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Overview of 1997 New Tax Laws

Introduction

The Congress passed and the President signed into law, on August 5, 1997, three new laws containing tax provisions or affecting the conduct of Internal Revenue Service employees. These new laws are:

The Balanced Budget Act of 1997, Public Law 105-33;

The Taxpayer Relief Act of 1997, Public Law 105-34; and

Taxpayer Browsing Protection Act, Public Law 105-35.

Objective

This document is intended for all Internal Revenue Service employees to provide them **only** with a summary of the provisions contained in the three new tax laws and should not be considered a training document, nor is it intended to replace formal structured training material.

Detailed training on these new laws will be developed for employees in the future.

Technical Corrections

At the time this document was going to print, Congress was expressing the possibility of new legislation before the end of 1997 to enact a "Technical Corrections" act regarding numerous provisions found in the Taxpayer Relief Act of 1997. If such legislation is passed, and signed into law, explanations contained in this document would change for affected sections.

TAXPAYER BROWSING PROTECTION ACT of 1997

Criminal Penalty Sec. 2

A new criminal penalty has been established for the willful, unauthorized inspection of a tax return or return information. The penalty imposes a maximum of:

- $1,000 fine; and/or
- up to one year imprisonment, plus
- costs of prosecution.

The penalty applies to all federal employees, state employees, and contractors who receive federal tax information. In addition, if convicted, a federal employee will be dismissed from employment.

Effective for inspections or disclosures made on or after August 5, 1997.

Civil Penalties Expanded Sec. 3

Existing civil penalties (maximum of $1,000 or actual damages) for the unauthorized disclosure of returns or return information are expanded to cover the unauthorized inspection of returns or return information.

The civil penalties apply to all federal employees, state employees, and contractors who knowingly, or due to negligence, inspect or disclose returns or return information.

The civil penalties will not apply to:

- accidental or inadvertent inspection;
- inspections resulting from good faith, but erroneous, interpretations of § 6103; or
- inspections requested by the taxpayer.

Taxpayers are required to be notified of an unauthorized inspection or disclosure once a person is criminally charged by indictment.

Effective for violations occurring on or after August 5, 1997.

BALANCED BUDGET ACT of 1997

Medicare+Choice MSAs
Sec. 4006

Medical savings accounts are being made available to Medicare eligible individuals. Of the options available, a new option is the Medicare+ Choice MSA. Under this plan, the Secretary of Health and Human Services makes specific contributions directly to a designated Medicare+Choice MSA account to which no other contribution can be made. The contributions, as well as earnings on amounts held in the account, would not be included in the individual's gross income.

Withdrawals used for qualified medical expenses are not taxable. All other withdrawals, except due to the death or disability of the MSA holder, are includible in income and subject to an additional tax of 50 percent on the amount the total distribution for nonmedical purposes exceed the amount by which the value of the MSA, as of December 31 of the preceding year, exceeds 60 percent of the deductible of the account holder's MSA plan.

Effective for taxable years beginning after December 31, 1998.

Hospitals Which Participate in Provider-Sponsored Organizations
Sec. 4041

An organization exempt under §501(c)(3) may continue to be considered "organized and operated exclusively for a charitable purpose" even though it owns and operates a hospital which participates in a provider-sponsored organization (PSO), whether or not the PSO is exempt from tax.

Effective August 5, 1997.

Extension of Certain Payer Provisions
Sec. 4631

Medicare's data match program, which matches beneficiaries against Social Security and Internal Revenue Service data files is made permanent.

Effective August 5, 1997.

Election Workers Exempt from Unemployment Tax
Sec. 5405

Compensation paid to an election worker or official is not subject to state unemployment compensation tax if total annual wages received for the services are less than $1,000.

Effective August 5, 1997.

Treatment of Certain Services Performed by Inmates Sec. 5406	Amounts paid for services performed by inmates of a penal institution are not subject to FUTA taxes. In addition, inmates are ineligible from claiming unemployment benefits based on compensation for services performed while an inmate of a penal institution. Effective retroactively for services performed after January 1, 1994.
Certain Religious School Workers Exempt from FUTA Sec. 5407	Work performed in an elementary or secondary school operated primarily for religious purposes is exempt from Federal Unemployment Tax and Unemployment Insurance. Effective August 5, 1997.

TAXPAYER RELIEF ACT of 1997

1. INDIVIDUALS

Child Tax Credit
Sec. 101

Credit Amount

Beginning with the 1998 tax year, a new $400 credit is allowed for each qualifying child under age 17. The credit increases to $500 beginning in 1999.

Tax Treatment

Generally, the child credit is limited to the net tax liability after credits other than EIC. For families with one or two children it is non-refundable, but may be refundable for families with three or more children.

Credit Phase-out

The child credit is reduced (phased out) by $50 for each $1,000 that AGI exceeds:

$110,000 for taxpayers filing jointly;
$ 55,000 for married filing separately; and
$ 75,000 for single filers.

Qualifying Child

A son, daughter, grandchild or qualifying foster child for whom the taxpayer claims a dependency exemption is eligible for credit. Name and social security number of qualifying child(ren) must be shown on the return. If omitted, IRS can recompute the tax liability and deny the credit under the math error procedures. Taxpayers may claim both the dependency exemption and the child tax credit.

Amount of Credit Allowed

Generally, the credit is $500 ($400 in 1998) times the number of qualifying children.

Nonrefundable Credit Limit: If the taxpayer has one or two children, the child tax credit is not refundable. Like other nonrefundable credits, the amount of child tax credit allowed is further limited to the amount of the taxpayer’s regular tax liability minus the tentative minimum tax liability.

Refundable Credit Limit: If the taxpayer has three or more children, a portion of the child tax credit may be refundable. The amount of the credit limit is the greater of:

1. the nonrefundable credit limit (regular tax liability minus tentative minimum tax liability), or

2. the taxpayer's regular tax liability minus the tentative minimum tax liability, plus social security taxes and one-half of the self-employment taxes, minus earned income credit.

If the amount of the credit calculated using method 2 is greater than the credit calculated using method 1, the amount of the excess is a refundable credit.

Supplemental Child Credit

A portion of the child tax credit allowed a taxpayer who is also entitled to the earned income credit may be treated as a supplemental child credit under the earned income credit. The supplemental child tax credit is determined as follows:

1. calculate the amount using the nonrefundable credit limit; and

2. calculate the amount using only item 2. of the refundable credit limit.

Subtract 2 from 1. The amount of the excess is the supplemental child credit under the earned income credit. The supplemental child credit does not reduce the amount of the earned income credit allowed. It is subtracted from the regular child tax credit to prevent the taxpayer from receiving a double credit.

Increased Meal Expenses Sec. 969

The away-from-home deduction for certain food and beverage expenses of individuals subject to the hours of duty limitations in Department of Transportation (DOT) regulations, is increased for taxable years beginning in 1998, phased in according to the following schedule:

Tax Year Begins in	Deductible Percentage
1998, 1999	55
2000,2001	60
2002,2003	65
2004, 2005	70
2006, 2007	75
2008, and thereafter	80.

Affected Transportation Employees	Benefiting from this increase are the following DOT regulated workers: - certain air transportation employees (pilots, crew, dispatchers, and control tower operators), - certain interstate truck and bus operators, - certain railroad employees (engineers, conductors, train crews, dispatchers and control operators), and - certain merchant mariners.
Meals Provided on Premises - De Minimis Fringe Benefit Sec. 970	Effective for taxable years beginning after 1997, for purposes of determining whether an employee cafeteria qualifies as a de minimis fringe eating facility,meals provided to employees in the cafeteria for the convenience of the employer are treated as if the employees had paid for them in an amount equal to the direct costs of the meals.
Mileage Rate for Charitable Use of Automobile Sec. 973	The mileage rate is increased to 14 cents for individuals who use their autos to perform activities for charitable organizations. Effective for tax years beginning in 1998.
Computing AGI for Expenses in Connection with Service Performed by Certain Officials Sec. 975	Employee business expenses incurred by an official of a State or local government are deductible in computing adjusted gross income if the official is compensated in whole or part on a fee basis. The expenses are also deductible for minimum tax purposes. Effective for expenses paid or incurred in taxable years beginning after December 31, 1986.

Improved Earned Income Credit Compliance
Sec. 1085

Denial of EIC	A taxpayer who fraudulently claims the earned income tax credit cannot claim the EIC for the next 10 years. A taxpayer who erroneously claims the EIC due to reckless or intentional disregard of rules and regulations cannot claim the EIC for the next two years. These sanctions are in addition to any other penalty imposed under current law including the accuracy-related penalty and fraud penalty. Effective for final determinations made with respect to tax years beginning after December 31, 1996.

Eligibility Requirements After Denial of EIC

If the IRS denies a taxpayer's claim for the EIC through the deficiency procedures, the taxpayer cannot claim the EIC in a subsequent year unless information required by the IRS is provided to show that the taxpayer is eligible to claim the EIC. The IRS will send the taxpayer information about how to establish eligibility to claim the EIC. If the required information is not provided, any claim for the EIC will automatically be denied. Eligibility requirements do not apply if the IRS disallows all or part of the EIC due to a mathematical or clerical error.

Effective for denials made with respect to taxable years beginning after December 31, 1996.

Due Diligence Requirements for Paid Preparers

Beginning with the 1997 return, return preparers are required to fulfill certain due diligence requirements for income tax returns they prepare claiming the EIC. These due diligence requirements will be established by the IRS. Return preparers who fail to meet these requirements are subject to a penalty of $100 for each failure.

Definition of Modified AGI Used to Phase out EIC

Beginning with the 1998 return, modified AGI is expanded to include tax-exempt interest and nontaxable distributions from pensions, annuities and individual retirement arrangements not rolled over. Also, the amount of net loss from carrying on trades or businesses that must be added back to AGI in computing modified AGI is increased from 50 to 75 percent.

Treatment of Workfare Payments

Beginning with the 1998 return, earned income for the purposes of the EIC does not include certain workfare payments. These are payments identified in section 407(d) of the Social Security Act (42 U.S.C. § 607(d) as either (1) word experience (including work associated with the refurbishing of publicly assisted housing) if sufficient private sector employment is not available, and (2) community service programs.

