definition of qualifying income would be clarified to provide that qualifying income from minerals or natural resources is intended to cover depletable minerals or natural resources.

3. Application of qualifying passive-type income for formerly untraded partnerships.--The amendment would provide that the qualifying income requirements must be met for each year after which the partnership is publicly traded (as opposed to each year it is in existence), in order for such partnership not be treated as a corporation.

D. Corporate Tax Provisions

1. Computation of earnings and profits for purposes of intercorporate dividends and basis adjustments under consolidated return provisions (overruling of Woods Investment Co.).--The amendment would provide Treasury regulatory authority to permit a taxpayer election to reduce its basis in indebtedness of a corporation with respect to which there would have been an excess loss account, in certain cases where the bill (sec. 204(i)(1)(B)) requires negative basis treatment on the disposition of stock.

2. Mirror subsidiary transactions.--The amendment would modify the transition rule applicable to "mirror subsidiary" and related transactions, to clarify that the ownership of distributees may be aggregated (to the extent permitted by prior law) in the case of certain distributees whose ownership of the distributing corporation was indirect, through an intermediate corporation that goes out of existence in the transaction.

3. Limitation on use of preacquisition losses to offset built-in gains.--

a. Ordering rules for losses.--The amendment would clarify the order in which losses are used where losses are subject to limitation (under new section 384) because they may not be used to offset built-in gains.

b. Effective date.--For transactions occurring before March 31, 1988, the amendment would provide that a taxpayer could make an election to apply the limitations on the use of preacquisition losses to offset built-in gains not taking into account the provisions of the technical corrections bill.

4. Recapture of LIFO amount in the case of election by S corporation.--The amendment would provide that the tax attributable to LIFO recapture by reason of electing Subchapter S would not be included on the seller's consolidated return, notwithstanding that the income from the corporation's last taxable year as a C corporation would otherwise be included on the seller's consolidated return.

5. Greenmail excise tax.--The amendment would apply the provision that greenmail includes any consideration transferred by any person acting in concert with a corporation to acquire its stock only for transactions occurring on or after March 31, 1988.

E. Insurance Provisions

1. Reserves of life insurance companies.--The amendment would provide that, in computing life insurance reserves, certain amounts in the nature of interest are not taken into account beyond the end of the taxable year to the extent that the rate exceeds the greater of the prevailing State assumed interest rate or the applicable Federal interest rate. In addition, the amendment would provide that required interest for purposes of determining the company's and the policyholders' share of net investment income is determined by using another appropriate rate in any case where the prevailing State assumed interest rate or the applicable Federal rate is not used in determining the reserve for a contract.

2. Foreign insurance companies.--The amendment would provide that the domestic investment yield and the worldwide current investment yield are determined on the basis of all of the assets of insurance companies rather than only those assets held for the production of investment income. In addition, the amendment would authorize the Treasury Department to prescribe separate domestic asset/liability percentages for certain types of property and casualty insurance companies. For this purpose, property and casualty insurance companies could be categorized based on the predominant type of business (e.g., short-tail, long-tail or reinsurance) of the company.

II. Amendments Related to the Pension Protection Act

1. Interest rate on employee contributions.--Under the amendment, the rules on attributing income to employee contributions under a defined benefit plan would be modified as follows: (a) employee contributions plus income would not be limited by the employee's accrued benefit under the plan's benefit formula; and (b) the conversion of the employee's contributions plus income to an annuity would be performed under the plan's interest rate. A transition rule would apply so that a plan amendment to conform to this rule would not be a cutback in an employee's accrued benefit.

2. Variable rate premium.--Under the amendment, if deductible contributions cannot be made to a plan for a plan year because of the full funding limitation, no additional PBGC premium would be required with respect to the plan in the following plan year.

III. Amendments Related to the Consolidated Omnibus Budget Reconciliation Act of 1985

1. Health care continuation: preexisting condition.--The provision in the introduced bill that requires employers to provide continuation coverage even if employees are covered under a health plan of another employer would be effective with respect to events occurring after December 31, 1988, that would otherwise result in termination of continuation coverage (rather than years beginning after December 31, 1988).

AMENDMENTS RELATING TO OTHER LEGISLATION

I. Social Security Amendments

A. Continuation of Disability Benefits During Appeal

Present Law

A disability insurance beneficiary who is determined to be no longer disabled may appeal the determination sequentially through three appellate levels within the Social Security Administration (SSA): a reconsideration, usually conducted by the State Disability Determination Service that rendered the initial unfavorable determination; a hearing before an SSA administrative law judge (ALJ); and a review by a member of SSA's Appeals Council.

The beneficiary has the option of having his or her benefits continued through the hearing stage of appeal. If the earlier unfavorable determinations are upheld by the ALJ, the benefits are subject to recovery by the agency. (If an appeal is determined to be in good faith, benefit repayment may be considered for waiver.) Medicare eligibility is also continued, but Medicare benefits are not subject to recovery.

The Omnibus Budget Reconciliation Act of 1987 extended this provision for one year. The Act authorized the payment of interim benefits to persons in the process of appealing termination decisions made before January 1, 1989. Such payments may continue through June 30, 1989 (i.e., through the July 1989 check).

Description of Proposal

The period in which benefits may be paid and Medicare eligibility continued while an appeal is in progress would be extended for one additional year. Upon application by the beneficiary, benefits would be paid while an appeal is in progress with respect to unfavorable determinations made on or before December 31, 1989 and would be continued through June 1990 (i.e., through the July 1990 check).

The provision would apply pending a report from the Secretary of Health and Human Services to the Committee on Ways and Means and the Committee on Finance. The report is to assess the impact of the continuation of benefits on the Social Security and Medicare Trust Funds and the rate of appeals of disability determinations to administrative law judges.

Effective Date

The provision would be effective with respect to unfavorable decisions made on or before December 31, 1989.

Cost

CBO estimates the provision to cost $ 8 million in fiscal year 1989, $20 million in fiscal 1990, less than $ 0.5 million in fiscal 1991, and $3 million in each of fiscal years 1992 and 1993.

B. Consolidation of Reports on Continuing Disability Reviews

Present Law

The Secretary of Health and Human Services is required to make two types of reports on continuing disability reviews to the Senate Committee on Finance and the House Committee on Ways and Means. The first is a semi-annual report on the results of continuing disability reviews. The second is an annual report on the appropriate number of disability cases to be reviewed in each State.

Description of Proposal

These two types of reports on continuing disability reviews would be consolidated into one annual report to be made to the Senate Committee on Finance and the House Committee on Ways and Means. The report would remain separate from the Social Security Administration's Annual Report to the Congress.

Effective Date

This provision would be effective with respect to reports required to be submitted after the date of enactment.

Cost

No cost is estimated for this provision.

C. Denial of Benefits to Individuals Deported or Ordered Deported on the Basis of Association with the Nazi Government of Germany During World War II

Present Law

People who are deported for violating specified provisions of the Immigration and Nationality Act lose their social security benefits. The list of provisions for which people are denied benefits does not, however, include paragraph 19 of that Act. Paragraph 19, which was added to the Immigration and Nationality Act in 1978, pertains to people deported for certain activities in association with the Nazi government of Germany during World War II.

