SUMMARY OF REVENUE PROVISIONS CONTAINED IN LEGISLATION ENACTED DURING THE 105TH CONGRESS

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary of the revenue provisions contained in legislation enacted during the 105th Congress. This summary is prepared for the convenience of the Members and the general public.

Part One of this document is a summary of the provisions contained in the Airport and Airway Trust Fund Extension Act of 1997 (H.R. 668, Public Law 105-2), enacted on February 28, 1997. Part Two is a summary of the Taxpayer Relief Act of 1997 (H.R. 2014, Public Law 105-34), enacted on August 5, 1997. Part Three is a summary of the revenue provisions contained in the Balanced Budget Act of 1997 (H.R. 2015, Public Law 105-33), enacted on August 5, 1997. Part Four is a summary of the Taxpayer Browsing Protection Act (H.R. 1226, Public Law 105-35), enacted on August 5, 1997. Part Five is a summary of the extension of the Highway Trust Fund (S. 1519, Public Law 105-130), enacted on December 1, 1997. Part Six is a summary of the revenue provisions in the Transportation Equity Act for the 21st Century (Title IX of H.R. 2400, Public Law 105-178), enacted on June 9, 1998. Part Seven is a summary of the Internal Revenue Service Restructuring and Reform Act of 1998 (H.R. 2676, Public Law 105-206), enacted on July 22, 1998. Part Eight is a summary of the Tax and Trade Relief Extension Act of 1998, which was contained in Division J of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (H.R. 4328, Public Law 105-277), enacted on October 21, 1998. Part Nine is a summary of the revenue provision contained in the Ricky Ray Hemophilia Relief Fund Act of 1998 (sec. 103(h) of H.R. 1023, Public Law 105-369), enacted on November 12, 1998. A topical index is contained in Appendix A.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Summary of Revenue Provisions Contained in Legislation Enacted in the 105th Congress* (JCX-75-98), November 19, 1998.

PART ONE: AIRPORT AND AIRWAY TRUST FUND EXTENSION ACT OF 1997 (H.R. 668)[2]

1. Reinstate air transportation excise taxes

The Airport and Airway Trust Fund Extension Act of 1997 ("the Airport and Airway Act") reinstated the air transportation excise taxes that expired after December 31, 1996, during the period beginning seven days after the date of enactment and ending after September 30, 1997. These taxes included commercial aviation, passenger ticket, and freight waybill taxes and the noncommercial aviation gasoline and jet fuels taxes. See, also, Part Two, which further extended and modified the aviation excise taxes, and Part Eight, which describes subsequent changes to conform to new Trust Fund expenditure authority.

2. Transfer revenues to the Airport Trust Fund

The Airport and Airway Act authorized the Treasury Department to transfer to the Airport Trust Fund receipts attributable to excise taxes described above that were imposed on commercial and general aviation. This reauthorization permitted transfer of receipts attributable to taxes imposed both during the period August 27, 1996, through December 31, 1996, and during the period beginning seven days after the date of enactment.

3. Modify Treasury Department excise tax deposit regulations

The provisions of Treasury Department regulations providing an exception to penalties for underpayment of estimated excise taxes based on a look-back period were made inapplicable when tax was not imposed throughout the look-back period. In such a case, taxpayers may continue to use an alternative safe harbor that provides that no underpayment penalty is imposed as long as the taxpayer has paid at least 95 percent of the current quarter's liability.

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[2] P.L. 105-2; February 28, 1997. H.R. 668 was reported by the House Committee on Ways and Means on February 13, 1997 (H. Rept. 105-5). The bill was passed by the House on February 26, 1997, and by the Senate on February 27, 1997. H.R. 668 was signed by the President on February 28, 1997. See also Part Two for a description of the subsequent 10-year extension and modification of the Airport Trust Fund excise taxes in the Taxpayer Relief Act of 1997 (sec. 1031 of H.R. 2014).

PART TWO: TAXPAYER RELIEF ACT OF 1997 (H.R. 2014)[3]

TITLE I.--CHILD TAX CREDIT; HEALTH CARE FOR CHILDREN

1. Child tax credit

Size of credit.--The Taxpayer Relief Act of 1997 (the "1997 Act") provided a $500 ($400 for taxable year 1998) credit for each qualifying child of a taxpayer under the age of 17. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency

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[3] P.L. 105-34; August 5, 1997. H.R. 2014 was reported by the House Committee on the Budget on June 24, 1997 (H. Rept. 105-148), after the revenue reconciliation provisions were approved by the House Committee on Ways and Means on June 13, 1997. The bill, as amended, was passed by the House on June 26, 1997.

S. 949 was reported by the Senate Committee on Finance on June 20, 1997 (S. Rept. 105-33). The bill was considered by the Senate on June 25-27, 1997, and the provisions of the bill as amended, were incorporated in the Senate-passed version of H.R. 2014 on June 27, 1997. A conference report on H.R. 2014 was filed in the House on July 30, 1997 (H. Rept. 105-220); the House passed the conference report on July 31, 1997; and the Senate also passed the conference report on July 31, 1997. H.R. 2014 was signed by the President on August 5, 1997.

Two provisions in the conference agreement on H.R. 2014 as passed by the House and the Senate were canceled by the President under the Line Item Veto Act: (1) temporary exceptions under subpart F for certain active financing income; and (2) nonrecognition of gain on the sale of stock in agricultural processors facilities to certain farmer's cooperatives. Modified versions of these two canceled provisions were passed by the House in H.R. 2513, as amended, on November 8, 1997. (See report of the Committee on Ways and Means on H.R. 2513; H. Rept. 105-318, Part I, October 9, 1997. H.R. 2513 was referred to the House Committee on the Budget, and the bill was discharged from the Committee on the Budget on October 22, 1997.) The Supreme Court subsequently held the Line Item Veto Act was unconstitutional, thereby reinstating the two canceled provisions.

Further, section 977 of H.R. 2014 (relating to carryback of existing net operating losses of the National Railroad Passenger Corporation (Amtrak)) was contingent on the enactment of Amtrak reform legislation. S. 738 ("Amtrak Reform and Accountability Act of 1997") was reported by the Senate Committee on Commerce, Science, and Transportation on May 14, 1997 (S. Rept. 105-85), and was passed by the Senate, as amended, on November 7, 1997. S. 738 was passed by the House, with amendment, on November 13, 1997, and the Senate agreed to the House amendment on November 13, 1997. S. 738 was signed by the President on December 2, 1997 (P.L. 105-134).

exemption and who is a son or daughter of the taxpayer (or descendent of either), a stepson or stepdaughter of the taxpayer or an eligible foster child of the taxpayer.

Phaseout of credit.--For taxpayers with modified adjusted gross income (AGI) in excess of certain thresholds, the otherwise allowable child credit is phased out at a rate of $50 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

Maximum allowable child credit.–The child credit, together with the other nonrefundable credits, generally may not exceed the amount by which the individual's regular tax exceeds the tentative minimum tax.[4]

Refundable child credit.–For a taxpayer with three or more children, the child credit may be refundable up to the amount by which the taxpayer's social security taxes exceeds the amount of the earned income tax credit.

Supplemental child credit.–In the case of a taxpayer whose credits (including the earned income credit) exceed the sum of the regular income tax and the social security taxes, the child credit may be deemed to be an additional earned income credit. This provision does not change the individual's total credits.

Effective date.--Generally, the child tax credit was effective for taxable years beginning after December 31, 1997.

2. Expand definition of high-risk individuals with respect to tax-exempt State-sponsored organizations providing health coverage

Present law provides tax-exempt status to any membership organization that is established by a State exclusively to provide coverage for medical care on a nonprofit basis to certain high-risk individuals, provided certain criteria are satisfied. The 1997 Act expanded the definition of high-risk individuals to include the spouse or any child of an individual who meets the prior-law definition of a high-risk individual, subject to certain requirements. The provision was effective for taxable years beginning after December 31, 1997.

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[4] For taxable years beginning after 1998, the nonrefundable personal credits may offset the entire regular tax. See the description of this provision in Part Eight, below.

TITLE II.--EDUCATION TAX INCENTIVES

1. HOPE tax credit and Lifetime Learning tax credit for higher education tuition expenses[5]

HOPE credit.--Individual taxpayers are allowed to claim a nonrefundable HOPE credit against Federal income taxes up to $1,500 per student for qualified tuition and fees paid during the year on behalf of a student (i.e., the taxpayer, the taxpayer's spouse, or a dependent) who is enrolled in a post-secondary degree or certificate program at an eligible institution on at least a half-time basis. The credit rate is 100 percent on the first $1,000 of qualified tuition and fees and 50 percent on the next $1,000 of qualified tuition and fees. The HOPE credit is available only for the first two years of a student's post-secondary education. For taxable years beginning after 2001, the $1,500 maximum HOPE credit amount will be indexed for inflation. The HOPE credit amount that a taxpayer may otherwise claim is phased out for taxpayers with modified AGI between $40,000 and $50,000 ($80,000 and $100,000 for joint returns).

The HOPE credit is computed on a per-student basis (i.e., a HOPE credit may be computed separately for each eligible student in a taxpayer's family). If a parent claims a child as a dependent, then only the parent may claim the HOPE credit with respect to such child, and any qualified expenses paid by the child are deemed to be paid by the parent.

For a taxable year, a taxpayer may elect with respect to an eligible student the HOPE credit, the 20-percent Lifetime Learning credit (as provided for by the Act), or the exclusion from gross income for certain distributions from an education IRA (also as provided for by the Act).

The HOPE credit is available for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date.

See, also, the provisions relating to reporting requirements for education tax credits in Part Seven, below.

Lifetime Learning credit.--The 1997 Act provided that individual taxpayers are allowed to claim a nonrefundable Lifetime Learning credit against Federal income taxes equal to 20 percent of qualified tuition and fees paid during the taxable year on behalf of the taxpayer, the taxpayer's spouse, and any dependent. The student must be enrolled at an eligible educational institution but need not be enrolled on at least a half-time basis. Instead, the student is eligible for the Lifetime Learning credit so long as he or she is taking undergraduate or graduate-level classes to acquire or improve job skills (assuming that the other requirements for the credit are satisfied). For expenses paid before January 1, 2003, up to $5,000 of qualified tuition and fees

[5] See, also, the provision in Part Eight, below, providing rules for 1998 relating to the use of nonrefundable credits that will affect the amount of the Hope and Lifetime Learning tax credits for which a taxpayer may be eligible.

per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and fees per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $2,000). The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased out over the same income phase-out range that applies for purposes of the HOPE credit.

The Lifetime Learning credit is computed on a per-taxpayer return basis (i.e., the credit does not vary based on the number of students in a taxpayer's family). However, in contrast to the HOPE credit, the Lifetime Learning credit may be claimed for an unlimited number of taxable years. If a parent claims a child as a dependent, then only the parent may claim the Lifetime Learning credit with respect to such child, and any qualified tuition and fees paid by the child are deemed to be paid by the parent.

The Lifetime Learning credit is available for expenses paid after June 30, 1998, for education furnished in academic periods beginning after such date.

See, also, the provisions relating to reporting requirements for education tax credits in Part Seven, below.

2. Deduction for student loan interest

Under the 1997 Act, certain individuals who are legally obligated to pay interest on qualified education loans may claim an above-the-line deduction for such interest expenses, up to a maximum deduction of $2,500 per year. The maximum deduction is phased in over four years, with a $1,000 maximum deduction in 1998, $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001. The maximum deduction amount is not indexed for inflation. In addition, the deduction is phased out ratably for individual taxpayers with modified AGI of $40,000 to $55,000 ($60,000 to $75,000 for joint returns); such income ranges will be indexed for inflation occurring after the year 2002, rounded down to the closest multiple of $5,000.

The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. A qualified education loan generally is defined as any indebtedness incurred solely to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer. Qualified higher education expenses generally include tuition, fees, room and board, and related expenses, reduced by certain educational benefits that are excludable from gross income (e.g., amounts excluded under section 135, excludable distributions from an education IRA, section 117 scholarship or fellowship grants, and section 127 employer-provided educational assistance). Such expenses must be paid or incurred within a reasonable period before or after the indebtedness is incurred, and must be attributable to a period when the student is at least a half-time student.

Any person in a trade or business or any governmental agency that receives $600 or more in qualified education loan interest from an individual during a calendar year must provide an information report on such interest to the IRS and to the payor.

The provision is effective for interest payments due and paid after December 31, 1997, on any qualified education loan.

3. Tax treatment of qualified State tuition programs and education IRAs; exclusion for certain distributions from education IRAs used to pay qualified higher education expenses

Qualified State tuition programs.--The 1997 Act expanded section 529--which provides tax-exempt status and deferral of tax on earnings of qualified State tuition programs--to include State programs under which individuals prepay (or save) not only for post-secondary tuition, fees, books, and supplies, but also for future room and board expenses of a designated beneficiary. The 1997 Act also expanded the definition of eligible educational institutions for purposes of section 529 and the definition of the term "member of the family" for purposes of allowing tax-free rollovers of credits or account balances in qualified State tuition programs. The 1997 Act also included provisions clarifying the estate and gift tax treatment of contributions to qualified State tuition programs or education IRAs (described below).

Under the 1997 Act, to the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and fees at an eligible post-secondary institution, then the student (or his or her parent) may be able to claim the HOPE credit or Lifetime Learning credit provided for by the 1997 Act with respect to such tuition and fees (depending on whether the income limitations and other requirements of the HOPE credit or Lifetime Learning credit are satisfied). The modifications to section 529 generally were effective after December 31, 1997.

Education IRAs.--The 1997 Act provided that taxpayers may establish education IRAs, meaning trusts or custodial accounts created exclusively for the purpose of paying qualified higher education expenses of a named beneficiary. Annual contributions to education IRAs may not exceed $500 per beneficiary, and may not be made after the designated beneficiary reaches age 18. The contribution limit is phased out for taxpayers with modified adjusted gross income ("AGI") between $95,000 and $110,000 (between $150,000 and $160,000 in the case of a married couple filing a joint return). No contribution may be made by any person to an education IRA during any year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary.

Until a distribution is made from an education IRA, earnings on contributions to the account are not subject to tax. In addition, the 1997 Act provided that distributions from an education IRA are excludable from gross income to the extent that the distribution does not exceed qualified higher education expenses incurred by the beneficiary during the year the distribution is made, regardless of whether the student is enrolled in classes on a full-time, half-time, or less than half-time basis. However, certain room and board expenses are qualified higher education expenses only if the student incurring such expenses is enrolled at an eligible educational institution on at least a half-time basis. The earnings portion of an education IRA distribution not used to pay qualified higher education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax penalty. Any balance remaining in an education IRA will be deemed to be distributed within 30 days after the date the designated beneficiary reaches age 30. However, prior to the beneficiary reaching age 30, the Act allows tax-free (and penalty-free) rollovers of account balances from an education IRA benefiting one family member to an education IRA benefiting another family member. The provisions governing education IRAs apply to taxable years beginning after December 31, 1997.

4. Treatment of cancellation of certain student loans

The 1997 Act provided that an individual's gross income does not include forgiveness of loans made by educational organizations and certain tax-exempt organizations if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance outstanding student loans and the student is not employed by the lender organization. The exclusion applies only if the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers. In addition, the student's work must fulfill a public service requirement. The provision applies to discharges of indebtedness after August 5, 1997.

5. Penalty-free withdrawals from IRAs for higher education expenses

The 1997 Act permitted penalty-free withdrawals from individual retirement arrangements (IRAs) for qualified higher education expenses (including those related to graduate level courses) of the taxpayer, the taxpayer's spouse, or any child, or grandchild of the individual or the individual's spouse. This provision was effective for distributions made after December 31, 1997, which respect to expenses paid after such date for education furnished in academic periods beginning after such date.

6. Employer-provided educational assistance

The 1997 Act extended the exclusion from gross income for employer-provided educational assistance for undergraduate education through May 31, 2000.

7. Modification of $150 million limit on qualified 501(c)(3) bonds other than hospital bonds

The 1997 Act repealed the $150 million limit on qualified 501(c)(3) bonds issued by a State or local government after August 5, 1997, to finance capital expenditures incurred after such date.

8. Enhanced deduction for corporate contributions of computer technology and equipment

The 1997 Act permitted C corporations that donate computer technology and equipment that is not more than two years old for educational purposes in any of grades K-12 to claim an augmented charitable contribution deduction. The provision is effective for contributions made in taxable years beginning after 1997 and before January 1, 2001.

9. Expansion of arbitrage rebate exception for certain bonds

Under present and prior law, an exception to the arbitrage rebate rules applies for bonds issued by governmental units having general taxing powers if the governmental unit issues $5 million or less of governmental bonds during the calendar year ("the small issue exception"). The 1997 Act provided that up to $5 million dollars of bonds of State or local governments used to finance public school capital expenditures incurred after December 31, 1997, are excluded from application of the limit for the small issue exception. Thus, small issuers continue to benefit from the small issue exception from arbitrage rebate if they issue no more than $10 million in governmental bonds per calendar year and no more than $5 million of the bonds is used to finance expenditures other than for public school capital expenditures. The provision is effective for bonds issued after December 31, 1997.

10. Tax credit for holders of qualified zone academy bonds

Under the 1997 Act, certain financial institutions that hold "qualified zone academy bonds" are entitled to a nonrefundable tax credit in an amount equal to a credit rate (set by the Treasury Department) multiplied by the face amount of the bond. "Qualified zone academy bonds" are any bond issued by a State or local government, provided that: (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain property or services with a value equal to at least 10 percent of the bond proceeds. A school is a "qualified zone academy" if: (1) the school is a public school that provides education and training below the college level; (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates; and (3) either (a) the school is located in an empowerment zone or enterprise community (including empowerment zones designated or authorized to be designated under the Act), or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

A total of $400 million of "qualified zone academy bonds" may be issued in each of 1998 and 1999. The $800 million aggregate bond cap is allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit to qualified zone academies within such State.

The provision is effective for bonds issued after 1997.

TITLE III.--SAVINGS AND INVESTMENT INCENTIVES

1. Individual retirement arrangements

The 1997 Act increased the income ranges over which the $2,000 IRA deduction limit is phased out for individuals who are active participants in an employer-sponsored retirement plan. Under the 1997 Act, in 1998, the phase out ranges are increased to $50,000 to $60,000 of AGI for married couples and to $30,000 to $40,00 of AGI for single taxpayers. The income limits are increased each year thereafter until they are double the present-law limits; i.e., until the phase-out range is $80,000 to $100,000 for married taxpayers and $50,000 to $60,000 for single taxpayers.

The 1997 Act permitted deductible contributions for spouses of individuals who are in an employer-sponsored retirement plan. The deduction is phased out for taxpayers with AGI between $150,000 and $160,000.

The 1997 Act created a new, tax-free nondeductible IRA called the "Roth IRA" for individuals with AGI between $95,000 and $110,000 and married couples with AGI between $150,000 and $160,000. Distributions from a Roth IRA are tax free if made more than five years after a Roth IRA has been established and if the distribution is (1) made after age 59-1/2, death, or disability, or (2) for first-time homebuyer expenses (up to $10,000). No more than $2,000 per year can be contributed to all an individual's IRAs. See, also, the provisions relating to Roth IRAs in Part Seven, below.

The 1997 Act permitted IRAs to invest in certain gold coins and bullion.

The 1997 Act permitted penalty-free withdrawals from IRAs for first-time homebuyer expenses (up to $10,000) and higher education expenses.

2. Capital gains provisions

The 1997 Act reduced the maximum capital gains rate for individuals to 20 percent (10 percent for taxpayers in the 15-percent bracket), effective May 7, 1997. Real estate depreciation recapture generally is taxed at a maximum rate of 25 percent. The prior-law maximum 28-percent rate was retained for collectibles and, effective July 29, 1997, for assets held between one year and 18 months. Beginning in 2001, assets held for five years will get lower rates (8 percent for 15-percent bracket taxpayers in 2001 and 18 percent for others in 2006). See, also, the provisions relating to capital gains in Part Seven, below, eliminating the 18-month holding period for capital gains.

The 1997 Act provided a $250,000 gain exclusion from the sale of a principal residence ($500,000 in the case of a joint return), effective on May 7, 1997.

The 1997 Act allowed the tax-free rollover of gain from certain small business stock to other small business stock, effective on August 5, 1997.

TITLE IV.--ALTERNATIVE MINIMUM TAX PROVISIONS

1. Repeal alternative minimum tax for small businesses and repeal the deprecation adjustment

For taxable years beginning after 1997, the 1997 Act repealed the corporate alternative minimum tax for small businesses (i.e., generally those with average gross receipts of less than $7.5 million).

In addition, for property placed in service after 1998, the 1997 Act conformed the depreciable lives used for purposes of the alternative minimum tax to the depreciable lives used for purposes of the present-law regular tax.