Involuntarily Converted Property Replacement from Unrelated Person Sec. 1087

The present denial of deferring the gain realized on involuntarily converted property replaced with property from a related person is modified to apply to all taxpayers, including individuals. The denial applies to any taxpayer that acquires replacement property from a related party, unless the taxpayer has aggregate realized gain on the conversion of $100,000 or less for the taxable year. The $100,000 annual limitation applies both to each partner and the partnership, and applies both to each shareholder and the S corporation.

Effective for involuntary conversions occurring after June 8, 1997.

Estimated Tax Penalty - Safe Harbor Sec. 1091

For estimated tax payments for taxable years beginning before 1998, individuals with AGI of $150,000 may avoid estimated tax penalties if their estimated tax payments equal 110 percent of the tax shown on last year's return. The percentages are changed as follows:

- for 1998:	100 percent of the prior year's tax;
- for 1999, 2000, and 2001:	105 percent of the prior year's tax;
- for 2002:	112 percent of the prior year's tax;
- for 2003 and thereafter:	110 percent of the prior year's tax.

Waiver of Estimated Tax Penalties Sec. 1 (d)

No estimated tax penalty will be assessed with respect to individuals or corporations for any payment due before January 16, 1998, on an underpayment created or increased by the Taxpayer Relief Act of 1997.

Dependents: Standard Deduction and Modified AMT Sec. 1201

The standard deduction for dependents increases to the lesser of:

- the standard deduction for single taxpayers, or

- the greater of $500 (indexed for inflation) or the individual's earned income plus $250.

The $250 is indexed for inflation after 1998.

The Alternative Minimum Tax exemption for children under age 14 is increase to the lesser of:

- $33,750, or

- the sum of the child's earned income plus $5,000.

After 1998, the $5,000 is indexed for inflation.

Effective for taxable years beginning after December 31, 1997.

Estimated Tax Threshold for Individuals

Beginning in 1998 the $500 threshold for determining if an estimated tax penalty applies is increased to $1,000.

Sec. 1202 For taxable years beginning in 1998.

Reimbursed Expenses of Rural Letter Carriers' Personal Vehicles Sec. 1203

The special mileage rate for rural letter carriers is repealed. The rate of reimbursement provided by the Postal Service under the 1991 collective bargaining agreement is considered to be equivalent to their vehicle expenses. This reimbursement is treated as if paid under an accountable plan. The rate specified in the 1991 agreement may be increased by no more than the rate of inflation.

Effective for taxable years beginning in 1998.

Travel Expenses of Federal Employees Participating in a Federal Criminal Investigation Sec. 1204

The one-year limitation with respect to the deductibility of away-from-home travel expenses does not apply to federal employees certified by the Attorney General as traveling in a temporary duty status to investigate (or to provide for the investigation of) a federal crime. Thus, traveling expenses of these individuals during these periods are deductible during the period certified, as long as other requirements for claiming the deduction are met.

Effective for taxable years ending after August 5, 1997.

Payment of Tax by Commercially Acceptable Means Sec. 1205

Generally, the acceptable payment of taxes is primarily by checks or money orders. System changes to accept other commercial payments are designed to generate additional revenue through improved voluntary compliance by reducing taxpayer burden. Also, these changes are expected to achieve greater productivity within the IRS.

Credit, Debit, and Charge Card Payments

Effective May 1, 1998, the IRS may accept debt card, credit card, and charge card payments by commercially acceptable means to the extent and under the conditions deemed appropriate by the Secretary of the Treasury.

Resolution of Billing Errors

Billing errors arising from credit card transactions are resolved according to § 161 of TILA. Debit card billing errors are governed under § 908 of EFTA. Examples of billing errors include transactions posting:

- to the cardholder's account without authorization,
- to the wrong cardholder's account, or
- an incorrect amount.

Overpayments

The IRS is authorized to utilize the appropriate credit or debit card system to initiate a credit to the taxpayer's credit or debit card account when so entitled.

Disclosure

The Secretary of the Treasury is directed to issue published procedures on what constitutes authorized uses and disclosure. It is anticipated these procedures will prohibit:

- tax transaction information for marketing tax related services,
- marketing that targets only individuals who use their credit card to pay their taxes, and
- the sale of transaction information to a third party.

Additional disclosure procedures are necessary since the public may largely be unaware of how widely credit card transaction information is shared. Some financial institutions share credit, payment and purchase information with private credit bureaus who in turn sell it to marketing companies.

Clarification of Period for Filing Claims for Refund Sec. 1282

Certain taxpayers are permitted to obtain a refund of excessive amounts paid within the three-year period prior to the date of the mailing of a notice of deficiency. These are taxpayers who initially fail to file a return, but who are mailed a notice of deficiency and file suit to contest in Tax Court during the third year after the due date of the return, with extensions.

Effective for certain Tax Court refund claims with tax years ending after August 5, 1997.

Repeal of Authority to Disclose Audit of Prospective Juror Sec. 1283

The requirement that the Secretary disclose, upon written request of either party to the lawsuit, whether an individual has or has not been the subject of an audit or other tax investigation of the IRS is repealed.

Effective for judicial proceedings commenced after August 5, 1997.

Clarification of Statue of Limitations Sec. 1284

The return of the taxpayer, not the return of the pass-through entity from whom income, gain, loss, or credit is received, starts the running of the statue of limitation.

Effective for tax years beginning after August 5, 1997.

Awarding Administrative Costs Sec. 1285

A taxpayer who seeks an award of administrative costs must apply for such costs within 90 days of the date on which the final decision of the IRS as to the determination of the tax, interest, or penalty is mailed to the taxpayer. Also, a taxpayer who seeks review of an administrative cost award must petition the Tax Court within 90 days after the date that the IRS mails the denial notice. Dispositions by the Tax Court of petitions relating only to administrative costs are to be reviewed in the same manner as other Tax Court decisions.

Effective for civil actions or proceedings commencing after August 5, 1997.

Puerto Rico Tax Withholding from Federal Employees Sec. 1462

Clarification is given by making any Commonwealth eligible to make an agreement with the Secretary of Treasury to withhold income tax from the wages of Federal employees.

Effective January 1, 1998.

2. CAPITAL GAINS

20 Percent Maximum Rate for Individuals Sec. 311

A lower capital gain tax rate may be available for all taxpayers, not just those in the 31 percent income tax bracket. Net gain from sales, exchanges, or conversions (including installment payments received) of certain capital assets (for example; stock but not collectibles) after May 6, 1997 may have the 20 percent new capital gain tax rate, instead of 28 percent (this rate is generally 10 percent for individuals whose tax rate on ordinary income is 15 percent). Pass-through entities, such as trusts, estates, partnerships, and sub S corporations determine when a gain or loss is taken into account for their beneficiaries or investors.

Sales Before May 7, 1997

The lower rates will generally not apply to net gain from capital assets sold, exchanged, or converted (including installment payments received) before May 7, 1997.

Sales Between May 7, 1997 and July 28, 1997

The lower rates will generally apply to net gain from certain capital assets sold, exchanged, or converted (including installment payments received) after May 6, 1997, and before July 29, 1997, for assets held more than one year, but not more than 18 months.

Sale of Principal Residence

Sec. 312

Exclusion of Gain For sales of a principal residences occurring after May 6, 1997, taxpayers may exclude gain if certain ownership and use requirements are met. Unless taxpayers make an election, the old rules relating to the postponement of gain in a rollover transaction and the $125,000 exclusion for individuals over age 55 do not apply to sales after May 6, 1997.

Taxpayers can elect to have the old rules apply for sales:

- on or before August 5, 1997;
- on or after August 5, 1997, pursuant to a contract that was binding on August 5, 1997; or
- on or after August 5, 1997, if, under the old rollover transaction rules, gain would not have been recognized because a replacement residence was acquired (or pursuant to a binding contract) on or before August 5, 1997.

Exclusion Amount If the ownership and use requirements are met, taxpayers can exclude up to $250,000 ($500,000 for certain joint returns), of gain from gross income. For a joint return, each spouse can exclude up to $250,000 if the ownership and use requirements are met. There is an additional limitation that taxpayers can only exclude gain in excess of depreciation adjustments (such as for business or rental use) after May 6, 1997.

Ownership and Use Requirements The taxpayer must own and use the property as a principle residence for periods totaling at least two years during the five-year period prior to the sale. Taxpayers who fail to meet these requirements due to a change in their place of employment or health are allowed to exclude a fraction of the $250,000 ($500,000 for certain joint returns) equal to the ratio that the total periods of ownership and use compare to two years.

There are also exceptions to the two-year use requirement for:

- property transferred by a spouse;
- property owned by a spouse or former spouse;
- property acquired after an involuntary conversion;
- property acquired in a rollover transaction;

- periods of out-of-residence care in a nursing home; and

- property of a deceased spouse (an exception to the ownership requirement also applies to such property).

Sales Within a Two-Year Period

Taxpayers are allowed to exclude gain on the sale of a principle residence only once every two years (sales prior to May 7, 1997, are not counted for this purpose). An exception to this rule is allowed for sales due to a change in health or employment. For such sales, taxpayers are allowed to exclude a fraction of the $250,000 ($500,000 for certain joint returns) equal to the ration that the period from the most recent sale to the current sale compares to two years.

Sales Excepted From Reporting Requirements

Persons closing real estate transactions are not required to file information returns reporting the sale of a personal principal residence if the sales price does not exceed $500,000 ($250,000, if unmarried).

Eligible Transactions

The seller must provide a written assurance to persons who close real estate transactions. The written assurance must state:

- the property is the seller's principal residence; and

- the full amount of the gain from the sale or exchange is excludable from gross income.

Effective for principal residence transactions occurring after May 6, 1997.

Rollover of Gain from Sale of Certain Small Business Stock Sec. 313

Qualified small business stock (QSBS) is issued by a corporation whose gross assets did not exceed $50 million. Also, the corporation must meet active trade or business requirements. After August 5, 1997, taxpayers may defer capital gains from the sale of QSBS held for more than six months.

