EXPLANATION OF TAX PROPOSALS

RELATING TO

TAX CREDIT FOR CHILD CARE AND
CERTAIN HEALTH INSURANCE PREMIUMS,

SIMPLIFICATION OF SECTION 89 NONDISCRIMINATION
RULES APPLICABLE TO CERTAIN EMPLOYEE BENEFIT PLANS (S. 1129),

EXTENSION OF TELEPHONE EXCISE TAX, AND

ESTIMATED TAX PAYMENT REQUIREMENTS OF S CORPORATIONS

Scheduled for Markup

By the

SENATE COMMITTEE ON FINANCE

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Prepared by the Staff

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on June 13, 1989, on tax proposals relating to (A) tax credit for child care and certain health insurance premiums; (B) simplification of section 89 nondiscrimination rules applicable to certain employee benefit plans (S. 1129, introduced by Senator Bentsen and others); (C) extension of the telephone excise tax; and (D) estimated tax payment requirements of S corporations.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and an explanation of the tax proposals scheduled for the markup, and estimated revenue effects of the tax proposals.

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[1] This document may be cited as follows: Joint Committee on Taxation, _Explanation of Tax Proposals Relating to Tax Credit for Child Care and Certain Health Insurance Premiums, Simplification of Section 89 Nondiscrimination Rules Applicable to Certain Employee Benefit Plans (S. 1129), Extension of Telephone Excise Tax, and Estimated Tax Requirements of S Corporations_ (JCX-20-89), June 13, 1989.

EXPLANATION OF TAX PROPOSALS

A. Tax Credit for Child Care and Certain Health Insurance Premiums

Present Law

Child and dependent care credit

Under present law, an individual who maintains a household that includes one or more qualifying individuals is entitled to a nonrefundable tax credit equal to a percentage of the employment-related child or dependent care expenses paid by the individual for the taxable year to enable the individual to work (sec. 21). The maximum amount of the credit is 30 percent of allowable employment-related expenses. This 30 percent is reduced by one percentage point for each $2,000 (or fraction thereof) of the taxpayer's adjusted gross income (AGI) between $10,000 and $28,000. The credit rate is 20 percent for taxpayers with AGI in excess of $28,000.

The maximum amount of expenses that may be taken into account in calculating the credit is limited to $2,400 per year in the case of one qualifying individual and $4,800 in the case of more than one qualifying individual. In addition, the maximum amount of expenses taken into account cannot exceed the individual's earned income or, in the case of married taxpayers, the lesser of the individual's earned income or the earned income of his or her spouse. A special rule applies for determining the income of the taxpayer's spouse if the spouse is a full-time student or mentally or physically incapable of caring for himself or herself.

A "qualifying individual" is (1) a dependent of the taxpayer who is under the age of 13 and with respect to whom the taxpayer is entitled to claim a dependent exemption, (2) a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself, or (3) the spouse of the taxpayer, if the spouse is physically or mentally incapable of caring for himself or herself.

Tax provisions relating to individual health insurance

Present law generally does not provide tax benefits specifically designed to encourage the purchase of health insurance by individuals; however, present law does provide certain tax benefits for health insurance in particular circumstances.

Under present law, health insurance that is paid by an employer is generally excluded from an employee's gross income. This exclusion also applies for employment tax purposes. In addition, self-employed individuals are entitled to deduct 25 percent of the amount paid for medical insurance for the individual or his or her spouse or dependents; this provision is scheduled to expire for taxable years beginning after December 31, 1989. These provisions are subject to the application of nondiscrimination rules and certain other requirements.

Taxpayers who itemize deductions may deduct expenses for medical care (not compensated by insurance or otherwise) of the taxpayer or his or her spouse or dependents to the extent such expenses exceed 7.5 percent of the taxpayer's adjusted gross income. Premiums paid for health insurance qualify for the deduction.

Explanation of Proposal

The proposal would make the present-law dependent care credit refundable for certain taxpayers, would increase and modify the dependent care credit, and would allow an additional credit for expenditures for certain health insurance policies.

Health insurance credit

The proposal would amend the dependent care credit to add a new refundable credit for health insurance expenses. The proposal would provide that an individual who maintains a household containing one or more qualifying individuals is entitled to a credit equal to a percentage of the individual's qualified health insurance expenses. The maximum credit percentage is 50 percent of the qualified health insurance expenses. This 50 percent is reduced by 5 percentage points for each $1,000 (or fraction thereof) by which the taxpayer's adjusted gross income (AGI) exceeds $12,000. Thus, the credit is zero for taxpayers with AGI in excess of $21,000.