2. Repeal AMT installment method adjustment for farmers

The 1997 Act repealed the installment sales adjustment applicable to the alternative minimum tax, generally for sales after 1987. Thus, qualified farmers are eligible to use the installment sales method of accounting for both regular tax and alternative minimum tax purposes.

TITLE V.--ESTATE, GIFT, AND GENERATION-SKIPPING TAX PROVISIONS

1. Increase in estate and gift tax unified credit

Under the 1997 Act, the exemption equivalent of the estate and gift tax unified credit was increased as follows: the effective exemption is $625,000 for decedents dying and gifts made in 1998; $650,000 in 1999; $675,000 in 2000 and 2001; $700,000 in 2002 and 2003; $850,000 in 2004; $950,000 in 2005; and $1 million in 2006 and thereafter. These amounts are not indexed for inflation.

2. Indexing of certain other estate and gift tax provisions

After 1998, the $10,000 annual exclusion for gifts, the $750,000 ceiling on special use valuation, the $1,000,000 generation-skipping transfer tax exemption, and the $1,000,000 ceiling on the value of a closely-held business eligible for the special low interest rate are indexed annually for inflation.

3. Estate tax deduction for qualified family-owned businesses

Under the 1997 Act, for estate tax purposes, an executor may elect a deduction equal to the value of certain qualified "family-owned business interests" if such interests comprise more than 50 percent of a decedent's estate and certain other requirements are met. The deduction for family-owned business interests may be taken only to the extent that the deduction for family-owned business interests, plus the amount effectively exempted by the unified credit, does not exceed $1.3 million. The provision was effective for decedents dying after December 31, 1997.

4. Reduction in estate tax for certain land subject to permanent conservation easement

An executor may elect to exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement that meets the following requirements: (1) the land is located within 25 miles of a metropolitan area or a national park or wilderness area, or within 10 miles of an Urban National Forest; (2) the land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution of a qualified real property interest was granted by the decedent, the decedent's estate, or a member of the decedent's family. The maximum exclusion for land subject to a qualified conservation easement is limited to $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter. The exclusion for land subject to a qualified conservation easement may be taken in addition to the maximum deduction for qualified family-owned business interests (i.e., there is no coordination between the two provisions). Debt-financed property is eligible for this provision to the extent of the net equity in the property.

5. Installment payments of estate tax attributable to closely held businesses

For estate taxes that are deferred under section 6166, the tax attributable to the first $1,000,000 in taxable value of the closely held business (i.e., the first $1,000,000 in value in excess of the effective exemption provided by the unified credit and any other exclusions) is subject to interest at a rate of two percent. The remainder of such taxes is subject to interest at a rate equal to 45 percent of the rate applicable to underpayments of tax, and all taxes paid under section 6166 are made nondeductible. The provision was effective for decedents dying after December 31, 1997. Taxpayers currently deferring taxes under section 6166 may make a one-time election to receive similar treatment.

6. Estate tax recapture from cash leases of specially-valued property

The cash lease of specially-valued real property by a lineal descendant of the decedent to a member of the lineal descendant's family, who continues to operate the farm or closely held business, does not cause the qualified use of such property to cease for purposes of imposing the additional estate tax under section 2032A(c), effective with respect to leases entered into after December 31, 1976.

7. Clarify eligibility for extension of time for payment of estate tax

Taxpayers are given access to the courts to resolve disputes over an estate's eligibility for the section 6166 election by authorizing the U.S. Tax Court to provide declaratory judgments regarding initial or continuing eligibility for deferral under section 6166, effective with respect to estates of decedents dying after August 5, 1997.

8. Gifts may not be revalued for estate tax purposes after expiration of statute of limitations

A gift that has been adequately disclosed for which the three-year statute of limitations period has passed cannot be revalued for purposes of determining the applicable estate tax bracket and available unified credit, effective for gifts made after August 5, 1997.

9. Repeal of throwback rules applicable to certain domestic trusts

Amounts distributed by certain domestic trusts are exempted from the throwback rules. The throwback rules continue to apply with respect to (1) foreign trusts, (2) domestic trusts that were once treated as foreign trusts (except as provided in Treasury regulations), and (3) domestic trusts created before March 1, 1984, that would be treated as multiple trusts under section 643(f) of the Code. In addition, precontribution gain on property sold by certain domestic trusts no longer is subject to section 644 (i.e., taxed at the contributor's marginal tax rates). The provision was effective for taxable years beginning after August 5, 1997.

10. Modification of generation-skipping transfer tax for transfers to individuals with deceased parents

The prior-law "predeceased parent exception" was extended to transfers to collateral heirs, provided that the decedent has no living lineal descendants at the time of the transfer, and to taxable terminations and taxable distributions, provided that the parent of the relevant beneficiary was dead at the earliest time that the transfer (from which the beneficiary's interest in the property was established) was subject to estate or gift tax. The provision was effective for generation-skipping transfers made after December 31, 1997.

TITLE VI.--EXTENSION OF CERTAIN EXPIRING TAX PROVISIONS

1. Research tax credit

The 1997 Act extended the research tax credit (which provides a 20-percent tax credit for qualified research expenses in excess of a taxpayer's research credit base amount) for 13 months--i.e., generally for the period June 1, 1997, through June 30, 1998. See, also, the provisions contained in Part Eight, below, providing for a subsequent extension of the research tax credit through June 30, 1999.

2. Contributions of stock to private foundations

The special rule contained in section 170(e)(5) that permits a fair-market value deduction for contributions of qualified appreciated stock to private foundations was extended for the period June 1, 1997, through June 30, 1998. See, also, the provisions contained in Part Eight, below, providing for a permanent extension of the deduction.

3. Work opportunity tax credit

The 1997 Act provided a nine-month extension of the work opportunity tax credit. It also provided a credit percentage of 25 percent for employment of less than 400 hours of employment and 40 percent for employment of 400 or more hours, reduces the period employees must be employed to qualify for the credit, and makes other changes. The Act was generally effective for wages paid to qualified individuals who begin work for an employer after September 30, 1997, and before July 1, 1998. See, also, the provision contained in Part Eight, below, providing a subsequent extension of the work opportunity tax credit through June 30, 1999.

4. Orphan drug tax credit

The orphan drug tax credit provides a 50-percent tax credit for qualified clinical testing expenses incurred in testing certain drugs for rare diseases or conditions. The 1997 Act permanently extended the orphan drug tax credit, effective for expenses paid or incurred after May 31, 1997.

TITLE VII.--DISTRICT OF COLUMBIA TAX INCENTIVES

1. Designation of D.C. Enterprise Zone

The 1997 Act designated certain economically depressed census tracts within the District of Columbia as the "D.C. Enterprise Zone," within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Enterprise Zone for purposes of the wage credit, expensing, and tax-exempt financing incentives include all census tracts that presently are part of the D.C. enterprise community and census tracts within the District of Columbia where the poverty rate is not less than 20 percent. The D.C. Enterprise Zone designation generally remains in effect for five years for the period from January 1, 1998, through December 31, 2002.

2. Empowerment zone wage credit, expensing, and tax-exempt financing

The 1997 Act made the following tax incentives that are available under present law in empowerment zones generally available in the D.C. Enterprise Zone: (1) a 20-percent wage credit for the first $15,000 of wages paid to D.C. residents who work in the D.C. Enterprise

Zone; (2) an additional $20,000 of expensing under Code section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities.

3. Zero-percent capital gains rate

The 1997 Act provided a zero-percent capital gains rate for capital gains from the sale of certain qualified D.C. Zone assets held for more than five years. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent.

4. First-time homebuyer tax credit

The 1997 Act allowed first-time homebuyers of a principal residence in the District a tax credit of up to $5,000 of the amount of the purchase price, except that the credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000-$130,000 for joint filers). The credit is available with respect to property purchased after August 4, 1997, and before January 1, 2001.

TITLE VIII.--WELFARE-TO-WORK TAX CREDIT

The 1997 Act provided 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. The provision 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. See, also, the provisions in Part Eight, below, providing for a subsequent extension of the welfare to work tax credit through June 30, 1999.

TITLE IX.--MISCELLANEOUS PROVISIONS

1. Excise tax provisions

<u>Repeal excise tax on diesel fuel used in recreational motorboats</u>.--The 1997 Act repealed the 24.3-cents-per-gallon excise tax on diesel fuel used in recreational motorboats. Imposition of this tax previously had been suspended through December 31, 1997.

<u>Continued application of tax on imported recycled halon-1211</u>.--The 1997 Act repealed the prior-law exemption from the excise tax on ozone-depleting chemicals for imported recycled halon-1211, effective on August 5, 1997.

Transfer 4.3-cents-per-gallon General Fund highway fuels tax to Highway Trust Fund..--The 1997 Act provided for transfer of the 4.3-cents-per-gallon General Fund excise taxes on gasoline, diesel fuel, special motor fuels, and kerosene to the Highway Trust Fund, effective after September 30, 1997. Provisions were included to ensure that this transfer had no effect on direct spending under the Budget Act. Certain tax deposit rules were modified for 1998. See, also, the provisions described in Part Five, below.

Tax certain alternative fuels based on energy equivalency to gasoline.--The 1997 Act adjusted the excise tax rate on propane, methanol derived from natural gas, and liquefied natural gas to reflect the relative Btu content of these fuels to gasoline, effective on October 1, 1997.

Certain gasoline "chain retailers" treated as wholesale distributors.--The 1997 Act extended eligibility to file excise tax refund claims on behalf of certain exempt gasoline users to retailers selling the fuel from 10 or more commonly controlled outlets. This provides treatment to these retail dealers comparable to that previously provided only to wholesale distributors. The provision was effective after September 30, 1997.

Exemption of electric and other clean-fuel vehicles from luxury automobile classification.--The 1997 Act modified the threshold above which the luxury excise tax on automobiles will apply for each of two identified classes of automobiles. First, for an automobile that is not a clean-burning fuel vehicle to which retrofit parts and components are installed to make the vehicle a clean-burning vehicle, the threshold is $30,000, as adjusted for inflation under prior law, plus an amount equal to the increment to the retail value of the automobile attributable to the retrofit parts and components installed. In the case of a passenger vehicle designed to be propelled primarily by electricity and built by an original equipment manufacturer, the threshold applicable for any year is modified to equal 150 percent of $30,000, with the result increased for inflation occurring after 1990.

Reduce rate of alcohol excise tax on certain hard ciders.--The 1997 Act reduced the tax rate on still apple cider having an alcohol content of less than 7 percent to 22.6 cents per gallon for those persons who produce more than 100,000 gallons of "hard cider" during a calendar year, effective on October 1, 1997.

Study feasibility of moving collection point for distilled spirits excise tax.--The $13.50 per proof gallon distilled spirits excise tax is imposed when these beverages are removed from a distillery (or imported). The 1997 Act directed the Secretary of the Treasury to study and report to Congress on compliance and budgetary effects of various options for changing the point where this tax is imposed.

Codify rules on use of semi-generic names on wine labels.--The 1997 Act codified the Treasury regulatory list of semi-generic wine names (i.e., names having geographic significance) that may be used by U.S. wine producers and the conditions in which those names may be used for wines not originating in the historical area to which the name relates, effective on August 5, 1997.

Uniform rate of excise tax on vaccines.--The 1997 Act replaced the prior-law excise taxes on vaccines, that differ by vaccine, with a single rate tax of $0.75 per dose on any listed vaccine component. In addition, the Act added three new taxable vaccines to the list of taxable vaccines: (1) HIB (hemophilus influenza type B); (2) Hepatitis B; and (3) varicella (chickenpox), generally effective on August 5, 1997. See, also Part Eight, below, for subsequent modifications to the vaccine excise tax.

2. Disaster relief provisions

Authority to postpone certain tax-related deadlines on account of Presidentially declared disasters.--The 1997 Act provided Treasury with the authority to postpone certain tax-related deadlines by reason of a Presidentially declared disaster, effective with respect to any period for performing an act that had not expired before August 5, 1997.

Use of certain appraisals to establish amount of disaster loss.--The 1997 Act provided that the Treasury Department may issue guidance providing that an appraisal for the purpose of obtaining a Federal loan or Federal loan guarantee as the result of a Presidentially declared disaster may be used to establish the amount of the disaster loss, effective on August 5, 1997.

Treatment of livestock sold on account of weather-related conditions.--Present law allows taxpayers, in certain circumstances, to defer gain recognized on the sale of livestock sold on account of drought. The 1997 Act expanded these exceptions to livestock sold on account of flood or other weather-related conditions. The provisions were effective for sales and exchanges after 1996.

Mortgage bond financing for residences located in Presidentially declared disaster areas.--Qualified mortgage bonds are private activity tax-exempt bonds issued by States and local governments acting as conduits to provide mortgage loans to first-time home buyers who satisfy specified income limits and who purchase homes that cost less than statutory maximums. The 1997 Act allowed waivers of the first-time homebuyer requirement, the income limits, and the purchase price limits for loans to finance homes in certain Presidentially declared disaster areas. The waiver applied only during the two-year period following the date of disaster declaration. The provision applies to loans financed with bonds issued after December 31, 1996, and before January 1, 1999.

Abatement of interest by reason of Presidentially declared disaster.--The 1997 Act required the IRS to abate interest for individual taxpayers in Presidentially declared disaster areas under specified circumstances for disasters in 1997, effective with respect to disasters declared after December 31, 1996. See, also, the provision relating to abatement of interest in disaster areas in Part Seven, below.

3. Employment tax provisions

The 1997 Act clarified the standards to be used in determining whether securities brokers are employees for Federal tax purposes. The Act provided that certain termination payments received by former insurance salesmen are not subject to SECA taxes. The 1997 Act imposed a moratorium on the issuance of IRS regulations relating to the definition of limited partner for SECA tax purposes until July 1, 1998.

The 1997 Act established a demonstration project for combined Federal/State employment tax reporting.

4. Small business provisions

EFTPS.--The 1997 Act delayed the imposition of penalties for certain failures to make payments electronically through the Electronic Funds Transfer Payment System ("EFTPS") through June 30, 1998. The Internal Revenue Service further extended the delay through June 30, 1999, by administrative action.

Home office deduction: clarification of definition of principal place of business.--The 1997 Act enhanced the ability of taxpayers who work at home to claim deductions for home office expenses by expanding the definition of "principal place of business" to include a home office that is used by the taxpayer to conduct administrative or management activities of the business, provided that there is no other fixed location where the taxpayer conducts substantial administrative or management activities of the business. As under prior law, deductions are allowed for a home office only if the office is exclusively used on a regular basis as a place of business and, in the case of an employee, only if such exclusive use is for the convenience of the employer.

The provision is effective for taxable years beginning after December 31, 1998.

Increase in self-employed health deduction.--The 1997 Act increased the deduction for health insurance of self-employed individuals as follows: 40 percent in 1997, 45 percent in 1998 and 1999, 50 percent in 2000 and 2001, 60 percent in 2002, 80 percent in 2003 through 2005, 90 percent in 2006, and 100 percent in 2007 and thereafter. See, also, the provisions in Part Eight, below, accelerating the increases in the deduction for health insurance of self-employed individuals.

5. Other provisions

Shrinkage estimates for inventory accounting.--Under the 1997 Act, a method of keeping inventories will not be considered unsound, or to fail to clearly reflect income, solely because it includes an adjustment for the shrinkage estimated to occur through year-end, based on inventories taken other than at year-end. Safe harbor methods of estimating inventory shrinkage will be established by Treasury regulation; a safe harbor method specific to retail trade was described in the Conference Report. The provision was effective for taxable years ending after August 5, 1997.

Treatment of workmen's compensation liability under rules for certain personal injury liability assignments.--The 1997 Act extended the exclusion for qualified assignments under Code section 130 to amounts assigned for assuming a liability to pay compensation under any workmen's compensation act. The provision was effective for workmen's compensation claims filed after August 5, 1997.

Tax-exempt status for certain State workmen's compensation act companies.--The 1997 Act clarified the tax-exempt status of any organization that: (1) is created by State law, (2) is organized and operated exclusively to provide workmen's compensation insurance and related coverage that is incidental to workmen's compensation insurance, and (3) meets certain additional requirements. Among these additional requirements are requirements that: (1) the State must either extend its full faith and credit to the initial debt of the organization or provide the initial operating capital of such organization, and (2) the assets of the organization must revert to the State upon dissolution or State law must not permit the dissolution of the organization. The provision was effective for taxable years beginning after December 31, 1997. No inference was intended that organizations described in the provision were not tax-exempt under prior law.

Election for 1987 partnerships to continue exception from treatment of publicly traded partnerships as corporations.--Under the 1997 Act, in the case of an existing 1987 publicly traded partnership that elects under the provision to be subject to a tax on gross income from the active conduct of a trade or business, the rule of present law treating a publicly traded partnership as a corporation does not apply. The tax is 3.5 percent of the partnership's gross income from the active conduct of a trade or business. The provision was effective for taxable years beginning after December 31, 1997.

Exclusion from UBIT for certain corporate sponsorship payments.--The 1997 Act provided an exclusion from the unrelated business income tax (UBIT) for qualified sponsorship payments received by tax-exempt organizations (and State colleges and universities). "Qualified sponsorship payments" are defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities. Such a use or acknowledgment does not include advertising of such person's products or services--meaning qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use such products or services. The safe-harbor exclusion provided by the Act for "qualified sponsorship payments" does not apply to payments that entitle the payor to the use or acknowledgment of the payor's trade or business name or logo (or product lines) in tax-exempt organization periodicals (or to payments made in connection with certain convention or trade show activities), which continue to be governed by present-law rules to determine whether the payment is subject to the UBIT.

The provision applies to qualified sponsorship payments solicited or received after December 31, 1997.

Timeshare associations.--The 1997 Act permitted timeshare associations to be taxed similarly to homeowner's associations, except the tax rate on their association income is 32 percent, effective for taxable years beginning after December 31, 1996.

Exception from real estate reporting requirements for certain sales of principal residences.--The 1997 Act provided that sales of personal residences with a gross sales price of $500,000 or less ($250,000 or less in the case of a seller who is not married) are excluded from the real estate transaction reporting requirement, provided the seller represents that any gain on the sale will be exempt from Federal income tax.

Increased deduction for business meals for individuals operating under Department of Transportation hours of service limitation.--The deductible percentage of the cost of food and beverages consumed while away from home by an individual during, or incident to, a period of duty subject to the hours of service limitations of the Department of Transportation is gradually increased from 50 to 80 percent. The percentage allowable increases in 5-percent increments every other year beginning in 1998.

Deductibility of meals provided for the convenience of the employer.--The 1997 Act clarified the tax treatment of meals provided for the convenience of the employer, effective for taxable years beginning after December 31, 1997. See, also, the provision in Part Seven, below,

Increase in standard mileage rate for purposes of computing charitable deduction.--The 1997 Act increased from 12 cents per mile to 14 cents per mile the standard mileage rate used for purposes of computing the charitable deduction, effective for taxable years beginning after December 31, 1997.

Expensing of environmental remediation costs ("brownfields").--The 1997 Act allowed taxpayers to elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. A "qualified contaminated site" generally is any property that: (1) is held for use in a trade or business, for the production of income, or as inventory; (2) is certified by the appropriate State environmental agency to be located within a targeted area; and (3) contains (or potentially contains) a hazardous substance (so-called "brownfields"). Targeted areas include: (1) empowerment zones and enterprise communities as designated under prior law and under the Act (including any supplemental empowerment zone designated on December 21, 1994); (2) sites announced before February 1997, as being subject to one of the 76 Environmental

Protection Agency (EPA) Brownfields Pilots; (3) any population census tract with a poverty rate of 20 percent or more; and (4) certain industrial and commercial areas that are adjacent to census tracts with a poverty rate of 20 percent or more. The provision applied to eligible expenditures incurred in taxable years ending after August 5, 1997, and before January 1, 2001.

Modify limits on depreciation of luxury automobiles for certain clean-burning fuel and electric vehicles.--The 1997 Act modified the limitation on depreciation in the case of qualified clean-burning fuel vehicles and certain electric vehicles. With respect to qualified clean-burning fuel vehicles, the 1997 Act generally has the effect of only subjecting the cost of the vehicle before modification to the limitations. In the case of a passenger vehicle designed to be propelled primarily by electricity and built by an original equipment manufacturer, the prior-law base-year limitation amounts were tripled. The provision is effective for property placed in service after August 5, 1997, and before January 1, 2005.

Modification of advance refunding rules for certain tax-exempt bonds issued by the Virgin Islands.--Under the 1997 Act, one additional advance refunding was allowed for bonds issued by the Virgin Islands that were advance refunded before June 9, 1997, effective on change of the Virgin Islands debt provisions to repeal a then-existing priority first lien requirement.