Maximum Capital Gain Tax

The 28 percent rate (or 15 percent for individuals whose tax rate on ordinary income is 15 percent) generally applies to an amount equal to the gain excluded from gross income. The lower rate of 20 percent generally does not apply to the sale of qualified small business stock. However, the effective tax rate on gain from the sale of the stock is generally 14 percent (or 7.5 percent) because individuals may exclude 50 percent of the gain, up to a certain amount, from the sale of small business stock held for five years or more.

Note: because the 50 percent exclusion only applies to stock issued after August 10, 1993, the effective rate of 14 percent (or 7.5 percent) described above will not apply until after August 10, 1998.

Minimum Tax Preference Preference amount is 42 percent instead of 50 percent.

Tax-free Rollover To qualify for the tax-free rollover, there must be a purchase of qualified small business stock within 60 days of the sale of other qualified small business stock.

Gain on Rollover Initial gain realized that is not used to purchase replacement small business stock within 60 days will be recognized. The amount of initial gain deferred by purchasing the replacement stock will decrease the basis of the replacement stock in the order of purchase. The replacement stock can be purchase at different times during the 60 day period.

Rules for Replacement Stock The corporation must continue as an active business for six months after the small business stock roll over to postpone the gain from the sale of the first stock. If it meets the active business test, the holding period for the replacement stock will include the period of the stock sold.

Recognized gain The amount that was not spent to purchase qualified replacement stock within 60 days of the small business stock is recognized in the year of sale.

Effective for sales occurring after August 5, 1997.

Corporate Capital Gains Sec. 314 The amount of gain subject to the alternative tax rate may not exceed the corporation's taxable income. However, the alternative tax does not currently apply. Thus, this change will not have any effect under the capital gain tax rate of present law.

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3. EDUCATION INCENTIVES

HOPE Scholarship and Lifetime Learning Credits

Sec. 201

Two New Credits

Two new credits for post-secondary educational expenses are created: HOPE Scholarship Credit and lifetime Learning Credit. Depending on eligibility, a taxpayer may only claim one of the credits with respect to a particular student for a particular year. Neither credit may be claimed if the student made a tax-free withdrawal from an education IRA that year. The credits are phased out for AGI above $40,000 ($80,000 for married filing jointly) and eliminated completely for AGI over $50,000 ($100,000 for married filing jointly).

HOPE Scholarship Credit

Beginning in 1998, a maximum credit of $1,500 may be allowable for qualified tuition and related expenses paid for enrollment in post secondary undergraduate programs. Enrollment cannot be less than half of the full-time workload for the course of study the student is pursuing. The HOPE Scholarship Credit is not allowed with a student convicted of a felony drug offense.

Only qualified tuition and related expenses paid for enrollment in the first two years of post-secondary education are allowed. Graduate and professional level program fees are not allowed. Taxpayers must reduce the amount of tuition expenses eligible for the HOPE Scholarship Credit by any grants or exempt scholarship and fellowships credited to the student's account for that tax year.

Lifetime Learning Credit

Unlike the HOPE Scholarship Credit, the Lifetime Learning Credit applies to qualified tuition and related expenses for undergraduate, graduate level and professional degree courses. The Lifetime Learning Credit can be used for an unlimited number of years, as long as the taxpayer or eligible dependents are pursuing post secondary education. For expenses paid after June 30, 1998, for education furnished for academic periods beginning after that date, a maximum Lifetime Learning Credit of $1,000 per taxpayer return may be claimed. Beginning in 2003, the maximum credit increases to $2,000.

Who Claims the Credits

Under either credit, either the parent or the student may claim the credit. However, if the parent claims tuition and related expenses paid for a dependent child, the dependent cannot claim the credit. When both taxpayer and dependent have paid these expenses, the party claiming the credit is deemed to have paid the expenses paid by the other. Both cannot claim credits, only one person. If the taxpayer is married, the credit may only be claimed on a joint return. The credits are not allowed unless the student's

TIN is on the return. Math error procedures apply for missing TINs.

Qualified Educational Expenses

The definition of qualified educational expenses is identical for both educational provisions:

- qualified tuition and related expenses include qualifying amounts paid for enrollment or attendance of the taxpayer, the taxpayer's spouse, of the taxpayer's dependent in an eligible institution;

- an eligible institution is generally an institution that is eligible to participate in the Department of Education student aid programs and which is accredited and offer credits toward an associate, bachelor's, graduate-level or professional degree or other recognized credentials, including accredited vocational schools;

- charges and fees for books, meals, lodging, activities, athletics, insurance, transportation, and similar personal living or family expenses are not included when computing the credit. Charges for any course or other education involving sports, games, or hobbies are not included unless required by the student, degree program; and

- both credits may be claimed for qualified tuition and related expenses paid with loan proceeds.

Interest on Education Loans Sec. 202

Interest Deduction on Qualified Education Loans

Effective in 1998, a limited interest deduction will be allowed to taxpayers for interest paid on qualified higher education loans in the 1998 tax year and after. These educational loans must have paid qualified expenses of either the taxpayer, taxpayer's spouse, or any dependent of the taxpayer at the time the debt was incurred. The educational expenses for an eligible student must be paid within a reasonable period before or after the debt was created. The eligible student must be enrolled for half the normal full-time course load required for their chosen program of study.

Qualified Higher

Generally, tuition, fees, room and board, and related expenses (books and

Education Expenses for Interest Deduction

supplies) must have been paid from loan proceeds. Also, to qualify, the loans must be for a period the taxpayer was enrolled and attending a degree, certificate, or other program leading to credentials at an accredited post-secondary educational institution, vocational school, hospital or health care facility that offer postgraduate training.

Maximum Interest Deduction

Currently, the maximum interest deductions (not indexed for inflation) is:

Tax year	Maximum interest
1998	$1,000
1999	$1,500
2000	$2,000
2001 and after	$2,500

Deduction Phase-out

The educational interest deduction phases out ratably for taxpayer with modified AGI of $40,000-$50,000 ($60,000-$75,000, joint returns). Phase-out income ranges will be indexed for inflation in the year 2003. In calculating modified AGI, disregard the education interest deduction.

Period Deduction Allowed

The deduction for higher education loan interest is limited to the first 60 months interest payments are required and repaid. Months in which the education loan is deferred do not count against the 60 months. If an original loan is refinanced, both are treated as a single loan. Any portion of the 60 months remaining from the original loan, is applied to the refinanced loan.

Caution: An education loan interest deduction is not allowed to individuals who are claimed as dependents on another's return nor to a married taxpayer who files a separate return. Individuals who meet the rules for living apart and not considered married may claim the deduction.

Where to Deduct

This is an "above the line" deduction taken as an adjustment on Forms 1040EZ, 1040A or 1040. Schedule A, Itemized Deduction is not required. However, if the interest is paid from a source otherwise allowed as an itemized deduction (i.e. home equity loan), the interest expense cannot be taken as qualified education loan interest.

Penalty-free Withdrawals from IRAs for Higher Education

The 10-percent additional tax on early withdrawals from retirement plans will not apply if the withdrawal is from an IRA and is used to pay qualified higher education expenses of the taxpayer, the taxpayer's spouse, or the child or grandchild of either. The 10 percent early withdrawal tax does not

Expenses
Sec. 203

apply to an IRA withdrawal to the extent that the amount of the withdrawal does not exceed the student's qualified higher education expenses during the taxable year. "Qualified higher education expenses" include tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible educational institution. Qualified higher education expenses also include room and board if the student is enrolled at least on a half-time basis.

Effective for distributions made after December 31, 1997, for expenses paid after December 31, 1997, for academic periods beginning after December 31, 1997.

Qualified State Tuition Programs
Sec. 211

The following definitions are modifications to the tax treatment of State tuition programs:

- "qualified higher education expenses" is expanded to include room and board for while the student is at least a half-time student;

- "eligible education institution" is expanded to include post-secondary educational institutions offering credit towards:

    - a bachelor's degree;
    - an associate's degree;
    - a graduate-level or professional degree; or
    - another recognized post-secondary credential.

- "member of family" is expanded to include "any spouse" of family members (i.e. son, daughter, brother, sister, nephew, niece, etc.).

Generally effective after December 31, 1997. The expanded definition of "qualified higher education expenses" is effective as if included in the Small Business Job Protection Act of 1996.

Education Individual Retirement Accounts
Sec. 213

A new Code section authorizes the establishment of education IRAs. An education IRA distinct from IRAs described in § 408 and § 408A (regular IRAs, SIMPLE IRAs, and the new ROTH IRAs), and intended for use as a funding vehicle to pay the qualified higher education expenses of a designated beneficiary.

Contributions are not deductible but earnings on the contributions accumulate tax-free until distributed. In addition, the distribution will be tax-free to the extent such distribution does not exceed the qualified higher education expenses of the designated beneficiary. "Qualified higher education expenses" include tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible educational institution. Qualified higher education expenses also include room and board if the student is enrolled at least on a half-time basis. If amounts in an educational IRA are distributed for another purpose, the taxable portion is includible in the distributee's gross income and, generally, will be subject to an additional tax of 10 percent of the includible amount.

The maximum amount that a contributor can put into an education IRA is phased out for taxpayers with adjusted gross income between $95,000 and $110,000 ($150,000 and $160,000 for married taxpayers filing a joint return). An education IRA can be rolled over to another education IRA, or the beneficiary designation changed, provided, in either case, the new beneficiary is a family member of the old beneficiary.

Effective for taxable years beginning after December 31, 1997.

Employer Provided Educational Assistance Exclusion Sec. 221

The cost of undergraduate courses begun before June 1, 2000 are excluded from employee's wages when paid or incurred by the employer for the education of the employee. The $5,250 exclusion limit remains. This act does not extend to graduate-level courses.

Qualified Bonds Other Than Hospital Bonds Sec. 222

The $150 million limit on the amount of outstanding bonds a § 501(c)(3) organization may issue is repealed when 95 percent of the net proceeds are used to finance capital expenditures.

