

**DESCRIPTION OF PROVISIONS**  
**IN S. 2622,**  
**THE TAX RELIEF EXTENSION ACT OF 1998**

**Prepared by the Staff**  
**of the**  
**JOINT COMMITTEE ON TAXATION**

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**JCX-70R-98**

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## INTRODUCTION

S. 2622, the Tax Relief Extension Act of 1998 ("the Tax Extension Act"), was introduced by Senator William V. Roth, Jr., Senator Daniel Patrick Moynihan, and others on October 10, 1998.

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, describes the proposals contained in the Tax Extension Act. Part I of this document contains the expiring provision proposals, Part II contains other proposals, Part III contains a revenue offset proposal, and Part IV contains tax technical corrections.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of Provisions in S. 2622, the Tax Relief Extension Act of 1998* (JCX-70R-98), October 10, 1998. (References in this document to the "1997 Act" refer to the Taxpayer Relief Act of 1997.)

## **TITLE I. EXTENSION OF EXPIRING PROVISIONS**

### **Subtitle A—Tax Provisions**

#### **A. Extension of Research Tax Credit (sec. 101 of the bill and sec. 41 of the Code)**

##### **Present Law**

##### **General rule**

Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceeded its base amount for that year. The research tax credit expired and generally does not apply to amounts paid or incurred after June 30, 1998.

A 20-percent research tax credit also applied to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the "university basic research credit" (see sec. 41(e)).

##### **Computation of allowable credit**

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of 3 percent.<sup>2</sup>

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<sup>2</sup> A special rule is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm will be assigned a fixed-base percentage of 3 percent for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. In the event that the research credit is extended beyond the scheduled expiration date, a start-up firm's fixed-based percentage for its sixth

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

### **Alternative incremental research credit regime**

Taxpayers are allowed to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative credit regime, a credit rate of 1.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1 percent (i.e., the base amount equals 1 percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 2.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of 2 percent. A credit rate of 2.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 2 percent. An election to be subject to this alternative incremental credit regime may be made for any taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years (in the event that the credit subsequently is extended by Congress) unless revoked with the consent of the Secretary of the Treasury.

### **Eligible expenditures**

Qualified research expenditures eligible for the research tax credit consist of: (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses").<sup>3</sup>

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through tenth taxable years after 1993 in which it incurs qualified research expenditures will be a phased-in ratio based on its actual research experience. For all subsequent taxable years, the taxpayer's fixed-based percentage will be its actual ratio of qualified research expenditures to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993 (sec. 41(c)(3)(B)).

<sup>3</sup> Under a special rule, 75 percent of amounts paid to a research consortium for qualified research is treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under sec. 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must involve a process of experimentation related to functional aspects, performance, reliability, or quality of a business component.

Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

### **Relation to deduction**

Deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year. Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

### **Description of Proposal**

The bill extends the research tax credit for 12 months--i.e., generally, for the period July 1, 1998, through June 30, 1999.

In extending the credit, the scope of the term "qualified research" is reaffirmed. Section 41 targets the credit to research which is undertaken for the purpose of discovering information which is technological in nature and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer. However, eligibility for the credit does not require that the research be successful-- *i.e.*, the research need not achieve its desired result. Moreover, evolutionary research activities intended to improve functionality, performance, reliability, or quality are eligible for the credit, as are research activities intended to achieve a result that has already been achieved by other persons but is not yet within the common knowledge (*e.g.*, freely available to the general public) of the field (provided that the research otherwise meets the requirements of section 41, including not being excluded by subsection (d)(4)).

Activities constitute a process of experimentation, as required for credit eligibility, if they involve evaluation of more than one alternative to achieve a result where the means of achieving the result are uncertain at the outset, even if the taxpayer knows at the outset that it may be

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conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer.



technically possible to achieve the result. Thus, even though a researcher may know of a particular method of achieving an outcome, the use of the process of experimentation to effect a new or better method of achieving that outcome may be eligible for the credit (provided that the research otherwise meets the requirements of section 41, including not being excluded by subsection (d)(4)).

Lastly, the lack of clarity in the interpretation of the distinction between internal-use software, the costs of which may be eligible for the credit if additional tests are met, and other software has been observed. The application of the definition of internal-use software should fully reflect Congressional intent.

#### **Effective Date**

The extension of the research credit is effective for qualified research expenditures paid or incurred during the period July 1, 1998, through June 30, 1999.

**B. Extension of the Work Opportunity Tax Credit  
(sec. 102 of the bill and sec. 51 of the Code)**

**Present Law**

**In general**

The work opportunity tax credit ("WOTC"), which expired on June 30, 1998, was available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The credit equals 40 percent (25 percent for employment of 400 hours or less) of qualified wages. Qualified wages are wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. For a vocational rehabilitation referral, however, the period begins on the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan.

The maximum credit per employee is \$2,400 (40% of the first \$6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is \$1,200 (40 percent of the first \$3,000 of qualified first-year wages).

The employer's deduction for wages is reduced by the amount of the credit.

**Targeted groups eligible for the credit**

The eight targeted groups are: (1) families eligible to receive benefits under the Temporary Assistance for Needy Families (TANF) Program; (2) high-risk youth; (3) qualified ex-felons; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; (7) families receiving food stamps; and (8) persons receiving certain Supplemental Security Income (SSI) benefits.

**Minimum employment period**

No credit is allowed for wages paid to employees who work less than 120 hours in the first year of employment.

**Expiration date**

The credit is effective for wages paid or incurred to a qualified individual who began work for an employer before July 1, 1998.

### **Description of Proposal**

The proposal extends the work opportunity tax credit, for 12 months, through June 30, 1999.

### **Effective Date**

The proposal is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after July 1, 1998, and before July 1, 1999.

**C. Extension of the Welfare-To-Work Tax Credit  
(sec. 103 of the bill and sec. 51A of the Code)**

**Present Law**

The Code provides to employers a tax credit on the first \$20,000 of eligible wages paid to qualified long-term family assistance (AFDC or its successor program) recipients during the first two years of employment. The credit is 35 percent of the first \$10,000 of eligible wages in the first year of employment and 50 percent of the first \$10,000 of eligible wages in the second year of employment. The maximum credit is \$8,500 per qualified employee.

Qualified long-term family assistance recipients are: (1) members of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received family assistance for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit if they are hired within 2 years after the date that the 18-month total is reached; and (3) members of a family who are no longer eligible for family assistance because of either Federal or State time limits, if they are hired within 2 years after the Federal or State time limits made the family ineligible for family assistance.

Eligible wages include cash wages paid to an employee plus amounts paid by the employer for the following: (1) educational assistance excludable under a section 127 program (or that would be excludable but for the expiration of sec. 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

The welfare to work credit is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 1998, and before May 1, 1999.

**Description of Proposal**

The proposal extends the welfare-to-work credit effective for wages paid or incurred to a qualified individual who begins work for an employer on or after May 1, 1999, and before July 1, 1999.

**Effective Date**

The proposal is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after May 1, 1999, and before July 1, 1999.

## **D. Extend the Deduction Provided for Contributions of Appreciated Stock to Private Foundations (sec. 104 of the bill and sec. 170(e)(5) of the Code)**

### **Present Law**

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization.<sup>4</sup> However, in the case of a charitable contribution of short-term gain, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose.