Deferral of gain on certain sales of farm product refiners and processors.--The 1997 Act extended the deferral provided under section 1042 to the sale of stock of a qualified refiner or processor to an eligible farmer's cooperative. The provision was effective for sales after December 31, 1997. This provision was (1) identified as a limited tax benefit subject to the Line Item Veto Act, (2) cancelled by the President pursuant to his authority under the Line Item Veto Act, and (3) reinstated when the U.S. Supreme Court ruled that the Line Item Veto Act was unconstitutional.

Above-the-line deduction for certain expenses.--The 1997 Act provided that employee business expenses relating to service as an official of a State or local government (or political subdivision thereof) are deductible in computing AGI, provided the official is compensated in whole or in part on a fee basis. The provision was effective with respect to expenses paid or incurred in taxable years beginning after December 31, 1986.

Survivor benefits of public safety officers killed in the line of duty.--The 1997 Act provided an exclusion from gross income for certain survivor benefits paid on account of the death of a public safety officer killed in the line of duty. The provision was effective for amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after that date.

Temporary suspension of income limitations on percentage depletion for production from marginal wells.--The 1997 Act suspended the 100-percent-of-net-income property limitation with respect to oil and gas produced from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

Purchasing of receivables by tax-exempt hospital cooperative service organizations.--The 1997 Act clarified that, for purposes of section 501(e), billing and collection services include the purchase of patron accounts receivable on a recourse basis. The provision was effective for taxable years beginning after December 31, 1996.

Designation of additional empowerment zones; modification of empowerment zone and enterprise community criteria

a. Two additional empowerment zones with same tax incentives as previously designated empowerment zones

Under the 1997 Act, the Secretary of HUD was authorized to designate two additional empowerment zones located in urban areas (thereby increasing to eight the total number of empowerment zones located in urban areas) with respect to which the same tax incentives (i.e., the wage credit, additional expensing, and special tax-exempt financing) generally apply as are available within the empowerment zones authorized by the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993). The wage credit available in the two new urban empowerment zones was modified slightly to provide that the percentage of wages taken into account for purposes of determining the wage credit is 20 percent for 2000-2004, 15 percent for 2005, 10 percent for 2006, and 5 percent for 2007. No wage credit is available in the two new urban empowerment zones after 2007. The two additional empowerment zones are subject to the same eligibility criteria that applies to the original six urban empowerment zones. The designations do not take effect before January 1, 2000, and generally remain in effect for 10 years.

b. Designation of additional empowerment zones

The 1997 Act authorized the Secretaries of HUD and Agriculture to designate an additional 20 empowerment zones (no more than 15 in urban areas and no more than five in rural areas). With respect to these additional empowerment zones, the present-law eligibility criteria were expanded slightly.

Within the 20 additional empowerment zones, qualified "enterprise zone businesses" are eligible to receive up to $20,000 of additional section 179 expensing and to utilize special tax-exempt financing benefits. The "brownfields" tax incentive provided under the Act also is available within all designated empowerment zones. Businesses within the 20 additional empowerment zones are not, however, eligible to receive the present-law wage credit available within the 11 other designated empowerment zones.

The 20 additional empowerment zones are required to be designated before 1999, and the designations generally will remain in effect for 10 years.

c. Modification of definition of enterprise zone business

The 1997 Act provided that an entity may qualify as an "enterprise zone business" if (in addition to the other present-law criteria) at least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business within an empowerment zone or enterprise community. In addition, the 1997 Act made certain other modifications to the definition of an "enterprise zone business." This modified "enterprise zone business" definition applies to all previously designated empowerment zones and enterprise communities, the two urban empowerment zones designated under the 1997 Act, as well as to the 20 additional empowerment zones authorized to be designated pursuant to the 1997 Act. The modifications to the definition of "enterprise zone business" were effective for taxable years beginning on or after August 5, 1997.

d. Tax-exempt financing rules

The 1997 Act allowed "new empowerment zone facility bonds" to be issued for qualified enterprise zone businesses in the 20 additional empowerment zones. These bonds are not subject to the State private activity bond volume caps or the special limits on issue size applicable to qualified enterprise zone facility bonds. The maximum amount of these bonds that can be issued is limited to $60 million per rural zone, $130 million per urban zone with a population of less than 100,000, and $230 million per urban zone with a population of 100,000 or more.

The 1997 Act also made certain modifications to the special tax-exempt bond financing available under present-law rules in empowerment zones and enterprise communities. The changes to the tax-exempt financing rules were effective for qualified enterprise zone facility bonds and the new empowerment zone facility bonds issued after August 5, 1997.

e. Special rules for Alaska and Hawaii

The 1997 Act modified the prior-law empowerment zone and enterprise community designation criteria so any zones or communities designated in the States of Alaska or Hawaii will not be subject to the general size limitations, nor will such zones or communities be subject to the general poverty-rate criteria. Instead, nominated areas in either State are eligible for designation as an empowerment zone or enterprise community if, for each census tract or block group within such area, at least 20 percent of the families have incomes which are 50 percent or less of the State-wide median family income. Such zones and communities are subject to the population limitations under section 1392(a)(1). The provision was effective on August 5, 1997.

<u>Income averaging for farmers</u>.--Under the 1997 Act, an individual taxpayer generally is allowed to elect to compute his or her current year regular tax liability by averaging, over the prior three-year period, all or a portion of his or her taxable income from the trade of business of farming. The provision applies to taxable years beginning after December 31, 1997, and before

January 1, 2001. See, also, the provisions in Part Eight, which made permanent the rules providing for income averaging for farmers.

Elective carryback of existing net operating losses of the National Railroad Passenger Corporation (Amtrak).--Under the 1997 Act, Amtrak is allowed a tax refund based on the carryback of its net operating losses against the tax attributes of its predecessor railroads. The availability of the provision is conditioned on Amtrak (1) agreeing to make payments of one percent of the amount it receives to each of the non-Amtrak States to offset certain transportation related expenditures and (2) using the balance for certain qualified expenses. The maximum refund payable to Amtrak under this provision is limited to $2,323,000,000. One half of the refund is treated as a payment of estimated tax by Amtrak for each of the first two taxable years ending after August 5, 1997. However, no refund could be made as a result of this provision earlier than the date of enactment of S. 738 ("Amtrak Reform and Accountability Act of 1997"), which authorizes reforms of Amtrak. S. 738 was enacted on December 2, 1997 (P.L. 105-134). See, also, the provision relating to Amtrak NOL monies in Part Six, below.

TITLE X.--REVENUE-INCREASE PROVISIONS

1. Financial product provisions

Require recognition of gain on certain appreciated positions in personal property.--The 1997 Act required recognition of gain (but not loss) upon a constructive sale of any appreciated position in stock, a partnership interest or certain debt instruments. A constructive sale occurs when a taxpayer enters into a short against the box sale, an offsetting notional principal contract or certain other transactions. The provision is generally effective for constructive sales entered into after June 8, 1997.

Election of mark-to-market for securities traders.--The 1997 Act allowed securities traders and commodities traders and dealers to elect mark-to-market accounting similar to that currently required for securities dealers. The election applies to taxable years ending after August 5, 1997.

Limitation on exception for investment companies under section 351.--The 1997 Act expanded the definition of an "investment company" for purposes of the exception for such companies from the general rules allowing tax-free contributions of property to corporations and partnerships. Under the 1997 Act, an investment company includes a company more than 80 percent of the assets of which consist of securities and other high-quality investment assets. The provision is effective for transfers after June 8, 1997, with an exception for transfers pursuant to certain binding contracts in effect on that date.

Treatment of certain transactions as exchanges.--The 1997 Act provided that redemptions of debt issued by natural persons and debt issued before July 2, 1982, is treated as an exchange and, accordingly, any gain or loss on that redemption would be capital gain or loss effective for debt issued or purchased after June 8, 1997. In addition, the 1997 Act treated as capital gains or losses the gains or losses arising from the cancellation, lapse, expiration, or other termination after September 4, 1997, of a right or obligation with respect to all types of property that are (or on acquisition would be) capital assets in the hands of the taxpayer. Lastly, the 1997 Act provided that a taxpayer that enters into a short sale of property (and, to the extent provided in Treasury regulations, any option with respect to property, any offsetting notional principal contract with respect to property, any futures or forward contract to deliver property, or with respect to any similar transaction or position) that becomes substantially worthless after August 5, 1997, shall recognize gain as if the short sale (or other property) were closed (or sold) when the property becomes substantially worthless.

Determination of original issue discount where pooled debt obligations subject to acceleration.--The 1997 Act required a reasonable assumption for interest income accruals with respect to a pool of debt instruments the payments on which may be affected by reason of prepayments. Thus, if a taxpayer holds a pool of credit card receivables that require interest to be paid if the borrowers do not pay their accounts by a specified date, the taxpayer would be required to accrue interest on such pool based upon a reasonable assumption regarding the timing of the payments of the accounts in the pool. Similar rules apply under present law with respect to the accrual of original issue discount with respect to REMICs. The provision was effective for taxable years beginning after August 5, 1997.

Deny interest deduction on certain debt instruments.--The 1997 Act denied interest deductions on certain corporate instruments payable in stock of the issuer or a related party, including instruments a substantial portion of the principal or interest on which is mandatorily (or at the option of the issuer or a related party) payable or convertible into such stock, or determined by reference to the value of such stock, or that are part of an arrangement designed to result in such payment of the instrument with or by reference to such stock.

The provision was effective for instruments issued after June 8, 1997, but does not apply to such instruments (1) issued pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

2. Corporate organizations and reorganizations

Require gain recognition for certain extraordinary dividends.--Under the 1997 Act, a corporate shareholder recognizes gain immediately with respect to any redemption treated as a dividend when the nontaxed portion of the dividend exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership. In addition, the provision requires immediate gain recognition whenever the basis of stock with respect to which any extraordinary dividend was received is reduced below zero.

The provision generally was effective for distributions after May 3, 1995, unless made pursuant to the terms of a written binding contract in effect on May 3, 1995 and at all times thereafter before such distribution, or a tender offer outstanding on May 3, 1995. In certain types of cases, September 13, 1995, is substituted for May 3, 1995.

Require gain recognition on certain distributions of controlled corporation stock.--The 1997 Act restricted certain otherwise tax-free "spin-off" transactions after April 16, 1997, under section 355 of the Code, in which a distributing corporation distributes stock of a controlled corporation to shareholders. Corporate level gain is recognized on a spin-off which is part of a plan or series of related transactions in which there is an acquisition of 50-percent or more of the vote or value of stock of either the distributing corporation or the controlled corporation. The gain is recognized immediately before the distribution, in 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.

In addition, distributions within an affiliated group of corporations, in connection with such an acquisition transaction, are not treated as tax-free spin-offs. The Treasury Department also has additional regulatory authority to adjust the basis of stock in intra-group spin-off distributions generally.

For certain transfers of property to a corporation as part of a spin-off after August 5, 1997, the prior law requirement that shareholders of the contributing corporation own 80 percent of the voting power and 80 percent of each other class of stock after the distribution is modified to a requirement of greater-than-50 percent of the vote and value of the stock.

The provision was generally effective for distributions after April 16, 1997.

The provision does not apply to a distribution after April 16, 1997, that is part of an acquisition that would otherwise cause gain recognition to the distributing or controlled corporation under the 1997 Act if such acquisition is: (1) made pursuant to a written agreement which was binding on April 16, 1997, and at all times thereafter; (2) described in a ruling request submitted to the Internal Revenue Service on or before such date; or (3) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission ("SEC") required solely by reason of the acquisition or transfer. Any written agreement, ruling request, or public announcement or SEC filing is not within the scope of these transition provisions unless it identifies the acquiror of the distributing corporation or of any controlled corporation, whichever is applicable.

Reform tax treatment of certain corporate stock transfers.--The 1997 Act modified certain rules that apply if one corporation purchases stock of a related corporation and the transaction is treated as a distribution. A special rule applies to transactions involving acquisitions by foreign corporations, limiting the earnings and profits of the acquiring foreign corporation that are taken into account.

The provision was effective for distributions or acquisitions after June 8, 1997, except that the provision does not apply to any such distribution or acquisition (1) made pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

Modify holding period for dividends-received deduction.--The 1997 Act modified the 46-day holding period for the dividends-received deduction (or 91-day period for certain dividends on preferred stock) to require that the holding period be met with respect to each dividend received. Present law restrictions against diminishing risk of loss likewise apply to each dividend under the provision.

The provision generally was effective for dividends paid or accrued after September 4, 1997. However, the provision does not apply to certain dividends received within two years of August 5, 1997, if (1) the dividend is paid with respect to stock held on June 8, 1997, and at all times thereafter until the dividend is received, and (2) certain other requirements are continuously met with respect to identified risk-reduction positions.

3. Other corporate provisions

Corporate tax shelter registration.--The 1997 Act required that certain confidential corporate tax shelters register with the Treasury and made parallel changes to the substantial understatement penalty.

Treat certain preferred stock as "boot".--The 1997 Act required certain preferred stock that is received in otherwise tax-free transactions to be treated as taxable "boot." Thus, when a taxpayer exchanges appreciated property for this preferred stock in a transaction that otherwise qualifies as tax-free, gain is recognized.

The provision was effective for transactions after June 8, 1997, but does not apply to such transactions (1) made pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

4. Administrative provisions

Payments to attorneys.--The 1997 Act required the reporting to the IRS of certain payments made to attorneys, effective for payments made after December 31, 1997.

Payments to corporations performing services for Federal agencies.--The 1997 Act lowered the information reporting threshold with respect to information reporting on persons receiving contract payments from certain Federal agencies, effective for any return the due date for which is after November 3, 1997.

Veterans Administration disclosure.--The 1997 Act provided for the continuation of authorization for the disclosure of tax return information for purposes of the administration of certain veterans programs.

Continuous levy.--The 1997 Act established continuous levy by the IRS and limits the exemptions from levy, effective for levies issued after August 5, 1997.

Consistency rule for beneficiaries of trusts and estates.--The 1997 Act required a beneficiary of an estate or trust to file its return in a manner that is consistent with the information received from the estate or trust, unless the beneficiary identifies the inconsistency.

5. Excise tax provisions

Extend and modify the Airport and Airway Trust Fund excise taxes.--The 1997 Act extended the prior-law Airport and Airway Trust Fund excise taxes (commercial passenger ticket, commercial cargo shipping invoice, and noncommercial aviation fuels) for 10 years with modifications, through September 30, 2007.

The commercial passenger taxes were modified, as follows:

(1) The prior-law 10-percent ad valorem tax rate was replaced with a combination ad valorem and flight segment dollar rate tax. The revised rates are --

October 1, 1997 - September 30, 1998	9% of fare plus $1 per domestic flight segment
October 1, 1998 - September 30, 1999	8% of fare plus $2 per domestic flight segment
October 1, 1999 - December 31, 1999	7.5% of fare plus $2.25 per domestic flight segment

After December 31, 1999, the ad valorem rate remains at 7.5 percent, but the domestic flight segment rate will increase to $2.50 (calendar year 2000), $2.75 (calendar year 2001), and $3 (calendar year 2002). After 2002, the $3 rate is indexed to the consumer price index.

(2) The $6 per passenger international departure tax was increased to $12 per passenger and that rate was extended to international arrivals as well. (The $6 rate was retained for the

international portion of certain domestic flights between the continental United States and Alaska or Hawaii.) The new rates are indexed to the consumer price index after 1998.

(3) A special rule was provided reducing the tax rate for flight segments to or from certain small, rural airports to 7.5 percent, with no domestic flight segment tax being imposed on those flight segments.

Additionally, clarification was provided that the ad valorem portion of the tax (at the 7.5-percent rate) applies to payments to airlines for frequent flyer and similar awards from banks and credit card companies, merchants, frequent flyer program partners (e.g., other airlines, hotels, or rental car companies), and other businesses.

Air carriers were made liable for payment of the Airport and Airway Trust Fund excise taxes.

Certain tax deposits rules were modified for 1997 and 1998.

These provisions generally apply to transportation beginning after September 30, 1997. See, also, the provisions in Part One, above.

Extend diesel fuel excise tax rules to kerosene.--The 1997 Act provided that kerosene generally will be taxed the same as diesel fuel. Thus, when kerosene is removed from pipeline terminals, it either will be taxed (at 24.4 cents per gallon) or dyed (if destined for nontaxable use). Exceptions were provided allowing undyed kerosene to be sold without tax for certain aviation and industrial uses. Additionally, ultimate vendors are allowed to claim expedited refunds for undyed kerosene sold for use in space heaters. To ensure availability of dyed kerosene, eligibility of terminals to store untaxed fuel is conditioned on offering dyed fuel to customers. The provision was effective after June 30, 1998. See, also, Part Six, below, describing a provision which suspended the dyeing mandate for two years.

Reinstate Leaking Underground Storage Trust Fund excise tax.--The 1997 Act reinstated an expired 0.1-cent-per-gallon excise tax on gasoline, diesel fuel, special motor fuels, aviation fuels, and inland waterway fuels for a 7-1/2 year period beginning on October 1, 1997, through March 31, 2005. Revenues from this tax will be deposited in the Leaking Underground Storage Tank Trust Fund to finance cleanup of damage resulting from underground petroleum storage tanks.

Application of communications excise tax to prepaid telephone cards.--The 1997 Act clarified that any amounts paid to communications service providers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate telephone service (i.e., local or toll telephone service) are treated as amounts paid for taxable communication services, subject to the 3-percent ad valorem tax rate.

Modify treatment of tires under the heavy vehicle retail excise tax.--The 1997 Act substituted a credit for tire tax paid for a prior-law tax deduction in calculating the 12-percent retail excise on heavy highway vehicles. The provision was effective after December 31, 1997.

6. Provisions relating to exempt organizations

Extend UBIT rules to second-tier subsidiaries and amend control test.--The 1997 Act modified section 512(b)(13) (which treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business taxable income if such income is received or accrued from certain controlled subsidiaries of a tax-exempt organization). The 1997 Act provided that "control" for this purpose generally means ownership by vote or value of more than 50 percent of the ownership interests in the entity. In addition, the 1997 Act applied the constructive ownership rules of section 318 for purposes section 512(b)(13). The provision generally applies to taxable years beginning after August 5, 1997. However, the provision does not apply to payments received or accrued during the first two taxable years beginning on or after August 5, 1997, if such payments are received or accrued pursuant to a binding written contract in effect on June 8, 1997, and at all times thereafter before such payment, but not pursuant to any contract provision that permits optional accelerated payments.

Repeal grandfather rule with respect to pension business of certain insurers.--The 1997 Act repealed the grandfather rules applicable to that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund which is attributable to pension business and to that portion of the business of Mutual of America which is attributable to pension business. Special rules relating to the change in method of accounting and the basis of assets apply, and reserve weakening after June 8, 1997, is treated as occurring in 1998. The provision applies for taxable years beginning after December 31, 1997.

7. Foreign provisions

Inclusion of income from notional principal contracts and stock lending transactions under subpart F.--The 1997 Act added to the definition of foreign personal holding company income for subpart F purposes net income from all types of notional principal contracts and payments in lieu of dividends derived from equity securities lending transactions. The 1997 Act provided an expanded dealer exception from the definition of foreign personal holding company income.

Restrict like-kind exchange rules for certain personal property.–Under present law, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like-kind" which is to be held for productive use in a trade or business or for investment. In general, any kind of real estate is treated as of a like-kind with other real property as long as the properties are both located either within or both outside the United States.

The 1997 Act provided that personal property predominantly used within the United States and personal property predominantly used outside the United States are not "like-kind" properties. The provision is effective for exchanges after June 8, 1997, unless the exchange is pursuant to a binding contract in effect on such date and all times thereafter.

Impose holding period requirement for claiming foreign tax credits with respect to dividends.--The 1997 Act disallowed the foreign tax credits normally available with respect to a dividend from a foreign corporation or regulated investment company if the shareholder has not held the stock for 16 days in the case of common stock and 46 days in the case of preferred stock.

Limitation on treaty benefits for payments to hybrid entities.--The 1997 Act limited the availability of a reduced rate of withholding tax under an income tax treaty in the case of income derived through a hybrid entity in order to prevent tax avoidance.

Interest on underpayment reduced by foreign tax credit carryback.--The 1997 Act provided that, if an underpayment for a taxable year is reduced or eliminated by a foreign tax credit carryback from a subsequent taxable year, such carryback does not affect the computation of interest on the underpayment for the period ending with the filing date for such subsequent taxable year in which the foreign taxes were paid or accrued.

Determination of period of limitations relating to foreign tax credits.--The 1997 Act provided that, in the case of a claim relating to an overpayment attributable to foreign tax credits, the limitations period is determined by reference to the year in which the foreign taxes were paid or accrued.

Repeal special exception to foreign tax credit limitation for alternative minimum tax purposes.--Under present law, the combination of the taxpayer's net operating loss carryover and foreign tax credits cannot reduce the taxpayer's alternative minimum tax liability by more than 90 percent of the amount determined without these items. The Omnibus Budget Reconciliation Act of 1989 ("1989 Act") provided a special exception to the limitation on the use of the foreign tax credit against the tentative minimum tax. The 1997 Act repealed this special exception for taxable years beginning after August 5, 1997.