Description of Proposal

Benefits to individuals deported as Nazi war criminals under paragraph 19 of the Immigration and Nationality Act would be terminated.

Effective Date

The provision would apply only in the case of deportations occurring, and final orders of deportation issued, on or after the date of enactment, and only with respect to benefits beginning on or after such date.

Cost

No cost is estimated for this provision.

D. Requirement of Social Security Number as a Condition for Receipt of Social Security Benefits

Present Law

Applicants for social security benefits are not required to have social security numbers in order to receive benefits. The absence of a social security number for auxiliary and survivor beneficiaries hampers monitoring which might detect duplicate benefit payments, miscredited earnings, or entitlement to other benefits.

SSA currently requests that applicants voluntarily provide their social security numbers. Under Federal law, recipients of Aid to Families with Dependent Children, Supplemental Security Income, and Veterans' Assistance benefits are currently required to provide their social security numbers in order to receive benefits under those programs.

Description of Proposal

Individuals would be required to have a social security number in order to receive social security benefits. Those lacking a social security number would be required to apply for one. Beneficiaries currently on the rolls would not be subject to this requirement. However, they would be encouraged to provide a correct social security number or to apply for a number if one had not previously been assigned.

Effective Date

The provision would be effective with respect to benefit entitlements commencing after the sixth month following the month of enactment.

Cost

No cost estimate is available.

E. Substitution of Certificate of Election for Application to Establish Entitlement for Certain Reduced Widow(er)'s Benefits

Present Law

An individual who (1) is receiving a combination of a reduced spouse's benefit and either retirement or disability benefits on his or her own record and (2) is between the ages of 62 and 65 when his or her spouse dies, must file an application to receive reduced widow(er)'s benefits.

Those who are over age 65 when the worker dies and who are receiving spouses' benefits or those age 62-65 when the worker dies who are not entitled to their own retirement or disability benefits may receive reduced widow(er)s' benefits by filing a certificate of election rather than an application. An application for a reduced widow(er)'s benefit is generally not effective for months before the month of filing. Thus, a break in entitlement could occur if the application were not filed in a timely fashion.

Description of Proposal

An individual who is receiving both a reduced spouse's benefit and a retirement or disability benefit and who is between the ages of 62 and 65 when his or her spouse dies, could receive a reduced widow(er)'s benefit by filing a certificate of election. A certificate of election would be effective for up to 12 months before it is filed.

Effective Date

The provision would be effective with respect to benefits payable based on the record of individuals who die after the month of enactment.

Cost

CBO estimates that this provision will cost less than $0.5 million in each of fiscal years 1989 - 1992 and $1 million in fiscal year 1993.

II. AFDC: Moratorium on Emergency Assistance/Special Needs Regulations

Present Law

Under current law, States may operate an emergency assistance program for needy families with children (whether or not eligible for AFDC), if the assistance is necessary to avoid the destitution of the child or to provide living arrangement in a home for the child. The statute authorizes 50-percent Federal matching funds for emergency assistance furnished for a period not in excess of 30 days in a 12-month period. Current regulations state that Federal matching is available for emergency assistance authorized by the State during one period of 30 consecutive days in any 12 consecutive months, including payments which are to meet needs which arose before the 30-day period, or are for such needs as rent which extend beyond the 30 day period.

Under the regular AFDC program, current regulations also allow States to include in their State standards of need, provision for meeting "special needs" of AFDC applicants and recipients. The State plan must specify the circumstances under which payments will be made for special needs.

On December 14, 1987, the Department of Health and Human Services published in the Federal Register a proposed regulation which would have restricted the use of AFDC emergency assistance funds for homeless families and would have limited States' authority to make payments for special needs of AFDC recipients. Specifically, the proposed regulations would have prohibited special needs based on the type of housing and would have prohibited emergency assistance to cover needs over a period in excess of 30 days per year.

The Omnibus Budget Reconciliation Act of 1987 established a moratorium under which the Secretary of Health and Human Services is directed not to implement the proposed regulations or otherwise modify current policy with respect to the matters address in those proposed regulations prior to October 1, 1988.

Description of Proposal

The proposal would extend the moratorium on changing current policy with respect to emergency assistance and special needs for homeless families.

Cost

CBO estimates this proposal to have no cost.

III. Delay in Reporting Date for National Commission on Children

Present Law

The National Commission on Children, authorized under the Omnibus Budget Reconciliation Act of 1987, is required to study and issue a report with recommendations with respect to the following subjects: health of children, social and support services for children and their parents, education, income security, and tax policy. The Commission is composed of 36 members, with the President, the President pro tempore of the Senate, and the Speaker of the House each appointing 12 members. No funds have yet been appropriated for the Commission. However, the Senate's 1989 Labor-HHS appropriations bill includes $800,000 to fund the Commission. These funds would become available October 1, 1989, at which time the Commission could begin its work.

Description of Proposal

Present law requires the Commission to issue an interim report on September 30, 1988, with a final report due March 30, 1989. To accommodate the delay in funding for the Commission, the reporting dates would be postponed for one year. The interim report would be due September 30, 1989, and the final report would be due March 30, 1990.

III. ADDITIONAL SIMPLIFICATION AND CLARIFICATION PROVISIONS

A. Nondiscrimination Rules for Statutory Employee Benefit Plans (sec. 89 Plans)

The proposal would modify the nondiscrimination rules applicable to employee benefits (Code sec. 89). The proposal follows the provisions in the Ways and Means Committee bill (H.R. 4333 as amended), with certain modifications and additions noted below.

Summary of Ways and Means Committee Bill

Valuation.--Under the Ways and Means Committee bill, any rules issued by the Secretary with respect to the valuation of accident or health coverage are effective as of the latest of (1) the first testing year beginning at least 6 months after issuance of such rules, (2) the first testing year beginning after December 31, 1990, or (3) the effective date specified by the Secretary for such rules. In addition, the Ways and Means Committee bill provides a temporary special valuation rule that applies prior to the effective date of rules issued by the Secretary.

The Ways and Means Committee bill also provides that both during and after the application of the temporary special valuation rule, in determining the benefits provided under a multiemployer plan, an employer generally may treat the contribution it makes to the plan on behalf of an employee as the benefit provided to the employee under such multiemployer plan. This special rule for multiemployer plans does not apply to a multiemployer plan that covers any professional (e.g., a doctor, lawyer, or investment banker).

Former employees.--Employees who separated from service prior to January 1, 1987, generally may be disregarded in applying the nondiscrimination rules to former employees, except with respect to benefit increases after the effective date of section 89.

Testing dates.--Generally, the nondiscrimination rules are applied based on the benefits available and provided on one day in a year (with appropriate adjustments for plan design changes and highly compensated employee elections). The testing date is required to be designated in the plan and consistently applied. For years beginning in 1989, however, the consistency requirement does not apply.

Also, the sworn statements regarding family status and core health coverage from another employer generally are required to relate to the facts in existence on the plan's testing date. This requirement does not apply to years beginning in 1989.

<u>Qualification requirements</u>.--Employers are entitled to comply with the written plan requirement of section 89(k)(1)(A) for any plan year beginning in 1989 by completing the required, full written documentation by the end of such plan year. For years beginning after 1989, rules prescribed by the Secretary are to permit employers a reasonable period to move from a written plan evidenced by a collection of separate written documents to a written plan evidenced by a stand-alone document.