In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property. However, under a special rule contained in section 170(e)(5), taxpayers are allowed a deduction equal to the fair market value of "qualified appreciated stock" contributed to a private foundation prior to July 1, 1998. Qualified appreciated stock is defined as publicly traded stock which is capital gain property. The fair-market-value deduction for qualified appreciated stock donations applies only to the extent that total donations made by the donor to private foundations of stock in a particular corporation did not exceed 10 percent of the outstanding stock of that corporation. For this purpose, an individual is treated as making all contributions that were made by any member of the individual's family.

### **Description of Proposal**

The proposal extends the special rule contained in section 170(e)(5) for one year--for contributions of qualified appreciated stock made to private foundations during the period July 1, 1998, through June 30, 1999.

### **Effective Date**

The proposal is effective for contributions of qualified appreciated stock to private foundations made during the period July 1, 1998, through June 30, 1999.

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<sup>4</sup> The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)).

**E. Exceptions Under Subpart F for Certain Active Financing Income**  
**(sec. 105 of the bill and secs. 953 and 954 of the Code)**

**Present Law**

**In general**

Under the subpart F rules, certain U.S. shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, "foreign personal holding company income" and insurance income. The U.S. 10-percent shareholders of a CFC also are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (i.e., income derived from services performed for a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and REMICs; (3) net gains from commodities transactions; (4) net gains from foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; and (7) payments in lieu of dividends.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other-country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income (Prop. Treas. Reg. sec. 1.953-1(a)).

Temporary exceptions from foreign personal holding company income and foreign base company services income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, insurance, or similar business.<sup>5</sup> These exceptions (described below) are applicable only for taxable years beginning in 1998.

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<sup>5</sup> The President canceled these exceptions in 1997 pursuant to the Line Item Veto Act. On June 25, 1998, the U.S. Supreme Court held that the cancellation procedures set forth in the Line Item Veto Act are unconstitutional. Clinton v. City of New York, 118 S. Ct. 2091 (June 25, 1998).

### **Income from the active conduct of a banking, financing, or similar business**

A temporary exception from foreign personal holding company income applies to income that is derived in the active conduct of a banking, financing, or similar business by a CFC that is predominantly engaged in the active conduct of such business. For this purpose, income derived in the active conduct of a banking, financing, or similar business generally is determined under the principles applicable in determining financial services income for foreign tax credit limitation purposes. However, in the case of a corporation that is engaged in the active conduct of a banking or securities business, the income that is eligible for this exception is determined under the principles applicable in determining the income which is treated as nonpassive income for purposes of the passive foreign investment company provisions. In this regard, the income of a corporation engaged in the active conduct of a banking or securities business that is eligible for this exception is the income that is treated as nonpassive under the regulations proposed under section 1296(b) (as in effect prior to the enactment of the Taxpayer Relief Act of 1997). See Prop. Treas. Reg. secs. 1.1296-4 and 1.1296-6. The Secretary of the Treasury is directed to prescribe regulations applying look-through treatment in characterizing for this purpose dividends, interest, income equivalent to interest, rents and royalties from related persons.

For purposes of the temporary exception, a corporation is considered to be predominantly engaged in the active conduct of a banking, financing, or similar business if it is engaged in the active conduct of a banking or securities business or is a qualified bank affiliate or qualified securities affiliate. In this regard, a corporation is considered to be engaged in the active conduct of a banking or securities business if the corporation would be treated as so engaged under the regulations proposed under prior law section 1296(b) (as in effect prior to the enactment of the Taxpayer Relief Act of 1997); qualified bank affiliates and qualified securities affiliates are as determined under such proposed regulations. See Prop. Treas. Reg. secs. 1.1296-4 and 1.1296-6.

Alternatively, a corporation is considered to be engaged in the active conduct of a banking, financing, or similar business if more than 70 percent of its gross income is derived from such business from transactions with unrelated persons located within the country under the laws of which the corporation is created or organized. For this purpose, income derived by a qualified business unit ("QBU") of a corporation from transactions with unrelated persons located in the country in which the QBU maintains its principal office and conducts substantial business activity is treated as derived by the corporation from transactions with unrelated persons located within the country in which the corporation is created or organized. A person other than a natural person is considered to be located within the country in which it maintains an office through which it engages in a trade or business and by which the transaction is effected. A natural person is treated as located within the country in which such person is physically located when such person enters into the transaction.

### **Income from the active conduct of an insurance business**

A temporary exception from foreign personal holding company income applies for certain investment income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. These rules differ from the rules of section 953 of the Code, which determines the subpart F inclusions of a U.S. shareholder relating to insurance income of a CFC. Such insurance income under section 953 generally is computed in accordance with the rules of subchapter L of the Code.

A temporary exception applies for income (received from a person other than a related person) from investments made by a qualifying insurance company of its reserves or 80 percent of its unearned premiums. For this purpose, in the case of contracts regulated in the country in which sold as property, casualty or health insurance contracts, unearned premiums and reserves are defined as unearned premiums and reserves for losses incurred determined using the methods and interest rates that would be used if the qualifying insurance company were subject to tax under subchapter L of the Code. Thus, for this purpose, unearned premiums are determined in accordance with section 832(b)(4), and reserves for losses incurred are determined in accordance with section 832(b)(5) and 846 of the Code (as well as any other rules applicable to a U.S. property and casualty insurance company with respect to such amounts).

In the case of a contract regulated in the country in which sold as a life insurance or annuity contract, the following three alternative rules for determining reserves apply. Any one of the three rules can be elected with respect to a particular line of business.

First, reserves for such contracts can be determined generally under the rules applicable to domestic life insurance companies under subchapter L of the Code, using the methods there specified, but substituting for the interest rates in Code section 807(d)(2)(B) an interest rate determined for the country in which the qualifying insurance company was created or organized, calculated in the same manner as the mid-term applicable Federal interest rate ("AFR") (within the meaning of section 1274(d)).

Second, the reserves for such contracts can be determined using a preliminary term foreign reserve method, except that the interest rate to be used is the interest rate determined for the country in which the qualifying insurance company was created or organized, calculated in the same manner as the mid-term AFR. If a qualifying insurance company uses such a preliminary term method with respect to contracts insuring risks located in the country in which the company is created or organized, then such method is the method that applies for purposes of this election.

Third, reserves for such contracts can be determined to be equal to the net surrender value of the contract (as defined in section 807(e)(1)(A)).



In no event can the reserve for any contract at any time exceed the foreign statement reserve for the contract, reduced by any catastrophe or deficiency reserve. This rule applies whether the contract is regulated as a property, casualty, health, life insurance, annuity or any other type of contract.

A temporary exception from foreign personal holding company income also applies for income from investment of assets equal to: (1) one-third of premiums earned during the taxable year on insurance contracts regulated in the country in which sold as property, casualty, or health insurance contracts; and (2) the greater of 10 percent of reserves, or, in the case of a qualifying insurance company that is a startup company, \$10 million. For this purpose, a startup company is a company (including any predecessor) that has not been engaged in the active conduct of an insurance business for more than 5 years. In general, the 5-year period commences when the foreign company first is engaged in the active conduct of an insurance business. If the foreign company was formed before being acquired by the U.S. shareholder, the 5-year period commences when the acquired company first was engaged in the active conduct of an insurance business. In the event of the acquisition of a book of business from another company through an assumption or indemnity reinsurance transaction, the 5-year period commences when the acquiring company first engaged in the active conduct of an insurance business, except that if more than a substantial part (e.g., 80 percent) of the business of the ceding company is acquired, then the 5-year period commences when the ceding company first engaged in the active conduct of an insurance business. Reinsurance transactions among related persons may not be used to multiply the number of 5-year periods.