8. Pension and employee benefit revenue-increase provisions

The 1997 Act contained several revenue-increasing provisions relating to pension and employee benefits. These provisions: (1) increase the amount of benefits that may be cashed out of a retirement plan from $3,500 to $5,000, effective for plan years beginning after August 5, 1997; (2) repeal the 15-percent excise tax applicable to excess plan distributions and excess retirement plan accumulations, effective for estates of decedents dying after December 31, 1996; (3) increase the penalty tax on prohibited transactions from 10 percent to 15 percent, effective with respect to prohibited transactions occurring after August 5, 1997; (4) revise the basis recovery rules related to retirement plan payments, effective with respect to annuity starting dates beginning after December 31, 1997; and (5) permit employees to elect cash compensation in lieu of nontaxable parking benefits, effective for taxable years beginning after December 31, 1997.

9. Other revenue-increase provisions

Phase out suspense accounts for certain large farm corporations.--The 1997 Act repealed the ability of a family farm corporation to establish a suspense account when it is required to change from the cash method to an accrual method of accounting. Thus, any family farm corporation required to change to an accrual method of accounting would restore the section 481 adjustment applicable to the change in gross income ratably over a 10-year period beginning with the year of change.

In addition, any taxpayer with an existing suspense account is required to restore the account into income ratably over a 20-year period beginning in the first taxable year beginning after June 8, 1997. The amount required to be restored to income for a taxable year pursuant to the 20-year spread period shall not exceed the net operating loss of the corporation for the year (in the case of a corporation with a net operating loss) or 50 percent of the net income of the taxpayer for the year (for corporations with taxable income). The 1997 Act repealed the requirement that a corporation restores a portion of its suspense account as its gross receipts decreases.

Modify net operating loss ("NOL") carryback and carryforward rules.--The 1997 Act limited the NOL carryback period to two years (from three years) and extended the NOL carryforward period to 20 years (from 15 years). The three-year carryback is retained for NOLs attributable to casualty losses of individuals and NOLs of farmers and small businesses attributable to losses incurred in Presidentially declared disaster areas. The provision was effective for NOLs arising in taxable years beginning after August 5, 1997.

Expand the limitations on deductibility of premiums and interest with respect to life insurance, endowment and annuity contracts.--Under the 1997 Act, the premium deduction limitation with respect to life insurance contracts is modified to provide that no deduction is permitted for premiums paid on any life insurance, annuity or endowment contract, if the taxpayer is directly or indirectly a beneficiary under the contract. Also, generally, no deduction is allowed for interest paid or accrued on any indebtedness with respect to life insurance policy, or endowment or annuity contract, covering the life of any individual. In addition, 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. The provisions apply generally with respect to contracts issued after June 8, 1997.

Allocation of basis of properties distributed to a partner by a partnership.--The 1997 Act modified the basis allocation rules for distributee partners, so that the basis of distributed property generally is allocated in proportion to the fair market values of the property. The provision applied to partnership distributions after August 5, 1997.

Treatment of inventory items of a partnership.--The 1997 Act eliminated the requirement that inventory be substantially appreciated in order to give rise to ordinary income under the rules relating to sales and exchanges of partnership interests. The provision was effective for sales and exchanges, and distributions after August 5, 1997, with an exception for written binding contracts in effect on June 8, 1997.

Treatment of appreciated property contributed to a partnership.--The 1997 Act extended from five years to seven years the period in which a partner recognizes pre-contribution gain with respect to property contributed to a partnership. The provision was effective for property contributed to a partnership after June 8, 1997. An exception was provided for property contributed to a partnership pursuant to a written binding contract in effect on June 8, 1997.

Earned income credit compliance provisions

a. Deny EIC eligibility for prior acts of recklessness or fraud

Under the 1997 Act, a taxpayer who fraudulently claims the earned income credit (EIC) is ineligible to claim the EIC for a subsequent period of 10 years. In addition, a taxpayer who erroneously claims the EIC due to reckless or intentional disregard of rules or regulations is ineligible to claim the EIC for a subsequent period of two years. These sanctions apply in addition to any other penalty imposed under present law. The determination of fraud or of reckless or intentional disregard of rules or regulations are made in a deficiency proceeding (which provides for judicial review). The provision is effective for taxable years beginning after December 31, 1996.

b. Recertification required when taxpayer found to be ineligible for EIC in past

Under the 1997 Act, a taxpayer who has been denied the EIC as a result of deficiency procedures is ineligible to claim the EIC in subsequent years unless evidence of eligibility for the credit is provided by the taxpayer. To demonstrate current eligibility, the taxpayer is required to meet evidentiary requirements established by the Secretary of the Treasury. Failure to provide this information when claiming the EIC is treated as a mathematical or clerical error. If a taxpayer is recertified as eligible for the credit, the taxpayer is not required to provide this information in the future unless the IRS again denies the EIC as a result of a deficiency procedure. Ineligibility for the EIC under the provision is subject to review by the courts. The provision is effective for taxable years beginning after December 31, 1996.

c. Due diligence requirements for paid preparers

Under the 1997 Act, return preparers are required to fulfill certain due diligence requirements with respect to returns they prepare claiming the EIC. The penalty for failure to meet these requirements is $100. This penalty is in addition to any other penalty imposed under present law. The provision is effective for taxable years beginning after December 31, 1996.

d. Modify the definition of AGI used to phaseout the EIC

Under present law, the EIC is phased out above certain income levels. For individuals with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. The 1997 Act modified the definition of AGI used for phasing out the credit by adding two items of nontaxable income and changing the percentage of certain losses disregarded. The two items added are: (1) tax-exempt interest, and (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements (but only if not rolled over into similar vehicles during the applicable rollover period). The 1997 Act also increased the amount of net losses from businesses, computed separately with respect to sole proprietorships (other than farming), sole proprietorships in farming, and other businesses disregarded from 50 percent to 75 percent. The provision was effective for taxable years beginning after December 31, 1997.

Eligibility for income forecast method.--The 1997 Act limited the types of property to which the income forecast method may be applied. Under the 1997 Act, the income forecast method is available to motion picture films, television films and taped shows, books, patents, master sound recordings, copyrights, and other such property as designated by the Secretary of the Treasury. In addition, consumer durables subject to rent-to-own contracts are provided a three-year recovery period and a four-year class life for MACRS purposes (and would not be eligible for the income forecast method). Such property generally is described in Rev. Proc. 95-38, 1995-34 I.R.B. 25. The provisions generally are effective for property placed in service after August 5, 1997.

Modify the exception to the related party rule of section 1033 for individuals to only provide an exception for de minimis amounts.--Under section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified replacement period of time. Corporations are not entitled to defer gain under section 1033 if the replacement property or stock is purchased from a related person.

The 1997 Act expanded the denial of the application of section 1033 to any other taxpayer (including an individual) that acquires replacement property from a related party unless the taxpayer has aggregate realized gain of $100,000 or less for the taxable year with respect to converted property with aggregate realized gains. The provision applies to involuntary conversions occurring after June 8, 1997.

Repeal of installment sale accounting for certain manufacturers.--The 1997 Act repealed a provision that permits the use of the installment method of accounting for certain sales by manufacturers to dealers effective for taxable years beginning August 5, 1998.

Extension of Federal unemployment surtax.--The 1997 Act extended the temporary surtax rate through December 31, 2007. It also increased the limit from 0.25 percent to 0.50 percent of covered wages on the Federal Unemployment Account (FUA) in the Unemployment Trust Fund. The provision is effective for labor performed on or after January 1, 1999.

Additional requirements for charitable remainder trusts.--Under the 1997 Act, a trust cannot be a charitable remainder annuity trust if the annuity for any year is greater than 50 percent of the initial fair market value of the trust's assets or be a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent effective for transfers to a trust made after June 18, 1997. In addition, the 1997 Act required that the value of the charitable remainder with respect to any transfer to a qualified charitable remainder annuity trust or charitable remainder unitrust be at least 10 percent of the net fair market value of such property transferred in trust on the date of the contribution to the trust, effective for transfers to a trust made after July 28, 1997. The 1997 Act contained special rules that deal with revocations and reformations of trusts that do not meet the 10-percent requirement. In addition, the 10-percent requirement does not apply to trusts created by will or other testamentary instrument if the settler dies before January 1, 1999, and the will or other testamentary instrument is not changed after July 28, 1997, or the settlor is under a mental disability on that date. Finally, the 1997 Act provided that additional contributions made after July 28, 1997, to a charitable remainder unitrust created before July 29, 1997, that does not meet the 10-percent requirement with respect to the additional contribution, is treated, under Treasury regulations, as if those contributions were made to a new trust that does not affect the status of the original unitrust as a charitable remainder trust.

Modify general business credit carryback and carryforward rules.--The 1997 Act reduced the carryback period for the general business credit to one year (from three years) and extended the carryforward period to 20 years (from 15 years). The provision was effective for credits arising in taxable years beginning after December 31, 1997.

Using Federal case registry of child support orders for tax enforcement purposes.--The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 mandated the creation of a Federal Case Registry of Child Support Orders (the FCR) by October 1, 1998. Although HHS has not yet issued final regulations, the FCR is required to include the names, and the State case identification numbers, of individuals who are owed or who owe child support or for whom paternity is being established. It also may include the social security numbers (SSNs) of these individuals. Not later than October 1, 1999, the Secretary of the Treasury will have access to the

Federal Case Registry of Child Support Orders. Also, by October 1, 1999, the data elements on the State Case Registry will include the SSNs of children covered by cases in the Registry, and the States will provide the SSNs of these children to the FCR. The provision is effective on October 1, 1999.

Expanded SSA records for tax enforcement.--Under the Family Support Act of 1988, States must require each parent to furnish their social security number (SSN) for birth records. Parents can apply directly to the Social Security Administration (SSA) for an SSN for their child; or, in most states, they may apply for the child's SSN when obtaining a birth certificate. On an individual's SSN application, the SSA currently requires the mother's maiden name but not her SSN. Under the 1997 Act, SSA is required to obtain social security numbers (SSNs) of both parents on minor children's applications for SSNs. The SSA will provide this information to the IRS as part of the Data Master File ("DM-1 file"). The provision was effective February 1, 1998.

Treatment of amounts received under the work requirements of the Personal Responsibility and Work Opportunity Act of 1996.--The 1997 Act provided that workfare payments are not wages for purposes of the earned income credit. No inference was intended with respect to whether workfare payments otherwise qualify as wages for purposes of income and employment taxes or as wages for purposes of an employer's eligibility for the work opportunity tax credit and the welfare-to-work tax credit. Also, no inference was intended with respect to whether workfare payments are wages for purposes of the earned income credit before enactment of this provision.

Modification of estimated tax requirements.--Under present law, an individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to: (1) 110 percent of the tax shown on the return of the individual for the preceding year (the "110 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year.

The 1997 Act changed the 110 percent of last year's liability safe harbor to be a 100 percent of last year's liability safe harbor for taxable years beginning in 1998, a 105 percent of last year's liability safe harbor for taxable years beginning in 1999, 2000, and 2001, and a 112 percent of last year's liability safe harbor for taxable years beginning in 2002. In addition, no estimated tax penalties will be imposed under section 6654 or 6655 for any period before January 1, 1998, for any payment the due date of which is before January 16, 1998, with respect to an underpayment to the extent the underpayment is created or increased by a provision of the 1997 Act. See, also, the provision modifying the individual estimated tax safe harbor rules in Part Eight, below.

TITLE XI.--FOREIGN TAX PROVISIONS

1. Simplify foreign tax credit limitation for individuals

The 1997 Act exempted individuals with no more than $300 ($600 in the case of married persons filing jointly) of creditable foreign taxes, and no foreign source income other than passive income, from the foreign tax credit limitation rules, effective for taxable years beginning after December 31, 1997.

2. Simplify translation of foreign taxes

The 1997 Act generally provided for accrual-basis taxpayers to translate foreign taxes at the average exchange rate for the taxable year to which such taxes relate. The 1997 Act also provided that, in cases where the foreign taxes actually are paid more than two years after such accrual, taxes eligible for the direct foreign tax credit are taken into account for the year to which they relate and taxes eligible for the indirect foreign tax credit are taken into account for the year in which paid; in all such cases, the taxes subsequently paid are translated at the exchange rate for the time of payment. The provision is effective for taxes that relate to taxable years beginning after December 31, 1997.

3. Election to use simplified foreign tax credit limitation for alternative minimum tax purposes

The 1997 Act permitted taxpayers to elect to use as their AMT foreign tax credit limitation fraction the ratio of foreign source <u>regular</u> taxable income to entire alternative minimum taxable income, rather than the ratio of foreign source <u>alternative minimum</u> taxable income to entire alternative minimum taxable income, effective for taxable years beginning after December 31, 1997.

4. Simplify treatment of personal transactions in foreign currency

The 1997 Act applied nonrecognition treatment to any exchange gain that results from an individual's acquisition of foreign currency and disposition of it in a personal transaction, provided that such gain does not exceed $200, effective for taxable years beginning after December 31, 1997.

5. Simplify foreign tax credit limitation for dividends from 10/50 companies

Under the 1997 Act, dividends paid by a so-called 10/50 company out of earnings and profits for taxable years beginning after 2002 will be subject to look-through treatment for foreign tax credit limitation purposes (i.e., such dividends are characterized based on the character of the underlying income of the company). In the case of dividends paid by 10/50 companies out of earnings and profits for taxable years beginning before 2003, a single foreign tax credit limitation generally will apply to such dividends received by the taxpayer from all 10/50 companies (other than any 10/50 company that qualifies as a passive foreign investment company). The provision is effective for taxable years beginning after December 31, 2002.

6. General provisions affecting treatment of controlled foreign corporations

The 1997 Act made several modifications to the treatment of controlled foreign corporations and lower-tier controlled foreign corporations. In addition, the 1997 Act extended the application of the indirect foreign tax credit to taxes paid or accrued by fourth- through sixth-tier controlled foreign corporations.

7. Modification of passive foreign investment company provisions to eliminate overlap with subpart F, to allow mark-to-market election, and to require measurement based on value for PFIC asset test

Under the 1997 Act, a shareholder that is subject to the subpart F rules with respect to stock of a passive foreign investment company that also is a controlled foreign corporation is not subject also to the passive foreign investment company provisions with respect to the same stock. In addition, the Act allows a shareholder of a passive foreign investment company to make a mark-to-market election with respect to the stock of the passive foreign investment company, provided that such stock is marketable. Finally, the 1997 Act requires that the measurement of assets for purposes of the PFIC asset test be based on value in the case of publicly-traded corporations.

8. Simplify formation and operation of international joint ventures

The 1997 Act repealed the excise tax that applies to transfers of appreciated property by U.S. persons to certain foreign entities. The 1997 Act also required enhanced information reporting by U.S. persons with respect to their interests in foreign partnerships.

9. Modification of reporting threshold for stock ownership of a foreign corporation

The 1997 Act increased the stock ownership threshold that results in an information reporting obligation with respect to a foreign corporation from 5 percent to 10 percent.

10. Transition rule for certain trusts

The 1997 Act granted regulatory authority to allow nongrantor trusts that had been treated as U.S. trusts prior to the enactment of the Small Business Job Protection Act of 1996 to elect to continue to be treated as U.S. trusts.

11. Simplify stock and securities trading safe harbor

The 1997 Act modified the "safe harbor" from U.S. net income taxation for foreign persons that trade in stocks or securities for their own accounts. The 1997 Act eliminated the safe harbor's requirement for both partnerships and foreign corporations that the entity's principal office not be within the United States.

12. Clarification of determination of foreign taxes deemed paid

The 1997 Act clarified that, for purposes of the indirect foreign tax credit, a foreign corporation's foreign tax pool does not include any taxes that are attributable to dividends distributed by the foreign corporation in prior taxable years.

13. Clarification of foreign tax credit limitation for financial services income

The 1997 Act clarified that the exclusion from passive income for income that is treated as high-taxed income does not apply for purposes of the separate foreign tax credit limitation applicable to financial services income.

14. Eligibility of licenses of computer software for foreign sales corporation benefits

The 1997 Act provided that computer software licensed for reproduction abroad is not excluded from the definition of export property for purposes of the foreign sales corporation provisions. Accordingly, computer software that is exported with a right to reproduce is eligible for the benefits of the foreign sales corporation provisions.

15. Increase dollar limitation on section 911 exclusion

Under the 1997 Act, the $70,000 limitation on the exclusion for foreign earned income is increased to $80,000, in increments of $2,000 each year beginning in 1998, and is indexed for inflation beginning in 2008.

16. Treatment of certain securities positions under the subpart F investment in U.S. property rules

The 1997 Act provided two additional exceptions from the definition of U.S. property for purposes of the subpart F rules. These exceptions cover collateral or margin deposit and repurchase agreement transactions entered into by a securities or commodities dealer in the ordinary course of its business.

17. Exception from foreign personal holding company income under subpart F for active financing income

The 1997 Act provided a temporary exception from foreign personal holding company income for subpart F purposes for certain income that is derived in the active conduct of an insurance, banking, financing or similar business. This temporary exception was applicable only for taxable years beginning in 1998. This provision was (1) identified as a limited tax benefit subject to the Line Item Veto Act, (2) canceled by the President pursuant to his authority under the Line Item Veto Act, and (3) reinstated when the Supreme Court ruled that the Line Item Veto Act was unconstitutional. See, also, the provision contained in Part Eight, below, providing for a modified version of this exception that will apply to taxable years beginning in 1999.

18. Treat service income of nonresident alien individuals earned on foreign ships as foreign source income and disregard U.S. presence of such individuals

The 1997 Act generally treated income of a nonresident alien individual, who is present in the United States as a member of the regular crew of a foreign vessel, from the performance of personal services in connection with the international operation of a ship as income from foreign sources exempt from U.S. income and withholding tax. The 1997 Act further provided that any day that such an individual is present in the U.S. as a crew member is disregarded for purposes of determining whether the individual is treated as a U.S. resident for tax purposes, unless the individual otherwise engages in trade or business in the United States on such day.

TITLE XII.--SIMPLIFICATION PROVISIONS RELATING TO INDIVIDUALS AND BUSINESSES

1. Individual simplification provisions

Increased standard deduction for dependent children.--The 1997 Act increased the standard deduction for a taxpayer with respect to whom a dependency exemption is allowed on another taxpayer's return to the lesser of: (1) the standard deduction for individual taxpayers or (2) the greater of: (a) $500 (indexed for inflation as under prior law), or (b) the individual's earned income plus $250, effective for taxable years beginning after December 31, 1997. The $250 amount is indexed for inflation after 1998. In addition, the 1997 Act increased the AMT exemption amount for a child under age 14 to the lesser of (1) $33,750 or (2) the sum of the child's earned income plus $5,000, effective for taxable years beginning after December 31, 1997. The $5,000 amount is indexed for inflation after 1998.

Estimated tax for individuals.--The 1997 Act increased the de minimis threshold for estimated tax payments from $500 to $1000 per year for individuals, effective for taxable years beginning after December 31, 1997.

Rural mail carriers.--The 1997 Act simplified the treatment of certain reimbursed expenses of rural letter carriers' vehicles.

Travel expenses of certain Federal employees.--The 1997 Act simplified the tax treatment of travel expenses of Federal employees participating in a Federal criminal investigation.

Payment of taxes by credit card.--The 1997 Act permitted the payment of taxes by commercially acceptable means (such as credit cards). The 1997 Act prohibited the payment of any credit card fees by the Treasury.

2. Business simplification provisions

Modifications to look-back method for long-term contracts.--The 1997 Act provided two safe harbors such that a taxpayer may elect not to apply the look-back method for de minimis changes in estimated income from a long-term contract. In addition, the 1997 Act provided that, for purposes of the look-back method, only one rate of interest is to apply for each accrual period. The provisions apply to contracts completed in taxable years ending after August 5, 1997.

Minimum tax treatment of certain property and casualty insurance companies.--The 1997 Act provided that a property and casualty insurance company that elects for regular tax purposes to be taxed only on taxable investment income determines its adjusted current earnings under the alternative minimum tax without regard to any amount not taken into account in determining its gross investment income. The provision was effective for taxable years beginning after December 31, 1997.

Treatment of construction allowances provided to lessees.--The 1997 Act provided that the gross income of a lessee does not include amounts received in cash (or treated as a rent reduction) from a lessor under a short-term lease of retail space for the purpose of the lessee's construction or improvement of qualified long-term real property for use in the lessee's trade or business at such retail space.

In addition, the lessor must treat the amounts expended on the construction allowance as nonresidential real property owner by the lessor. Reporting requirements are provided to ensure that both the lessor and lessee treat such amounts as nonresidential real property. The provision applies to leases entered into after August 5, 1997.