Qualified health insurance expenses are amounts paid during the taxable year for health insurance that includes coverage for one or more qualifying individuals. For purposes of this credit, a qualifying individual is a dependent of the taxpayer who is under age 19 and with respect to whom the taxpayer can claim a dependent exemption.

Up to $1,000 of qualified health insurance expenses may be taken into account in calculating the credit. However, the maximum expenses taken into account cannot exceed the earned income of the taxpayer, reduced by employment-related expenses taken into account in determining the child care credit. Expenses, to the extent paid, reimbursed, or subsidized by the Federal government or a State or local government, would not be eligible for the credit.

Eligible taxpayers may claim both the dependent care credit and the health insurance credit.

For taxable years beginning after December 31, 1991, the health insurance credit would be refundable on an advance payment basis.

<u>Refundable dependent care credit</u>

The proposal would make the present-law dependent care credit refundable. That is, taxpayers who do not have sufficient taxable income to offset the credit would be entitled to receive the amount of the credit not offset against tax liability in cash. However, under the proposal, taxpayers with adjusted gross income (AGI) in excess of $28,000 would not be entitled to claim the refundable credit, but instead would be eligible for the dependent care credit as under present law.

For taxable years beginning in 1990, the dependent care credit would be 50 percent refundable.

For taxable years beginning after December 31, 1991, the dependent care credit would be fully refundable on an advance payment basis (similar to the present-law earned income credit).

<u>Increase percentage of dependent care credit</u>

The proposal would increase the dependent care credit to 34 percent for taxpayers with AGI less than $8,000 and to 32 percent for taxpayers with AGI of at least $8,000 but less than $10,000. For taxpayers with AGI of at least $10,000, the credit rate would be the same as the present-law rate.

If the costs of child care are paid, reimbursed, or subsidized to any extent by the Federal government or a State or local government, expenses for such child care would not be eligible for the child care credit.

<u>Child health demonstration projects</u>

The proposal authorizes the appropriation of $25 million for each of the fiscal years 1990 through 1994 to enable the Secretary of Health and Human Services to conduct demonstration projects to evaluate and extend health insurance to children under age 19 who are not covered by other public or private health programs.

The Secretary is authorized to enter into agreements with public and private organizations (for example, schools and hospitals) to provide health insurance coverage to such children. The Federal government is to share up to 50 percent of the cost of programs under such agreements.

The health care program provided by an organization pursuant to such an agreement cannot restrict enrollment on the basis of a child's medical condition or impose waiting periods or exclusions for preexisting conditions. The program can also cover the parents of the child. The Secretary may permit the organization to charge for the health care.

The Secretary is directed to publish criteria governing the eligibility and participation of organizations in the demonstration projects by January 1, 1990.

GAO Study/IRS Information Program

The GAO, in consultation with the IRS, would be required to conduct a study to determine (1) the effectiveness of the advance payment system and (2) how to implement it to avoid administrative complexity for small business. A report to the Committee on Finance and the Committee on Ways and Means with recommendations would be required within one year after enactment.

The IRS would be required to undertake efforts to inform the public of the availability of the credit in order to assure that persons who may be eligible will know the requirements for receiving the credit and how to apply for it.

Effective dates

The refundability feature and the modifications to the present-law dependent care credit would be effective with respect to taxable years beginning after December 31, 1989. The health insurance credit would be effective for taxable years beginning after December 31, 1990.

Revenue Effect

(Fiscal years; millions of dollars)

Proposal	1990	1991	1992	1993	1994	1990-94
Dependent care credit	-40	-779	-1,680	-1,749	-1,912	-6,160
Child health insurance credit	--	-70	-1,473	-1,385	-1,368	-4,296

B. Simplification of Section 89 Nondiscrimination Rules Applicable to Certain Employee Benefit Plans (S. 1129)

Present Law

Nondiscrimination rules; in general

Under present law, the nondiscrimination rules contained in section 89 apply to certain types of fringe benefit plans, including employer-provided health plans. There are two different ways of testing for nondiscrimination: a 4-part test and a 2-part test. An employer is not required to test under both methods. The employer elects which method to apply.