Under rules prescribed by the Secretary, income is allocated to contracts as follows. In the case of contracts that are separate account-type contracts (including variable contracts not meeting the requirements of sec. 817), only the income specifically allocable to such contracts are taken into account. In the case of other contracts, income not specifically allocable is allocated ratably among such contracts.

A qualifying insurance company is defined as any entity which: (1) is regulated as an insurance company under the laws of the country in which it is incorporated; (2) derives at least 50 percent of its net written premiums from the insurance or reinsurance of risks situated within its country of incorporation; and (3) is engaged in the active conduct of an insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

The temporary exceptions do not apply to investment income (includable in the income of a U.S. shareholder of a CFC pursuant to sec. 953) allocable to contracts that insure related party risks or risks located in a country other than the country in which the qualifying insurance company is created or organized.

### **Anti-abuse rule**

An anti-abuse rule applies for purposes of these temporary exceptions. For purposes of applying these exceptions, items with respect to a transaction or series of transactions are disregarded if one of the principal purposes of the transaction or transactions is to qualify income or gain for these exceptions, including any change in the method of computing reserves or any other transaction or transactions one of the principal purposes of which is the acceleration or deferral of any item in order to claim the benefits of these exceptions.

### **Foreign base company services income**

A temporary exception from foreign base company services income applies for income derived from services performed in connection with the active conduct of a banking, financing, insurance or similar business by a CFC that is predominantly engaged in the active conduct of such business or is a qualifying insurance company.

### **Description of Proposal**

The proposal extends for one year the present-law temporary exceptions from foreign personal holding company income and foreign base company services income for income that is derived in the active conduct of a banking, financing, insurance or similar business.

### **Effective Date**

The proposal applies only to the first full taxable year of a foreign corporation beginning in 1998 and to the taxable year of such corporation immediately following such first full taxable year, and to taxable years of U.S. shareholders with or within which such taxable years of such foreign corporation end. If a foreign corporation does not have such a first full taxable year beginning in 1998, the proposal applies only to the first taxable year of the foreign corporation beginning in 1999, and to taxable years of U.S. shareholders with or within which such taxable year of such foreign corporation ends.

**F. Extend Placed in Service Date for Certain Nonconventional Fuels Facilities  
(sec. 106 of the bill and sec. 29 of the Code)**

**Present Law**

Under present law, certain fuels produced from "nonconventional sources" and sold to unrelated parties are eligible for an inflation-adjusted income tax credit (equal to \$6.10 in 1997) per barrel of oil or British Thermal Unit barrel oil equivalent. The credit is available for qualified fuels produced through December 31, 2007, by coal or biomass facilities placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997.

**Description of Proposal**

The proposal extends the placed in service date, but not the binding contract date, for facilities producing nonconventional fuels from coal and biomass through June 30, 1999.

**Effective Date**

This proposal is effective on the date of enactment (i.e., applies to facilities placed in service after June 30, 1998 and before July 1, 1999).

**G. Disclosure of Return Information to Department of Education in Connection with Income Contingent Loans (sec. 107 of the bill and sec. 6103(l)(13) of the Code)**

**Present Law**

Under section 6103(l)(13) of the Code, the Secretary of Treasury was authorized to disclose to the Department of Education certain return information with respect to any taxpayer who has received an "applicable student loan." An "applicable student loan" is any loan made under (1) part D of title IV of the Higher Education Act of 1965 or (2) parts B or E of title IV of the Higher Education Act of 1965 which is in default and has been assigned to the Department of Education, if the loan repayment amounts are based in whole or in part on the taxpayer's income. The Secretary is permitted to disclose only taxpayer identity information and the adjusted gross income of the taxpayer. The Department of Education may use the information only to establish the appropriate income contingent repayment amount for an applicable student loan.

The disclosure authority under section 6103(l)(13) terminated with respect to requests made after September 30, 1998.

**Description of Proposal**

The provision reinstates the disclosure authority under section 6103(l)(13) with respect to requests made after the date of enactment and before October 1, 2004.

**Effective Date**

The disclosure authority under section 6103(l)(13) applies to requests made after the date of enactment and before October 1, 2004.

## **Subtitle B – Trade Provisions**

### **A. Extension of the Generalized System of Preferences (sec. 111 of the bill and sec. 505 of the Trade Act of 1974)**

#### **Present Law**

Title V of the Trade Act of 1974, as amended, grants authority to the President to provide duty-free treatment on imports of certain articles from beneficiary developing countries subject to certain conditions and limitations. To qualify for GSP privileges, each beneficiary country is subject to various mandatory and discretionary eligibility criteria. Import sensitive products are ineligible for GSP. The GSP program, which is designed to promote development through trade rather than traditional aid programs, expired after June 30, 1998.

#### **Description of Proposal**

The proposal reauthorizes the GSP program to terminate after December 31, 1999. Refunds are authorized, upon request of the importer, for duties paid between July 1, 1998, and the date of enactment of the bill.

#### **Effective Date**

The proposal is effective for duties paid on or after July 1, 1998, and before December 31, 1999.

**B. Extension of the Trade Adjustment Assistance Program  
(sec. 112 of the bill and sec. 245 of the Trade Act of 1974)**

**Present Law**

Title II of the Trade Act of 1974, as amended, authorizes three trade adjustment assistance (TAA) programs for the purpose of providing assistance to individual workers and firms that are adversely by the reduction of barriers to foreign trade. Those programs include –

(1) The general TAA program for workers provides training and income support for workers adversely affected by import competition.

(2) The TAA program for firms provides technical assistance to qualifying firms.

(3) The third program, the North American Free Trade Agreement ("NAFTA") program for workers (established by the North American Free Trade Agreement Implementation Act of 1993) provides training and income support for workers adversely affected by trade with or production shifts to Canada and/or Mexico.

All three TAA programs expired on September 30, 1998. The TAA program for firms is also subject to annual appropriations.

**Description of Proposal**

The proposal reauthorizes each of the three TAA programs through June 30, 1999.

**Effective Date**

The proposal is effective on the date of enactment.

## **TITLE II. OTHER TAX PROVISIONS**

### **A. Increase Deduction for Health Insurance Expenses of Self-Employed Individuals (sec. 201 of the bill and sec. 162(l) of the Code)**

#### **Present Law**

Under present law, self-employed individuals are entitled to deduct a portion of the amount paid for health insurance for the self-employed individual and the individual's spouse and dependents. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. The deduction is available in the case of self insurance as well as commercial insurance. The self-insured plan must in fact be insurance (e.g., there must be appropriate risk shifting) and not merely a reimbursement arrangement.

The portion of health insurance expenses of self-employed individuals that is deductible is 45 percent for taxable years beginning in 1998 and 1999, 50 percent for taxable years beginning in 2000 and 2001, 60 percent for taxable years beginning in 2002, 80 percent for taxable years beginning in 2003, 2004, and 2005, 90 percent for taxable years beginning in 2006, and 100 percent for taxable years beginning in 2007 and thereafter.

Under present law, employees can exclude from income 100 percent of employer-provided health insurance.

#### **Description of Proposal**

The proposal increases the deduction for health insurance of self-employed individuals to 70 percent for taxable years beginning in 2001 and to 100 percent for taxable years beginning in 2002 and thereafter.