Effective for bonds issued after August 5, 1997, to finance capital expenditures incurred after August 5, 1997.

Increase in Arbitrage Rebate Exception for Certain Bonds Sec. 223

Up to $5 million dollars of bonds used to finance public school capital expenditures are excluded from applying the existing $5 million limit.

Effective for bonds issued after December 31, 1997.

Contributions of Computer

Existing rules providing "augmented deductions" for corporate contributions is expanded to include gifts of computer technology and

Technology and Equipment Sec. 224

equipment used in the U. S. for educational purposes.

Effective for contributions made in taxable years beginning after 1997 and before January 1, 2001.

Cancellation of Certain Student Loans Sec. 225

After August 5, 1997, the exclusion from income of the forgiveness of certain student loans has been expanded to include the forgiveness of student loans made by:

A. Education organizations, from funds other than those supplied by federal, state, and local governments or their instrumentalities pursuant to an agreement; and

B. Tax exempt organizations, including educational organizations that have refinanced otherwise qualifying loans originally made from these funds;

and forgiveness of student loans refinanced by:

C. Educational organizations, if the original loans were made from funds provided by government entities or their instrumentalities pursuant to an agreement; and

D. Exempt organizations, including educational organizations, if the loans were originally made by government entities or their instrumentalities.

In the case of A and B, all five of the following conditions must be met. In the case of C and D, only conditions 3, 4 and 5 must be met.

1. The loan was made pursuant to a program of the education organization to encourage students to serve in occupations or areas with unmet needs;

2. The work of the student or former student is for, or under, the supervision of a governmental unit or a § 501(c)(3) organization exempt under § 501(a);

3. The discharge may not be on account of services performed by the student-borrower for the lending institution;

4. The discharge is pursuant to a provision of the loan under which all or part would be discharged if the individual worked in certain professions for any time of a broad class of employers for a

period of time; and

5. The loan was made to assist the individual to attend an educational organization.

Incentives for Education Zones
Sec. 226

Qualified Zone Academy Bonds

To assist in the revitalization of schools, qualified zone academy bonds are created. These bonds are defined as bonds issued by a State or local government provided that:

- 95 percent of the proceeds are used for renovating, purchasing equipment for, developing course material used by, or training personnel in a "qualified zone academy", and

- private entities have promised to contribute equipment, services, training, or other services or property with a value of at least ten percent of the bond proceeds.

Qualified Zone Academy

A qualified zone academy is defined as a school that:

- is a public school below college level;

- operates a special program with businesses to enhance curriculum and increase graduation and employment rates; and

- is either located in an empowerment zone or enterprise community or expects at least 35 percent of students to be eligible for free or reduced lunches under the National School Lunch Act.

Bond Treatment

Holders of qualified zone academy bonds receive a nonrefundable tax credit equal to a credit rate, set by Treasury, multiplied by the face amount of the bond. The credit is included in gross income and claimed against regular income tax and AMT liability.

Effective Date

Effective for bonds issued after 1997. A total of $400 million bonds may be issued in each of 1998 and 1999.

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4. INDIVIDUAL RETIREMENT ACCOUNTS

Restoration of IRA Deduction for Certain Taxpayers Sec. 301

The amount that taxpayers who participate in their employers' retirement plans ("active participants") can earn and still make deductible contributions to their own IRAs is increased. In addition, an individual who is not an active participant, but is married to, and files jointly with, someone who is, can now make a fully deductible IRA contribution if their combined adjusted gross income is not more than $150,000, or a partially deductible IRA contribution if the combined adjusted gross income is between $150,000 and $160,000.

Active Participant Status Modified

For active participants, contributions are fully deductible if the taxpayer's AGI is below the applicable dollar amount. Contributions are partially deductible if the taxpayer's AGI is between the dollar amounts listed below. No deduction is permitted if the taxpayer's AGI exceeds the upper threshold of the dollar amounts listed below. The deductible IRA Phase-out is as follows:

Year	Married Filing Jointly	Single Filers
1998	$50,000-60,000	$30,000-40,000
1999	$51,000-61,000	$31,000-41,000
2000	$52,000-62,000	$32,000-42,000
2001	$53,000-63,000	$33,000-43,000
2002	$54,000-64,000	$34,000-44,000
2003	$60,000-70,000	$40,000-50,000
2004	$65,000-75,000	$45,000-55,000
2005	$70,000-80,000	$50,000-60,000
2006	$75,000-85,000	$50,000-60,000
2007	$80,000-100,000	$50,000-60,000

The maximum deductible of $2,000 remains.

Effective Date

Effective for taxable years beginning after December 31, 1997.

Establishment of Nondeductible Tax-free Individual Retirement Accounts Sec. 302

A new kind of IRA is authorized, called a Roth IRA, for low- to middle-income taxpayers. The rules that apply to traditional IRAs generally apply to Roth IRAs except:

- contributions are not deductible;

- qualified distributions are not taxable;

- required distribution rules do not apply before death; and
- contributions can be made after age 70 ½.

The maximum Roth IRA annual contribution, $2,000, is phased out at adjusted gross income levels between $95,000 and $110,000, for single taxpayers, and between $150,000 and $160,000, for married taxpayers filing joint returns. Qualified distributions are distributions made after attainment of age 59 ½, for the purchase of a first home (up to a $10,000 lifetime cap), or on account of death or disability. A distribution cannot be a qualified distribution unless made five taxable years after the taxable year in which the first contribution is made to a Roth IRA, or in the case of a rollover from a traditional IRA, five taxable years after the taxable year in which the rollover was made.

Distributions that are not qualified distributions are treated as first being made from contributions, and not earnings, so that the distribution would not be taxable until the amount distributed, when added to all previous distributions, exceeded the amount of contributions. Taxpayers with adjusted gross incomes of $100,000 or less can roll over amounts in their traditional IRAs to Roth IRAs, but amounts rolled over that had not previously been taxed will be included in gross income. If the rollover occurs in 1998, the income inclusion is spread ratably over the four-taxable-year period beginning in 1998.

Effective for taxable years beginning after December 31, 1997.

Distributions Used Without Penalty to Purchase First Homes
Sec. 303

The 10 percent additional tax on early distributions from retirement plans does not apply to an IRA withdrawal made by a taxpayer to acquire a first-time principal residence for the taxpayer or a family member. If the money withdrawn is not used for such purpose within 120 days, the taxpayer can make a rollover contribution to an IRA. A lifetime cap of $10,000 applies to each taxpayer.

Effective for distributions made in taxable years beginning after December 31, 1997.

Certain Bullion not Treated as Collectibles
Sec. 304

IRAs and self-directed accounts in employer-sponsored retirement plans are permitted to invest in certain platinum coins, and in certain gold, silver, platinum, or palladium bullion provided that the bullion is in the physical possession of the IRA (or plan) trustee.

Effective for taxable years beginning after December 31, 1997.

5. DISASTERS

Tax-Related Deadlines Sec. 911

Effective August 6, 1997, for any period for performing an act that has not expired, the Secretary of Treasury may specify that any or all deadlines (other than interest on certain overpayments or underpayments) may be suspended for a period of up to 90 days in Presidentially declared disaster areas.

Losses - Use of Appraisals Sec. 912

Treasury may issue guidance providing that an appraisal used in obtaining a federal loan (or loan guarantee) as a result of a Presidentially declared disaster, may be used to establish the amount of a disaster loss.

Livestock Sold Due to Weather Conditions
Sec. 913

Deferral of Livestock Income

Effective for sales and exchanges after December 31, 1996, a cash method taxpayer whose principal trade or business is farming may elect to defer income from forced sales due to drought, flood, or other weather related condition to the tax year following the year of sale. § 451(e) is amended to include flood or weather related conditions.

This elective deferral of income from the sale of livestock is only available if the taxpayer can establish that the sale would not have occurred were it not for drought, flood, or other weather related condition that resulted in the area being designated eligible for federal assistance.

Involuntary Conversion

Taxpayers can treat as an involuntary conversion, the sale of a higher quantity (in excess of the number that would be sold if drought, flood, or other weather related conditions did not exist) of draft, breeding, or dairy livestock (other than poultry). Also effective for sales after December 31, 1996.

Mortgage Bond Financing Sec. 914

Tax-exempt bonds issued by States and local governments to provide mortgage loans to first-time home buyers, who satisfy income limits and cost maximums, are qualified mortgage bonds.

Between January 1, 1997 and December 31, 1998, for residences located in certain Presidentially declared disaster areas, the income and purchase price limits will be eased. The waivers apply only during the two-year period after the date of disaster declaration.

Abate Interest on Underpayments Sec. 915	The IRS is required to abate interest for any period for which the Secretary extends the time to file and the time to pay (and waives penalties relating to failure to file and pay) for any individual located in a Presidentially declared disaster area in 1997.

6. EMPLOYMENT TAX

Securities Registered Representatives Employment Tax Status Sec. 921	No weight is to be given to instructions imposed only in compliance with governmental investor protection standards when determining the federal tax status of registered representatives of securities Effective for services performed after December 31, 1997.
Former Insurance Agents' Termination Payments Sec. 922	Payments received after December 31, 1997 by a former insurance agent are not subject to tax under the Self-Employment Contributions Act (SECA) if: - payments are received after termination of the service agreement; - the agent performs no services after termination and before the close of the tax year; - the agent agrees not to compete with the company for at least one year after termination; - the amount of the payments depends primarily on the policies sold by or credited to the agent's account during the final year of the agreement, and/or to the extent such policies remain in effect after termination; and - the amount of the payments does not depend on length of service or overall earnings with the company (though eligibility for payments may be based on length of service).
Workmen's Compensation Liability Rules for Certain Personal Injury Liability Assignments	A qualified assignment of workmen compensation claim is excludible from income. It is required that the assignee assumes liability from a person who is a party to the claim. A qualified assignment is any transfer of liability to a third party to make periodic payments as damages because of physical injury or sickness, if the

Sec. 962

liability is assumed from one of the parties to the suit or agreement. The terms of the assignment require:

- fixed amount and time of periodic payment;
- payments may not be changed by recipient;
- the assignee's (person assuming liability) obligation is no greater than the assignor's (person transferring liability), and
- the payments must be excludible under § 104(a)(2) as damages because of personal injury or sickness.