Four requirements must be met under the 4-part test. First, at least half of the employees eligible to participate in the plan must be rank and file employees. This test is designed to limit the tax-favored treatment of plans primarily covering highly compensated employees (e.g., executive-only plans).

The second requirement is that at least 90 percent of the rank and file employees must have available to them a benefit at least half as valuable as the most valuable benefit available to any highly compensated employee. This test is designed to ensure that a significant percentage of rank and file employees have a minimum benefit available to them. For example, if the highest benefit available to any highly compensated employee is worth $1,000, then to pass this test, 90 percent of the rank and file employees must have available a benefit of at least $500.

The third requirement is that the value of coverage received by rank and file employees must be at least 75 percent of the average value of coverage received by highly compensated employees. This test is designed to ensure that rank and file employees actually receive a significant portion of the tax benefits spent for health coverage.

Finally, under the 4-part test, the plan may not contain any provision relating to eligibility to participate that discriminates in favor of highly compensated employees (the nondiscriminatory provisions test). This is a subjective test and is intended to be applied in situations that are not measured by the numerical tests, for example, where coverage for a rare disease is theoretically provided to all employees but in fact only the company president can benefit from the coverage. This test also applies to the method by which the employer tests.

Under the 2-part test, the following requirements must be satisfied. First, at least 80 percent of the employer's rank and file employees must be covered by the plan (or group of aggregated plans). This test was designed primarily for small employers.

The second requirement under the 2-part test is that the plan must satisfy the nondiscriminatory provisions test. This is the same test that is described above.

If an employer's plan does not meet one of the nondiscrimination tests, then the highly compensated employees must include in income the value of coverage received (e.g., insurance premiums) in excess of the maximum amount that could be received if the nondiscrimination rules were satisfied.

<u>Excludable employees; separate testing</u>

Certain employees are disregarded in applying the nondiscrimination tests. In general, the employees that may be excluded are: (1) employees who normally work less than 17 1/2 hours per week (i.e., part-time employees), (2) employees who normally work less than 6 months during a year (i.e., seasonal employees), (3) employees under age 21, (4) employees who have not completed a minimum service requirement, and (5) nonresident aliens.

In general, employees who are covered under a plan of another employer (e.g., a plan of the spouse's employer) may be disregarded in applying the nondiscrimination tests. In addition, under special rules, family coverage may be tested separately from other coverage and only by taking into account those employees with families. Under these rules, an employer's plans will not fail the nondiscrimination tests simply because more highly compensated employees have families than do rank and file employees.

<u>Highly compensated employees</u>

Under the rules relating to testing for nondiscrimination, a highly compensated employee is defined as an employee who, during the year or the preceding year, (1) was a 5 percent owner of the employer, (2) received compensation in excess of $70,000 (indexed) ($81,720 for 1989), (3) is an officer of the employer and received compensation in excess of $45,000 (indexed), or (4) received compensation in excess of $50,000 (indexed) ($54,480 for 1989) and was in the top-paid 20 percent of employees. In lieu of calculating the top-paid 20 percent of employees, the employer may elect to treat employees with compensation in excess of $50,000 (indexed) as highly compensated employees. An employer is treated as having at least one officer even if that officer does not have compensation in excess of the

$45,000 limit.

Qualification rules

In addition to the nondiscrimination rules, section 89 contains minimum requirements for health plans (and certain other types of plans). These rules require that a plan be in writing, legally enforceable, maintained for the exclusive benefit of employees, intended to be maintained indefinitely, and that employees be given reasonable notification of plan terms. If an employer's plan fails to satisfy the qualification rules, all employees participating in the plan must include in income the value of benefits (e.g., reimbursements) received under the plan.

Explanation of the Bill: (S. 1129)

Delay all present law section 89 rules

The bill delays the application of the section 89 nondiscrimination rules and qualification rules for one year, to plan years beginning after December 31, 1989.

Repeal present-law section 89 nondiscrimination rules and replace with simplified test

The bill replaces the current section 89 nondiscrimination rules for health plans with a single test (the "eligibility test"). In general, an employer's health plan passes section 89 if the plan is not discriminatory on its face and at least one plan or a group of plans providing primarily core health coverage is available to at least 90 percent of the employer's employees at an employee cost of no more than 40 percent of the total cost of the plan in the case of individual coverage, or 40 percent of the total cost of the plan in the case of family coverage (including coverage for the employee).