3. Partnership simplification provisions

Simplified flow-through for electing large partnerships.--The 1997 Act modified the tax treatment of an electing large partnership (generally, any partnership that elects under the provision, if the number of partners in the preceding taxable year is 100 or more) and its partners. The provision provides that each partner takes into account separately the partner's distributive share of certain items of partnership income, gain, loss, deduction and credit. The provisions generally apply to partnership taxable years beginning after December 31, 1997.

Simplified audit procedures for electing large partnerships.--The 1997 Act created a new audit system for electing large partnerships (generally, any partnership that elects under the reporting provisions, if the number of partners in the preceding taxable year is 100 or more). Partnership adjustments generally flow through to the partners for the year in which the adjustment takes effect. In lieu of flowing an adjustment through to its partners, the partnership may elect to pay an imputed underpayment. The provision applies to partnership taxable years beginning after December 31, 1997.

Due date for furnishing information to partners of electing large partnerships.--The 1997 Act provided that an electing large partnership must furnish information returns to partners by the first March 15 following the close of the partnership's taxable year. Electing large partnerships are those partnerships subject to the simplified reporting and audit rules (generally, any partnership that elects under the reporting provision, if the number of partners in the preceding taxable year is 100 or more). The provision is effective for partnership taxable years beginning after December 31, 1997.

Partnership returns required on magnetic media.--The 1997 Act provided generally that any partnership is required to provide the tax return of the partnership (Form 1065), as well as copies of the schedule sent to each partner (Form K-1), to the Internal Revenue Service on magnetic media. An exception is provided for partnerships with 100 or fewer partners. The provision is effective for partnership taxable years beginning after December 31, 1997.

Treatment of partnership items of individual retirement arrangements.--The 1997 Act modified the filing threshold for an IRA with an interest in a partnership that is subject to the partnership-level audit rules. A fiduciary of an IRA that receives taxable income from such a partnership of less than $1,000 (before the $1,000 specific deduction) is not required to file an income tax return if the IRA does not have any other income from an unrelated trade or business. The provision applies to taxable years beginning after December 31, 1997.

Other partnership audit rules.--The 1997 Act contained provisions to simplify the partnership audit rules enacted in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

Closing of partnership taxable year with respect to deceased partner.--The 1997 Act provided that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation or otherwise. The provision is effective for partnership taxable years beginning after December 31, 1997.

4. REIT simplification

The 1997 Act modified the following provisions relating to the requirements for qualification as, and the taxation of, a REIT, effective for taxable years beginning after August 5, 1997:

Alternative penalties for failure to request information from shareholders.--The 1997 Act replaced the rule that disqualifies a REIT for any year in which the REIT failed to comply with regulations to ascertain its ownership with an intermediate penalty of $25,000 ($50,000 for intentional violations). In addition, a REIT that complied with the regulations for ascertaining its ownership, and which did not know, or have reason to know, that it was so closely held as to be classified as a personal holding company, would not be treated as a personal holding company.

De minimis rule for tenant service income.--The 1997 Act permitted a REIT to render a *de minimis* amount of impermissible services to tenants, or in connection with the management of property, and still treat amounts received with respect to that property as rent. The value of the impermissible services could not exceed one percent of the gross income from the property.

Attribution rules applicable to tenant ownership and independent contractors.-- The 1997 Act modified the rules relating to attribution to partnerships for purposes of defining qualified rent and independent contractor, so that attribution would occur only when a partner owns a 25 percent or greater interest in the partnership.

Credit for tax paid by REIT on retained capital gains.-- The 1997 Act permitted a REIT to elect to retain and pay income tax on net long-term capital gains it received during the tax year, just as a RIC is permitted to so elect.

Repeal of 30-percent gross income requirement.--The 1997 Act repealed the rule that requires less than 30 percent of a REIT's gross income be derived from gain from the sale or other disposition of stock or securities held for less than one year, certain real property held less than four years, and property that is sold or disposed of in a prohibited transaction.

Modification of earnings and profits for determining whether REIT has earnings and profits from non-REIT year.-- The 1997 Act changed the ordering rule for purposes of the requirement that newly-electing REITs distribute earnings and profits that were accumulated in non-REIT years so that distributions of accumulated earnings and profits generally would be treated as made from the entity's earliest accumulated earnings and profits, rather than the most recently accumulated earnings and profits.

Treatment of foreclosure property.--The 1997 Act lengthened the original grace period for foreclosure property to three taxable years and permits extension of the grace period for an additional three years by filing a request to the IRS. A REIT could revoke an election to treat property as foreclosure property for any taxable year. Further, the 1997 Act conformed the definition of independent contractor for purposes of the foreclosure property rule to the definition of independent contractor for purposes of the general rules.

Payments under hedging instruments.--The 1997 Act treated income from all hedges that reduce the interest rate risk of REIT liabilities, not just from interest rate swaps and caps, as qualifying income.

Excess noncash income.--The 1997 Act (1) expanded the class of excess noncash items to include income from the cancellation of indebtedness and (2) extended the treatment of original issue discount and coupon interest as excess noncash items to REITs that use an accrual method of taxation.

Prohibited transaction safe harbor.--The 1997 Act excluded from the prohibited sales rules property that was involuntarily converted.

Shared appreciation mortgages.--The 1997 Act provided that interest received on a shared appreciation mortgage is not subject to the tax on prohibited transactions where the property subject to the mortgage is sold within four years of the REIT's acquisition of the mortgage pursuant to a bankruptcy plan of the mortgagor unless the REIT that acquired the mortgage knew or had reason to know that the property subject to the mortgage would be sold in a bankruptcy proceeding.

Wholly-owned REIT subsidiaries.--The 1997 Act permitted any corporation wholly-owned by a REIT to be treated as a qualified subsidiary, regardless of whether the corporation had always been owned by the REIT. Where the REIT acquired an existing corporation, the Act treats any such corporation as being liquidated as of the time of acquisition by the REIT and then reincorporated (thus, any of the subsidiary's pre-REIT built-in gain would be subject to tax). In addition, any pre-REIT earnings and profits of the subsidiary must be distributed before the end of the REIT's taxable year.

5. Repeal of 30-percent requirement of regulated investment companies

The 1997 Act repealed the requirement that a regulated investment company ("RIC") must derive less than 30 percent of its gross income from the sale or disposition of certain investments (including stock, securities, options, futures, and forward contracts) held less than three months (the "short-short test") (sec. 851(b)(3)), effective for taxable years beginning after August 5, 1997.

6. Taxpayer protections

The 1997 Act provided several additional protections for taxpayers, such as providing a reasonable cause exception for additional penalties where one does not now exist, clarifying several aspects of the statute of limitations, and repealing the authority to disclose whether a prospective juror has been audited.

TITLE XIII.--ESTATE, GIFT, AND TRUST SIMPLIFICATION PROVISIONS

The 1997 Act contained a number of simplification provisions relating to Federal estate, gift and trust taxes that are intended to simplify administration of the Internal Revenue Code. These provisions: (1) eliminate gift tax filing requirements for gifts to charities; (2) clarify waivers of certain rights of recovery; (3) provide that certain trusts created before the enactment of the Omnibus Budget Reconciliation Act of 1990 are treated as satisfying the withholding requirement if the governing instruments require that all trustees be U.S. citizens or domestic corporations; (4) provide that any debt obligation, the income from which would be eligible for the exemption for short-term OID under section 871(g)(1)(B)(i) if such income were received by the decedent on the date of his death, is treated as property located outside of the United States in determining the U.S. estate tax liability of a nonresident not a U.S. citizen; (5) conform the treatment of estates and trusts by (a) providing an irrevocable election to treat a qualified revocable trust as part of the decedent's estate for Federal income tax purposes, (b) extending the application of the 65-day rule applicable under present law to trusts to distributions by estates, and (c) extending the separate share rule to estates; (6) treat an estate and a beneficiary of that estate as related persons for purposes of sections 267 and 1239, except in the case of a sale or exchange in satisfaction of a pecuniary bequest; (7) allow the trustee of a pre-need funeral trust to elect special tax treatment for such a trust; (8) clarify the treatment of certain transfers made through a revocable trust within three years of death; (9) clarify that the marital deduction is available with respect to a nonparticipant spouse's interest in an annuity attributable to community property laws where he or she predeceases the participant spouse; (10) provide the Treasury Department with regulatory authority to treat as trusts legal arrangements that have substantially the same effect as a trust; (11) provide an opportunity to correct certain failures in an election to specially value certain real property used in farming or other closely held businesses; and (12) waive the requirement of a U.S. trustee for qualified domestic trusts.

TITLE XIV.--EXCISE TAX AND OTHER SIMPLIFICATION PROVISIONS

1. Excise tax simplification

The 1997 Act included a package of excise tax simplification provisions.

(1) Certain de minimis exceptions to the taxes on heavy highway vehicles and luxury automobiles for after-market additions were increased from $200 to $1,000.

(2) Various changes were made to the excise taxes on distilled spirits, wine, and beer to conform the treatment of the three beverages under various prior-law rules or to conform the Code to changes in the administration of those taxes enacted in recent years.

(3) The Internal Revenue Service was provided expanded authority to exempt taxpayers from registration requirements of the Code.

(4) The prior-law 11-percent excise tax on arrows was replaced by a 12.4-percent tax on four component parts of arrows, effective after September 30, 1997.

(5) The rules governing when modified trucks are "remanufactured" and thus subject to the retail tax on heavy highway vehicles were clarified.

(6) Clarification was provided that skydiving flights are taxed as noncommercial aviation subject to a fuels tax (rather than to the commercial passenger ticket tax).

(7) A provision eliminating double taxation of certain aviation fuel was provided.

(8) Certain "deadwood" provisions were deleted from the Code.

2. Tax-exempt bond provisions

Repeal of $100,000 limitation on unspent proceeds under one-year exception from rebate.--Under the 1997 Act, the $100,000 limit on proceeds that may remain unspent after six months for certain governmental and qualified 501(c)(3) bonds otherwise exempt from the rebate requirement was deleted. Thus, if at least 95 percent of the proceeds of these bonds is spent within six months after their issuance, and the remainder is spent within one year, the six-month exception is deemed to be satisfied. The provision applies to bonds issued after August 5, 1997.

Exception from rebate for earnings on bona fide debt service fund under construction bond rules.--The 1997 Act exempted earnings on bond proceeds invested in bona fide debt service funds from the arbitrage rebate requirement and the penalty requirement of the 24-month exception if the spending requirements of that exception are otherwise satisfied. The provision applies to bonds issued after August 5, 1997.

Repeal of debt service-based limitation on investment in certain nonpurpose investments.--The 1997 Act repealed the 150-percent of debt service yield restriction. The provision applies to bonds issued after August 5, 1997.

Repeal of expired provisions relating to student loan bonds.--Prior law included two special exceptions to the arbitrage rebate and pooled financing temporary period rules for certain qualified student loan bonds. These exceptions applied only to bonds issued before January 1, 1989. These special exceptions were deleted as "deadwood."

3. Tax Court provisions

The 1997 Act clarified several aspects of the procedures utilized in the Tax Court, and establishes jurisdiction for the Tax Court to determine employment status.

4. Other provisions

Due date for first quarter estimated tax payments by private foundations.--The 1997 Act provided that a calendar-year foundation's first-quarter estimated tax payment is due on May 15 (which is the same day that its annual return, Form 990-PF, for the preceding year is due). The provision applies to taxable years beginning after August 5, 1997.

Withholding of Puerto Rico taxes for Federal employees.--The 1997 Act provided the authority for the withholding of Commonwealth income taxes from the wages of Federal employees.

Certain notices disregarded.--The 1997 Act provided that certain notices are to be disregarded under the provision increasing the interest rate on large corporate underpayments.

TITLE XV.--PENSION AND EMPLOYEE BENEFIT PROVISIONS

The 1997 Act contained a variety of miscellaneous provisions relating to pensions and other benefits. Several provisions apply to State and local governmental plans, including an exemption from the discrimination rules, a portability provision which permits employees participating in governmental plans to purchase additional service credit for their retirement benefit, and a provision that provides for an income exclusion for disability payments made to public safety employees.

The 1997 Act contained certain rules relating to ESOPs of S corporations, including the repeal of the application of the unrelated business taxable income rules to S corporation income allocated to an ESOP. The 1997 Act contained a waiver of the 10-percent tax on nondeductible contributions to pension plans in the case of matching and elective deferral contributions, included a requirement that cash or deferred arrangements provide diversification of investments, and increased the 150-percent of current liability full funding limit.

In addition, the 1997 Act provided tax sanctions with respect to the requirements of The Newborns' and Mothers' Health Protection Act of 1996 and The Mental Health Parity Act of 1996.

The 1997 Act also contained pension simplification provisions which address a variety of plan administration issues, including the use of new technologies in retirement plans, the elimination of paperwork burdens on plans, a modification to the antiassignment and alienation rules, and a simplification of the rollover rules applicable to qualified retirement plans.

TITLE XVI.--TECHNICAL CORRECTIONS PROVISIONS

The 1997 Act contained technical, clerical, and conforming amendments to the Small Business Job Protection Act of 1996, the Health Insurance Portability and Accountability Act of 1996, the Taxpayer Act of Rights 2, and other recently enacted legislation.

PART THREE: REVENUE PROVISIONS OF THE BALANCED BUDGET ACT OF 1997 (H.R. 2015)[6]

A. Taxation of Medicare+Choice Medical Savings Accounts

Under the Balanced Budget Act of 1997 ("BBA"), individuals who are eligible for Medicare are permitted to choose either the traditional Medicare program or a Medicare+Choice MSA plan.[7] If an individual chooses such a plan, the Secretary of Health and Human Services makes a specified contribution directly into a Medicare+Choice MSA designated by such individual. Only contributions by the Secretary of Health and Human Services can be made to a Medicare+Choice MSA and such contributions are not included in the taxable income of the Medicare+Choice MSA holder. Income earned on amounts held in a Medicare+Choice MSA are not currently includible in taxable income. Withdrawals from a Medicare+Choice MSA are excludable from taxable income if used for the qualified medical expenses of the Medicare+Choice MSA holder. Medical expenses of the account holder's spouse or dependents are not treated as qualified medical expenses. Withdrawals from a Medicare+Choice MSA that are not used for the qualified medical expenses of the account holder are includible in income and may be subject to an additional tax.

The provision is effective for taxable years beginning after December 31, 1998.

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[6] P.L. 105-33; August 5, 1997. H.R. 2015 was reported by the House Committee on the Budget on June 24, 1997 (H. Rept. 105-149). The Committee on Ways and Means approved its health and human resources reconciliation provisions on June 9 and 10, 1997, respectively, which were incorporated in H.R. 2015 as reported. The bill, as amended, was passed by the House on June 25, 1997.

S. 947 was reported by the Senate Committee on the Budget on June 20, 1997 (no written report). S. 947 included the health and human resources reconciliation provisions as approved by the Committee on Finance on June 18, 1997. S. 947 was considered by the Senate on June 23 and 24, 1997, and was passed, as amended, on June 25, 1997.

H.R. 2015, as amended by the Senate provisions of S. 947, was passed by the Senate on June 25, 1997. A conference report was filed in the House on July 30, 1997 (H. Rept. 105-217); the House passed the conference report on July 30, 1997; and the Senate passed the conference report on July 31, 1997. H.R. 2015 was signed by the President on August 5, 1997.

H.R. 2015, as enacted, includes the revenue-related provisions described in this Part.

[7] As under prior law, individuals who are eligible for Medicare are not eligible for an MSA that is not a Medicare+Choice MSA.

B. Tax Treatment of Hospitals Which Participate in Provider-Sponsored Organizations

The BBA provides that an organization does not fail to be treated as organized and operated exclusively for a charitable purpose for purposes of Code section 501(c)(3) solely because a hospital which is owned and operated by such organization participates in a provider-sponsored organization ("PSO") (as defined in section 1845(a)(1) of the Social Security Act), whether or not such PSO is exempt from tax. Thus, participation by a hospital in a PSO (whether taxable or tax-exempt) is deemed to satisfy the first part of the inquiry under current IRS ruling practice.[8]

C. Provision of Employer Identification Numbers by Medicare Providers

The BBA requires that all Medicare providers supply the Secretary of HHS with the employer identification number ("EIN") of each disclosing entity, each person with an ownership or control interest, and any subcontractor in which the entity has a direct or indirect 5 percent or more ownership interest. The provision is effective 90 days after the Secretary of HHS submits to the Congress a report on the steps taken to ensure the confidentiality of social security account numbers required to be provided to the Secretary of HHS.

D. Disclosure of Tax Return Information for Verification of Employment Status of Medicare Beneficiaries and the Spouse of a Medicare Beneficiary

The BBA permanently extended a provision permitting disclosure of taxpayer filing status and identity information for the purpose of verifying the employment status of Medicare beneficiaries and the spouse of a Medicare beneficiary. The provision was effective on August 5, 1997.

E. Employment Tax Provisions

1. Exemption from service performed by election workers from the Federal Unemployment Tax

The BBA exempted from Federal unemployment tax ("FUTA") service performed as an election official or election worker. This exemption applies only if the annual wages received by the individual for such service are less than $1,000. These persons also are ineligible to claim unemployment benefits with respect to such wages. The provision was effective with respect to service performed after August 5, 1997.

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[8] The qualification of a hospital as a tax-exempt charitable organization under section 501(c)(3) is determined as under present law. See Rev. Rul. 69-545, 1969-2 C.B. 117.

2. Treatment of certain services performed by inmates

The BBA exempted wages paid to persons committed to penal institutions from the definition of wages for FUTA tax purposes. These persons are also ineligible to claim unemployment benefits with respect to such wages. The provision was effective with respect to service performed after January 1, 1994.

3. Exemption of service performed for an elementary or secondary school operated primarily for religious purposes from the Federal unemployment tax

The BBA exempted service, which is performed in an elementary or secondary school that is operated primarily for religious purposes, from FUTA requirements of coverage under State unemployment compensation laws. This exemption is available to such schools even though they are not operated, supervised, controlled, or principally supported by a church or convention or association of churches. Persons performing such service also are ineligible to claim unemployment benefits with respect to such wages. The provision was effective with respect to service performed after August 5, 1997.

F. Authorization of Appropriations for Enforcement Initiatives Related to the Earned Income Credit

The BBA authorized to be appropriated to the Secretary of the Treasury for improved application of the earned income credit, the following amounts: $138 million in FY 1998, $143 million in FY 1999, $144 million in FY 2000, $145 million in FY 2001, and $146 million in FY 2002. The provision was effective on August 5, 1997.

G. Increase in Excise Tax on Tobacco Products

The BBA increased the excise tax rates on all tobacco products, including cigarettes, cigars, chewing tobacco, snuff, and pipe tobacco, effective in two stages: an increase of 10 cents per pack of cigarettes on January 1, 2000, and a further increase of 5 cents per pack of cigarettes on January 1, 2002. Proportionate increases apply to other tobacco products. The excise tax also is imposed on "roll-your-own" tobacco, beginning in 2000. Floor stocks taxes are imposed on tobacco products at the time of the rate increases (including tobacco products in foreign trade zones). The BBA also included expanded compliance measures designed to prevent diversion of non-tax-paid tobacco products nominally destined for export to use within the United States. The provision generally is effective on January 1, 2000.

PART FOUR: TAXPAYER BROWSING PROTECTION ACT (H.R. 1226)[9]

The Taxpayer Browsing Protection Act created a new criminal penalty in the Internal Revenue Code. The penalty is imposed for willful inspection (except as authorized by the Code) of any tax return or return information by any Federal employee or IRS contractor. The penalty also applies to willful inspection (except as authorized) by any State employee or other person who acquired the tax return or return information under specific provisions of section 6103. Upon conviction, the penalty is a fine in any amount not exceeding $1,000,[10] or imprisonment of not more than one year, or both, together with the costs of prosecution. In addition, upon conviction, an officer or employee of the United States would be dismissed from office or discharged from employment.

The Taxpayer Browsing Protection Act amended the provision providing for civil damages for unauthorized disclosure by also providing for civil damages for unauthorized inspection. Damages are available for unauthorized inspection that occurs either knowingly or by reason of negligence. Accidental or inadvertent inspection that may occur (such as, for example, by making an error in typing in a TIN) would not be subject to damages because it would not meet this standard. The Act also provides that no damages are available to a taxpayer if that taxpayer requested the inspection or disclosure.

The Taxpayer Browsing Protection Act also required that, if any person is criminally charged by indictment or information with inspection or disclosure of a taxpayer's return or return information in violation of section 7213 (a) or (b), new section 7213A (as added by the Act), or 18 USC section 1030(a)(2)(B), the Treasury Secretary must notify that taxpayer as soon as practicable of the inspection or disclosure.