#### **Effective Date**

The proposal is effective for taxable years beginning after December 31, 2000.

## **B. Farm Production Flexibility Contract Payments (sec. 202 of the bill)**

### **Present law**

A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless such amount properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment.

The Federal Agriculture Improvement and Reform Act of 1996 (the "FAIR Act") provides for production flexibility contracts between certain eligible owners and producers and the Secretary of Agriculture. These contracts generally cover crop years from 1996 through 2002. Annual payments are made under such contracts at specific times during the Federal government's fiscal year. Section 112(d)(2) of the FAIR Act provides that one-half of each annual payment is to be made on either December 15 or January 15 of the fiscal year, at the option of the recipient.<sup>6</sup> This option to receive the payment on December 15 potentially results in the constructive receipt (and thus potential inclusion in income) of one-half of the annual payment at that time, even if the option to receive the amount on January 15 is elected.

The remaining one-half of the annual payment must be made no later than September 30 of the fiscal year. The Emergency Farm Financial Relief Act of 1998 added section 112(d)(3) to the FAIR Act which provides that all payments for fiscal year 1999 are to be paid at such time or times during fiscal year 1999 as the recipient may specify. Thus, the one-half of the annual amount that would otherwise be required to be paid no later than September 30, 1999 can be specified for payment in calendar year 1998. This potentially results in the constructive receipt (and thus required inclusion in taxable income) of such amounts in calendar year 1998, whether or not the amounts actually are received or the right to their receipt is fixed.

### **Description of Proposal**

The time a production flexibility contract payment under the FAIR Act properly is includible in income is determined without regard to the options granted by section 112(d)(2) (allowing receipt of one-half of the annual payment on either December 15 or January 15 of the fiscal year) or section 112(d)(3) (allowing the acceleration of all payments for fiscal year 1999) of that Act.

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<sup>6</sup> This rule applies to fiscal years after 1996. For fiscal year 1996, this payment was to be made not later than 30 days after the production flexibility contract was entered into.



**Effective Date**

The proposal is effective for production flexibility contract payments made under the FAIR Act in taxable years ending after December 31, 1995.

**C. Permanent Extension of Income Averaging for  
Farmers (sec. 203 of the bill and sec. 1301 of the Code)**

**Present Law**

An individual engaged in a farming business may elect to compute his or her current year tax liability by averaging, over the prior three-year period, all or a portion of the taxable income that is attributable to the farming business.

In general, an individual who makes the election (1) designates all or a portion of his or her taxable income attributable to any farming business from the current year as "elected farm income;"<sup>7</sup> (2) allocates one-third of the elected farm income to each of the three prior taxable years; and (3) determines the current year section 1 tax liability by combining (a) his or her current year section 1 tax liability excluding the elected farm income allocated to the three prior taxable years, plus (b) the increases in the section 1 tax liability for each of the three prior taxable years caused by including one-third of the elected farm income in each such year. Any allocation of elected farm income pursuant to the election applies for purposes of any election in a subsequent taxable year.

The provision does not apply for employment tax purposes, or to an estate or a trust. The provision also does not apply for purposes of the alternative minimum tax. The provision is effective for taxable years beginning after December 31, 1997, and before January 1, 2001.

**Description of Proposal**

The proposal permanently extends the income averaging provision for farmers.

**Effective Date**

The proposal is effective for taxable years beginning after December 31, 2000.

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<sup>7</sup> The amount of elected farm income of a taxpayer for a taxable year may not exceed the taxable income attributable to any farming business for the year.

**D. Personal Credits Fully Allowed Against Regular Tax Liability During 1998**  
**(sec. 204 of the bill and sec. 26 of the Code)**

**Present Law**

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, and the D.C. homebuyer's credit). Generally, these credits are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax (determined without regard to the AMT foreign tax credit).

The tentative minimum tax is an amount equal to (1) 26 percent of the first \$175,000 (\$87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent of the remaining AMTI. The maximum tax rates on net capital gain used in computing the tentative minimum tax are the same as under the regular tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments. The exemption amounts are: (1) \$45,000 in the case of married individuals filing a joint return and surviving spouses; (2) \$33,750 in the case of other unmarried individuals; and (3) \$22,500 in the case of married individuals filing a separate return, estates and trusts. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) \$150,000 in the case of married individuals filing a joint return and surviving spouses, (2) \$112,500 in the case of other unmarried individuals, and (3) \$75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

For families with three or more qualifying children, an additional child credit is provided which may offset the liability for social security taxes to the extent that tax liability exceeds the amount of the earned income credit. The additional child credit is reduced by the amount of the individual's minimum tax liability (i.e., the amount by which the tentative minimum tax exceeds the regular tax liability).

**Description of Proposal**

The proposal allows the nonrefundable personal credits to offset the individual's regular tax in full for taxable years beginning in 1998 (as opposed to only the amount by which the regular tax exceeds the tentative minimum tax, as under present law).

The provision of present law that reduces the additional child credit by the amount of an individual's AMT will not apply for taxable years beginning in 1998.

**Effective Date**

The proposal is effective for taxable years beginning in 1998.

### **TITLE III. REVENUE OFFSET PROVISION**

#### **A. Treatment of Certain Deductible Liquidating Distributions of Regulated Investment Companies and Real Estate Investment Trusts (sec. 301 of the bill and secs. 332 and 334 of the Code)**

##### **Present Law**

Regulated investment companies ("RICs") and real estate investment trusts ("REITs") are allowed a deduction for dividends paid to their shareholders. The deduction for dividends paid includes amounts distributed in liquidation which are properly chargeable to earnings and profits, as well as, in the case of a complete liquidation occurring within 24 months after the adoption of a plan of complete liquidation, any distribution made pursuant to such plan to the extent of earnings and profits. Rules that govern the receipt of dividends from RICs and REITs generally provide for including the amount of the dividend in the income of the shareholder receiving the dividend that was deducted by the RIC or REIT. Generally, any shareholder realizing gain from a liquidating distribution of a RIC or REIT includes the amount of gain in the shareholder's income. However, in the case of a liquidating distribution to a corporation owning 80-percent of the stock of the distributing corporation, a separate rule generally provides that the distribution is tax-free to the parent corporation. The parent corporation succeeds to the tax attributes, including the adjusted basis of assets, of the distributing corporation. Under these rules, a liquidating RIC or REIT might be allowed a deduction for amounts paid to its parent corporation, without a corresponding inclusion in the income of the parent corporation, resulting in income being subject to no tax.

A RIC or REIT may designate a portion of a dividend as a capital gain dividend to the extent the RIC or REIT itself has a net capital gain, and a RIC may designate a portion of the dividend paid to a corporate shareholder as eligible for the 70-percent dividends-received deduction to the extent the RIC itself received dividends from other corporations. If certain conditions are satisfied, a RIC also is permitted to pass through to its shareholders the tax-exempt character of the RIC's net income from tax-exempt obligations through the payment of "exempt interest dividends," though no deduction is allowed for such dividends.

##### **Description of Proposal**

Any amount which a liquidating RIC or REIT may take as a deduction for dividends paid with respect to an otherwise tax-free liquidating distribution to an 80-percent corporate owner is includible in the income of the recipient corporation. The includible amount is treated as a dividend received from the RIC or REIT. The liquidating corporation may designate the amount distributed as a capital gain dividend or, in the case of a RIC, a dividend eligible for the 70-percent dividends received deduction or an exempt interest dividend, to the extent provided by the RIC or REIT provisions of the Code.