Effective August 7, 1997.

Tax Exempt Status for Certain State Worker's Compensation Act Companies
Sec. 963

The existing tax exemption for certain State-created worker's compensation act companies is expanded to include those meeting the following requirements:

- the organization is operated exclusively to provide worker's compensation coverage required by state law and related coverage;
- related coverage includes liability under Federal workmen's compensation laws, the Jones Act, and the Longshore and Harbor Workers Compensation Act;
- the State must extend its full faith and credit to the initial debt or provide the initial operating capital;
- should dissolution be permitted by State law, then assets of the organization will revert to the State;
- the majority of the board of directors (oversight body) must be appointed by an official of the executive branch of the State or the State legislature, or both; and
- the organization must provide the worker's compensation insurance to any employer meeting reasonable requirements and seeking the coverage.

No inference is intended about the exempt status of current organizations under present law.

Effective for taxable years beginning after December 31, 1997.

Combined Reporting Test with State of Montana Sec. 976

A demonstration project is permitted between the Service and the State of Montana for five years to assess the feasibility and desirability of expanding combined reporting. The project is limited to employment tax reporting and limits any IRS disclosure items to the name, address, TIN, and signature of the taxpayer.

This provision is effective on August 5, 1997 and will expire five years after the date enacted, August 6, 2002.

Temporary Unemployment Tax Sec. 1035

The temporary surtax, in affect through 1998, is extended through December 31, 2007.

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7. BUSINESS

Welfare-to-Work Credit Sec. 801

A credit is established for employers on eligible wages paid to qualified long-term recipients of family assistance (Aid to Families with Dependent Children or a successor program). The credit is:

- 35 percent of the first $10,000 of eligible wages in the first year; and

- 50 percent of the first $10,000 of eligible wages in the second year.

Eligible wages include amounts paid by an employer for:

- nontaxable education assistance;

- employee health care coverage; and

- nontaxable dependent care assistance.

Qualified long-term recipients are members of families that:

- received assistance for at least 18 consecutive months ending on the date of hiring;

- received assistance for any 18 months after August 5, 1997 if hired within two years after the date the 18 month total is reached; or

- after August 5, 1997, ceased to be eligible for assistance due to maximum period limitations imposed by Federal or state law if hired within two years after eligibility ceased.

Effective for wages paid to eligible employees who begin work on or after January 1, 1998, and before May 1, 1999.

EFTPS - Failure to Deposit Penalty Sec. 931

No penalty will be imposed solely because a business does not use the Electronic Federal Tax Payment System (EFTPS) to make deposits prior to July 1, 1998 (for taxpayers first required to electronically deposit on or after July 1, 1997). However, the taxes must be timely deposited using Form 8109, Federal Tax Deposit Coupons (paper) while converting to EFTPS.

Businesses required to deposit using EFTPS, which deposited more than $50,000 in taxes in either 1995 or 1996, are impacted by this delay.

Home Office Use for Administrative and Management Activities Sec. 932

The definition "principal place of business" is expanded if a home office is used for administrative or management purposes.

A home office will qualify as a "principal place of business" for a self-employed individual or an employee and a deduction generally will be allowed if:

1. the office is used by the taxpayer to conduct administrative or management activities;

2. there is no other fixed location where the taxpayer conducts substantial administrative or management activities;

3. the office is used exclusively and regularly as a place of business; and

4. in the case of employees, the home office is used for the convenience of the employer.

Other Business

For self-employed individuals -

Locations

If the other tests are met, the deduction is allowed even when other administrative or management activities connected with the taxpayer's trade or business are performed by others at another fixed location (e.g. billing).

Moreover, so long as administrative or management duties are performed in the home office, eligibility to claim the home office deduction will not be affected by taxpayers occasionally or minimally performing these duties at another fixed location of the business. Nor will the fact that he performs these duties out of a car or hotel room affect the taxpayer's ability to claim home office deduction.

For employees -

To be deductible, an employee's use of the home office must be for the "employer's convenience". An employee's decision not to use suitable space made available by the employer for administrative activities is a relevant factor in determining whether the convenience-of-the-employer test has been met.

An employee may be in more than one business. If the employee conducts some other business from the home office, the tests may be applied to see whether a home office deduction is available for the other business.

Effective for tax years beginning after December 31, 1998.

Averaging of Farm Income Over 3 Years Sec. 933

An individual who may elect to compute the current year's tax liability by averaging farm income over a three year period. The individual:

- designates all or a portion of the taxable income from the trade or business of farming from the current year as elected farm income;

- allocates 1/3 of the elected farm income to each of the 3 prior taxable years; and

- determines the current year's regular tax liability on taxable income, less the elected farm income (allocated to the three prior taxable years) and adds to that the increases in regular tax liability for each of the three prior year taxable years by taking into account the allocable share of the elected farm income for such years.

If the individual elects this provision, the allocation of elected farm income among taxable years because of the election applies to any election in a subsequent year. This provision does not apply to an estate or trust, or for the purposes of the employment taxes or the alternative minimum tax.

The individual is not required to recalculate the tax liability of another taxpayer: for example, the parents of a minor child required to use the tax rates of his or her parents do not recalculate the child's "Kiddie Tax".

Effective for taxable years beginning after December 31, 1997, and before January 1, 2001.

Increased Health Insurance Deduction for Self-employed Sec. 934

The amount of health insurance premiums deductible by self-employed individuals is increased as follows:

Year	Percentage Deductible
1997	40 percent
1998 & 1999	45 percent
2000 & 2001	50 percent
2002	60 percent
2003 - 2005	80 percent
2006	90 percent
2007 and after	100 percent

Moratorium on Regulations-Limited Partners Sec. 935

Any regulations relating to the definition of a limited partner for self-employment tax purposes won't be issued or effective before July 1, 1998.

Effective August 5, 1997.

Shrinkage for Inventory Accounting Sec. 961

The Tax Court has held that a taxpayer may estimate the amount of shrinkage that occurs during the year for the accounting of inventory. It is allowable if the method used is sound and clearly reflects income.

A method of accounting for inventory will not be considered unsound and not clearly reflecting income solely because inventory includes an estimate for shrinkage based on inventories taken at a time other than at year-end. The estimate must be based on actual physical counts. The physical count must be made at each location on a regular and consistent basis.

It is anticipated that a safe harbor method will be established by guidance from the Secretary of Treasury. A voluntary change in the method of accounting for inventories is subject to a § 481 adjustment. It may be taken into account over a four year period.

Effective for taxable years ending after August 5, 1997.

1987 Partnerships Exempt from Publicly Traded Partnerships Sec. 964

Generally, a publicly traded partnership is treated as a corporation for tax purposes (under § 7704). However, certain publicly traded partnerships that existed in 1987 could continue to be treated as partnerships until the end of 1997, pursuant to a 10-year grandfather rule enacted in 1987. If such a partnership elects for its first taxable year, beginning after December 31, 1997, to be subject to tax on gross income from the active conduct of the trade or business it will continue to be treated as partnerships.

The election to be subject to tax is in effect until it is revoked by the partnership. Once it is revoked, it cannot be reinstated.

The tax is 3.5 percent of the partnership's gross income from the active conduct of the trade or business. The income includes the share of business income from a lower-tier partnership.

If an electing 1987 partnership adds a substantial new line of business, it ceases to be treated as a partnership as of the first day after December 31, 1997.

Depreciation for Clean Burning Fuel and Electric Vehicles Sec. 971

Clean-burning Fuel Vehicles

Clean-fuel burning modifications are depreciated separately from the vehicles in which they are installed. The portion of the cost of the vehicle allocable to the modification is not subject to the depreciation limitations of § 280F(a), unlike the rest of the vehicle cost. The 1997 depreciation limitations are:

- $3,160 for the first year;
- $5,000 for the second year;
- $3,050 for the third year; and
- $1,775 for the fourth and subsequent years.

Electric Vehicles

The depreciation deduction limitation for vehicles with original equipment designed primarily for electric propulsion is triple the base depreciation limitation amount for automobiles and is indexed for inflation after October, 1997. For 1997, the limitation amounts are:

- $9,480 for the first year;
- $15,000 for the second year;
- $9,150 for the third year; and
- $5,325 for the fourth and subsequent years.

Effective Dates

Effective for qualifying vehicles placed in service after August 5, 1997 and before January 1, 2005.

Percentage Depletion for Marginal Production Sec. 972

The limitation based on 100 percent of taxable income from the property limitation is temporarily suspended for domestic oil and gas production from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

Suspense Accounts for Family Corporations Required to Use Accrual Method of Accounting Sec. 1081

The establishment of the suspense account for change of accounting method for family farm corporations to the accrual method is repealed. The § 481 adjustment (which was the amount assigned to the suspense account) will be restored into income ratably over a 10 year period beginning with the year of change.

There is a phaseout provision for suspense accounts established under the prior law. If there is an existing suspense account, the taxpayer is required to restore a portion of the account ratably over a 20 year period beginning in the first taxable year beginning after June 8, 1997.

The present-law requirement to accelerate recovering the suspense account when gross receipts decrease is repealed.

According to a conference agreement noted in the legislative history, if a family farm corporation elects to be an S corporation for a taxable year, the net operating loss and 50 percent of taxable income limitations are determined by:

- taking into account all of the items of income, gain, deduction and loss of the corporation,

- whether or not the items are separately stated and passed through to the shareholders.

Effective for taxable years ending after June 8, 1997.

Net Operating Loss Carryback and Carryforward Periods
Sec. 1082

A taxpayer may elect to carry forward the loss and not carry it back three years. The carryback period is lowered from three years and the carryforward is extended from 15 years to the following periods:

- net operating losses can be carried back two years; and

- can be carried forward 20 years.

This change from a three to a two-year carryback period does not apply to:

- specified liability losses;
- casualty or theft losses of individuals; and
- losses attributable to Presidential declared disasters for taxpayers engaged in a farming business or small business.