In order to provide employers flexibility in offering multiple health benefits with differing levels and percentages of employer contributions, a separate benefits test is provided. This test does not apply in cases in which the employer only makes one health plan available. Under the benefits test, the maximum tax-favored benefit that a highly compensated employee may receive is no more than 133 percent of the employer premium for the employee-only coverage that was taken into account in applying the eligibility test.

Under the benefits test, if a highly compensated employee elects a specific level of family coverage, and if the employer maintains a plan that provides family coverage that meets the requirements under the bill for the eligibility test, then the tax-favored premium is increased to 133 percent of the employer-paid family premium taken into account in applying the eligibility test. For purposes of testing under the benefits test, the bill makes permanent the temporary valuation rule under present law.

If a plan fails the eligibility test, highly compensated employees are to include in income the total value of coverage received under the plan.

If a plan passes the eligibility test, then a highly compensated employee must include in income only the employer-paid premium (if any) received by a highly compensated employee in excess of the level of employer-paid premium that meets the benefits requirement.

<u>Special rules for small employers</u>

The bill provides the following special rules for small employers:

(1) for purposes of the eligibility test, a small employer may disregard employees who are determined to be uninsurable by reason of a medical condition by the insurance company that provides core health coverage to the employees of the employer;

(2) a small employer may also exclude part-time employees normally working less than 30 hours per week in 1990, 27.5 hours per week in 1991, and 25 hours per week thereafter;

(3) in determining the number of employees who must be eligible for coverage under the eligibility test, an employer may round down to the nearest number of employees;

(4) a small employer may use average premium cost even if the employer's premium is calculated on an individually rated basis; and

(5) the written plan requirement under the qualification rules may be satisfied by a small employer by the insurance contract that is currently in effect relating to the coverage provided by the employer.

For purposes of the bill, a small employer is an employer with 20 or fewer employees.

<u>Part-time employees</u>

Under the bill, employees who normally work less than 25 hours a week are disregarded for purposes of the nondiscrimination tests (compared with 17.5 hours under present law). In addition, the employee premium and the employer-provided coverage may be proportionately adjusted for less than full-time employees. Under this rule, the maximum employee contribution limitation is increased to 60 percent for employees normally working between 25 and 30 hours per week. Further, for purposes of the benefits test, such an employee is treated as contributing only 40 percent of the total cost of the plan despite the higher contribution level.

Leased employees

Under the bill, the present-law historically performed test is repealed, and an individual will not be considered a leased employee unless the individual is under the control of the recipient organization. Persons who perform services incidental to the sale of goods or equipment or incidental to the construction of a facility are generally not leased employees.

The bill clarifies present law in that support staff of professionals continue to be treated as leased employees (to the extent they are not common law employees).

Union employees

The bill provides that plans maintained pursuant to collective bargaining agreements are tested separately with respect to employees covered by the agreement. The separate testing rule applies on a bargaining unit by bargaining unit basis.

In addition, multiemployer plans are generally exempt from the nondiscrimination rules of section 89. Finally, employees who are covered under the Davis-Bacon Act are excluded employees for purposes of the nondiscrimination rules.

Former employees

As under present law, the nondiscrimination tests are applied separately to former employees of the employer. Employees who separate from service prior to 1990 are not considered for purposes of testing. In addition, in determining whether the benefits are provided to former employees on a nondiscriminatory basis, the employer may consider only those employees who meet certain reasonable eligibility requirements relating to age or service. Under the bill, in applying the nondiscrimination tests to former employees, the mandatory employee contribution limits do not apply.

Individuals participating in certain government-sponsored programs

Under the bill, the following additional individuals may be excluded for purposes of determining whether the employer meets the nondiscrimination test: (1) senior citizens employed pursuant to Title V of the Older Americans Act or under the Environmental Programs Assistance Act of 1984; (2) students under certain programs qualified under Title VIII of the Higher Education Act of 1965; (3) inmates in state, local, or Federal correctional facilities and (4) similar classes of individuals as designated by the Secretary.

Definition of highly compensated employee

The bill amends the definition of highly compensated employee for purposes of section 89. Under the bill, only officers with compensation in excess of the $50,000 limitation (indexed to $54,480 for 1989) that is otherwise applicable for determining who are highly compensated employees are to be considered highly compensated employees.