<u>Testing period</u>.--An employer may designate in its plans a common 12-month period for testing all or some of its plans even if such plans have different plan years and even if none of the plans' plan years is the same as the common 12-month testing period. (The testing period chosen by the employer, whether it is this common 12-month period or each plan year, is referred to as the testing year.)

<u>Sampling</u>.--Employers are entitled to demonstrate compliance with section 89 on the basis of a statistically valid random sample of employees that is not inconsistent with rules prescribed by the Secretary. Such random sampling may be performed only by an independent third party. For this purpose, sampling is treated as valid only if the statistical method and sample size produce a 99 percent level of confidence that the sample results have a margin of error not greater than two percent.

<u>Definition of highly compensated employee</u>.--Employers are entitled to elect to determine their highly compensated employees under a simplified method. The simplified method is the same as present law with the following exception. An electing employer is not required to determine the employees who (1) received more than $75,000 in annual compensation from the employer, or (2) received more than $50,000 in annual compensation from the employer and were members of the top-paid group. In lieu of these determinations, the employer is simply required to determine the employees who received more than $50,000 in annual compensation from the employer.

An employer is not entitled to make this election with respect to a current testing year unless (1) the employer did not maintain a top-heavy plan (sec. 416) at any time during such year, and (2) at all times during such year, the employer maintained business activities and employees in at least two geographically separate areas.

<u>Part-time employees</u>.--Under present law, under certain circumstances, employees who normally work less than 17-1/2 hours per week are disregarded in applying the nondiscrimination rules. There are also special rules for employees who normally work less than 30 hours per week.

The Ways and Means Committee bill provides a simplified method of determining the number of hours an employee is considered to work normally in a week. Until the end of the applicable testing year in which an employee commences work, an employee is considered to work normally the average number of hours such employee is scheduled to work during such year (disregarding any time the employee is not employed by the employer). The determination of the average scheduled hours is to be made in good faith and is to take into account periods in which it is expected that hours will be higher due to, for example, seasonal business cycles.

For subsequent testing years, an employee is considered to work normally the average number of hours worked during the preceding testing year (disregarding any time the employee was not employed by the employer). In determining the number of hours an employee has worked or is scheduled to work, rules similar to the qualified plan "hour of service" rules would apply.

Initial service requirements.--Generally, under present law, for purposes of the nondiscrimination rules, employees who have not completed one year of service (or, in the case of core health benefits, six months of service) are disregarded. However, the one-year and six-month figures generally are reduced to the shortest initial service requirement applicable to any employee for eligibility in a plan of the same type.

Under the Ways and Means Committee bill, the initial service requirement applicable under a multiemployer plan is not taken into account in determining the extent to which the one-year and six-month figures are reduced. This special rule for multiemployer plans does not apply to a multiemployer plan that covers any professional (e.g., a doctor, lawyer, or investment banker).

Comparability.--Under present law, for purposes of applying the 80-percent test to accident and health plans, in general, a group of plans are comparable and may be aggregated as one plan if the least valuable plan has a value of at least 95 percent of the value of the most valuable plan.

Under the Ways and Means Committee bill, an employer may elect to reduce the 95-percent figure to 80-percent. However, in any year that election is made, the 80-percent test is modified to be a 90-percent test.

Other coverage.--Under present law, for purposes of applying the 75-percent benefits test to accident or health plans, an employer generally may disregard any employee or family member of an employee if such individual receives core health coverage from another employer of the employee or of the employee's spouse or dependents.

The Ways and Means Committee bill expands this rule in two respects. First, under the bill, an individual could be disregarded based on core health coverage received from another employer of any family member, including a parent. Second, with respect to testing accident or health coverage, the 80-percent test is modified to have two parts: (1) the present-law 80-percent coverage requirement with the "other coverage" rule described above, and (2) a requirement that the plan be available to 80 percent of the employer's nonhighly compensated employees.

Sworn statements.--The present-law rules governing sworn statements are modified by (1) not requiring that the statements be on an IRS form; and (2) directing the IRS to supply language for inclusion on appropriate employer documents (such as enrollment forms). In addition, after initial enrollment, the sworn statements are required to be collected no more frequently than once every three years except to the extent that an employee otherwise makes an election with respect to an employee benefit program (including an election not to participate).

Further, no nonhighly compensated employee (or family member) may be disregarded based on their receipt of other core health coverage unless the employee has the right, if such other coverage ceases, to elect health coverage from the employer without regard to whether it is otherwise open season. For all purposes, such election is to be on the same terms as if such employee had initially elected health coverage from the employer and at a subsequent open season was changing such coverage. A similar rule applies in the case of the treatment of an employee as not having a family. The modifications described in this paragraph apply to years beginning after December 31, 1989.

Finally, the bill modifies a rule included in H.R. 4333 (as introduced). Under the introduced bill, an employer ("first employer") may treat an individual as having core health coverage from another employer without a sworn statement if (1) the first employer makes core health coverage available to the individual at no cost, and (2) such coverage and all other health coverage from the first employer are rejected. Under the bill (as amended), the rule in (2) is modified to require only rejection of all core health coverage.

Line of business.--Generally, the safe-harbor rule for lines of business or operating units (sec. 414(r)(3)) may be applied based on the proportions of highly compensated employees in the preceding testing year.

The present-law rules that allocate to a line of business or operating unit any employee who performs a majority of his or her services for such line of business or operating unit are modified so that only employees who perform at least 75 percent of their services for a particular line of business or operating unit are required to be allocated to such line or unit.

The modifications described above with respect to separate lines of business or operating units also apply for qualified plan purposes.

Definition of plan.--Each different option is valued separately, but is not considered a separate plan. A plan is a group of options with comparable values (under the otherwise applicable comparability rules). With respect to the nondiscrimination rules, the effect of these changes is only one of terminology rather than of substance. (For convenience, the present-law terminology is used throughout this document.)

Penalty for failure to report.--The penalty tax on the employer for the failure to report discriminatory excess with respect to an employee is the penalty tax determined under present law reduced, prior to multiplication by the highest individual rate, by the amount of the discriminatory excess properly reported by the employer in a timely fashion. The same rule applies in the case of amounts includible by reason of a failure to satisfy the qualification rules.

Treasury rules.--The Secretary is required to issue rules by October 1, 1988, providing guidance under section 89 on which employers may rely. Such guidance is to address those areas not addressed by the statute or legislative history and with respect to which employers need immediate guidance in order to comply with the nondiscrimination rules.

Good faith.--Until the issuance of rules by the Secretary, an employer's compliance with its reasonable interpretation of section 89 based on the statute and its legislative history, if made in good faith, constitutes compliance with section 89.

Effective date.--Except as otherwise provided, these provisions apply as if included in the Tax Reform Act of 1986.

Modifications and Additions to Ways and Means Committee Bill

The proposal would follow the Ways and Means Committee bill, except as otherwise provided below. In addition, the proposal would include additional provisions described below.

<u>Safe harbor</u>.--For purposes of the 80-percent test, a group of plans would be treated as comparable with respect to a group of employees if:

(1) such plans are available to all employees within the group on the same terms; and

(2) the difference in annual cost to the employees between the plan in the group with the smallest employee cost and the plan in the group with the largest employee cost is no more than $100 (indexed beginning in 1990 for increases in the consumer price index).