The provision does not otherwise change the tax treatment of the distribution to the parent corporation or to the RIC or REIT. Thus, for example, the liquidating corporation will not recognize gain (if any) on the liquidating distribution and the recipient corporation will hold the assets at a carryover basis, even where the amount received is treated as a dividend..

#### **Effective Date**

The provision is effective for distributions on or after May 22, 1998, regardless of when the plan of liquidation was adopted.

No inference is intended regarding the treatment of such transactions under present law.

## **TITLE IV. TAX TECHNICAL CORRECTIONS**

Except as otherwise provided, the technical corrections contained in the bill generally are effective as if included in the originally enacted related legislation.

### **A. Technical Corrections to the 1998 Act**

#### **1. Burden of proof (sec. 402(b) of the bill, sec. 3001 of the 1998 Act, and sec. 7491 (a)(2)(C) of the Code)**

##### **Present Law**

The Treasury Secretary has the burden of proof in any court proceeding with respect to a factual issue if the taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer's tax liability, provided specified conditions are satisfied (sec. 7491). One of these conditions is that corporations, trusts, and partnerships must meet certain net worth limitations. These net worth limitations do not apply to individuals or to estates.

##### **Description of Proposal**

The proposal removes the net worth limitation from certain revocable trusts for the same period of time that the trust would have been treated as part of the estate had the trust made the election under section 645 to be treated as part of the estate.

#### **2. Relief for innocent spouses (sec. 402(c) of the bill, sec. 3201 of the 1998 Act, and secs. 6015(e) and 7421(a) of the Code)**

##### **Present Law**

A taxpayer who is no longer married to, is separated from, or has been living apart for at least 12 months from the person with whom he or she originally joined in filing a joint Federal income tax return may elect to limit his or her liability for a deficiency arising from such joint return to the amount of the deficiency that is attributable to items that are allocable to such electing spouse. The election is limited to deficiency situations and only affects the amount of the deficiency for which the electing spouse is liable. Thus, the election cannot be used to generate a refund, to direct a refund to one spouse or the other, or to allocate responsibility for payment where a balance due is reported on, but not paid with, a joint return.

In addition to the election to limit the liability for deficiencies, a taxpayer may be eligible for innocent spouse relief. Innocent spouse relief allows certain taxpayers who joined in the filing of a joint return to be relieved of liability for an understatement of tax that is attributable to items of the other spouse to the extent that the taxpayer did not know or have reason to know of

the understatement. The Secretary is also authorized to provide equitable relief in situations where, taking into account all of the facts and circumstances, it is inequitable to hold an individual responsible for all or a part of any unpaid tax or deficiency arising from a joint return. Under certain circumstances, it is possible that a refund could be obtained under this authority.

### **Description of Proposal**

The proposal clarifies that the ability to obtain a credit or refund of Federal income tax is limited to situations where the taxpayer qualifies for innocent spouse relief or where the Secretary exercises his authority to provide equitable relief.

### **3. Interest netting (sec. 402(d) of the bill and sec. 3301 (c)(2) of the 1998 Act)**

#### **Present Law**

For calendar quarters beginning after July 22, 1998, a net interest rate of zero applies where interest is payable and allowable on equivalent amounts of overpayment and underpayment of any tax imposed by the Internal Revenue Code. In addition, the net interest rate of zero applies to periods on or before July 22, 1998, providing (1) the statute of limitations has not expired with respect to either the underpayment or overpayment, (2) the taxpayer identifies the periods of underpayment and overpayment where interest is payable and allowable for which the net interest rate of zero would apply, and (3) on or before December 31, 1999, the taxpayer asks the Secretary to apply the net zero rate.

### **Description of Proposal**

The proposal restores language originally included in the Senate amendment that clarifies that the applicability of the zero net interest rate for periods on or before July 22, 1998 is subject to any applicable statute of limitations not having expired with regard to either a tax underpayment or overpayment.

### **4. Effective date for elimination of 18-month holding period for capital gains (sec. 402(i) of the bill, sec. 5001 of the 1998 Act, and sec. 1(h) of the Code)**

#### **Present Law**

The 1998 Act repealed the provision in the 1997 Act providing a maximum 28-percent rate for the long-term capital gain attributable to property held more than one year but not more than 18 months. Instead, the 1998 Act treated this gain in the same manner as gain from property held more than 18 months. The provision in the 1998 Act is effective for amounts properly taken into account after December 31, 1997. For gains taken into account by a pass-thru entity, such as a partnership, S corporation, trust, estate, RIC or REIT, the date that the entity properly took the gain into account is the appropriate date in applying this provision. Thus, for example, amounts



properly taken into account by a pass-thru entity after July 28, 1997, and before January 1, 1998, with respect to property held more than one year but not more than 18 months which are included in income on an individual's 1998 return are taken into account in computing 28-percent rate gain.

### **Description of Proposal**

Under the proposal, in the case of a capital gain dividend made by a RIC or REIT after 1997, no amount will be taken into account in computing the net gain or loss in the 28-percent rate gain category by reason of property being held more than one year but not more than 18 months, other than amounts taken into account by the RIC or REIT from other pass-thru entities (other than in structures, such as a "master-feeder structure", in which the RIC invests a substantial portion of its assets in one or more partnerships holding portfolio securities and having the same taxable year as the RIC). A similar rule applies to amounts properly taken into account by a RIC or REIT by reason of holding, directly or indirectly, an interest in another RIC or REIT to which the rule in the preceding sentence applies.

For example, if a RIC sold stock held more than one year but not more than 18 months on November 15, 1997, for a gain, and makes a capital gain dividend in 1998, the gain is not taken into account in computing 28-percent rate gain for purposes of determining the taxation of the 1998 dividend. (Thus, all the netting and computations made by the RIC need to be redone with respect to all post-1997 capital gain dividends, whether or not dividends of 28-percent rate gain.) If, however, the gain was taken into account by a RIC by reason of holding an interest in a calendar year 1997 partnership which itself sold the stock, the gain will not be recharacterized by reason of this proposal (unless the RIC's investment in the partnership satisfies the exception for master-feeder structures). If the gain was taken into account by a RIC by reason of holding an interest in a REIT and the gain was excluded from 28-percent rate gain by reason of the application of this proposal to the REIT, the gain will be excluded from 28-percent rate gain in determining the tax of the RIC shareholders.

The proposal also corrects a cross reference.

## **B. Technical Corrections to the 1997 Act**

### **1. Treatment of interest on qualified education loans (sec. 403(a) of the bill, sec. 202 of the 1997 Act, and secs. 221 and 163(h) of the Code)**

#### **Present Law**

Present law, as modified by the 1997 Act, provides that certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expense, up to a maximum dollar amount per year (\$1,000 for taxable years beginning in 1998), subject to certain requirements (sec. 221). The maximum deduction is phased out ratably for individual taxpayers with modified AGI between \$40,000 and \$55,000 (\$60,000 and \$75,000 for joint returns). Present law also provides that in the case of a taxpayer other than a corporation, no deduction is allowed for personal interest (sec. 163(h)). For this purpose, personal interest means any interest allowable as a deduction, other than certain types of interest listed in the statute. This proposal does not specifically provide that otherwise deductible qualified education loan interest is not treated as personal interest.