The three-year carryback period remains in effect for the portion of a net operating loss of a farmer or small business attributable to a Presidential declared disaster and for the portion of a net operating loss attributable to a casualty or theft loss of an individual.

Effective for net operating losses for taxable years beginning after August 5, 1997.

Taxable Years Unused Credits Taken
Sec. 1083

The periods which an unused general business credit may be carried is:

- carryback one year; and

- carryforward 20 years.

Effective for credits arising in taxable years beginning after December 31, 1997.

Expansion of Denial of Deduction for Certain Amounts Paid in Connection with Insurance

Sec. 1084

Premium Deduction Limitation

A deduction is not allowed for premiums paid on any life insurance, annuity or endowment contract, if the taxpayer is directly or indirectly a beneficiary under the contract.

Interest Disallowance To Individuals Who Have Insurable Interest

A deduction is not allowable for interest paid or accrued on any indebtedness related to a life insurance policy, or endowment or annuity contract, covering the life of any individual.

Pro Rata Disallowance Of Interest On Debt To Fund Life Insurance

For a taxpayer that is not a natural person, a deduction is not allowed for the portion of the interest expense that is allocable to unborrowed policy cash surrender values on any life insurance policy or annuity or endowment contract issued after June 8, 1997.

The interest is allocated to unborrowed policy cash values based on the ratio of the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts issued after June 8, 1997, to the sum of:

- in the case of assets that are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values, and

- in the case of other assets, the average adjusted bases for all other assets of the taxpayer.

The unborrowed policy cash values means the cash surrender value of the policy or contract determined without regard to any surrender charge, reduced by the amount of any loan with respect to the policy or contract.

The cash surrender value is determined without regard to any other contractual or noncontractual arrangement that artificially depresses the cash value of a contract. If interest expense is disallowed under § 264 and § 265, then the disallowed interest is not taken into account, and the average adjusted bases is reduced by the amount of debt on which the interest is disallowed.

This new rule does not apply to any policy or contract owned by an entity engaged in a trade or business, covering any individual that is an employee, officer or director of trade or business at the time first covered by the policy or contract.

This exception applies to any policy or contract which covers one individual who is:

- a 20 percent owner of the entity, or
- an individual who is an officer, director or employee of the trade or business.

It also applies to a joint-life policy or contract under which the sole insured are a 20-percent owner and the spouse of the 20-percent.

Treatment Of Insurance Companies

The rules for the reduction of certain deductions of insurance companies are modified. An increase in the policy cash value for any policy or contract is:

- the amount of the increase in the adjusted cash value, reduced by
- the gross premiums received with respect to the policy or contract during the taxable year, and increased by
- distributions under the policy or contract to which § 72(e) applies.

Effective for contracts issued after June 8, 1997. A material increase in death benefit or material change in the contract causes the contract to be treated as a new contract under the new provisions. To the extent of additional covered lives under a contract after June 8, 1997, the contract is treated as a new contract only with respect to such additional lives. If an increase of a death benefit is converted to extended term insurance pursuant to nonforfeiture provisions, in a transaction which § 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 applies, the contract is not treated as a new contract.

Limitation on Property for Use of Income Forecast Method Sec. 1086

The type of property eligible for the income forecast method of depreciation is clarified. The method is available for:

- motion picture films or video tapes;
- sound recordings;
- copyrights;
- books; and
- patents.

The method may also be applied to other property designated in regulations. Income forecast may not be used with respect to any amortizable § 197 intangible, nor any consumer rent-to-own property.

A special three year recovery period for depreciation allowance has been created for qualified rent-to-own property. Such qualified property is tangible personal property that is subject to a lease and is generally used in the home for personal use, but not for business use. Some rent-to-own property used in the home might be for personal or business use, such as a computer. Where such dual-use property is not a significant portion of a taxpayer's leasing property and the remaining leasing property is predominantly qualified rent-to-own, then the dual-use property may be qualified rent-to-own property. The burden of proof is on the taxpayer to show that the property is qualified rent-to-own property.

Leases that provide for decreasing periodic payments may also fall within the type of leases that may qualify as rent-to-own..

Effective for property placed in service after August 5, 1997.

Installment Sales Rules for Sales by a Manufacturer to a Dealer Sec. 1088

The exception that allows the installment method of accounting on sales by manufacturers to dealers is repealed.

Effective for taxable years beginning more than one year after August 5, 1997. Any adjustment required as a result of the change in method of accounting will be included in income over a four year period beginning with the year of change.

Expanded SSA Records for Tax Enforcement Sec. 1090

The Social Security Administration (SSA) is required to obtain the social security number (SSN) of both parents on minor children's applications for SSNs.

The SSA will provide this information to the IRS as part of the Data Masterfile ('DM-1 File'). IRS will use this information to identify questionable claims for the earned income credit, the dependent exemption, and other tax benefits, before tax refunds are paid out.

Effective August 5, 1997.

Modifications to Look-back Method for Long-term Contracts

After a long term contract is completed, the taxpayer is required to apply the first step of the look-back method but is not required to apply the additional steps of the method if the application of the first step results in a de minimis change.

Sec. 1211

The election applies to all long term contracts completed during the taxable year in which the election is made and to all long term contracts completed during subsequent taxable years. The election may be revoked only with the consent of the Secretary of Treasury.

A taxpayer may elect not to reapply the look-back method on a contract, if at the close of the taxable year after the year the contract is completed, the cumulative taxable income or loss under the contract is within 10 percent of the cumulative look-back income at the close of the most recent year when the look-back method was applied or would have applied except for the de minimis rule.

An electing taxpayer does not need to apply or reapply the look-back method if the amounts taken into account after completion of the contract is de minimis.

Only one rate of interest applies for each accrual period. An accrual period:

- begins on the day after the due date of the return without regard to extensions for the taxable year and

- ends on the due date of the return without regard to extensions for the following taxable year.

The rate of interest is the overpayment rate in effect for the calendar quarter in which the accrual period begins.

Effective for contacts completed in taxable years ending after August 5, 1997.

Minimum Tax Treatment of Certain Property and Casualty Insurance Companies Sec. 1212

A property and casualty insurance company that elects to be taxed only on taxable investment income will determine its adjusted current earnings under alternative minimum tax without regard to any amount not taken into account in determining its gross investment income under § 834(b).

Effective for taxable years after December 31, 1997.

Qualified Lessee Construction Allowances for Short Term Leases

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. This applies where the purpose of the payment is for the lessee's construction or improvement of qualified long term real property for use in the lessee's business at the retail space. It only applies to the extent the

Sec. 1213

allowance does not exceed the amount expended by the lessee on the construction or improvement of qualified long term real property.

Qualified long term real property is nonresidential real property that is part of the retail space used by the lessee and reverts to the lessor at the termination of the lease.

A short term lease is a lease or other agreement for the occupancy or use for 15 years or less.

Retail space is real property leased, occupied, or used by the lessee in the business of selling tangible personal property or services to the public.

The lessor will treat the amounts expended on the construction allowance as nonresidential real property. The lessee's exclusion will not be dependent upon the lessor's treatment of the property as nonresidential property. As in present law, lessors can take losses on abandoned leasehold improvements at the end of the lease.

Effective for leases entered into after August 5, 1997.

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30 Percent Gross Income Limit for Regulated Investment Companies Sec. 1271

The requirement, to qualify as a Regulated Investment Company (RIC), that a company must obtain less than 30 percent of its gross income from the sale of stock or securities held for less than three months is repealed.

Effective for taxable years beginning after August 5, 1997.

Reasonable Cause Exception for Certain Penalties Sec. 1281

The following penalties may be waived if the failure is shown to be due to reasonable cause and not to willful neglect:

- failure to file a report in connection with deductible employee contributions to a retirement savings plan, § 6652(g);
- failure to file a report of certain small business stock transactions, § 6652(k);
- failure of a foreign corporation to file a return of personal holding company tax, § 6683; and
- failure to make required payments for entities electing not to have the required tax year, § 7519.

Effective for taxable years beginning after August 5, 1997.

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8. PARTNERSHIPS

Allocation of Basis of Property Distributed Sec. 1061

The basis allocation rules are modified for certain distributions of partnership property to a partner. As under current law, the distributee partner's basis first is allocated to unrealized receivables and inventory items that are distributed in an amount equal to the partnership's basis in those items. Any remaining basis is allocated among the other items that are distributed to a partner to the extent of each distributed property's adjusted basis to the partnership. If the sum of the adjusted basis to the partnership of the distributed property does not equal the basis to be allocated among the distributed property, then the basis is increased or decreased as follows:

1. If the remaining basis adjustment is an increase, it is allocated among properties with unrealized appreciation in proportion to their unrealized appreciation (up to the amount of the unrealized appreciation), and then in proportion to their fair market value;

2. If the remaining basis adjustment is a decrease, it is allocated among properties with unrealized depreciation in proportion to their unrealized depreciation (up to the amount of the unrealized depreciation), and then in proportion to their adjusted basis.

Effective for partnership distributions after August 5, 1997.

Substantially Appreciated Partnership Inventory Sec. 1062

The requirement that inventory owned by a partnership be substantially appreciated before the portion of the gain from the sale or exchange of an interest in a partnership owning the inventory is treated as ordinary income under § 751(a) is repealed. The substantially appreciated requirement still applies to distributions treated as sales or exchanges under § 751(b).

Effective for sales or exchanges and distributions after August 5, 1997. However, the provision does not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997 and in force at all times before the sale or exchange.

Extension of Time for Taxing Precontribution Gain Sec. 1063

The time period for distribution that will result in recognition of a gain under § 704(c)(1)(B) and § 737 is extended. The contributing partner will recognize gain on the distribution of appreciated contributed property if it is within seven years after the contribution to the partnership.

Effective for property contributed to a partnership after June 8, 1997.

Closing of Partnership Taxable Year Sec. 1246

The taxable year of a partnership with respect to a partner whose entire interest in the partnership terminates is now closed, whether by:

- death;
- liquidation; or
- otherwise.

Effective for partnership taxable years beginning after December 31, 1997.