In addition, the bill requires that the compensation levels specified in the definition of highly compensated employee will be rounded to the nearest $1,000 beginning in 1990.

Cafeteria plans

The bill provides special rules for the treatment of salary reduction contributions. For purposes of the eligibility test, the general rule is that salary reduction contributions are treated as employee contributions.

For purposes of both the eligibility and benefits tests, certain salary reduction contributions are treated as an employer-provided benefit. These salary reduction amounts are those that relate to the plan being considered and that are available to the employee only to the extent that: (1) the employee has core health coverage elsewhere; (2) the employee does not elect any core health plan maintained by the employer; and (3) such amount is available in cash to the employee.

In determining the employer-provided portion of the qualified core health plan that is multiplied by 1.33 to determine the benefits limitation under the benefits test, certain salary reduction amounts other than those amounts described in the preceding paragraph may also be considered (to the extent that such amounts relate to the plan in question). These additional salary reduction contributions are treated as employer-provided to the extent they do not exceed the employer-provided premium relating to such plan, excluding all salary reduction contributions.

For purposes of determining the employer-provided coverage provided to the highly compensated employees, all salary reduction contributions are considered employer-provided.

Group-term life insurance

The bill provides that the nondiscrimination rules in effect prior to the Tax Reform Act of 1986 (with certain modifications) apply to group-term life insurance for years beginning in 1989 (sec. 79(d)).

For years beginning after December 31, 1989, the nondiscrimination rules applicable to group-term life insurance are modified to compare highly and nonhighly compensated employees, rather than comparing key and non-key employees. In addition, the Tax Reform Act rule that group-term life insurance is discriminatory to the extent it takes into account compensation in excess of $200,000 in determining a multiple of compensation benefit is retained.

Under the bill, accidental death and dismemberment plans (AD&D) are treated as group-term life insurance plans solely for purposes of nondiscrimination testing.

Dependent care assistance programs

Under the bill, section 89 does not apply to dependent care assistance programs. For plan years beginning in 1989, the present-law nondiscrimination rules under section 129(d) are applicable to such plans and are modified as follows: (1) if a plan fails to meet the requirements of section 129(d), only highly compensated employees are required to include benefits under the program in gross income, and (2) if a dependent care assistance program fails the 55-percent benefits test (sec. 129(d)(7)), then the highly compensated employee is required to include in gross income only that amount of benefit in excess of the level of benefit that would meet the benefits test.

Election not to test

Under the bill, an employer may elect to forego testing and instead include the employer premium for health coverage as taxable income on the W-2 of highly compensated employees.

Qualification rules

The bill replaces the present-law sanction for failure to satisfy the qualification rules with an excise tax on the employer and makes certain modifications to the qualification standards. Under the bill, the qualification rules no longer apply to any plan the benefits under which are excludable under section 132, (i.e., no-additional-cost services, qualified employee discounts, and employer-provided eating facilities).

The bill modifies the exclusive benefit requirement by providing that the requirement is not violated merely because nonemployees or other individuals without a service nexus to the employer are covered under the plan on an after-tax basis.

The bill replaces the present-law sanction with an excise tax on the employer. Under the bill, no penalty applies with respect to a failure to satisfy the qualification rules if the employer corrects the failure to comply within 6 months of the date the employer knew or should have known of such failure. If the employer does not correct the failure within this 6-month period, then an excise tax is imposed. The excise tax is equal to 34 percent of the costs paid or incurred by the employer for coverage under the plan that relates to the failure. In the event of a willful failure to comply with the qualification requirements, the tax is imposed from the date of the failure without regard to any subsequent correction. Under the bill, the Secretary is authorized to waive the excise tax in whole or in part if the failure is not due to willful neglect and to the extent the payment of the tax would be excessive relative to the failure involved. In the event the failure relates to a multiemployer plan, the excise tax is imposed on the plan.

Good faith compliance

Under the bill, until the Secretary issues guidance on which taxpayers may rely with respect to the provisions of the bill, an employer's compliance with its reasonable interpretation of such provision, based on the statute and its legislative history, if made in good faith, constitutes compliance with the provision.

The bill also provides that, with respect to lines of business that do not meet the guidance issued by the Secretary, the good faith standard applies to the determination of whether lines of business are separate until the Secretary begins issuing rulings relating to lines of business.