Present law provides that a qualified education loan does not include any indebtedness owed to a person who is related (within the meaning of sec. 267(b) or 707(b)) to the taxpayer (sec. 221(e)(1)).

#### **Description of Proposal**

The proposal clarifies that otherwise deductible qualified education loan interest is not treated as nondeductible personal interest.

The proposal also clarifies that, for purposes of section 221, modified AGI is determined after application of section 135 (relating to income from certain U.S. saving bonds) and section 137 (relating to adoption assistance programs).

The proposal also provides that a qualified education loan does not include any indebtedness owed to any person by reason of a loan under any qualified employer plan (as defined in section 72(p)(4)) or under any contract purchased under a qualified employer plan (as described in sec. 72(p)(5)).

### **2. Capital gain distributions of charitable remainder trusts (secs. 402(i)(3) and 403(b) of the bill, sec. 311 of the 1997 Act and sec. 5001 of the 1998 Act, and sec. 1(h) of the Code)**

#### **Present Law**

Under present law, the income beneficiary of a charitable remainder trust ("CRT") includes the trust's capital gain in income when the gains are distributed to the beneficiary (sec.

664(b)(2)). Internal Revenue Service Notice 98-20 provides guidance with respect to the categorization of long-term capital gain distributions from a CRT under the capital gain rules enacted by the 1997 Act. Under the Notice, long-term capital gains properly taken into account by the trust before January 1, 1997, are treated as falling in the 20-percent group of gain (i.e., gain not in the 28-percent rate gain or unrecaptured sec. 1250 gain). Long-term capital gains properly taken into account by the trust after December 31, 1996, and before May 7, 1997, are included in 28-percent rate gain. Long-term capital gains properly taken into account by the trust after May 6, 1997, are treated as falling into the category which would apply if the trust itself were subject to tax.

### **Description of Proposal**

The proposal provides that, in the case of a capital gain distribution by a CRT after December 31, 1997, with respect to amounts properly taken into account by the trust during 1997, amounts will not be included in the 28-percent rate gain category solely by reason of being properly taken into account by the trust before May 7, 1997, or by reason of the property being held not more than 18 months. Thus, for example, gain on the sale of stock by a CRT on February 1, 1997, will not be taken into account in determining 28-percent rate gain where the gain is distributed after 1997.<sup>8</sup>

### **Effective Date**

The proposal applies to taxable years beginning after December 31, 1997.

### **3. Gifts may not be revalued for estate tax purposes after expiration of statute of limitations (sec. 403(c) of the bill, sec. 506 of the 1997 Act, and sec. 2001(f)(2) of the Code)**

### **Present Law**

Basic structure of Federal estate and gift taxes.--The Federal estate and gift taxes are unified so that a single progressive rate schedule is applied to an individual's cumulative gifts and bequests. The tax on gifts made in a particular year is computed by determining the tax on the sum of the taxable gifts made in that year and in all prior years and then subtracting the tax on the prior years taxable gifts and the unified credit. Similarly, the estate tax is computed by

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<sup>8</sup> The bill contains a similar amendment to section 1(h)(13), as amended by section 5001 of the 1998 Act, to provide that, for purposes of taxing the recipient of a distribution made after 1997 by a CRT, amounts will not be taken into account in computing 28-percent rate gain by reason of being properly taken into account before May 7, 1997, or by reason of the property being held for not more than 18 months. Thus, no amount distributed by a CRT after 1997 will be treated as in the 28-percent category (other than by reason of the disposition of collectibles or small business stock).

determining the tax on the sum of the taxable estate and prior taxable gifts and then subtracting the tax on taxable gifts, the unified credit, and certain other credits.

This structure raises two different, but related, issues: (1) what is the period beyond which additional gift taxes cannot be assessed or collected -- generically referred to as the "period of limitations" -- and (2) what is the period beyond which the amount of prior transfers cannot be revalued for the purpose of determining the amount of tax on subsequent transfers.

Gift and estate tax period of limitations.--Section 6501(a) provides the general rule that any tax (including gift and estate tax) must be assessed, or a proceeding begun in a court for the collection of such tax without assessment, within three years after the return is filed by the taxpayer. Under section 6501(e)(2), the period for assessments of gift or estate tax is increased to six years where there is more than a 25 percent omission in the amount of the total gifts or gross estate disclosed on the gift or estate tax return. Section 6501(c)(9) provides an exception to these rules under which gift tax may be assessed, or a proceeding in a court for collection of gift tax may be begun, at any time unless the gift is disclosed on a gift tax return or a statement attached to a gift tax return.

Revaluation of gifts for estate tax purposes.--The value of a gift is its value as finally determined under the rules for purposes of determining the applicable estate tax bracket and available unified credit. The value of a gift is finally determined if (1) the value of the gift is shown on a gift tax return for that gift and that value is not contested by the Treasury Secretary before the expiration of the period of limitations on assessment of gift tax even where the value of the gift as shown on the return does not result in any gift tax being owed (e.g., through use of the unified credit), (2) the value is specified by the Treasury Secretary pursuant to a final notice of redetermination of value (a "final notice") within the period of limitations applicable to the gift for gift tax purposes (generally, three years) and the taxpayer does not timely contest that value, or (3) the value is determined by a court or pursuant of a settlement agreement between the taxpayer and the Treasury Secretary under an administrative appeals process whereby a taxpayer can challenge a redetermination of value by the IRS prior to issuance of a final notice. In the event the taxpayer and the IRS cannot agree on the value of a gift, the 1997 Act provided the U.S. Tax Court with jurisdiction to issue a declaratory judgment on the value of a gift (section 7477). A taxpayer who is mailed a final notice may challenge the redetermined value of the gift (as contained in the final notice) by filing a motion for a declaratory judgment with the U.S. Tax Court. The motion must be filed on or before 90 days from the date that the final notice was mailed. The statute of limitations is tolled during the pendency of the Tax Court proceeding.

Revaluation of gifts for gift tax purposes.--Similarly, under a rule applicable to the computation of the gift tax (sec. 2504(c)), the value of gifts made in prior years is its value as finally determined if the period of limitations for assessment of gift tax on the prior gifts has expired.

### **Description of Proposal**

The bill clarifies the rules relating to revaluations of prior transfers for computation of the estate or gift tax to provide that the value of a prior transfer cannot be redetermined after the period of limitations if the transfer was disclosed in a statement attached to the gift tax return, as well as on a gift tax return, in a manner to adequately apprise the Treasury Secretary of the nature the transfer, even if there was no gift tax imposed on that transfer.

#### **4. Coordinate Vaccine Injury Compensation Trust Fund expenditure purposes with list of taxable vaccines (sec. 403(d) of the bill, sec. 904 of the 1997 Act, and sec. 9510(c) of the Code)**

### **Present Law**

A manufacturer's excise tax is imposed on certain vaccines routinely recommended for administration to children (sec. 4131). The tax is imposed at a rate of \$0.75 per dose on any listed vaccine component. Taxable vaccine components are vaccines against diphtheria, tetanus, pertussis, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, and varicella (chicken pox). Tax was imposed on vaccines against diphtheria, tetanus, pertussis, measles, mumps, rubella, and polio by the Omnibus Budget Reconciliation Act of 1987. Tax was imposed on vaccines against HIB, hepatitis B, and varicella by the 1997 Act.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund ("Vaccine Trust Fund") to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. Present law provides that payments from the Vaccine Trust Fund may be made only for vaccines eligible under the program as of December 22, 1987 (sec. 9510(c)(1)). Thus, payments may not be made for injuries related to the HIB, hepatitis B or varicella vaccines.