The provisions of the Taxpayer Browsing Protection Act were effective for violations occurring on or after August 5, 1997.

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[9] P.L. 105-35; August 5, 1997. H.R. 1226 was reported by the House Committee on Ways and Means on April 14, 1997 (H. Rept. 105-51). The bill, as amended, passed the House on April 15, 1997, and was passed by the Senate on July 23, 1997. H.R. 1226 was signed by the President on August 5, 1997.

[10] Pursuant to 18 U.S.C. sec. 3571 (added by the Sentencing Reform Act of 1984), the amount of the fine is not more than the greater of the amount specified in this new Code section or $100,000.

PART FIVE: EXTENSION OF HIGHWAY TRUST FUND (S. 1519)[11]

S. 1519 extended the authority to make expenditures (subject to appropriations) from the Highway Trust Fund through September 30, 1998. S. 1519 also updated the Highway Trust Fund cross reference to authorizing legislation to include expenditure purposes in the Act as in effect on December 1, 1997.

In addition, S. 1519 extended the deadline for the transfer from the Highway Trust Fund to other Trust funds of revenues from the tax on gasoline and special motor fuels used in motorboats, gasoline used in small engines, and motor fuels used in off-highway recreational vehicles through September 30, 1998. Further, S. 1519 extended the expenditure authority from the Boat Safety Account of the Aquatic Resources Trust Fund for six months, through September 30, 1998, and extended the expenditure authority from the National Recreational Trails Trust Fund through September 30, 1998.

See, also, the provisions in Part Six, below, describing the revenue provisions of the Transportation Equity Act for the 21st Century (H.R. 2400).

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[11] P.L. 105-130; December 1, 1997 (Section 9 of the Surface Transportation Extension Act of 1997). S. 1519 was passed by the Senate on November 10, 1997, and by the House on November 12, 1997. The Act was signed by the President on December 1, 1997.

PART SIX: REVENUE PROVISIONS OF THE TRANSPORTATION EQUITY ACT FOR THE 21ST CENTURY (TITLE IX OF H.R. 2400)[12]

I. HIGHWAY-RELATED TAXES AND TRUST FUND

A. Extension and Modification of Highway-Related Taxes

1. Highway-related taxes and exemptions

The Transportation Equity Act for the 21st Century ("TEA 21") extended all of the prior-law Highway Trust Fund excise taxes through September 30, 2005. The ethanol and renewable-source methanol excise and income tax incentives were extended through September 30, 2007 (excise tax reduced rate), and December 31, 2007 (income tax credit), respectively. These incentives will be reduced from 54 cents per gallon to 51 cents per gallon over a 5-year period beginning on January 1, 2001.

2. Motor fuels tax refund procedure

TEA 21 combined refund procedures for all taxable motor fuels, allowing aggregation of quarterly amounts for all taxable fuels and filing of refund claims once a single $750 minimum amount is reached (determined on a year-to-date basis rather than an individual quarter basis). This provision was effective for claims filed after September 30, 1998.

3. Requirement that motor fuels terminals offer dyed fuel

TEA 21 delayed the effective date of a requirement, enacted in the Taxpayer Relief Act of 1997, that registered motor fuels terminals offer dyed fuel for two years, to July 1, 2000. See, also, the description of the dyeing requirement contained in Part Two, above.

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[12] Title IX of H.R. 2400 ("Surface Transportation Revenue Act of 1998"); P.L. 105-178. The revenue provisions (Title IX) of H.R. 2400 were reported by the House Committee on Ways and Means on March 27, 1998 (H. Rept. 105-467, Part II). H.R. 2400 was passed by the House on April 1, 1998.

The Senate passed H.R. 2400, as amended with the provisions of S. 1173, on April 2, 1998. The conference report was filed on the bill on May 22, 1998 (H. Rept. 105-550), and was passed by the House and the Senate on May 22, 1998. H.R. 2400 was signed by the President on June 9, 1998.

B. Highway Trust Fund Provisions

TEA 21 transferred the gross receipts from current highway excise taxes to the Highway Trust Fund through September 30, 2005. TEA 21 further provided that the Highway Trust Fund would earn no further interest on its cash balances after September 30, 1998. TEA 21 extended the Highway Trust Fund expenditure authority through September 30, 2003, and updated the expenditure purposes to be consistent with the provisions of the Act. TEA 21 conformed the one-year anti-deficit rule in the Mass Transit Account to the two-year rule in the Highway Account. The Act made two technical corrections to the 1997 Act relating to the Highway Trust Fund excise tax revenues and deleted a deadwood provision.

II. OTHER TRUST FUND PROVISIONS

A. Aquatic Resources Trust Fund

TEA 21 extended the transfer of 11.5 cents per gallon of motorboat fuels tax revenues to the Boat Safety Account and Wetlands Sub-Account of the Aquatic Resources Trust Fund through September 30, 2003. In addition, TEA 21 transferred an additional 1.5 cents per gallon of motorboat fuels tax and small-engine gasoline revenues to the Aquatic Resources Trust Fund during fiscal years 2002 and 2003 and 2 cents per gallon of such revenues for 2004 and thereafter. The provisions were effective on October 1, 1998. TEA 21 also extended the expenditure authority for the Boat Safety Account through September 30, 2003.

B. National Recreational Trails Trust Fund

TEA 21 repealed the National Recreational Trails Trust Fund ("Trails Fund") and the transfer of nonhighway recreational fuels taxes to the Trails Fund, effective on October 1, 1998. Under authorizing provisions of the TEA 21, Highway Trust Fund expenditures were authorized for similar purposes to those of the Trails Fund.

III. ADDITIONAL REVENUE PROVISIONS

A. Rail Fuels Excise Tax

TEA 21 repealed the additional 1.25 cents per gallon tax rate on fuel used in trains that was scheduled to expire after September 30, 1999. The repeal was effective November 1, 1998.

B. Income Tax Provisions

1. Tax treatment of parking and transit benefits

TEA 21 increased the exclusion for employer-provided transit passes and vanpooling to $100 per month, effective for taxable years beginning after December 31, 2001. In addition, TEA 21 provided that no amount is includible in gross income or wages of an employee merely because the employee is offered the choice of cash in lieu of one or more qualified transportation benefits, or a combination of such benefits. In addition, no amount is includible in income or wages merely because the employee is offered a choice among qualified transportation benefits. This provision was effective for taxable years beginning after December 31, 1997. TEA 21 also provided that there is no indexing of the dollar limit on any qualified transportation benefit in 1999.

2. Purposes for which Amtrak NOL monies may be used in non-Amtrak States

TEA 21 expanded the list of qualified expenses for which Amtrak NOL monies may be used in non-Amtrak States, effective as if included in the Taxpayer Relief Act of 1997. See, also, Part Two relating to the elective carryback of existing net operating losses of Amtrak.

PART SEVEN: INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998 (H.R. 2676)[13]

TITLE I.--REORGANIZATION OF STRUCTURE AND MANAGEMENT OF THE IRS

A. IRS Restructuring and Creation of IRS Oversight Board

1. IRS mission and restructuring

The Internal Revenue Service Restructuring and Reform Act of 1998 ("IRS Reform Act") directed the Internal Revenue Service ("IRS") to revise its mission statement to provide greater emphasis on serving the public and meeting the needs of taxpayers. The IRS Reform Act directed the Commissioner of Internal Revenue ("Commissioner") to restructure the IRS by eliminating or substantially modifying the three-tier geographic structure and replacing it with an organizational structure that features operating units serving particular groups of taxpayers with similar needs.

2. Establishment and duties of IRS Oversight Board

The IRS Reform Act provided for the establishment within the Treasury Department of the Internal Revenue Service Oversight Board (the "Board"). The general responsibilities of the Board are to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws. The Board also has the authority to recommend candidates for Commissioner to the President, and to recommend removal of the Commissioner. The Board has no authority to intervene in (1) specific taxpayer cases, including compliance activities involving specific taxpayers such as criminal investigations, examinations, and collection activities, (2) specific individual personnel matters, or (3) specific procurement matters. The Board has authority to oversee general law enforcement

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[13] P.L. 105-206. H.R. 2676 was reported by the House Committee on Ways and Means on October 31, 1997 (H. Rept. 105-364, Part I). The House passed the bill on November 5, 1997, and added (as new Title VI) the provisions of H.R. 2645 ("Tax Technical Corrections Act of 1997") as previously reported by the Committee on Ways and Means (H. Rept. 105-356, October 29, 1997).

H.R. 2676 was reported, as amended, by the Senate Committee on Finance on April 22, 1998 (S. Rept. 105-174), and was passed by the Senate, as amended, on May 7, 1998. The conference report on H.R. 2676 was filed on June 24, 1998 (H. Rept. 105-599). The House passed the conference report on June 25, 1998, and the Senate passed it on July 9, 1998.

H.R. 2676 was signed by the President on July 22, 1998.

matters, and it has the responsibility to ensure that the organization and operation of the IRS allows the IRS to carry out its mission.

The Oversight Board is composed of nine members. Six of the members are so-called "private-life" members who are not otherwise Federal officers or employees. The other members are: (1) the Secretary of the Treasury (or, if the Secretary so designates, the Deputy Secretary); (2) the Commissioner; and (3) an individual who is a full-time Federal employee or a representative of employees ("employee representative"). The private-life members of the Board and the Federal employee or employee representative are appointed by the President, with the advice and consent of the Senate. Under the IRS Reform Act, the private-life members of the Board are appointed without regard to political affiliation, based solely on their expertise in the following areas: management of large service organizations; customer service; the Federal tax laws, including tax administration and compliance; information technology; organization development; the needs and concerns of taxpayers; and the needs and concerns of small business.

Under the IRS Reform Act, Board members have limited access to confidential tax return and return information under section 6103. This limited access permits the Board to receive section 6103 information from the newly established Treasury Inspector General for Tax Administration or the Commissioner in connection with reports to the Board. This access to section 6103 information does not include the taxpayer's name, address, or taxpayer or employer identification number.

The provisions relating to the Board were effective on July 22, 1998. The President was directed to submit nominations for Board members to the Senate by December 22, 1998. The IRS Reform Act provided that the provisions relating to the Board are not to be construed to invalidate the actions and authority of the IRS prior to the appointment of members of the Board.

B. Appointment and Duties of IRS Commissioner and Chief Counsel and Other Personnel

1. IRS Commissioner and other personnel

As under prior law, the IRS Reform Act provided that the Commissioner is appointed by the President, with the advice and consent of the Senate, and may be removed at will by the President. Under the IRS Reform Act, one of the qualifications of the Commissioner is demonstrated ability in management. The Commissioner is appointed to a five-year term, beginning with the date of appointment. The Commissioner may be reappointed for more than one five-year term. The Board recommends candidates to the President for the position of Commissioner; however, the President is not required to nominate for Commissioner a candidate recommended by the Board. The Board has the authority to recommend the removal of the Commissioner.

2. IRS Chief Counsel

Under the IRS Reform Act, the IRS Chief Counsel is longer be an Assistant General Counsel of the Treasury and generally reports to the IRS Commissioner, with two exceptions. First, the Chief Counsel reports to both the Commissioner and the Treasury General Counsel with respect to (1) legal advice or interpretation of the tax law not relating solely to tax policy and (2) tax litigation. Second, the Chief Counsel reports only to the Treasury General Counsel with respect to legal advice or interpretation of the tax law relating solely to tax policy.

C. Structure and Funding of the Employee Plans and Exempt Organizations Division ("EP/EO")

To facilitate the reorganization of the IRS into operational units, the IRS Reform Act eliminated the statutory requirement that there be an "Office of Employee Plans and Exempt Organizations" under the supervision and direction of an Assistant Commissioner. In addition, the IRS Reform Act repealed the special statutory funding mechanism for EP/EO. These provisions were effective on July 22, 1998.

D. Taxpayer Advocate and Taxpayer Assistance Orders

The IRS Reform Act renamed the IRS Taxpayer Advocate as the "National Taxpayer Advocate." The National Taxpayer Advocate is appointed by the Secretary of the Treasury after consultation with the Commissioner and the IRS Oversight Board. The individual appointed to be the National Taxpayer Advocate cannot have been an officer or employee of the IRS (other than in the Office of the Taxpayer Advocate) during the two-year period ending with such individual's appointment, and must agree not to accept employment with the IRS (other than in the Office of the Taxpayer Advocate) for at least five years after ceasing to be the National Taxpayer Advocate.

The problem resolution system is replaced with a system of local Taxpayer Advocates who report directly to the National Taxpayer Advocate and who are independent from the IRS examination, collection, and appeals functions.

The IRS Reform Act expanded the circumstances under which a Taxpayer Assistance Order may be issued if a taxpayer is suffering from or about to suffer from a significant hardship.

These provisions generally were effective on July 22, 1998.

E. Treasury Office of Inspector General; IRS Office of the Chief Inspector

Under the IRS Reform Act, a new, independent Treasury Inspector General for Tax Administration ("Treasury IG for Tax Administration") is established within the Department of Treasury. The IRS Office of the Chief Inspector is eliminated, and all of its powers and responsibilities are transferred to the Treasury IG for Tax Administration, except for employee background checks and protection of employees against physical threats. The Treasury IG for Tax Administration has the powers and responsibilities generally granted to Inspectors General under the IG Act of 1978, without the limitations that currently apply to the Treasury IG under section D of that Act. The role of the existing Treasury IG is redefined to exclude responsibility for the IRS. The Treasury IG for Tax Administration is under the supervision of the Secretary of Treasury, with certain additional reporting to the IRS Oversight Board and the Congress.

The provision is effective on December 19, 1998.

F. Prohibition on Executive Branch Influence Over Taxpayer Audits

Subject to certain exceptions, the IRS Reform Act made it unlawful for the President, the Vice President, employees of the executive offices of the President or Vice President, as well as any individual (other than the Attorney General) serving in a Cabinet-level position to request that any officer or employee of the IRS conduct or terminate an audit or otherwise investigate or terminate the investigation of any particular taxpayer with respect to the tax liability of that taxpayer. This prohibition applies to both direct and indirect requests. Anyone convicted of violating this provision can be punished by imprisonment of not more than five years or a fine not exceeding $5,000 (or both). This provision was effective for violations after July 22, 1998.

G. IRS Personnel Flexibilities

The IRS Reform Act modified the employee personnel rules applicable to the IRS by providing certain personnel flexibility to facilitate the efforts of the IRS to better manage its workforce.

The IRS Reform Act addressed issues relating to senior management and technical positions, the establishment of a performance management system, the granting of awards to IRS employees, staffing flexibilities, employee training, and mandatory terminations of employees for certain proven actions.

TITLE II.--ELECTRONIC FILING

A. Electronic Filing of Tax and Information Returns

Under the IRS Reform Act, the policy of the Congress is to promote paperless filing, with a long-range goal of providing for the filing of at least 80 percent of all tax returns in electronic form by the year 2007.

B. Due Date for Certain Information Returns

The IRS Reform Act provided an incentive to filers of information returns to use electronic filing by extending the due date for filing such returns with the IRS from February 28 (under prior law) to March 31 of the year following the calendar year to which the return relates. The IRS Reform Act also required the Treasury to issue a study evaluating the merits and disadvantages, if any, of extending the deadline for providing taxpayers with copies of information returns (other than Forms W-2) from January 31 to February 15. This study is due by June 30, 1999.

C. Paperless Electronic Filing

To facilitate the filing of electronic returns, the Treasury Secretary is required to develop procedures that would eliminate the need to file a paper form relating to signature information. In addition, the Secretary is to establish procedures, to the extent practicable, to receive all forms electronically for taxable periods beginning after December 31, 1999. The IRS Reform Act also provided rules for determining when electronic returns are deemed filed and for authorization for return preparers to communicate with the IRS on matters included on electronically filed returns.

D. Return-Free Tax System

The IRS Reform Act required the Treasury Secretary to study the feasibility of, and develop procedures for, the implementation of a return-free tax system for appropriate individuals for taxable years beginning after 2007.

E. Access to Account Information

Under the IRS Reform Act, the Treasury Secretary is required to develop procedures not later than December 31, 2006, under which a taxpayer filing returns electronically could review the taxpayer's own account electronically, but only if all necessary privacy safeguards are in place by that date.

TITLE III.--TAXPAYER PROTECTION AND RIGHTS

A. Burden of Proof

The IRS Reform Act provided that 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 the factual issue relevant to ascertaining the taxpayer's tax liability. Four conditions apply. First, the taxpayer must comply with the requirements of the Internal Revenue Code and the regulations issued thereunder to substantiate any item. Second, the taxpayer must maintain records required by the Code and regulations. Third, the taxpayer must cooperate with reasonable requests by the Treasury Secretary for meetings, interviews, witnesses, information, and documents. Fourth, taxpayers other than individuals must meet the net worth limitations that apply for awarding attorney's fees. The provision applies to income, estate, gift, and generation-skipping transfer taxes.

The provision applies to court proceedings arising in connection with examinations commencing (or taxable periods or events beginning or occurring) after July 22, 1998.

B. Proceedings by Taxpayers

1. Expansion of authority to award costs and certain fees

The IRS Reform Act increased the hourly fee cap on attorneys fees and expanded the circumstances under which attorneys fees and administrative costs may be awarded to taxpayers, effective for costs incurred and services performed after December 19, 1998.

2. Civil damages for collection actions

The IRS Reform Act permitted up to $100,000 in civil damages caused by an officer or employee of the IRS who negligently disregards provisions of the Code or Treasury regulations in connection with the collection of Federal tax with respect to the taxpayer. The IRS Reform Act also permitted up to $1 million in civil damages caused by an officer or employee of the IRS who willfully violates provisions of the Bankruptcy Code relating to automatic stays or discharges. These provisions are effective for actions of officers or employees of the IRS occurring after July 22, 1998.

3. Increase in size of cases permitted on small case calendar

The IRS Reform Act increased the cap for small case treatment in the Tax Court from $10,000 to $50,000, effective for proceedings commenced after July 22, 1998.

4. Actions for refund with respect to certain estates which have elected the installment method of payment

The IRS Reform Act granted the U.S. Court of Federal Claims and the U.S. district courts jurisdiction to determine the correct amount of estate tax liability (or refund) in actions brought by taxpayers deferring estate tax payments under section 6166, as long as certain conditions are met. The IRS Reform Act further provided that once a final judgment has been entered by a district court or the U.S. Court of Federal Claims, the IRS is not permitted to collect any amount disallowed by the court, and any amounts paid by the taxpayer in excess of the amount the court finds to be currently due and payable are refunded to the taxpayer, with interest. The provision is effective for claims for refunds filed after July 22, 1998.

5. Review of an adverse IRS determination of a bond issue's tax-exempt status

The IRS Reform Act directed the Internal Revenue Service to modify its administrative procedures to allow tax-exempt bond issuers examined by the IRS to appeal adverse examination determinations to the Appeals Division of the IRS as a matter of right. Such an appeal is to be considered by senior personnel with experience in tax-exempt bonds issues. The direction to the IRS is effective on July 22, 1998.

6. Civil action for release of erroneous lien

The IRS Reform Act established an administrative procedure permitting a record owner of property against which a Federal tax lien has been filed to obtain a certificate of discharge of property from the lien as a matter of right if such record owner is not the person whose unsatisfied liability gave rise to the lien. The record owner is required to apply to the Secretary of the Treasury for such a certificate and either to deposit cash or to furnish a bond sufficient to protect the lien interest of the United States. The provision is effective on July 22, 1998.

C. Relief for Innocent Spouses and for Taxpayers Unable to Manage Their Financial Affairs Due to Disabilities

1. Relief for innocent spouses

The IRS Reform Act generally made innocent spouse relief easier to obtain. The IRS Reform Act eliminated all of the understatement thresholds and required only that the understatement of tax be attributable to an erroneous (and not just a grossly erroneous) item of the other spouse.

The IRS Reform Act also provided a separate liability election for a taxpayer who, at the time of the election, is no longer married to, is legally separated from, or has been living apart for at least 12 months from the person with whom the taxpayer originally filed a joint return. Such taxpayers may elect to have the liability for any deficiency limited to the portion of the deficiency that is attributable to items allocable to the taxpayer. The election is not available if the Treasury Secretary demonstrates that assets were transferred between individuals filing a joint return as part of a fraudulent scheme of the individuals or if both individuals had actual knowledge of the understatement of tax.

Expanded innocent spouse relief and the separate liability election must be elected no later than two years after the date on which the Secretary has begun collection activities with respect to the individual seeking the relief. The IRS Reform Act provided that the Tax Court has jurisdiction with respect to disputes about innocent spouse relief.

The IRS Reform Act further authorized the Treasury Secretary to relieve an individual of liability if relief is not available under the expanded innocent spouse rule or the separate liability election, but it would be inequitable to hold the individual liable for any unpaid tax or any deficiency.