For purposes of the $100 allowable cost differential, employee contributions may be compared only with other employee contributions made on the same basis (i.e., after-tax as opposed to pre-tax). If the employer elects to test coverage of employees separately from coverage of spouses and dependents, the $100 allowable cost differential may be allocated between coverage of employees and coverage of spouses and dependents in any way elected by the employer (e.g., $40 for employee coverage and $60 for coverage of spouses and dependents).

In addition, any other plan may be aggregated with the group of plans described above if such other plan is comparable (under the otherwise applicable comparability standard) to the plan within the group with the largest employer-provided benefit.

A plan also may be treated as comparable to the group of plans described above with respect to an employee if (1) the employee is eligible under the plan within the group with the largest employer-provided benefit, (2) the contribution under the plan outside the group is within the range permitted with respect to the group of plans, and (3) the employer-provided benefit under the plan outside of the group is less than the employer-provided benefit under the plan within the group with the largest such benefit. The first two requirements in the prior sentence only apply to nonhighly compensated employees.

<u>Line of business</u>.--Activities would be considered geographically separate for purposes of the operating unit rules if they are at least 35 miles apart. In addition, for testing years beginning in 1989, the classification test--passage of which is required to use the separate line of business or operating unit rule--is to be the prior-law section 410(b)(1)(B) test without regard to any modification of such test by the Secretary. These two provisions would only apply for purposes of section 89 (and thus would not apply for purposes of the qualified plan coverage test).

<u>Sampling</u>.--The sampling rules of the Ways and Means Committee bill would be modified by providing that sampling would be treated as valid if the statistical method and sample size produce a 95-percent level of confidence that the sample results have a margin of error not greater than three percent.

<u>Group-term life insurance</u>.--The amendment would modify the application of section 89 to group-term life insurance in certain respects. First, H.R. 4333 (as introduced) provides an exception to the general rule that if two types of insurance coverage vary in any way, they will be considered separate plans. Under this exception, if, with respect to group-term life insurance coverage, the required employee contributions vary according to the age of the employee, this variation will not preclude treatment of the coverage as a separate plan. Under the amendment, this exception would apply in the same manner to group-term life insurance coverage under which required employee contributions vary according to the age of the employee, but only up to a specified limit (e.g., the employee's cost may not exceed $X per $1,000 of coverage).

The amendment would delete the provision under which an employer that uses the exception in H.R. 4333 (as introduced) for age-related costs or the exception provided above must use the same exception with respect to all group-term life insurance coverage of the employer. Under the amendment, if one of the exceptions is used with respect to a plan, the same exception must be used with respect to all plans aggregated with such plan for purposes of the 50-percent test and the 80-percent test. In addition, for purposes of applying the 90-percent/50-percent test and the 75-percent test, the employer must elect to apply the tests as if it had used the general rule or one of the two exceptions with respect to all plans being tested.

The amendment also would modify the definition of compensation for purposes of applying section 89 to group-term life insurance. Under the amendment, for testing years beginning in 1989 and 1990, an employer may apply section 89 to group-term life insurance by using, in lieu of compensation as defined under section 414(s), base compensation. Thus, for example, overtime and bonuses would be disregarded. For testing years beginning after December 31, 1990, the employer may use base compensation, or another definition of compensation, provided that based on the experience in the prior year such definition of compensation is not discriminatory. A definition of compensation will be considered nondiscriminatory if the ratio of (i) the average compensation of the nonhighly compensated employees under the alternative definition to (ii) the average compensation of the nonhighly compensated employees under section 414(s) is at least 90 percent of the same ratio for highly compensated employees.

Sworn statements.--Under the amendment, the right of an employee to elect health coverage from the employer without regard to whether it is open season is to be on the same terms as if the employee initially had opted out of health coverage (individual coverage or coverage of his or her spouse and dependents, as the case may be) and at a subsequent open season was electing coverage. Thus, if the employer generally requires such employees to demonstrate evidence of insurability at open season, the employer may do so under this special rule. Also, the coverages required to be made available to the employee are those, if any, that would be available during open season to a similarly situated employee.

Comparability.--The general standard for comparability -- that the less valuable plan have a value equal to at least 95 percent of the value of the most valuable plan -- would be modified by substituting 90 percent for 95 percent.

Aggregation.--The amendment would liberalize in two respects an employer's ability to aggregate plans of different types for purposes of the 75-percent benefits test. First, the amendment would allow benefits of one or more types to be aggregated with all accident or health benefits in order to help the accident or health benefits satisfy the 75-percent benefits test. If the employer elects to test employee accident or health coverage separately from coverage of spouses and dependents, the non-accident or health benefits may be aggregated all with the employee coverage, all with the coverage of spouses and dependents, or partially with respect to each (provided that there are no benefits of the same type not aggregated with either).

The second modification of the aggregation rules would be that an employer may aggregate accident and health benefits with benefits of a different type for purposes of the 75-percent benefits test even if the employer elects to apply the 75-percent benefits test separately to coverage of employees and coverage of employees' spouses and dependents. In the event of such separate testing, the employer may aggregate with the benefits of another type the employee coverage, the coverage of the spouses and dependents, or both; however, for purposes of this aggregation, no employee or family member may be disregarded based on the receipt of other health coverage or on not having a family.

Former employees.--The amendment would make three modifications to the Ways and Means Committee bill with respect to former employees. First, the grandfather rule would apply to all employees who separate from service prior to January 1, 1989 (rather than January 1, 1987), with respect to the level of benefits provided on December 31,

1988. Second, any Federally mandated increase with respect to an employee who separated from service prior to January 1, 1989, would not be considered a benefit increase and thus would be included within the grandfather rule. Third, a benefit increase after December 31, 1988, with respect to an employee who separated from service before January 1, 1989, would be disregarded if (1) it is provided in the same manner to employees who separated from service after December 31, 1988, as it is to employees who separated from service before January 1, 1989, and (2) the benefit increase is nondiscriminatory with respect to employees who separated from service after December 31, 1988. A benefit increase will be considered provided in the same manner to the two groups of former employees if it is provided to the same reasonable classes of former employees within each group (e.g., all employees who satisfied certain reasonable length of service requirements).

<u>Part-time employees</u>.--The Ways and Means Committee bill method for determining the number of hours an employee is considered to work normally in a week would be modified. Under the amendment, for a testing year, an employee is considered to work normally the average number of hours worked during the period in the testing year prior to the testing date. If such period is less than 60 days, an employee is considered to work normally (1) the average number of hours worked during the prior testing year, or (2) if the employee did not work at least 60 days during the prior testing year, the average number of hours such employee is scheduled to work, as of the testing date, during the longer of (i) the next 60 days, or (ii) the period between the testing date and the end of the testing year. For purposes of all of the above rules, periods during which an employee does not work are disregarded. The amendment follows the Ways and Means Committee bill with respect to how scheduled hours are to be determined and the definition of hours worked.