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9. ELECTING LARGE PARTNERSHIPS

Simplified Rules for Electing Large Partnerships
Sec. 1221

Capital Gains

The reporting of the separately stated items for capital and § 1231 gains and losses by each partner is eliminated. Capital gains and losses are netted at the partnership level. The net capital gain or loss is separately stated to each partner and is treated as a long-term capital gain or loss.

The excess of the net short-term capital gain over net long-term capital loss is included with other taxable income of the partnership.

The net capital gain is allocated to passive loss limitation activities to

- extent of net capital gain from sales and exchanges of property used in connection with the activities, and

- any excess is allocated to other activities.

Gains and losses under § 1231 are netted at the partnership level. The net gain is treated as long-term capital gain. The net loss is treated as an ordinary loss and is included in computing the partnership's taxable income.

Deductions

Miscellaneous itemized deductions are no longer separately stated items. The deductions, with a limitation, are included in determining taxable income. However, 70 percent of the total miscellaneous itemized deductions are not allowable to the partnership. The remaining 30 percent is allowable and not subject to the two-percent floor.

Charitable contributions are allowed as a deduction to the partnership for arriving at its taxable income subject to the corporate limitations that apply to donors.

Credits in General

The partnership's general credits are separately stated to the partners as a single item, taken into account as a general business credit by the partners on their return. General credits do not include the following, which are separately stated::

- low-income housing credit;
- rehabilitation credit; and
- credit for producing fuel from a nonconventional source

The distributive share of general credits is considered as a current year general business credit.

Refundable credit for gasoline used for exempt purposes is allowed to the partnership.

Refund or credit for undistributed capital gains of a regulated investment company is allowed to the partnership.

Low-income housing and rehabilitation credits are reported separately by the partners.

Credit for producing fuel from a nonconventional source is also reported separately at the partner level. Credit recapture is imposed at the partnership level. The amount of recapture is determined by assuming that the credit fully reduced the taxes. The recapture is applied:

- first to reduce any current year credit;

- the partnership is liable for any remaining recapture.

Passive Losses

A partner in an electing large partnership separately accounts for the distributive share of the partnership's taxable income or loss from the activity subject to passive loss limitations. That income or loss is treated as an item of income or loss from a single activity under the passive loss rules.

Activity other than passive loss limitation activities is also accounted for separately.

If a partner holds an interest in an electing large partnership other than as a limited partnership, the distributive share of items are accounted for separately in compliance with the passive loss rules.

The requirement under § 469(k) that the passive loss rule be separately applied to each publicly traded partnership continues to apply.

Alternative Minimum Tax

Alternative minimum tax (AMT) adjustments and preferences present law are combined at the partnership level. A net AMT adjustment is reported separately to the partners. The net AMT adjustment is determined by using:

- the adjustments for individuals and
- the adjustments for corporations.

Discharge of Indebtedness Income

Income from the discharge of indebtedness is still a separately stated item. But, the rules under § 108 apply without consideration of the large partnership rules. The election under § 108 is made separately by each partner.

REMICS

All residual interests held in a REMIC by an electing large partnership are treated as held by a disqualified organization. The electing large partnership will be subject to a tax equal to:

- the excess inclusions,

- multiplied by the highest corporate tax rate.

The amount subject to tax is not included in the partnership income.

Election of Optional Basis Adjustments

An electing large partnership can still make the election to adjust the basis of its property under § 754. The computation of the partnership's taxable income does not include adjustments made under § 743(b). The adjustment is only made to the transferee partner.

The adjustment under § 734(b) is still available to electing large partnerships.

Terminations

An electing large partnership will not terminate under § 708(b)(1)(B) on the sale or exchange of 50 percent or more of the partnership interests within the 12 month period.

Partnerships and Partners Subject to Large Partnership Rules

An electing large partnership is any partnership that makes the election, and has 100 or more partners in the partnership the preceding taxable year. Only direct ownership of partnership interests, including interests held through nominees, are considered in the counting of the 100 or more. Indirect ownerships are not considered.

The election is in effect for the year made and all subsequent years. It is not revocable unless the Secretary consents.

Special Rules for Certain Service Partnerships

An election is not effective for any partnership if substantially all the partners are:

- individuals performing substantial services in connection with the partnership's activities, or personal service corporations and the owner-employee performs the services;

- retired partners who had performed the services; or

- spouses of partners who had performed the services.

The term "partner" does not include any individual:

- performing substantial services relating to the partnership's activities and holds a partnership interest, or

- who formerly performed services and held a partnership interest at the time the services were performed.

Exclusion for Commodity Partnerships

An election by any partnership whose principal activity is the buying and selling of commodities (not described in § 1221(1)) or options, futures, or forwards with respect to such commodities is not effective.

Special Rules for Partnerships Holding Oil and Gas Properties

Oil and gas large partnerships will report information to its partners on the simplified reporting system with the exception of partners who are disqualified persons. It is assumed that the partnership is the taxpayer and qualifies for percentage depletion. Disqualified persons are:

- taxpayers who do not qualify for the deduction for percentage depletion such as integrated producers of oil and gas; and

- any person whose average daily production of oil and gas exceeds 500 barrels for the taxable year in which the partnership's taxable year ends.

A disqualified person is responsible for informing the partnership of its status. Oil and gas large partnership report the oil and gas items separately to the disqualified persons.

The depletion deduction is reported to partners in their distributive share of income or loss from passive loss activities. In computing the depletion deduction, the 1,000 barrel per day limit and the 65 percent taxable income limitation do not apply.

The election to deduct intangible drilling costs (IDC) is made at the partnership level. The oil and gas large partnership will report the full deduction of IDC to the partners who are not disqualified. The partnership also must make the election to capitalize and amortize certain IDC.

A single alternative minimum tax (AMT) adjustment for oil and gas items is made at the partnership level and reported to the partners. The oil and gas large partnership is considered the taxpayer.

Oil and gas large partnerships disregard items of income, gain, loss, deduction, or credit from disqualified persons when computing items at the partnership level.

Administrative Proceedings

An electing large partnership can still make the election under § 754. The computation of taxable income does not include adjustments made under § 743(b). The adjustment is only made to the transferee partner. The adjustment under § 734(b) is still available to electing large partnerships.

Regulatory Authority

The Treasury Secretary is granted authority to prescribe regulations as may be appropriate to carry out these changes.

Effective Date

The provisions generally apply to partnership taxable years beginning after December 31, 1997.

Simplified Audit Procedures for Electing Large Partnerships

Sec. 1222

In General

A new audit system is created for electing large partnerships. The partnerships and partners are subject to the unified audit procedures. Instead of flowing adjustments to its partners, the partnership may elect to pay an imputed underpayment. It is calculated by:

- netting the adjustments to the income and loss items of the partnership and
- multiplying it by the highest tax rate, individual or corporate.

The partnership can make this election only if it meets requirements set out in Treasury regulations that will be designed to ensure payment.

The partnership is generally liable for any interest and penalties resulting from partnership adjustments. Interest is computed for the period:

- beginning on the return due date for the year the adjustment is made, and
- ending on the earlier of the return due date for the partnership taxable year in which the adjustment takes effect; or
- the date of the partnership pays the underpayment.

Penalties are determined on a year-by-year basis based on the imputed underpayment. The partnership is treated as if it were the taxable individual when determining reasonable cause, etc. Any payment for income taxes, interest or penalties made by an electing large partnership is not deductible.

Partnership Representative

An electing large partnership is required to designate a partner or other person to represent the partnership. If a representative is not designated, the IRS is permitted to make the designation. The person designated will be any one of the partners. However, an electing large partnership can designate a representative replacing the person the IRS designated.

Notice Requirements

The IRS is required to send notice only to the partnership of the beginning of the administrative proceedings and any notice of partnership adjustment. The notice must be sent certified or registered mail to the partnership's last known address. The IRS is not required to notify partners.

Adjudication of Disputes Concerning Partnership Items	A petition may still be filed in Tax Court, district court or Claims Court. However, only the partnership may file a petition. Partners do not have the right to file a petition individually.
Statute of Limitations	The IRS still has three years from the filing of the partnership return or due date to adjust any partnership item.
Regulatory Authority	The Treasury Secretary is granted authority to prescribe regulations as may be appropriate to carry out these changes.
Effective Date	Effective for partnership taxable years beginning after December 31, 1997.
Due Date for Furnishing Information to Partners of Electing Large Partnerships Sec. 1223	An electing large partnership must furnish a copy of its information return to each partner. This copy must be furnished by the first March 15 following the close of the partnership's taxable year. If the partnership is required to provide the IRS copies of the information return on magnetic media, each schedule (such as Schedule K-1) with respect to each partner is treated as a separate information return. Each schedule is also treated separately for corrective periods and penalties that apply to information returns. Effective for partnership taxable years beginning after December 31, 1997.
Returns Required on Magnetic Media Sec. 1224	A partnership is required to provide the tax return of the partnership (Form 1065), as well as copies of each partner's Schedule K-1, to the IRS on magnetic media. Partnerships with 100 or less partners are excluded from this requirement. Effective for partnership taxable years ending on or after December 31, 1997.
Treatment of Partnership Items of Individual Retirement	Where an IRA trust owns an interest in a partnership whose tax treatment is determined at the partnership level, the IRA fiduciary may use the trust's allocable share of partnership's taxable income instead of the partnership's gross income in determining the UBIT and whether a return must be filed.

Arrangements Sec. 1225

Effective for taxable years beginning after December 31, 1997.

10. TEFRA PARTNERSHIP PROCEEDINGS

Treatment of Partnership Items In Deficiency Proceedings Sec. 1231

The Munro decision, which required the IRS to ignore partnership items in computing a partner's deficiency with respect to nonpartnership items, is overruled, in an "oversheltered" context.

When a partner's return is oversheltered, the IRS is allowed to compute deficiencies on the assumption that all unified partnership proceedings items that have not been finally determined have been correctly reported on the taxpayer's return. A declaratory judgement procedure in the Tax Court is provided for redetermining adjustments to an oversheltered return. An oversheltered return is a return that

- shows no taxable income, and
- a net loss from partnership items.