The expanded innocent spouse relief, separate liability election, and authority to provide equitable relief apply to liabilities for tax arising after July 22, 1998, as well as any liability for tax arising on or before July 22, 1998, that remains unpaid on July 22, 1998.

2. Suspension of statute of limitations on filing refund claims during periods of disability

The IRS Reform Act permitted equitable tolling of the statute of limitations for refund claims of an individual taxpayer during any period of the individual's life in which he or she is unable to manage his or her financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or to last for a continuous period of not less than 12 months. Tolling does not apply during periods in which the taxpayer's spouse or another person is authorized to act on the taxpayer's behalf in financial matters. The provision applies to periods of disability before, on, or after July 22, 1998, but does not apply to any claim for refund or credit which (without regard to the provision) is barred by the statute of limitations as of July 22, 1998.

D. Provisions Relating to Interest and Penalties

1. Elimination of interest differential on overlapping periods of interest on income tax overpayments and underpayments

The IRS Reform Act established a net interest rate of zero when interest is payable and allowable on equivalent amounts of overpayment and underpayment of any taxes imposed by Title 26 (the Internal Revenue Code) that exist for any period. Each overpayment and underpayment is considered only once in determining whether equivalent amounts of overpayment and underpayment exist. The special rules that increase the interest rate paid on large corporate underpayments and decrease the interest rate received on corporate underpayments in excess of $10,000 do not prevent the application of the net zero rate. The provision applies to interest for periods beginning after July 22, 1998. The provision applies to interest for periods beginning before July 22, 1998, if: (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 for which the zero rate applies; and (3) on or before December 31, 1999, the taxpayer asks the Treasury Secretary to apply the zero rate.

2. Increase in overpayment rate payable to taxpayers other than corporations

The IRS Reform Act provided that the overpayment interest rate will be AFR plus three percentage points, except that for corporations, the rate remains at AFR plus two percentage points. The provision is effective for interest for the second and succeeding calendar quarters beginning after July 22, 1998.

3. Mitigation of penalty for individual's failure to pay during period of installment agreement

The IRS Reform Act provided that the penalty for failure to pay taxes is one half of the usual rate (0.25 percent instead of 0.50 percent) imposed with respect to the tax liability of an individual for any month in which an installment payment agreement with the IRS is in effect, provided that the individual filed the tax return in a timely manner (including extensions). The provision is effective for installment agreement payments made after December 31, 1999.

4. Mitigation of failure to deposit penalty for payroll taxes

The IRS Reform Act allowed a taxpayer to designate the period to which each deposit is applied. The designation must be made no later than 90 days of the related IRS penalty notice. The provision extends the authorization to waive the failure to deposit penalty to the first deposit a taxpayer is required to make after the taxpayer is required to change the frequency of the taxpayer's deposits. The provision is effective for deposits required to be made after December 19, 1998. The IRS Reform Act also provided that, for deposits required to be made after December 31, 2001, any deposit is to be applied to the most recent period to which the deposit relates, unless the taxpayer explicitly designates otherwise.

5. Suspension of interest and certain penalties if Secretary fails to contact individual taxpayer

The IRS Reform Act suspended the accrual of certain penalties and interest after one year if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability for additional taxes (and the basis for the liability) within one year following the date which is the later of (1) the original due date of the return or (2) the date on which the individual taxpayer timely filed the return. The suspension only applies to individuals who file a timely tax return and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. The provision is effective for taxable years ending after July 22, 1998. With respect to taxable years beginning before January 1, 2004, the one-year period is increased to 18 months. Interest and penalties resume 21 days after the IRS sends a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability. The provision is applied separately with respect to each item or adjustment.

6. Procedural requirements for imposition of penalties and additions to tax

The IRS Reform Act required that each notice imposing a penalty include the name of the penalty, the Code section imposing the penalty, and a computation of the penalty. The Act also requires the specific approval of IRS management to assess all non-computer generated penalties unless excepted. This provision does not apply to failure to file penalties, failure to pay penalties, or to penalties for failure to pay estimated tax. The provision is effective with respect to notices issued, and penalties assessed, after December 31, 2000.

7. Personal delivery of notice of penalty under section 6672

The IRS Reform Act permitted in-person delivery, as an alternative to delivery by mail, of a preliminary notice that the IRS intends to assess a 100-percent penalty, effective on July 22, 1998.

8. Notice of interest charges

The IRS Reform Act required every IRS notice that includes an amount of interest required to be paid by the taxpayer that is sent to an individual taxpayer to include a detailed computation of the interest charged and a citation to the Code section under which such interest is imposed, effective for notices issued after December 31, 2000.

9. Abatement of interest on underpayments by taxpayers in Presidentially declared disaster areas

The IRS Reform Act provided that taxpayers located in a Presidentially declared disaster area do not have to pay interest on taxes due for the length of any extension for filing their tax returns granted by the Secretary of the Treasury, effective for disasters declared after December 31, 1997, with respect to taxable years beginning after December 31, 1997. The provision is designated as emergency legislation under section 252(e) of the Balanced Budget and Emergency Deficit Control Act. See, also, the provisions in Part Two relating to disaster relief provisions contained in the Taxpayer Relief Act of 1997.

E. Protections for Taxpayers Subject to Audit or Collection Activities

1. Due process in IRS collection actions

The IRS Reform Act established formal procedures designed to insure due process where the IRS seeks to collect taxes by levy (including by seizure). The due process procedures also apply after notice of a Federal tax lien has been filed.

The IRS would be required to notify the taxpayer that a Notice of Lien had been filed. During the 30-day period beginning with the mailing or delivery of such notification, the taxpayer may demand a hearing before an appeals officer who has had no prior involvement with the taxpayer's case.

Before the IRS can levy against a taxpayer's property, it would be required to provide the taxpayer with a "Notice of Intent to Levy," similar to that currently required under section 6331(d). The notice would not be required to itemize the property the Secretary seeks to levy on. Service by registered or certified mail, return receipt requested, would be required.

Subject to the exceptions noted below, no levy could occur within the 30-day period beginning with the mailing of the "Notice of Intent to Levy." During that 30-day period, the taxpayer may demand a pre-levy hearing before an appeals officer who generally has had no prior involvement with the taxpayer's case.

If a return receipt is not returned, the Treasury Secretary may proceed to levy against the taxpayer 30 days after the Notice of Intent to Levy was mailed. The Treasury Secretary must provide a hearing equivalent to the pre-levy hearing if later requested by the taxpayer. However, the Treasury Secretary is not required to suspend the levy process pending the completion of a hearing that is not requested within 30 days of the mailing of the Notice.

An exception to the general rule prohibiting levies during the 30-day period would apply in the case of State tax offset procedures, and in the case of jeopardy or termination assessments.

No seizure of a dwelling that is the principal residence of the taxpayer or the taxpayer's spouse, former spouse, or minor child would be allowed without prior judicial approval. Notice of the judicial hearing must be provided to the taxpayer and relevant family member. At the judicial hearing, the Secretary would be required to demonstrate (1) that the requirements of any applicable law or administrative procedure relevant to the levy have been met, (2) that the liability is owed, and (3) that no reasonable alternative for the collection of the taxpayer's debt exists.

The provision is effective for collection actions initiated after December 19, 1998.

2. Examination activities

a. Uniform application of confidentiality privilege to taxpayer communications with federally authorized practitioners

In noncriminal proceedings, the IRS Reform Act extended the attorney-client privilege of confidentiality to communications between taxpayers and individuals who are authorized under Federal law to practice before the IRS. The privilege of confidentiality created by this provision does not apply to a written communication between federally authorized tax practitioner and any director, shareholder, officer, employee, agent, or representative of a corporation in connection with the promotion of any tax shelter (as defined in section 6662(d)(2)(C)(iii)) with respect to which such corporation is a direct or indirect participant.

The provision is effective with regard to communications made on or after July 22, 1998.

b. Limitation on financial status audit techniques

The IRS Reform Act prohibited the IRS from using financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the IRS has a reasonable indication that there is a likelihood of unreported income, effective on July 22, 1998.

c. Software trade secrets protection

The IRS Reform Act prohibited the Treasury Secretary from issuing (or beginning an action to enforce) a summons in a civil action for any portion of any third-party tax-related computer source code unless certain requirements are satisfied. The IRS Reform Act also established a number of protections against the disclosure and improper use of software and source code obtained by the IRS in the course of an examination. The IRS Reform Act specifically provided that computer software or source code that is obtained by the IRS in the course of the examination of a taxpayer's return is included in the definition of return information under section 6103.

The provision does not change or eliminate any other requirement of the Code. A summons for third-party tax-related computer source code that meets the standards established by the provision will not be enforced if it would not be enforced under prior law.

The provision is effective with respect to summons issued and software acquired after July 22, 1998. In addition, on October 20, 1998, the protections against the disclosure and improper use of trade secrets and confidential information added by the provision (except for the requirement that the Secretary provide a written agreement from non-U.S. government officers and employees) apply to software and source code acquired on or before July 22, 1998.

d. Threat of audit prohibited to coerce tip reporting alternative commitment agreements

The IRS Reform Act required the IRS to instruct its employees that they may not threaten to audit any taxpayer in an attempt to coerce the taxpayer to enter into a tip reporting alternative commitment ("TRAC") agreement, effective on July 22, 1998.

e. Taxpayers allowed motion to quash all third-party summonses

The IRS Reform Act generally expanded the current "third-party recordkeeper" procedures to apply to summonses issued to persons other than the taxpayer. Thus, the taxpayer whose liability is being investigated receives notice of the summons and is entitled to bring an action in the appropriate U.S. District Court to quash the summons. The provision is effective for summonses served after July 22, 1998.

f. Service of summonses to third-party recordkeepers permitted by mail

The IRS Reform Act allowed the IRS the option of serving any summons either in person or by certified or registered mail, effective for summonses served after July 22, 1998.

g. Notice of IRS contact of third parties

The IRS Reform Act provided that the IRS may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of the taxpayer without providing reasonable notice to the taxpayer that contacts with persons other than the taxpayer may be made. The provision is effective with respect to contacts made after December 19, 1998.

3. Collection activities

a. Approval process for liens, levies, and seizures

The IRS Reform Act required the IRS to implement an approval process under which any lien, levy or seizure would, when appropriate, be approved by a supervisor, who would review the taxpayer's information, verify that a balance is due, and affirm that a lien, levy or seizure is appropriate under the circumstances. Circumstances to be considered include the amount due and the value of the asset. The provision is effective for collection actions commenced after July 22, 1998, except in the case of any action under the automated collection system, the provision applies to actions initiated after December 31, 2000.

b. Modifications to certain levy exemption amounts

The IRS Reform Act increased the value of personal effects exempt from levy to $6,250 and the value of books and tools exempt from levy to $3,125. These amounts are indexed for inflation. The provision is effective for levies issued after July 22, 1998.

c. Release of levy upon agreement that amount is uncollectible

The IRS Reform Act required the IRS to release immediately a wage levy upon agreement with the taxpayer that the tax is not collectible, effective for levies imposed after December 31, 1999.

d. Levy prohibited during pendency of refund proceedings

The IRS Reform Act required the IRS to withhold collection by levy of liabilities that are the subject of a refund suit during the pendency of the litigation, effective for refund suits brought with respect to tax years beginning after December 31, 1998. Proceedings related to a proceeding under this provision include, but are not limited to, civil actions or third-party complaints initiated by the United States or another person with respect to the same kinds of tax (or related taxes or penalties) for the same (or overlapping) tax periods.

e. Approval required for jeopardy and termination assessments and jeopardy levies

The IRS Reform Act required IRS Chief Counsel review and approval before the IRS can make a jeopardy assessment, a termination assessment, or a jeopardy levy. If the Chief Counsel's approval is not obtained, the taxpayer is entitled to obtain abatement of the assessment or release of the levy, and, if the IRS fails to offer such relief, to appeal first to IRS Appeals under the new due process procedure for IRS collections and then to court. The provision is effective for taxes assessed and levies made after July 22, 1998.

f. Increase in amount of certain property on which lien not valid

The IRS Reform Act increased the dollar limit for purchasers at a casual sale from $250 to $1,000, and further increased the dollar limit from $1,000 to $5,000 for mechanics lienors providing home improvement work for owner-occupied personal residences and indexed these dollar amounts for inflation. The provision is effective on July 22, 1998.

g. Waiver of early withdrawal tax for IRS levies on employer-sponsored retirement plans or IRAs

The IRS Reform Act provided an exception from the 10-percent early withdrawal tax for amounts withdrawn from an employer-sponsored retirement plan or an IRA that are subject to a levy by the IRS. The exception applies only if the plan or IRA is levied; it does not apply, for example, if the taxpayer withdraws funds to pay taxes in the absence of a levy, in order to release a levy on other interests. The provision is effective for withdrawals after July 22, 1998.

h. Prohibition of sales of seized property at less than minimum bid

The IRS Reform Act prohibited the IRS from selling seized property for less than the minimum bid price, effective for sales occurring after July 22, 1998.

i. Accounting of sales of seized property

The IRS Reform Act required the IRS to provide a written accounting of all sales of seized property, whether real or personal, to the taxpayer. The accounting must include a receipt for the amount credited to the taxpayer's account. The provision is effective for seizures occurring after July 22, 1998.

j. Uniform asset disposal mechanism

The IRS Reform Act required the IRS to implement a uniform asset disposal mechanism for sales of seized property within two years after July 22, 1998.

k. Codification of IRS administrative procedures for seizure of taxpayer's property

The IRS Reform Act codified the IRS administrative procedures which require the IRS to investigate the status of certain property prior to levy, effective on July 22, 1998.

l. Procedures for seizure of residences and businesses

The IRS Reform Act prohibited the IRS from seizing any real property used as a residence by the taxpayer or any nonrental real property of the taxpayer used by any other individual as a residence to satisfy an unpaid liability of $5,000 or less, including penalties and interest. The IRS Reform Act required the IRS to exhaust all other payment options before seizing the taxpayer's business assets or principal residence. For this purpose, future income that may be derived by a taxpayer from the commercial sale of fish or wildlife under a specified State permit must be considered in evaluating other payment options before seizing the taxpayer's business assets. A levy is permitted on a principal residence only if a judge or magistrate of a United States district court approves (in writing) of the levy. The provision is effective on July 22, 1998.

4. Provisions relating to examination and collection activities

a. Procedures relating to extensions of statute of limitations by agreement

The IRS Reform Act eliminated the provision of prior law that allowed the statute of limitations on collections to be extended by agreement between the taxpayer and the IRS. Extensions of the statute of limitations on collection may be made as part of an installment agreement; the extension is only for the period for which the installment agreement by its terms extends beyond the end of the otherwise applicable 10-year period, plus 90 days.

The IRS Reform Act also required that, on each occasion on which the taxpayer is requested by the IRS to extend the statute of limitations on assessment, the IRS must notify the taxpayer of the taxpayer's right to refuse to extend the statute of limitations or to limit the extension to particular issues.

The provision is effective for requests to extend the statute of limitations made after December 31, 1999. If, in any request to extend the period of limitations made on or before December 31, 1999, a taxpayer agreed to extend that period beyond the 10-year statute of limitations on collection, that extension shall expire on the latest of: the last day of such 10-year period, December 31, 2002, or the 90th day after the end of the term of the installment agreement related to such request.

b. Offers-in-compromise

The IRS Reform Act expanded the authority for the IRS to accept offers-in-compromise.

The IRS Reform Act required the IRS to develop and publish schedules of national and local allowances that will provide taxpayers entering into an offer-in-compromise with adequate means to provide for basic living expenses. The IRS is required to consider the facts and circumstances of a particular taxpayer's case in determining whether the national and local schedules are adequate for that particular taxpayer. The IRS Reform Act prohibited the IRS from rejecting an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer.

The IRS Reform Act prohibited the IRS from collecting a tax liability by levy (1) during any period that a taxpayer's offer-in-compromise for that liability is being processed, (2) during the 30 days following rejection of an offer, (3) during any period in which an appeal of the rejection of an offer is being considered, and (4) while an installment agreement is pending.

The IRS Reform Act required that the IRS implement procedures to review all proposed IRS rejections of taxpayer offers-in-compromise and requests for installment agreements prior to the rejection being communicated to the taxpayer.

The IRS Reform Act provided that the IRS will adopt a liberal acceptance policy for offers-in-compromise to provide an incentive for taxpayers to continue to file tax returns and continue to pay their taxes.

The provisions are generally effective for offers-in-compromise submitted after July 22, 1998. The provision suspending levy is effective with respect to offers-in-compromise pending on or made after December 31, 1999.

c. Notice of deficiency to specify deadlines for filing Tax Court petition

The IRS Reform Act required the IRS to include on each deficiency notice the date determined by the IRS as the last day on which the taxpayer may file a petition with the Tax Court. The provision provides that a petition filed with the Tax Court by this date is treated as timely filed. The provision is effective for notices mailed after December 31, 1998.

d. Refund or credit of overpayments before final determination

The IRS Reform Act provided that a proper court (including the Tax Court) may order a refund of any amount that was collected within the period during which the Secretary is prohibited from collecting the deficiency by levy or other proceeding. The provision allows the refund of any overpayment determined by the Tax Court to the extent the overpayment is not contested on appeal. The provision is effective on July 22, 1998.

e. IRS procedures relating to appeal of examinations and collections

The IRS Reform Act codified existing IRS procedures with respect to early referrals to Appeals and the Collections Appeals Process. The IRS Reform Act also codified the existing Alternative Dispute Resolution ("ADR") procedures, as modified by eliminating the dollar threshold. The provision is effective on July 22, 1998.

f. Application of certain fair debt collection practices

The IRS Reform Act applied to the IRS certain restrictions relating to communication with taxpayer/debtors and the prohibitions on harassing or abusing a debtor. The provision is effective on July 22, 1998.

g. Guaranteed availability of installment agreements

The IRS Reform Act required the Treasury Secretary to enter an installment agreement, at the taxpayer's option, if: (1) the liability is $10,000, or less (excluding penalties and interest); (2) within the previous five years, the taxpayer has not failed to file or to pay, nor entered an installment agreement under this provision; (3) if requested by the Secretary, the taxpayer submits financial statements, and the Secretary determines that the taxpayer is unable to pay the tax due in full; (4) the installment agreement provides for full payment of the liability within three years; and (5) the taxpayer agrees to continue to comply with the tax laws and the terms of the agreement for the period (up to three years) that the agreement is in place. The provision is effective on July 22, 1998.

h. Prohibition on requests to taxpayers to waive rights to bring actions

The IRS Reform Act provided that the U.S. Government may not request a taxpayer to waive the taxpayer's right to sue the United States or one of its employees for any action taken in connection with the tax laws, unless (1) the taxpayer knowingly and voluntarily waives that right, or (2) the request is made to the taxpayer's attorney or other representative, effective on July 22, 1998.

F. Disclosures to Taxpayers

1. Explanation of joint and several liability

The IRS Reform Act required that the IRS establish procedures to clearly alert married taxpayers of their joint and several liability, the availability of electing separate liability, and an individual's right to expanded innocent spouse relief on all appropriate tax publications and instructions. The IRS Reform Act required that the procedures be established as soon as practicable, but no later than December 19, 1998.

2. Explanation of taxpayers' rights in interviews with the IRS

The IRS Reform Act required that the IRS rewrite Publication 1 ("Your Rights as a Taxpayer") to inform taxpayers more clearly of their rights (1) to be represented by a representative and (2) if the taxpayer is so represented, that interviews with the IRS may not proceed without the presence of the representative unless the taxpayer consents. The revisions are required no later than December 19, 1998.

3. Disclosure of criteria for examination selection

The IRS Reform Act required that IRS add to Publication 1 ("Your Rights as a Taxpayer") a statement which sets forth in simple and nontechnical terms the criteria and procedures for selecting taxpayers for examination. The statement is required to be included not later than December 19, 1998.

4. Explanation of the appeals and collection process

The IRS Reform Act required that, no later than December 19, 1998, a description of the entire process from examination through collections, including the assistance available to taxpayers from the Taxpayer Advocate at various points in the process, be provided with the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals.

5. Explanation of reason for refund disallowance

The IRS Reform Act required the IRS to notify the taxpayer of the specific reasons for the disallowance (or partial disallowance) of a refund claim, effective on December 19, 1998.

6. Statements to taxpayers with installment agreements

The IRS Reform Act required the IRS to send every taxpayer in an installment agreement an annual statement of the initial balance owed, the payments made during the year, and the remaining balance, effective July 1, 2000.

7. Notification of change in tax matters partner

The IRS Reform Act required the IRS to notify all partners of any resignation of the tax matters partner that is required by the IRS, and to notify the partners of any successor tax matters partner, effective for selections of tax matters partners made by the Treasury Secretary after July 22, 1998.

8. Conditions under which taxpayers' returns may be disclosed

The IRS Reform Act required that general tax forms instruction booklets include a description of conditions under which tax return information may be disclosed outside the IRS (including to States), effective on July 22, 1998.