In addition, present law permits the employer-provided benefit to be proportionately reduced under specified rules for employees who normally work less than 30 hours per week. These rules may not be applied, however, for any purpose in a plan year unless during such year more than 50 percent of the nonexcludable employees (determined without regard to plan provisions) normally work at least 30 hours per week. The amendment would allow the proportional reduction without regard to the 50-percent test described in the preceding sentence.

<u>Excluded employees under multiemployer plans</u>.--The amendment would extend the rule in the Ways and Means Committee bill with respect to the initial waiting period for multiemployer plans to employees excluded based on their age, part-time status, or seasonal status. Thus, the exclusion

(or lack thereof) under a multiemployer plan (as defined under the Ways and Means Committee bill) of employees based on age, part-time status, or seasonal status would not affect the employer's ability to disregard employees based on different age, part-time, or seasonal rules.

Reporting requirements for multiemployer plans.--The amendment would provide that in the case of benefits provided under a multiemployer plan, the Secretary is to allocate the reporting responsibility with respect to the plan under section 6039D between the employer and the multiemployer plan based on the agreement between the parties.

Qualification rule.--The amendment would delete the inference in the Ways and Means Committee bill that, after a transition period, the writing requirement may only be satisfied by a stand-alone document.

Definition of highly compensated employee.--The amendment would modify the Ways and Means Committee bill rule providing an alternative means of determining an employer's highly compensated employees. The amendment would delete the requirements that an employer operate in at least two geographic areas and not maintain any top-heavy plans in order to use this alternative rule.

Acquisitions and dispositions.--Under present law, a rule applies under section 89(j)(8) and section 410(b)(6)(C) for certain dispositions or acquisitions of a business. Under the amendment, the Secretary would be authorized to prescribe additional rules with respect to the application of section 89 in the case of business transactions. Such rules should facilitate the application of section 89 in such cases, but at the same time ensure that repeated transactions do not provide a means of avoiding section 89.

Valuation.--The amendment would modify the Ways and Means Committee bill provision regarding the effective date of rules issued by the Secretary with respect to the valuation of accident or health coverage by requiring that such rules be effective no earlier than the first year beginning at least 1 year after the issuance of such rules.

The amendment would modify the Ways and Means Committee bill with respect to the valuation of benefits provided under a multiemployer plan based on the employer contribution. The amendment would provide that the Secretary is to prescribe rules for the allocation of contributions that relate to benefits of different types. Under such rules, the allocation may be based on the prior year's claims or premiums, if this is reasonable under the circumstances.

Cafeteria plans.--The amendment would modify the nondiscrimination rules relating to cafeteria plans in two respects.

Under present law, employers are allowed to limit the elections of highly compensated employees under a cafeteria plan to the extent necessary to comply with the applicable nondiscrimination rules (e.g., sec. 89 or sec. 129(c)(7)). However, these limitations are to be applied in the manner prescribed for allocating discriminatory excess among highly compensated employees. Under the amendment, the limits could be applied in any manner used consistently by the employer that precludes employer discretion during the year in which the limitation applies. For years beginning after December 31, 1989, such nondiscretionary method is required to be established in the plan document prior to the beginning of the year to which the method applies.

The amendment also modifies the application of the 90-percent/50-percent test to cafeteria plans. Under present law, any elective contributions that an employee may make under a cafeteria plan are disregarded for purposes of the 90-percent/50-percent test. Under the amendment, elective contributions under a cafeteria plan may be taken into account for purposes of the 90-percent/50-percent test if the following requirements are satisfied:

(1) the percentage of nonhighly compensated employees eligible under the plan is equal to or less than the percentage of highly compensated employees eligible under the plan;

(2) all employees eligible under the plan are eligible under the same terms and conditions; and

(3) no highly compensated employee eligible under the plan is eligible inside or outside of the cafeteria plan for any benefit of the same type that is not available on the same terms and conditions to every nonhighly compensated employee eligible under the plan.

Dependent care assistance.--Under present law, a benefits test applies to dependent care assistance programs that are not treated as statutory employee benefit plans under section 89 (sec. 129(d)(8)). For purposes of applying this benefits test to salary reduction amounts, employees with compensation (as defined in sec. 414(q)(7)) below $25,000 are to be disregarded. (The introduced technical corrections bill makes this rule elective for employers.)

Under the amendment, under rules prescribed by the Secretary, the employer would be entitled to elect certain alternative definitions of compensation for purposes of the $25,000 rule provided that based on the experience in the prior year such definition does not overstate the number of employees with less than $25,000 of compensation under section 414(q)(7) by more than five percent.

Penalty for failure to report.--Under the amendment, the penalty for failure to report income includible under section 89 would only apply to the portion of the employee's benefit that bears the same relationship to the total benefit as the unreported amount bears to the entire amount that should have been reported.

Treasury rules.--The amendment would modify the Ways and Means Committee bill with respect to the issuance of rules by the Secretary by specifying that the rules are to include guidance with respect to the qualification requirements and the line of business or operating unit rules. The guidance with respect to the line of business or operating unit rules is to address the treatment of headquarters employees in a manner that facilitates administration of the rules within the expressed intent of the legislation.

Good faith.--The amendment would modify the Ways and Means Committee bill by extending the good faith compliance standard to all provisions for which regulations were required by February 1, 1988, under section 1141 of the Tax Reform Act of 1986.

B. Sanctions for Violation of the Health Care Continuation Rules

Description of Proposal

The proposal would replace the present-law income tax sanctions for failures to satisfy the health care continuation rules with a nondeductible excise tax.

1. Amount of the excise tax.--Under the proposal, the amount of the excise tax for any failure to satisfy the health care continuation rules would be $100 per day during the noncompliance period with respect to such failure. This excise tax would apply separately with respect to each qualified beneficiary with respect to whom there has been a failure to satisfy the health care continuation rules. However, if a failure occurs with respect to members of the same family, the excise tax would apply only once with respect to such failure.

2. Noncompliance period.--The noncompliance period generally would begin on the date the failure first occurs and end on the earlier of the date the failure is corrected or the last date on which the employer could have been required to provide continuation coverage, determined without regard to whether any premium was paid.

3. Inadvertent failures.--Subject to certain special rules described below, the noncompliance period would not start on the date the failure first occurred if it is established to the satisfaction of the Secretary that none of the persons who could be liable for the tax knew, or exercising reasonable diligence would have known, that the failure existed. In such a case, the noncompliance period would not commence until any of such persons knew or should have known of the failure. For purposes of this rule (and the other rules described below), a person is deemed to know the law under which the particular fact situation constituted a failure.

4. 30-day grace period.--The excise tax generally would not apply to any failure if such failure was due to reasonable cause and not to willful neglect and such failure is corrected within the first 30 days of the noncompliance period with respect to such failure.

5. Audit rule.--A special audit rule would override the inadvertent-failure and 30-day grace period rules described above. Under this special audit rule, if a failure with respect to a qualified beneficiary is not corrected by the date a notice of examination of income tax liability is sent to the employer and if the failure first occurred or continued during the period under examination, the excise tax

with respect to such qualified beneficiary would not be less than the lesser of (a) $2,500 or (b) the excise tax determined without regard to the inadvertent-failure and 30-day grace period rules. To the extent that failures for any year are more than de minimis, $15,000 is substituted for $2,500 in the preceding sentence.