Prior legislative history relating to any provision amended by the bill (including the rules of section 89) and guidance issued by the Secretary pursuant to any such provision continue in effect unless directly inconsistent with the provisions of the bill.

Effective date

The new discrimination rules relating to section 89 are generally effective for plan years beginning in 1990. An employer is permitted an election to use present law with respect to its plans for 1990 and 1991. This election relates to all plans of the employer and may be made on an annual basis. The employer may also elect to use present law to test its dependent care assistance programs under section 89 for 1990 and 1991. Whether or not the employer makes such election, the changes under the bill that relate to part-time employees apply.

Revenue Effect

(Fiscal years; millions of dollars)

Proposal	1989	1990	1991	1992	1993	1994	1990-94
One-year delay and simplification of sec. 89 (S. 1129)	-20	-57	--	--	--	--	-77

C. Extension of the Telephone Excise Tax

Present Law

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service. The tax is collected by the provider of the service from the consumer (business and personal service). The tax is scheduled to expire after December 31, 1990.

Under present law, the tax for a semi-monthly period is considered as collected during the second following semi-monthly period. Such tax is to be deposited within 3 banking days after the end of the semi-monthly period for which the tax is considered collected. (Rev. Proc. 76-45, 1976-2 C.B. 668).

The 3-percent telephone excise tax was last extended for 3 years (1988-1990) in the Omnibus Budget Reconciliation Act of 1987. The 3-percent tax was previously extended for 2 years (1986-1987) in the Deficit Reduction Act of 1984.

Explanation of Proposal

The 3-percent telephone excise tax would be made permanent. This proposal is included in the Administration's budget proposal.

Under the proposal, the tax for a semi-monthly period would be considered collected during the first week of the second following semi-monthly period. The tax would be required to be deposited within 3 banking days after the end of the period for which such tax is considered to be collected.

The proposal would be effective on the date of enactment. The proposal with respect to the time the tax is considered collected is effective with respect to taxes considered collected after August 15, 1990.

Revenue Effect[2]

(Fiscal years; millions of dollars)

Proposal	1990	1991	1992	1993	1994	1990-94
Permanently extend 3% telephone excise tax	--	1,612	2,732	2,930	3,143	10,417
Modification of collection period	102	7	8	8	9	134

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2 Net effect on budget receipts, after income and payroll tax offsets.

D. Estimated Tax Payment Requirements of S Corporations

Present Law

As a general rule, an S corporation is not subject to tax on its taxable income. Rather, that income flows through to its shareholders in a manner similar to a partnership. However, there are limited instances when an S corporation is subject to tax. These instances include (1) the recognition of a "built-in" gain within 10 years of the date that a former C corporation elected S corporation status (sec. 1374(a)); (2) the receipt of passive investment income in excess of 25 percent of total annual gross receipts if the corporation has undistributed earnings and profits from a year in which it was subject to tax under subchapter C of the Code (sec. 1375(a)); and (3) the recapture of investment tax credits claimed during a taxable year in which the corporation was not an S corporation (sec. 1371(d)).

Although situations exist where an S corporation is liable for income tax, present law does not require such corporation to make estimated tax payments. Instead, the tax must be paid no later than the unextended due date of the S corporation tax return.

Explanation of Proposal

The proposal would provide that an S corporation is required to make estimated tax payments if it (1) recognizes a built-in gain under section 1374(a); (2) has tax imposed on excess passive income under section 1375(a); or (3) is required to recapture investment tax credits under section 1371(d). The rules for estimated tax payments by corporations contained in section 6655 would generally apply.

The proposal would provide that for purposes of estimated tax payments on built-in gains and investment tax credit recapture, an S corporation would not be able to utilize the exception which allows estimated tax payments to be based on the corporation's prior year tax (sec. 6655(d)(1)(B)(ii)). The prior year's tax exception would be available with respect to the required estimated tax payment attributable to excess passive income. In all situations, an S corporation would be able to use the annualization exception (sec. 6655(e)).

The proposal would be effective for estimated tax payments due after the date of enactment.

Revenue Effect

(Fiscal years; millions of dollars)

Proposal	1989	1990	1991	1992	1993	1994	1989-94
Estimated tax payments of S Corps.	25	(1)	(1)	(1)	(1)	(1)	25

(1) Gain of less than $5 million.