### **Description of Proposal**

The proposal provides that payments are permitted from the Vaccine Trust Fund for injuries related to the administration of the HIB, hepatitis B, and varicella vaccines. The proposal also clarifies that expenditures from the Vaccine Trust Fund may occur only as provided in the Code and makes conforming amendments.

#### **5. Abatement of interest by reason of Presidentially declared disaster (sec. 403(e) of the bill, sec. 915 of the 1997 Act, and sec. 6404(h) of the Code)**

### **Present Law**

The Taxpayer Relief Act of 1997 ("1997 Act") provided that, if the Secretary of the

Treasury extends the filing date of an individual tax return for 1997 for individuals living in an area that has been declared a disaster area by the President during 1997, no interest shall be charged as a result of the failure of an individual taxpayer to file an individual tax return, or pay the taxes shown on such return, during the extension.

The Internal Revenue Service Restructuring and Reform Act of 1998 ("1998 Act") contains a similar rule applicable to all taxpayers for tax years beginning after 1997 for disasters declared after 1997. The status of disasters declared in 1998 but that relate to the 1997 tax year is unclear.

### **Description of Proposal**

The proposal amends the 1997 Act rule so that it is available for disasters declared in 1997 or in 1998 with respect to the 1997 tax year.

### **6. Treatment of certain corporate distributions (sec. 403(f) of the bill, sec. 1012 of the 1997 Act, and secs. 351(c) and 368(a)(2)(H) of the Code)**

#### **Present Law**

The 1997 Act (sec. 1012(a)) requires a distributing corporation to recognize corporate level gain on the distribution of stock of a controlled corporation under section 355 of the Code if, pursuant to a plan or series of related transactions, one or more persons acquire a 50-percent or greater interest (defined as 50 percent or more of the voting power or value of the stock) of either the distributing or controlled corporation (Code sec. 355(e)). Certain transactions are excepted from the definition of acquisition for this purpose. Under the technical corrections included in the Internal Revenue Service Restructuring and Reform Act of 1998, in the case of acquisitions under section 355(e)(3)(A)(iv), the acquisition of stock in the distributing corporation or any controlled corporation is disregarded to the extent that the percentage of stock owned directly or indirectly in such corporation by each person owning stock in such corporation immediately before the acquisition does not decrease.<sup>9</sup>

In the case of a 50-percent or more acquisition of either the distributing corporation or the controlled corporation, the amount of gain recognized is the amount that the distributing corporation would have recognized had the stock of the controlled corporation been sold for fair market value on the date of the distribution. No adjustment to the basis of the stock or assets of

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<sup>9</sup> This exception (as certain other exceptions) does not apply if the stock held before the acquisition was acquired pursuant to a plan (or series of related transactions) to acquire a 50-percent or greater interest in the distributing or a controlled corporation.

either corporation is allowed by reason of the recognition of the gain.<sup>10</sup>

The 1997 Act (as amended by the technical corrections contained in the Internal Revenue Service Restructuring and Reform Act of 1998) also modified certain rules for determining control immediately after a distribution in the case of certain divisive transactions in which a controlled corporation is distributed and the transaction meets the requirements of section 355. In such cases, under section 351 and modified section 368(a)(2)(H) with respect to reorganizations under section 368(a)(1)(D), the fact that the shareholders of the distributing corporation dispose of part or all of the distributed stock shall not be taken into account.

The effective date (Act section 1012(d)(1)) states that the relevant provisions of the 1997 Act apply to distributions after April 16, 1997, pursuant to a plan (or series of related transactions) which involves an acquisition occurring after such date (unless certain transition provisions apply).

### **Description of Proposal**

The proposal clarifies the "control immediately after" requirement of section 351(c) and section 368(a)(2)(H) in the case of certain divisive transactions in which a corporation contributes assets to a controlled corporation and then distributes the stock of the controlled corporation in a transaction that meets the requirements of section 355 (or so much of section 356 as relates to section 355). In such cases, not only the fact that the shareholders of the distributing corporation dispose of part or all of the distributed stock, but also the fact that the corporation whose stock was distributed issues additional stock, shall not be taken into account.

## **7. Treatment of affiliated group including formerly tax-exempt organization (sec. 403(g) of the bill and sec. 1042 of the 1997 Act)**

### **Present Law**

Present law provides that an organization described in sections 501(c)(3) or (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance. When this rule was enacted in 1986, certain treatment applied to Blue Cross and Blue Shield organizations providing health insurance that were subject to this rule and that met certain requirements. Treasury regulations were promulgated providing rules for filing consolidated returns for affiliated groups including such organizations (Treas. Reg. sec. 1.1502-75(d)(5)).

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<sup>10</sup> The 1997 Act does not limit the otherwise applicable Treasury regulatory authority under section 336(e) of the Code. Nor does it limit the otherwise applicable provisions of section 1367 with respect to the effect on shareholder stock basis of gain recognized by an S corporation under this provision.

The 1997 Act repealed the grandfather rules provided in 1986 (permitting the retention of tax-exempt status) that were applicable to that portion of the business of the Teachers Insurance Annuity Association and College Retirement Equities Fund which is attributable to pension business and to the portion of the business of Mutual of America which is attributable to pension business. The 1997 Act did not specifically provide rules for filing consolidated returns for affiliated groups including such organizations.

Present law with respect to consolidated returns provides for an election to treat a life insurance company as an includible corporation, and also provides that a life insurance company may not be treated as an includible corporation for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed (sec. 1504(c)(2)). Present law also provides that a corporation that is exempt from taxation under Code section 501 is not an includible corporation (sec. 1504(b)(1)).

### **Description of Proposal**

The proposal provides rules for filing consolidated returns for affiliated groups including any organization with respect to which the grandfather rule under Code section 501(m) was repealed by section 1042 of the 1997 Act. The proposal provides that rules similar to the rules of Treasury Regulation section 1.1502-75(d)(5) apply in the case of such an organization. Thus, an affiliated group including such an organization may make the election described in section 1504(c)(2) (relating to a 5-year period) without regard to whether the organization was previously exempt from tax under Code section 501.

## **8. Treatment of net operating losses arising from certain eligible losses (sec. 403(h) of the bill, sec. 1082 of the 1997 Act, and sec. 172(b)(1)(F) of the Code)**

### **Present Law**

The 1997 Act changed the general net operating loss ("NOL") carryback period of a taxpayer from three years to two years. The three-year carryback period was retained in the case of an NOL attributable to an eligible loss. An eligible loss is defined as (1) a casualty or theft loss of an individual taxpayer, or (2) an NOL attributable to a Presidentially declared disaster area by a taxpayer engaged in a farming business or a small business. Other special rules apply to real estate investment trusts (REITs) (no carrybacks), specified liability losses (10-year carryback), and excess interest losses (no carrybacks).

### **Description of Proposal**

The proposal coordinates the use of eligible losses with the general rule for NOLs in the same manner as a loss arising from a specified liability loss. Thus, an eligible loss for any year is treated as a separate net operating loss and is taken into account after the remaining portion of the net operating loss for the taxable year.