6. Maximum liability.--In the case of failures with respect to plans other than multiemployer plans, the maximum excise tax for failures during an employer's taxable year would be the lesser of (1) 10 percent of the total amount paid or incurred by the employer (or predecessor employer) during the preceding taxable year for the employer's group health plans, or (2) $500,000. If related employers that are treated as a single employer for purposes of the health care continuation rules have different taxable years, the taxable years taken into account would generally be determined based on the principles of Code section 1561.

In the case of failures with respect to a multiemployer plan, the maximum excise tax for failures during the taxable year of the plan trust would be the lesser of (1) 10 percent of the total amount paid or incurred by the trust that is part of such plan during the trust's taxable year to provide medical care (as defined in sec. 213(d)), or (2) $500,000. If an employer is liable for an excise tax attributable to a failure with respect to a multiemployer plan, such liability would be treated as if it related to a plan other than a multiemployer plan and thus would be subject to the limit described above.

The limits described above would not apply to failures to satisfy the health care continuation rules that are attributable to willful neglect.

7. Correction.--A failure to satisfy the health care continuation rules would be considered corrected if: (1) the rules are retroactively satisfied to the extent possible; and (2) the qualified beneficiary (or his or her estate) is placed in a financial position that is as good as he or she would have been in had the failure not occurred.

8. Liable persons.--In the case of a failure with respect to coverage provided by a plan other than a multiemployer plan, the employer would be liable for the excise tax. Under a special rule, certain other persons also would be liable for the excise tax (i.e., the IRS can collect the tax from the employer or from one of such other persons) if (1) such person fails to comply with a written request of the employer (or, in appropriate cases, a written request of a qualified beneficiary or plan administrator) to make available with respect to qualified beneficiaries the same benefits that such person provides with respect to similarly situated active employees; and (2) such benefits are not made

available by any person with respect to such qualified beneficiaries. However, such a person is not liable to the extent that an employer's act or failure to act made the person unable to comply with its responsibilities under the health care continuation rules.

In the case of a failure with respect to coverage provided by a multiemployer plan, the rules regarding liability would be the same as the rules described above, except that "multiemployer plan" replaces "employer" each place the employer is referred to above.

9. Waiver.--In the case of a failure that is due to reasonable cause and not to willful neglect, the Secretary would be authorized to waive part or all of the excise tax to the extent that the tax would be unreasonably burdensome. The determination of whether a tax is unreasonably burdensome would be based on the seriousness of the failure and not on a particular taxpayer's ability to pay the tax.

Effective Date

The proposal would apply to taxable years beginning after December 31, 1988. In addition, it is intended that, with respect to taxable years beginning before January 1, 1989, the Secretary is to exercise administrative restraint in applying the sanction technically applicable under present law, taking into account whether the employer has made all reasonable efforts to prevent and correct any violation of the health care continuation rules.

C. Estate and Gift Tax: Estate Freezes

Present Law

Section 2036(c) applies if a person holds a substantial interest in an enterprise and in effect transfers property having a disproportionately large share of the potential appreciation in such person's interest in the enterprise while retaining a disproportionately large share of the income of, or rights in, the enterprise. Under section 2036(c), an individual and his spouse are treated as one person.

Under S. 2238, if either the original transferor transfers his retained interest, or the original transferee transfers the transferred property to a person who is not a member of the original transferor's family, then the original transferor is treated as making a gift of property equal to the amount which would have been includible under section 2036(c) in his estate had he died at that time (determined without regard to secs. 2032 and 2032A).

Description of Proposal

These changes are made in order to clarify the statute and provide certainty to persons undertaking common business transactions. These changes were approved by the Ways and Means Committee in the technical corrections title of its bill (H.R. 4333).

a. Amendments to changes contained in S. 2238.--The provision in the pending technical corrections bill and the four amendments listed below would be effective for transfers made on or after June 21, 1988.

1. Prior gifts.--The amount of a gift deemed by virtue of a later transfer by either the original transferor or transferee would be reduced by the amount of any taxable gift resulting from the original transfer. Such amount would also be reduced by the amount of previous deemed gifts.

2. Later transfer to original transferor.--The rule deeming a gift whenever the original transferor or transferee later transfers an interest in the enterprise would not apply where the transferee transfers the interest back to the original transferor.

3. Effect of continuing interest in property.--A transfer of property would not result in a deemed gift if the transferor or transferee retains a direct or indirect continuing interest in such property, for example by transferring the property to a holding company.

b. Changes in estate freeze provision as enacted.--

1. <u>Receipt or retention of debt</u>.--An amount would not be includible in a person's estate solely because that person received or retained certain debt lacking equity features. Such debt would have to meet specified requirements regarding term, interest rate, payment dates, voting rights and conversion.

2. <u>Existence of sale, lease, or compensation agreement</u>.--An amount would not be includible in a person's estate solely because that person retained an arms length agreement with the enterprise for the sale or use of property or the providing of services which did not otherwise give that person an interest in the enterprise.

3. <u>Options</u>.--An option to buy property granted by a person would not be includible under section 2036(c) in that person's estate if the exercise price of the option is the fair market value of the property as of the date of exercise. Likewise, any other agreement to sell property entered into by a person would not be includible under section 2036(c) in that person's estate if the sale price under the agreement is the fair market value of the property as of the date of sale.

4. <u>Treatment of spouse</u>.--Regulatory authority would be granted to specify the circumstances in which an individual and his spouse would not be treated as one person.

5. <u>Contribution</u>.--The estate would be given the right to require that the transferee pay his or her share of estate tax attributable to operation of the freeze provision.

IV. DIESEL FUEL EXCISE TAX COLLECTION AND EXEMPTION PROCEDURES

Present Law

The 15.1-cents-per-gallon excise tax on diesel fuel is imposed on the sale of the taxable fuel by a producer, defined to include a wholesale distributor as well as an actual producer of the fuel.[3]

Exemptions from the 15-cents-per-gallon Highway Trust Fund rate are provided for off-highway business uses, including *inter alia*, use on a farm for farming purposes, use as supplies for vessels and trains, and use in construction activities. Further exemptions are provided for use by States and local governments and by nonprofit educational organizations. Uses that are exempt from the Highway Trust Fund rate also are exempt from the 0.1-cent-per-gallon Leaking Underground Storage Trust Fund rate, except for use in a vessel or a train.

In general, exemptions from the tax are realized by means of refunds (or credits against other tax payments) following tax-paid sales. The Treasury Department is authorized to adopt regulations permitting (on a case-by-case basis) sales without payment of tax when diesel fuel is sold directly by a producer to (1) a person who will use the fuel in a train or as a chemical feedstock and (2) States and local governments for their exclusive use. Fuel destined for use as heating oil also may be sold without payment of tax.

Pursuant to the Omnibus Budget Reconciliation Act of 1987, these provisions were effective on April 1, 1988.

Description of Proposal

The ability to purchase diesel fuel direct from producers without payment of tax would be extended to other off-highway business users (e.g., farmers) who were permitted to make such purchases before April 1, 1988, and to certain intercity bus users. Additionally, the definition of producer would be modified to include retail dealers that exclusively sell diesel fuel to waterway and marine users.

Further, the dollar threshold which determines when diesel fuel exempt users may file quarterly refund claims would be lowered and interest would accrue on such refunds.

