

**DESCRIPTION OF TAX TECHNICAL CORRECTIONS  
IN THE "TAXPAYER RELIEF ACT OF 1998"**

Scheduled for Markup

by the

HOUSE COMMITTEE ON WAYS AND MEANS

on September 17, 1998

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

September 15, 1998

JCX-61-98

## CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
DESCRIPTION OF TAX TECHNICAL CORRECTIONS .....	2
A. Technical Corrections to the 1998 Act .....	2
1. Burden of proof .....	2
2. Relief for innocent spouses .....	2
3. Interest netting .....	3
4. Effective date for elimination of 18-month holding period for capital gains .....	3
B. Technical Corrections to the 1997 Act .....	5
1. Treatment of interest on qualified education loans .....	5
2. Capital gains distributions of charitable remainder trusts .....	5
3. Gifts may not be revalued for estate tax purposes after expiration of limitations .....	6
4. Coordinate Vaccine Injury Compensation Trust Fund expenditure purposes with list of taxable vaccines .....	7
5. Abatement of interest by reason of Presidentially declared disasters ..	8
6. Treatment of certain corporate distributions .....	8
7. Treatment of net operating losses arising from certain eligible losses .....	10
8. Determination of unborrowed cash value under COLI pro rata interest disallowance rules .....	10
9. Payment of taxes by commercially acceptable means .....	11
C. Technical Corrections to the 1984 Act .....	12
1. Casualty loss deduction .....	12
D. Disclosure of Tax Return Information to Department of Agriculture .....	13
E. Technical Corrections to the Transportation Equity Act for the 21 <sup>st</sup> Century .....	14

## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's mark with respect to tax technical corrections proposals. The House Committee on Ways and Means has scheduled a markup of tax provisions on September 17, 1998.

References to the "1998 Act" are to the Internal Revenue Service Restructuring and Reform Act of 1998 (P.L. 105-206); references to the "1997 Act" are to the Taxpayer Relief Act of 1997 (P.L. 105-34); and references to the "1984 Act" are to the Tax Reform Act of 1984 (P.L. 99-514). Except as otherwise provided, the provisions described in this document generally are effective as if included in the originally enacted related legislation.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation; *Description of Tax Technical Corrections in the "Taxpayer Relief Act of 1998"* (JCX-61-98), September 15, 1998.

## DESCRIPTION OF TAX TECHNICAL CORRECTIONS

### A. Technical Corrections to the 1998 Act

#### 1. Burden of proof (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 is that corporations, trusts, and partnerships must meet certain net worth limitations. These net worth limitations do not apply to individuals or to estates.

##### Explanation of Provision

The provision 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. 3201 of the 1998 Act and secs. 2024(a) and 6015(e) 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.

### **Explanation of Provision**

The provision 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. 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 will apply 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.

### **Explanation of Provision**

The provision restores language originally included in the Senate amendment that clarifies that the statute of limitations must not have expired with regard to either a tax underpayment or overpayment for the net zero rate to apply.

### **4. Effective date for elimination of 18-month holding period for capital gains (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 in 1997 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.

### **Explanation of Provision**

Under the provision, in the case of a capital gain distribution made (or, treated under the RIC or REIT provisions of the Code, as made) by a RIC or REIT after 1997, no amount will be taken into account in computing 28-percent rate gain 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 in which the RIC or REIT holds an interest. 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. Thus, for example, if a RIC sold stock held more than 1 year but not more than 18 months on November 15, 1997, for a gain, and makes a capital gain distribution in 1998, the gain is not taken into account in computing 28-percent rate gain for purposes of determining the taxation of the 1998 distribution. If, however, gain was taken into account by a RIC by reason of holding an interest in a calendar year 1997 partnership, the gain will not be recharacterized by reason of this provision.

The provision also corrects a cross reference.

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

### **1. Treatment of interest on qualified education loans (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. Present law also provides that in the case of a taxpayer other than a corporation, no deduction is allowed for personal interest. For this purpose, personal interest means any interest allowable as a deduction, other than certain types of interest listed in the statute. This provision does not specifically provide that otherwise deductible qualified education loan interest is not treated as personal interest.

#### **Explanation of Provision**

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

### **2. Capital gain distributions of charitable remainder trusts (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.

#### **Explanation of Provision**

The provision 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, 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.

### Effective Date

The provision 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. 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 determining the tax on the sum of the taxable estate and prior taxable gifts and then subtracting the tax on taxable gifts and the unified credit.

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 "statute 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 tax statute of limitations.--Section 6501(a) provides the general rule that any tax (including gift and estate tax) must be assessed within 3 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 gross estate or total gifts disclosed on the gift or estate tax return.

Revaluation of gifts for gift tax purposes.--Under a rule applicable to the computation of the gift tax (sec. 2504(c)), the value of gifts made in prior years is the value that was used to determine the prior year's gift tax if the statute of limitations for assessment of gift tax on the prior gifts has expired. In addition, section 6501(c)(9) provides that the value of any item which is required to be disclosed on a gift tax return may not be redetermined by the Commissioner after the expiration of the statute of limitations.

The legislative history of that section that stated that: "This rule is applicable 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)...." That legislative history further stated that, in order to

revalue a gift that has been adequately disclosed on a gift tax return, the IRS must issue a final notice of redetermination of value (a "final notice") within the statute of limitations applicable to the gift for gift tax purposes (generally, three years). That legislative history continued by stating that the Congress anticipated that the IRS will develop 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 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 estate tax purposes.--Similarly, a gift cannot be revalued for purposes of determining the applicable estate tax bracket and available unified credit if (1) the statute of limitations has expired and (2) the value of the gift is shown or disclosed on gift tax return or is disclosed in a statement attached to the gift tax return (section 2001(f)).

#### **Explanation of Provision**

The provision clarifies the rules relating to revaluations of prior transfers for computation of the estate tax to provide that the value of a prior transfer cannot be redetermined if the transfer was disclosed on a gift tax return, or in a statement attached to the 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. In addition, the provision removes the revaluation rule in section 6501(c)(9) since the substance of that rule also is provided in sections 2001(f) and 2504(c).

#### **4. Coordinate Vaccine Injury Compensation Trust Fund expenditure purposes with list of taxable vaccines (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).

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.

#### **Explanation of Provision**

The provision provides that payments are permitted from the Vaccine Trust Fund for injuries related to the administration of the HIB, hepatitis B, and varicella vaccines.

#### **5. Abatement of interest by reason of Presidentially declared disaster (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.

#### **Explanation of Provision**

The provision 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. 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>2</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 either corporation is allowed by reason of the recognition of the gain.<sup>3</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).

#### **Explanation of Provision**

The provision clarifies the computation of 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.

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<sup>2</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.

<sup>3</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.

### Effective Date

The provision generally is effective for distributions after April 16, 1997, as if included in the 1997 Act.

### **7. Treatment of net operating losses arising from certain eligible losses (sec. 1082 of the 1997 Act and sec. 172 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) a loss incurred in 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).

#### Explanation of Provision

The provision 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.

### **8. Determination of unborrowed policy cash value under COLI pro rata interest disallowance rules (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.

### **Explanation of Provision**

The provision 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.

### **9. Payment of taxes by commercially acceptable means (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 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.

#### **Explanation of Provision**

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

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

### **1. Casualty loss deduction (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.

#### **Explanation of Provision**

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

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

The provision 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. 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.

**Explanation of Provision**

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

**E. Technical Corrections to the Transportation Equity Act for the 21st Century  
(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.

**Explanation of Provision**

The provision 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).