**9. Determination of unborrowed policy cash value under COLI pro rata interest disallowance rules (sec. 403(i) of the bill, sec. 1084 of the 1997 Act, and sec. 264(f) of the Code)**

**Present Law**

In the case of a taxpayer other than a natural person, no deduction is allowed for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash surrender values with respect to any life insurance policy or annuity or endowment contract issued after June 8, 1997. Interest expense is allocable to unborrowed policy cash values based on the ratio of (1) the taxpayer's average unborrowed policy cash values of life insurance policies and annuity and endowment contracts, issued after June 8, 1997, to (2) the sum of (a) in the case of assets that are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values and (b) in the case of other assets the average adjusted bases for all such other assets of the taxpayer. The unborrowed policy cash values means the cash surrender value of the policy or contract determined without regard to any surrender charge, reduced by the amount of any loan with respect to the policy or contract. The cash surrender value is to be determined without regard to any other contractual or noncontractual arrangement that artificially depresses the unborrowed policy cash value of a contract.

**Description of Proposal**

The proposal clarifies the meaning of "unborrowed policy cash value" under section 264(f)(3), with respect to any life insurance, annuity or endowment contract. The technical correction clarifies that under section 264(f)(3), if the cash surrender value (determined without regard to any surrender charges) with respect to any policy or contract does not reasonably approximate its actual value, then the amount taken into account for this purpose is the greater of (1) the amount of the insurance company's liability with respect to the policy or contract, as determined for purposes of the annual statement approved by the National Association or Insurance Commissioners, (2) the amount of the insurance company's reserve with respect to the policy or contract for purposes of such annual statement; or such other amount as is determined by the Treasury Secretary. No inference is intended that such amounts may not be taken into account in determining the cash surrender value of a policy or contract in such circumstances for purposes of any other provision of the Code.

**10. Payment of taxes by commercially acceptable means (sec. 403(k) of the bill, sec. 1205 of the 1997 Act, and sec. 6311 (d)(2) of the Code)**

**Present Law**

The Code generally permits the payment of taxes by commercially acceptable means (such as credit cards) (sec. 6311(d)). The Treasury Secretary may not pay any fee or provide any other consideration in connection with this provision. This fee prohibition may have an

unintended impact on Treasury contracts for the provision of services unrelated to the payment of income taxes by commercially acceptable means.

**Description of Proposal**

The proposal clarifies that the prohibition on paying any fees or providing any other consideration applies to the use of credit, debit, or charge cards for the payment of income taxes.

## **C. Technical Corrections to the 1984 Act**

### **1. Casualty loss deduction (sec. 404 of the bill, sec. 711(c) of the 1984 Act, and secs. 172(d)(4), 67(b)(3), 68(c)(3), and 873(b) of the Code)**

#### **Present Law**

The Tax Reform Act of 1984 ("1984 Act") deleted casualty and theft losses from property connected with a nonbusiness transaction entered into for profit from the list of losses set forth in section 165(c)(3). This amendment was made in order to provide that these losses were deductible in full and not subject to the \$100 per casualty limitation or the 10-percent adjusted gross income floor applicable to personal casualty losses. However, the amendment inadvertently eliminated the deduction for these losses from the computation of the net operating loss. Also, the Tax Reform Act of 1986 provided that casualty losses described in section 165(c)(3) are not miscellaneous itemized deductions subject to the 2-percent adjusted gross income floor, and the Revenue Reconciliation Act of 1990 provided that these losses are not treated as itemized deductions in computing the overall limitation on itemized deductions. The losses of nonresident aliens are limited to deductions described in section 165(c)(3). Because of the change made by the 1984 Act, the reference to section 165(c)(3) does not include casualty and theft losses from nonbusiness transactions entered into for profit.

#### **Description of Proposal**

The proposal provides that all deductions for nonbusiness casualty and theft losses are taken into account in computing the net operating loss. Also, these deductions are not treated as miscellaneous itemized deductions subject to the 2-percent adjusted gross income floor, or as itemized deductions subject to the overall limitation on itemized deductions, and are allowed to nonresident aliens.

#### **Effective Dates**

The proposal relating to the net operating loss and the deduction for nonresident aliens applies to taxable years beginning after December 31, 1983.

The proposal relating to miscellaneous itemized deductions applies to taxable years beginning after December 31, 1986.

The proposal relating to the overall limitation on itemized deductions applies to taxable years beginning after December 31, 1990.

**D. Disclosure of Tax Return Information to the Department of Agriculture  
(sec. 405(a) of the bill and sec. 6103 (j) of the Code)**

**Present Law**

Tax return information generally may not be disclosed, except as specifically provided by statute. Disclosure is permitted to the Bureau of the Census for specified purposes, which included the responsibility of structuring, conducting, and preparing the census of agriculture (sec. 6103(j)(1)). The Census of Agriculture Act of 1997 (P.L. 105-113) transferred this responsibility from the Bureau of the Census to the Department of Agriculture.

**Description of Proposal**

The proposal permits the continuation of disclosure of tax return information for the purpose of structuring, conducting, and preparing the census of agriculture by authorizing the Department of Agriculture to receive this information.

**Effective Date**

The proposal is effective on the date of enactment of this technical correction.

**E. Technical Corrections to the Transportation Equity Act for the 21st Century  
(sec. 405(b) of the bill, sec. 9004 of the Act, and sec. 9503(f) of the Code)**

**Present Law**

The Transportation Equity Act for the 21st Century ("Transportation Equity Act") (P.L. 105-178) extended the Highway Trust Fund and accompanying highway excise taxes. The Transportation Equity Act also changed the budgetary treatment of Highway Trust Fund expenditures, including repeal of a provision that balances maintained in the Highway Trust Fund pending expenditure earn interest from the General Fund of the Treasury.

**Description of Proposal**

The proposal clarifies that the Secretary of the Treasury is not required to invest Highway Trust Fund balances in interest-bearing obligations (because any interest paid to the Trust Fund by the General Fund would be immediately returned to the General Fund).

**F. Repeal of provisions relating to District of Columbia judicial retirement program  
(sec. 405(c) of the bill)**

**Present Law**

Section 804 of the Treasury and General Government Appropriations Act, 1999, makes certain technical and clarifying amendment to the Judicial Retirement Program of the District of Columbia. Included in these amendments were certain amendments that applied for purposes of the Internal Revenue Code of 1986.

**Description of Proposal**

Section 804 of the Treasury and General Government Appropriations Act, 1999, is repealed.

**Effective Date**

The proposal is effective on the date of enactment.

**G. Perfecting Amendments Related to Withholding From  
Social Security Benefits and Other Federal Payments  
(sec. 406 of the bill and secs. 201 and 207 of the Social Security Act)**

**Present Law**

The Uruguay Round Agreements Act (P.L. 103-465) contained a provision requiring that U.S. taxpayers who receive specified Federal payments (including Social Security benefits) be given the option of requesting that the Federal agency making the payments withhold Federal income taxes from the payments.

**Description of Proposal**

Due to a drafting oversight, the Uruguay Round Agreements Act included only the necessary changes to the Internal Revenue Code ("Code") and failed to make certain conforming changes to the Social Security Act (specifically a section that prohibits assignment of benefits). The proposal amends the Social Act anti-assignment section to allow the Code provisions to be implemented. The proposal also allocates funding for the Social Security Administration to administer the tax-withholding provisions.

**Effective Date**

The proposal applies to benefits paid on or after the first day of the second month beginning after the month of enactment.