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3 For a provision as previously reported by the Committee on Finance, see S. 2223, secs. 201-203 (S. Rpt. 100-309, March 29, 1988).

Persons purchasing diesel fuel without payment of tax would be required to satisfy Treasury Department registration and bonding requirements, and Treasury would be authorized specifically to require expanded information reporting similar to the Form 1099 requirements that apply to interest income on sellers and exempt purchasers. Any required reporting under this additional authority generally would be made by means of additional information on currently required income tax returns.

Effective Date

The proposal would apply to diesel fuel and nongasoline aviation fuel sold after September 30, 1988.

A special interest-bearing refund would be provided for purchases between March 31, 1988, and October 1, 1988, by exempt users newly authorized under the proposal to purchase diesel fuel without payment of tax.

V. REPEAL OF LIMITATION ON TREASURY LONG-TERM BOND AUTHORITY

Present Law

The Secretary of Treasury is allowed to issue up to $270 billion in bonds (obligations that mature more than 10 years after issue date) with interest rates above the 4 1/4 percent statutory limit. Bonds held by the general public are subject to the limitation; bonds held in Federal Government agency and Federal Reserve accounts are not included in the limit.

The last prior increase in the exception, from $250 billion to $270 billion, was enacted in the Omnibus Budget Reconciliation Act of 1987. An exception to the statutory limit was enacted initially in 1971 and applied only to bonds held by the general public in 1973.

Description of Ways and Means Committee Bill

Under H.R. 4333, the statutory limitation on Treasury long-term bond authority would be repealed.

Effective Date

The provision would be effective on the date of enactment.

VI. HOUSE-PASSED BILLS AND BILL REFERRED FROM OTHER SENATE COMMITTEE

A. Indian Fishing Rights (H.R. 2792)[4]

Present Law

Various treaties, Federal statutes, and executive orders reserve to Indian tribes (mostly in the West and Great Lakes regions) rights to fish for subsistence and commercial purposes both on and off reservations. Because the treaties, statutes, and executive orders were adopted before passage of the Federal income tax, they do not expressly provide whether income derived by Indians from protected fishing activities is exempt from taxation.

Indians generally are subject to Federal tax in the same manner as other U.S. citizens, absent a specific Federal exemption. Consequently, the Tax Court has ruled in three cases that income derived by Indians from protected fishing activities is taxable, and the Internal Revenue Service has assessed deficiencies in other cases.

Explanation of the Bill

The bill would provide that income derived by individual members of an Indian tribe, or by a qualified Indian entity, from fishing rights-related activity is exempt from Federal and State tax, including income, social security, and unemployment compensation insurance taxes.[5] The bill provides that the source and scope of this exemption is the Internal Revenue Code and not the Indian treaties.

The bill would define a "qualified Indian entity" as an entity in which (1) all of the equity interests are owned by tribal members; (2) substantially all of the management functions are performed by tribal members; and (3) if the entity engages in any substantial processing or transporting of fish, at least 90 percent of the annual gross receipts are derived from the exercise of protected fishing rights.[6] An

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[4] H.R. 2792 was passed by the House of Representatives on June 20, 1988. (See also H. Rpt. 100-312, Part 2, June 15, 1988.)

[5] Individuals may derive exempt income through self-employed activities, as employees, or as owners of qualified Indian entities.

[6] A qualified Indian entity may be jointly owned by members

(Footnote continued)

entity that failed to satisfy any of the criteria of a qualified Indian entity would not be eligible for the exemption from tax provided by the bill; any employee or owner of such an entity would not be eligible under the bill for tax exemption on income received from such entity.

In the case of an individual tribal member or a qualified Indian entity, the bill would exempt from taxation only that income "derived" from fishing rights-related activities. Thus, both individual tribal members and qualified Indian entities would be required to allocate income and expenses among fishing rights-related activities and all other activities.[7] Expenses and amounts otherwise deductible that were attributable to income that would be exempt under the bill could not be used by an individual or entity to offset any other income of the individual or entity. Likewise, income that is exempt from tax under the bill would be excluded in determining whether an individual was eligible for social security benefits or unemployment compensation.

Income from Indian fishing activities protected by treaty, Federal statute, or executive order would be exempt from Federal taxes only to the extent provided for by the bill. If income from fishing rights-related activity is exempt from Federal tax, then the bill would prohibit imposition under State or local law of any tax on such income. (However, the bill would not limit exemptions from State and local taxes that may be broader than the exemption it provides.)

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[6](continued)
of more than one Indian tribe, provided that the entity is engaged in fishing rights-related activity of each tribe of which the owners are members. If a jointly owned entity engages in substantial processing or transporting of fish, at least 90 percent of the annual gross receipts must be derived from fishing rights-related activities of tribes whose members own at least 10 percent equity interests in the entity. The bill does not affect the income of a tribal government received pursuant to the exercise of an essential governmental function (see Code secs. 115 and 7871; Rev. Rul. 67-284, 1967-2 C.B. 55, 58). However, wages paid to an Indian who was employed by an entity that was owned by his or her tribal government and that engaged in fishing rights-related activities could be exempt from tax under the bill only if the entity satisfied the bill's criteria for a qualified Indian entity (treating the tribal government's ownership as ownership by tribal members).

[7] However, allocations between exempt and taxable income would not be required where all but a de minimis amount of
(Footnote continued)

Effective Date

The bill would apply to all taxable years beginning before or after the date of enactment as to which the period of assessment has not expired.

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[7] (continued) the income of the individual or entity was derived from protected fishing activities.

B. Railroad Unemployment and Retirement Programs (H.R. 2167 with modifications requested by the Chairman and ranking minority member of the Committee on Labor and Human Resources)[8]

Present Law

1-Compensation base: $600 is the maximum monthly amount of earnings of each employee for purposes of computing the tax which supports the railroad unemployment program and for purposes of determining whether the employee has sufficient base year wages to qualify for benefits.

2-Tax rates: Railroad employers pay a uniform tax of 8 percent of the compensation base to support the railroad unemployment program. (The uniform rate can vary from year to year in a range of 0.5 to 8 percent but has been at 8 percent since January 1, 1981.)

3-Commuter railroads pay unemployment taxes on the same basis as other railroads.

4-The administrative costs of the program are financed by a tax of 0.5 percent.

5-In addition to other taxes, railroads now pay a special tax designed to repay the borrowings of the unemployment program from the railroad retirement program. This tax is 6 percent in 1988, 2.9 percent in 1989, and 3.2 percent in January - September of 1990. It expires at that time.

6-If there is any further borrowing by the unemployment program from the retirement program, a surtax of 3.5 percent would automatically go into effect. The surtax is not currently in effect.

7-Present law has no waiting period for railroad unemployment benefits.

8-Unemployment benefits are payable at a rate of $25 per day.

9-To qualify for unemployment benefits, an individual must have earned at least $1500 in creditable wages in the base year. (This is the equivalent of 2.5 months under the present law compensation base of $600.)

10-Certain individuals retiring from railroad employment receive a severance payment which is subject to the tier II railroad retirement tax even though the individual gets no

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[8] H.R. 2167 was passed by the House of Representatives on November 9, 1987. (See also H. Rpt. 100-102, Part 2, October 19, 1987.)

additional service-month credit because of that payment.