9. Disclosure of Chief Counsel advice

The IRS Reform Act amended established a structured process by which the IRS will make certain work products, designated as "Chief Counsel Advice," open to public inspection on an ongoing basis. It is designed to protect taxpayer privacy while allowing the public inspection of these documents in a manner generally consistent with the mechanism for the public inspection of written determinations. In general, the provision operates by establishing that Chief Counsel Advice are written determinations subject to the public inspection provisions of section 6110. The provision applies to Chief Counsel Advice issued after October 20, 1998.

G. Low-Income Taxpayer Clinics

The IRS Reform Act provided that the Treasury Secretary is authorized to provide up to $6 million per year in matching grants to certain low-income taxpayer clinics. No clinic could receive more than $100,000 per year. Eligible clinics would be those that charge no more than a nominal fee to either represent low-income taxpayers in controversies with the IRS or provide tax information to individuals for whom English is a second language. The provision is effective on July 22, 1998.

H. Other Provisions

1. Cataloging complaints

The IRS Reform Act required that, in collecting data for the annual report to the Congress on allegations of IRS employee misconduct, records of taxpayer complaints of misconduct by IRS employees must be maintained on an individual employee basis, effective January 1, 2000.

2. Archive of records of Internal Revenue Service

The IRS Reform Act provided an exception to the disclosure rules to require IRS to disclose IRS records to officers or employees of National Archives and Records Administration ("NARA"), upon written request from the U.S. Archivist, for purposes of the appraisal of such records for destruction or retention. The prohibitions on and penalties for disclosure of tax information generally apply to NARA. The provision is effective for requests made by the Archivist after July 22, 1998.

3. Payment of taxes

The IRS Reform Act required the Treasury Secretary or his delegate to establish such rules, regulations, and procedures as are necessary to allow payment of taxes by check or money order to be made payable to the United States Treasury, rather than to the IRS, effective on July 22, 1998.

4. Clarification of authority of Secretary relating to the making of elections

The IRS Reform Act clarified that, except as otherwise provided, the Treasury Secretary may prescribe the manner of making any election under the Code by any reasonable means, effective on July 22, 1998.

5. IRS employee contacts

The IRS Reform Act required any manually generated correspondence received by a taxpayer from the IRS to include in a prominent manner the name, telephone number, and unique identifying number of an IRS employee the taxpayer may contact with respect to the correspondence. Any other correspondence or notice received by a taxpayer from the IRS must include in a prominent manner a telephone number that the taxpayer may contact. An IRS employee must give a taxpayer during a telephone or personal contact the employee's telephone number and unique identifying number. The requirements for a unique identifying number are effective on December 22, 1998.

6. Use of pseudonyms by IRS employees

The IRS Reform Act provided that an IRS employee may use a pseudonym only if (1) adequate justification, such as protecting personal safety, for using the pseudonym was provided by the employee as part of the employee's request to use a pseudonym, and (2) IRS management has approved the request to use the pseudonym prior to its use. This provision is effective for requests made after July 22, 1998.

7. Illegal tax protester designations

The IRS Reform Act prohibited the use by the IRS of the "illegal tax protester" designation. Any extant designation in the individual master file (the main individual income tax computer file) must be removed and any other extant designation (such as on paper records that have been archived) must be disregarded. The IRS is, however, permitted to designate appropriate taxpayers as nonfilers. The IRS must remove the nonfiler designation once the taxpayer has filed valid tax returns for two consecutive years and paid all taxes shown on those returns. The provision is effective on July 22, 1998, except that the removal of any designation from the master file, is not required to begin before January 1, 1999.

8. Provision of confidential information to Congress by whistleblowers

The IRS Reform Act provided that any person (i.e., a whistleblower) who otherwise has or had access to any return or return information under section 6103 may disclose such return or return information to the House Ways and Means Committee, the Senate Finance Committee, or the Joint Committee on Taxation or to any individual authorized by one of those committees to receive or inspect any return or return information if such person (the whistleblower) believes such return or return information relates to evidence of possible misconduct, maladministration, or taxpayer abuse. The provision is effective on July 22, 1998.

9. Listing of local IRS telephone numbers and addresses

The IRS Reform Act required the IRS, as soon as is practicable, to publish addresses and local telephone numbers of local IRS offices in appropriate local telephone directories.

10. Identification of return preparers

The IRS Reform Act authorized the IRS to approve alternatives to Social Security numbers to identify tax return preparers, effective on July 22, 1998.

11. Offset of past-due, legally enforceable State income tax obligations against overpayments

The IRS Reform Act permitted States to participate in the IRS refund offset program for specified past-due, legally enforceable State income tax debts, providing the person making the Federal tax overpayment has shown on the Federal return for the taxable year of the overpayment an address that is within the State seeking the tax offset. The provision is effective for Federal income tax refunds payable after December 31, 1999.

12. Reporting requirements in connection with education tax credits

The IRS Reform Act modified the information reporting requirements applicable to certain educational institutions in connection with the HOPE Scholarship and Lifetime Learning credits. In addition to reporting the aggregate amount of payments for qualified tuition and related expenses received by the educational institution with respect to a student, the institution must report any grant amount received by the student and processed through the institution during the applicable calendar year. An educational institution also must report only the aggregate amount of reimbursements or refunds paid to a student by the institution (and not by any other party). The Act further clarifies that the definition of term "qualified tuition and related expenses" shall be as set forth in section 25A, determined without regard to section 25A(g)(2) (which requires adjustments for certain scholarships). The provision applies to returns required to be filed with respect to taxable years beginning after December 31, 1998. See, also, the provisions relating to the HOPE scholarship and Lifetime Learning tax credits in Part Two.

I. Studies

1. Administration of penalties and interest

The IRS Reform Act required the Joint Committee on Taxation and the Treasury to each conduct a separate study reviewing the interest and penalty provisions of the Code, and make any legislative and administrative recommendations deemed appropriate to simplify penalty administration and reduce taxpayer burden. The reports must be provided not later than July 22, 1999.

2. Confidentiality of tax return information

The IRS Reform Act required the Joint Committee on Taxation and Treasury to each conduct a separate study on provisions regarding taxpayer confidentiality. The studies are to examine: (1) present-law protections of taxpayer privacy; (2) the need, if any, for third parties to use tax return information; (3) whether greater levels of voluntary compliance can be achieved by allowing the public to know who is legally required to file tax returns but does not do so; (4) the interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code with those elsewhere in the United States Code (such as the Freedom of Information Act); (5) the impact on taxpayer privacy of sharing tax information for the purposes of enforcing State and local tax laws (other than income tax laws) and (6) an examination of whether the public interest would be served by greater disclosure of information relating to tax-exempt organizations. The findings of the studies, along with any recommendations, are required to be reported to the Congress no later than January 22, 2000.

3. Noncompliance with internal revenue laws by taxpayers

The IRS Reform Act provided that the Secretary of the Treasury and the Commissioner, in consultation with the Joint Committee on Taxation, must conduct a study of noncompliance with the tax law, including tax law complexity and willful noncompliance or other factors. The study must be reported to the Congress before July 22, 1999.

4. Payments for informants

The IRS Reform Act required a study and report by the Secretary of the Treasury to the Congress of the present-law informant reward program (including results) and any legislative or administrative recommendations regarding the program and its application. The study must be reported to the Congress before July 22, 1999.

TITLE IV.--CONGRESSIONAL ACCOUNTABILITY FOR THE IRS

A. Review of Requests for GAO Investigations of the IRS

Under the IRS Reform Act, the Joint Committee on Taxation is to review all requests (other than requests by the chair or ranking member of a Committee or Subcommittee of the Congress) for investigations of the IRS by the General Accounting Office ("GAO") and approve such requests when appropriate. In reviewing such requests, the Joint Committee on Taxation is to eliminate overlapping investigations, ensure that the GAO has the capacity to handle the investigation, and ensure that investigations focus on areas of primary importance to tax administration. The provision is effective with respect to requests for GAO investigations made after July 22, 1998.

B. Joint Congressional Review and Coordinated Oversight Reports

Under the IRS Reform Act, there will be one annual joint review which shall include two majority and one minority members of each of the Senate Committees on Finance, Appropriations, and Government Affairs and the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight. The review is to be held before June 1 on the progress of the IRS in meeting its objectives under the strategic and business plans, the progress of the IRS in improving taxpayer service and compliance, the progress of the IRS on technology modernization, and the annual filing season. The annual review will be called by the Chairman of the Joint Committee on Taxation and will take place in each of calendar years 1999-2003.

The IRS Reform Act provided that the Joint Committee on Taxation is to make a report once during each Congress to the Senate Committee on Finance and the House Committee on Ways and Means on the overall state of the Federal tax system, together with recommendations with respect to possible simplification proposals and other matters relating to the administration of the Federal tax system as it may deem advisable. This report will be required only if amounts necessary to carry out this requirement are specifically appropriated to the Joint Committee on Taxation. The Joint Committee on Taxation also is to report annually to the Senate Committees on Finance, Appropriations, and Government Affairs and the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight with respect to the matters that are the subject of the annual joint hearings of members of such Committees. This reporting requirement will apply only for calendar years 1999-2003.

C. Funding for Century Date Changes

The IRS Reform Act provided that it is the sense of the Congress that the IRS efforts to resolve the century date change computing problems should be fully funded to provide for certain resolution of such problems, and it is the sense of the Congress that the IRS should place resolving the century date change computing problems as a high priority.

D. Tax Law Complexity Analysis

The IRS Reform Act provided that it is the sense of the Congress that the IRS should provide the Congress with an independent view of tax administration and that the tax-writing committees should hear from front-line technical experts at the IRS during the legislative process with respect to the administrability of pending amendments to the Internal Revenue Code. In addition, the IRS is required to report by March 1 of each year to the House Committee on Ways and Means and the Senate Committee on Finance regarding sources of complexity in the administration of the Federal tax laws.

The IRS Reform Act required the Joint Committee on Taxation (in consultation with the IRS and Treasury) to provide an analysis of complexity or administrability concerns raised by tax legislation provisions of widespread applicability to individuals or small businesses, effective after 1998. The analysis is to be included in any Committee Report of the House Committee on Ways and Means or Senate Committee on Finance or Conference Report containing tax provisions, or provided to the Members of the relevant Committee or Committees as soon as practicable after the report is filed. A point of order is established with respect to the floor consideration by the House of Representatives of a Act or conference report that does not contain the required tax complexity analysis. The point of order may be waived by a majority vote.

TITLE V.--ADDITIONAL PROVISIONS

A. Elimination of 18-Month Holding Period for Capital Gains

The 1997 Act generally reduced the maximum capital gains rate for individuals to 20 percent (10 percent for taxpayers in the 15-percent bracket). The IRS Reform Act provided that property held more than one year (rather than more than 18 months) will be eligible for the lower rates, effective January 1, 1998.

B. Deductibility of Meals Provided for the Convenience of the Employer

The IRS Reform Act provided that all meals furnished to employees on the business premises of the employer are treated as provided for the convenience of the employer under section 119 if more than one-half of employees to whom such meals are furnished on the premises are furnished such meals for the convenience of the employer under section 119. If these conditions are satisfied, the value of all such meals would be excludable from the employee's income and fully deductible to the employer.

The provision is effective for taxable years beginning before, on, or after July 22, 1998.

TITLE VI.--TAX TECHNICAL CORRECTIONS

The IRS Reform Act contained technical, clerical, and conforming amendments to the Taxpayer Relief Act of 1997 and other recently enacted legislation. The provisions generally are effective as if enacted in the original legislation to which each provision relates.

TITLE VII.--REVENUE OFFSETS

A. Employer Deductions for Vacation and Severance Pay

The IRS Reform Act provided that, for purposes of determining whether an item of compensation is deferred compensation, the compensation is not considered to be paid or received until actually received by the employee. The IRS Reform Act is intended to overrule the result in *Schmidt Baking*. The provision is effective for taxable years ending after July 22, 1998, with a three-year spread under section 481.

B. Freeze Grandfathered Status of Stapled REITs

The IRS Reform Act treats activities and gross income of a stapled REIT group with respect to real property interests acquired after March 26, 1998, by any member of a stapled REIT group as activities and income of the REIT for certain purposes. There is an exception to this treatment for certain grandfathered real property interests. The provision is effective for taxable years ending after March 26, 1998.

C. Make Certain Trade Receivables Ineligible for Mark-to-Market Treatment

The IRS Reform Act provided that certain trade receivables are not eligible for mark-to-market treatment under section 475. The provision generally is effective for taxable years ending after July 22, 1998, with a four-year spread under section 481.

D. Exclusion of Minimum Required Distributions from AGI for Roth IRA Conversions

The IRS Reform Act excluded minimum required distributions from IRAs from the definition of AGI solely for purposes of determining eligibility to convert from an IRA to a Roth IRA. The provision is effective for taxable years beginning after December 31, 2004. See, also, the provisions relating to Roth IRAs in Part Two, above.

TITLE IX.--CORRECTIONS TO THE TRANSPORTATION EQUITY ACT FOR THE 21st CENTURY

The IRS Reform Act included corrections to the Transportation Equity Act for the 21st Century.

PART EIGHT: TAX AND TRADE RELIEF EXTENSION ACT OF 1998 (DIVISION J OF H.R. 4328, THE OMNIBUS CONSOLIDATED AND EMERGENCY SUPPLEMENTAL APPROPRIATIONS ACT, 1999)[14]

A. Emergency Tax Relief for Farmers

1. Income averaging for farmers

The Tax and Trade Relief Extension Act of 1998 ("the Tax Extension Act") permanently extended the income averaging provision available to farmers, effective for taxable years beginning after December 31, 2000. See, also, Part Two, above, which provided income averaging for farmers on a temporary basis.

2. Farm production flexibility contract payments

The time a production flexibility contract payment under the Federal Agriculture Improvement and Reform Act of 1996 ("FAIR Act") is properly 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 the FAIR Act. The provision is effective for taxable years ending after December 31, 1995.

3. Net operating loss carrybacks

The Tax Extension Act provided a special five-year carryback period for net operating losses attributable to a farming business. The provision is effective for net operating losses arising in taxable years beginning after December 31, 1997.

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[14] P.L. 105-277. The revenue provisions of H.R. 4328 generally originated in H.R. 4738. H.R. 4738 was reported by the Committee on Ways and Means on October 12, 1998 (H. Rept. 105-817), and was passed by the House on October 12, 1998. Some provisions were included in S. 2260, as introduced by Senators Roth and Moynihan. The conference report on H.R. 4328 was filed on October 19, 1998 (H. Rept 105-825). The House passed the conference report on October 20, 1998, and the Senate passed it on October 21, 1998.

H.R. 4328 was signed by the President on October 21, 1998.

B. Extension of Expiring Tax and Trade Provisions

The Tax Extension Act extends the following tax and trade provisions, retroactive to the existing expiration date:

(1) Research and experimentation tax credit (through June 30, 1999);
(2) Work opportunity tax credit (through June 30, 1999);
(3) Welfare-to-work tax credit (through June 30, 1999);
(4) Permanent extension of the deduction for contributions of appreciated stock to private foundations, along with public inspection of private foundation annual returns;
(5) Exceptions under subpart F for certain active financing income, with modifications, applicable only for taxable years beginning in 1999; and
(6) Disclosure of return information to the Department of Education for income contingent student loans (through September 30, 2003).

See, also, the provisions in Part Two, above, relating to: (1) prior extensions of the research and experimentation tax credit, the work opportunity tax credit, and the deduction for contributions of appreciated stock to private foundations; (2) the enactment of the welfare-to-work tax credit, and (3) the enactment of exceptions under subpart F for certain active financing income applicable only for taxable years beginning in 1998.

C. Other Revenue Provisions

1. Personal credits fully allowed against regular tax liability during 1998

The Tax Extension Act allowed the nonrefundable personal credits to offset the regular tax in full (without regard to the tentative minimum tax) for taxable years beginning during 1998. See, also, the provisions in Part Two, above, relating to the child tax credit, the Hope credit, and the Lifetime Learning credit.

2. Increase deduction for health insurance expenses of self-employed individuals

The Tax Extension Act increased the deduction for health insurance of self-employed individuals to 60 percent for taxable years beginning in 1999 through 2001, to 70 percent for taxable years beginning in 2002, and to 100 percent for taxable years beginning in 2003 and thereafter. See, also, the provision increasing the deduction for health insurance of self-employed individuals in Part Two, above.

3. Modification of individual estimated tax safe harbors

The Tax Extension Act modified the estimated tax safe harbor which is based on a taxpayer's prior year's liability for individual taxpayers with an adjusted gross income of more than $150,000. For taxable years beginning in 2000 and 2001, 106 percent of the prior year's liability must be paid by such taxpayers in order to satisfy the safe harbor. See, also, the provision relating to the individual estimated tax safe harbors contained in Part Two, above.

4. Volume limits on private activity bonds

The Tax Extension Act increased the annual State volume limits that apply to more private activity tax-exempt bonds to $75 per resident of each State or $225 million (if greater) beginning in calendar year 2007. The increase is phased in, beginning with $55 per capita or $165 million (if greater) in calendar year 2003.

5. Treasury study on depreciation

The Treasury Department is directed to conduct a comprehensive study of the recovery periods and depreciation methods under section 168 of the Internal Revenue Code, and to provide recommendations for determining such periods and methods in a more rational manner. The results and recommendations of the study are to be submitted to the House Ways and Means and Senate Finance Committees by March 31, 2000.

6. State election to exempt student employees from Social Security

The Tax Extension Act allowed a limited window of time (January 1 through March 31, 1999) for States to modify existing State agreements to exempt from Social Security coverage students (including graduate assistants) who are employed by a public school, university, or college in a nonexempted State. This provision applies to three States that did not previously elect to exempt student employees from Social Security coverage. The provision is effective with respect to earnings after June 30, 2000.

D. Revenue Offset Provisions

1. Treatment of certain deductible liquidating distributions of regulated investment companies ("RICs") and real estate investment trusts ("REITs")

Under the Tax Extension Act, 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 will be includible in the income of the recipient corporation. The provision is effective for distributions on or after May 22, 1998, regardless of when the plan of liquidation was adopted.

2. Vaccine excise tax

The Tax Extension Act added any vaccine against rotavirus gastroenteritis to the list of taxable vaccines. The net receipts from the tax are deposited in the Vaccine Injury

Compensation Trust Fund. The provision is effective beginning on October 22, 1998. See, also, the provision in relating to the vaccine excise tax in Part Two, above.

3. Mathematical error procedure

The Tax Extension Act clarified and expanded the mathematical and clerical error procedures so that a correct taxpayer identification number ("TIN") is a TIN assigned by the Social Security Administration (or Internal Revenue Service) to the individual identified on the tax return. The provision is effective for taxable years ending after October 21, 1998.

4. Restrict NOL carryback rules for specified liability losses

The Tax Extension Act limited the definition of specified liability losses that can be carried back 10 years. The provision is effective for net operating losses arising in taxable years ending after October 21, 1998.

E. Tax Technical Corrections Provisions

The Tax Extension Act made necessary technical corrections to recent tax legislation, including the Internal Revenue Service Restructuring and Reform Act of 1998, the Taxpayer Relief Act of 1997, and other tax legislation.

F. Revenue Offset for Medicare Home Health Provisions

1. Treatment of certain prizes

A prize winner who is provided the option to choose either cash or an annuity within 60 days after becoming entitled to the prize is not required to include amounts in gross income merely by reason of having the option. The provision is effective for prizes to which the taxpayer first becomes entitled after October 21, 1998. In addition, the provision applies to a prize to which the taxpayer became entitled before the date of enactment, if the taxpayer has the option to receive a single cash payment during the 18-month period beginning on July 1, 1999.

PART NINE: RICKY RAY HEMOPHILIA RELIEF FUND ACT OF 1998 (Sec. 103(h) of H.R. 1023)[15]

The Ricky Ray Hemophilia Relief Fund Act of 1998 provided that payments made under the Act to certain individuals with blood-clotting disorders who contracted HIV due to contaminated blood products are treated for purposes of the Internal Revenue Code as damages received on account of personal physical injury or physical sickness described in section 104(a)(2). The provision is effective on November 12, 1998.

[15] P.L. 105-369. H.R. 1023 was reported by the House Committee on Judiciary on March 25, 1998 (H. Rept. 105-465, Part I). The bill was reported by the House Committee on Ways and Means on May 7, 1998 (H. Rept. 105-465, Part II). The bill was passed by the House on May 19, 1998. The Senate Committee on Labor and Human Resources reported the bill on October 7, 1998. The Senate passed the bill on October 21, 1998. H.R. 1023 was signed by the President on November 12, 1998.

APPENDIX A: TOPICAL INDEX TO REVENUE PROVISIONS ENACTED DURING THE 105TH CONGRESS

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