11-Railroad retirement benefits (including spouses benefits) are not payable for months in which the retiree works for his or her last non-railroad employer.

12-Disability annuitants lose benefits for any month in which they have earnings of more than $200 for the month and more than $2400 for the year.

13-Military service credit is given under the railroad retirement system to certain individuals previously in rail employment if their military service occurred in a war period. The period of June 15, 1948 to December 15, 1950 is not considered a war period.

Description of Proposal

1-Compensation base: Starting with 1989, the compensation base would be automatically increased each year by 2/3 of the rise in wage levels in the economy using the same index as applies to the social security tax base. Conforming changes are made to the definition of subsidiary remuneration, to the maximum annual benefit amount, and to the amount of earnings required to terminate a disqualification.

2-The tax rate would remain at 8 percent through 1990. Starting with 1991, the tax rate would begin to be based on an experience rating formula under which tax rates would vary among employers according to the amount of benefits that had been paid to their employees. The experience rating system would become fully effective starting in 1993. The computation of each employer's tax liability would be adjusted to cover benefit costs which cannot be allocated to individual employers or which are not fully covered because of an overall 12 to 12.5 percent cap on individual employer rates. Employers would afforded an opportunity to appeal the award of benefits to their employees.

3-For 1989 and 1990, public commuter railroads would be exempt from paying the 8 percent tax and would instead reimburse the unemployment system for the amount of benefits paid during the year to their employees. Starting in 1991, those railroads would again pay taxes on the same basis as other railroads.

4-The tax to cover administrative costs would be increased from 0.5 percent to 0.65 percent.

5-The rate of the repayment tax would be changed to 4 percent effective with 1989 and it would stay in effect until all borrowing by the railroad unemployment system from the railroad retirement system prior to October 1, 1985 has been repaid with interest.

6-The present law contingent surtax of 3.5 percent would be eliminated starting in 1991. Instead, there would be a surcharge added to employers' unemployment taxes whenever the balance in the unemployment account as of the previous June 30 is less than $100 million. The surcharge rate would range from 1.5 to 3.5 percent depending on how low the balance had fallen.

7-No benefits would be payable during the first 2-week registration period each year in which the individual has more than four days of unemployment. A similar rule would apply to sickness benefits. In addition, no benefits would be paid during the first 14 days in which the individual is out of work because of a strike. In effect, this provision represents a 2-week waiting period for unemployment and sickness benefits.

8-Effective July 1, 1988, the daily unemployment benefit rate would be increased to $30. Starting in July of 1989, this amount would be indexed by 2/3 of the growth of wages in the general economy using the same index that is used to increase the social security taxable wage base.

9-The $1500 base year earnings requirement would be changed to a requirement of 2.5 times the indexed compensation amount. This would have the effect of continuing to require employment in at least 3 months of the base year.

10-A lump sum refund to employees would be made equal to the tier II taxes paid on severance payments which do not result in additional service-month credit. This would apply to such payments made on or after January 1, 1985.

11-The "last person service" rule would be eliminated. Instead, tier II benefits would be reduced by 50 percent of any earnings from the individual's last non-railroad employer. The total reduction in tier II plus supplemental benefits could not be more than 50 percent.

12-The earnings limit on disability annuities would be increased to $400 for the month and $4800 for the year. In determining these amounts, disability related work expenses would be excluded.

13-The June 15, 1948 to December 15, 1950 period would be added to what is considered to be a war period in the case of individuals who returned to railroad employment in the year in which their military service ended or in the following year.

The Railroad Retirement Board would be directed to make annual reports to Congress on the status of the unemployment insurance system.

The Comptroller General would be directed to conduct a study to determine the extent and impact of fraud and payment error in the railroad unemployment program.

Budgetary Impact

	FY88	FY89	FY90	FY91	FY92	FY93
Outlays:	5	20	21	24	25	31
Revenues:	0	-3	52	85	81	92
Deficit increase or (-) reduction:	5	23	-31	-61	-56	-61

C. Access to Tax Information by the Veterans' Administration (S. 2611--Senator Cranston)[9]

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information of taxpayers, with exceptions for authorized disclosure in certain enumerated instances (Code sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431).

Among the disclosures permitted under the Code is disclosure of return information to Federal, State, and local agencies administering certain programs under the Social Security Act or the Food Stamp Act of 1977. This disclosure, pursuant to a written request by the agency, is for the purpose of determining eligibility for, and the correct amount of benefits under, certain enumerated programs. Any authorized recipient of return information must maintain a system of safeguards to protect against unauthorized redisclosure of the information.

Explanation of the Bill

The bill would allow disclosure of certain tax return information to the Veterans' Administration to assist it in determining eligibility for, and establishing correct benefit amounts under, certain of its needs-based pension and other programs.

The Veterans' Administration would be required to comply with the safeguards presently contained in the Code and in section 1137(c) of the Social Security Act (governing the use of disclosed tax information). These safeguards include independent verification of tax data, notification to the individual concerned, and the opportunity to contest agency findings based on such information.

Effective Date

The bill would be effective on the date of enactment.

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[9] S. 2611 was favorably reported by the Senate Committee on Veterans' Affairs on July 6, 1988 (S. Rpt. 100-412).

VII. CORPORATE ESTIMATED TAX PAYMENTS

Present Law

Under present law, corporations are required to make estimated tax payments four times a year (sec. 6655). For small corporations, each installment is required to be based on an amount equal to the lesser of (1) 90 percent of the tax shown on the return or (2) 100 percent of the tax shown on the preceding year's return. For large corporations, each installment is required to be based on an amount equal to 90 percent of the tax shown on the return (except that the first payment may be based on 100 percent of the tax shown on the preceding year's return). For both large and small corporations, the amount of any payment is not required to exceed an amount which would be due if the total payments for the year up to the required payment equal 90 percent of the tax which would be due if the income already received during the current year were placed on an annual basis. Any reduction in a payment resulting from using this annualization rule must be made up in the subsequent payment if the corporation does not use the annualization rule for that subsequent payment. However, if the subsequent payment makes up at least 90 percent of the earlier shortfall, no penalty is imposed.

Description of Proposal

A corporation that uses the annualization method for a prior payment could be required to make up 94.25 percent of the shortfall (instead of 90 percent of the shortfall) in the subsequent payment in order to avoid an estimated tax penalty, effective for estimated tax payments required to be made in 1989, 1990, and 1991. A corporation that uses the annualization method for a prior payment could be required to make up 95 percent of the shortfall in the subsequent payment in order to avoid an estimated tax penalty, effective for estimated tax payments required to be made in 1992. A corporation that uses the annualization method for a prior payment could be required to make up 95.5 percent of the shortfall in the subsequent payment in order to avoid an estimated tax penalty, effective for estimated tax payments required to be made after December 31, 1992. Additional increases in the percentage after 1993 may be necessary to offset continuing revenue losses of other provisions.

Effective Date

The increase to 94.25 percent would be effective for estimated tax payments required to be made in 1989, 1990, and 1991. The increase to 95 percent would be effective for estimated tax payments required to be made in 1992. The increase to 95.5 percent would be effective for estimated tax payments required to be made after December 31, 1992.