The IRS is allowed to issue a notice of adjustment on the nonpartnership items even though a deficiency would not result from the adjustment. This notice can be issued only if a deficiency would arise if the net loss from the partnership items is not taken into account.

The Tax Court is granted jurisdiction to redetermine the correctness of such an adjustment, as well as to make a declaration as to any other item for the taxable year to which the notice of adjustment relates, except for partnership items and affected items requiring a partner level determination. A decision of the Tax Court will be final, and an appeal may be made by the IRS or the taxpayer.

Any adjustment from a nonpartnership item that increases the tax liability on a partnership item is treated as a computational adjustment and assessed upon conclusion of unified partnership proceedings. Deficiency procedures will not apply to the increase in tax. The statute of limitations that apply to unified partnership proceedings control the statute for the increase in tax.

Effective for partnership taxable years ending after August 5, 1997.

Partnership Return To Be Determinative of Audit Procedures To Be Followed Sec. 1232

The IRS can apply the unified partnership procedures if, based on the partnership's return for that year, it is reasonably determines that those procedures should apply.

Also, the IRS can apply normal deficiency procedures if, based on the partnership's return for the year, it is reasonably determined that those procedures should apply.

Effective for partnership taxable years ending after August 5, 1997.

Statute of Limitations Sec. 1233

Untimely Filed Petition

The suspension rules for a filing of a petition under the unified partnership proceedings are conformed with the rules for deficiency proceedings.

The period of limitations for assessment and collection is suspended when the petition is filed, regardless if it is timely. The suspension remains in effect until a final decision is given by the court and one year after.

Effective for all cases where the period of limitations has not expired under present law as of August 5, 1997.

Bankruptcy Proceedings

The present law, that if a bankruptcy proceeding is pending, the statute of limitations is suspended for the period of the bankrupcy stay is clarified. There has been uncertainty if the suspension of the statute for bankruptcy under deficiency proceedings apply to the conversion of partnership items to nonpartnership items because of a bankruptcy filing under the unified partnership rules.

The period of limitations for assessment and collection may be suspended for a partner named in a bankruptcy petition. The suspension period is for the entire period in which the IRS cannot make an assessment because of the bankruptcy stay and 60 days after. Under a 1995 change to the Bankruptcy Code, the Service is generally not stayed from making an assessment during the pendency of the bankruptcy proceeding. Hence, careful attention to whether there is a bankruptcy stay in effect is necessary in monitoring assessment dates.

Effective for agreements entered into after August 5, 1997.

Bankrupt Tax Matters Partner

The IRS does not automatically receive notification of bankruptcy filings and cannot easily determine if a taxpayer is in bankruptcy. A consent signed by an ineligible TMP may be relied on without knowledge of the TMP being in bankruptcy. As a result, the statute of limitations may expire.

Unless the IRS is notified of a bankruptcy proceeding, the IRS can rely on a consent executed by a TMP who is in bankruptcy at the time of the execution of the consent. The statute extension is binding on all partners in the partnership.

Effective for agreements entered into after August 5, 1997.

Small Partnership Exception
Sec. 1234

A small partnership may have a C corporation as a partner and not come under the unified partnership proceedings. Also, items may be specially allocated and the partnership will not be subject to the unified partnership proceedings.

Effective for partnership taxable years ending after August 5, 1997.

Exclusion of Partial Settlements From 1 Year limitation On Assessments
Sec. 1235

If a partner and the IRS enter into a partial settlement agreement resolving some of the issues but not all, the assessment period could be different for the agreed items and the remaining items.

The period for assessing tax on the resolved items is determined as if an agreement had not been entered into. The period of limitations that applies to the last item to be resolved for the taxable year controls all disputed items for the partnership taxable year.

Effective for settlements entered into after August 5, 1997.

Extension On Time For Filing A Request For Administrative Adjustment
Sec. 1236

If a consent to extend the statute of limitations in a unified partnership proceeding is executed, that agreement also extends the statute for filing claims for refund on partnership items until six months after the expiration of the period for assessment.

Effective as if included in the amendment made by § 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

These amendments apply to taxable years beginning after September 3, 1982, and ending after September 3, 1982.

Availability of Innocent Spouse Relief In Context of Partnership Proceedings Sec. 1237

Two forums are provided for raising the innocent spouse in a unified partnership proceeding. The forums are:

- prepayment; and

- refund.

The prepayment forum provides that a spouse can request the abatement of an assessment within 60 days of the date the computational adjustment is mailed to that party. Upon receipt of such a request, the assessment is abated and any reassessment is subject to deficiency procedures. The statute of limitations will not expire before 60 days after the date of abatement. If a petition is filed in Tax Court, the court only has jurisdiction over whether the requirements for innocent spouse relief are met.

The refund forum allows a spouse to file a claim for refund within six months from the date of the notice of computational adjustment is mailed to that person. If a claim for refund is denied, the spouse can file a refund action.

Effective as if included in the amendment made by § 402 of the Tax Equity and Fiscal Responsibility Act of 1982, for taxable years beginning after September 3, 1982, and ending after September 3, 1982.

Determination Of Penalties At Partnership Level Sec. 1238

The unified partnership proceeding is to include the determination of the application of penalties at the partnership level relating to partnership item adjustments. However, partners may contest the penalties in a refund forum at the partner level.

Effective for partnership taxable years ending after August 5, 1997.

Court Jurisdiction, Etc. Sec. 1239

Clarification is given that a partner may bring an action in tax court to enjoin premature assessments on partnership items. A partner also may participate in an action or file a petition contending the statute of limitations for assessing any tax attributable to partnership items has expired for that person. Tax Court has jurisdiction over overpayments relating to affected items.

Effective for partnership taxable years ending after August 5, 1997.

Treatment of Premature

Any petition filed prematurely by certain partners during the 90 day period that the Tax Matters Partner (TMP) has the exclusive right to file a petition

Petitions Filed By Notice Partners or 5 Percent Groups Sec. 1240

for readjustment of partnership items will be treated as if it was filed during the 60 day period.

Effective for petitions filed after August 5, 1997.

Bonds In Case Of Appeals From Certain Proceeding Sec. 1241

The amount of the bond is based on the Tax Court's estimate of the aggregate liability of only the parties to the action, and not all of the partners in the partnership.

Effective as if included in the amendment made by § 402 of the Tax Equity and Fiscal Responsibility Act of 1982, for taxable years beginning after September 3, 1982, and ending after September 3, 1982.

Interest In Computational Adjustment From Certain Settlements Sec. 1242

Interest is now suspended when there is a delay in making a computational adjustment from a unified partnership settlement.

Effective for adjustments relating to partnership taxable years beginning after August 5, 1997.

Administrative Adjustment Requests for Bad Debts or Worthless Securities Sec. 1243

The time for filing an RAA relating to a deduction for a bad debt or worthless security is extended. The period for filing the RAA is seven years from the due date of the partnership return, without regard to extensions. The RAA is still required to be filed before the final partnership administrative adjustment is mailed for the taxable year.

Effective as if included in the amendment made by § 402 of the Tax Equity and Fiscal Responsibility Act of 1982, for taxable years beginning after September 3, 1982, and ending after September 3, 1982.

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11. CORPORATIONS

Tax Treatment of Certain Extraordinary Dividends Sec. 1011

A corporate shareholder recognizes gain on any stock redemption treated as a dividend if:

- the nontaxed portion of the dividend exceeds the basis of the stock redeemed, and

- the redemption is treated as a dividend because options were taken into account to determine the redeemed shareholder's stock ownership after the redemption.

A corporate shareholder recognizes gain in the year an extraordinary dividend is received to the extent the nontaxed portion of the extraordinary dividend would otherwise reduce basis below zero. Basis reduction is treated as occurring at the beginning of the ex-dividend date of the extraordinary dividend.

Effective for:

1. redemptions that are part of a partial liquidation, not pro rata as to all shareholders, or treated as a dividend because of option attribution after May 3, 1995;

2. all other distributions to which § 1059 applies after September 13, 1995.

3. The amendments do not apply to distributions made pursuant to the terms of:

   - a binding written contract in effect on May 3, 1995 (or, if relevant, September 13, 1995), and at all times thereafter, before the distribution is made, or

   - a tender offer outstanding on May 3, 1995 (or, if relevant, September 13, 1995).

Application of Code Section 355 to Distributions in Connection with Acquisitions and to Intragroup Transactions
Sec. 1012

Corporate Level Gain on Distribution Involving Change of Control

Additional restrictions are imposed under § 355 on acquisitions and dispositions of the stock of the distributing and controlled corporation.

§ 355(e) is targeted at transactions where there is a § 355 distribution, but pursuant to a plan (or series of related transactions) of which the § 355 distribution is part, one or more persons acquire directly or indirectly a 50 percent or greater interest (by vote or value) in either the distributing or controlled corporation. Such transactions can include "Morris Trust" distributions of unwanted assets to facilitate mergers with another corporation. Where § 355(e) applies, the distributing corporation is taxed on any gain in the controlled stock under § 311.

There are several exceptions allowing a person to obtain a 50 percent or greater interest without triggering gain recognition. In general, the exceptions permit:

- the Distributing corporation to acquire stock in the Controlled corporation (e.g., in a "D" reorganization);

- the Distributing corporation’s shareholders to acquire Controlled corporation stock in the § 355 distribution;

- distributions if the Distributing and Controlled corporations remain members of the same affiliated group (under § 1504 without regard to § 1504(b)) after the completion of the planned transactions;

- the Distributing corporation's shareholders to acquire stock of a successor corporation in exchange for stock of the Distributing or Controlled corporation;

- acquisitions by persons who directly or indirectly owned 50 percent control of the acquired corporation before the distribution; and

- distributions in bankruptcy and similar cases.

Rules applicable to distributing and controlled corporations apply to predecessor and successor corporations.

The attribution rules of § 318(a)(2) apply in determining stock ownership, except that shareholders are treated as owning their proportionate share of their corporation's holdings without regard to the amount of stock they own in the corporation.

If one or more persons acquire 50 percent control of the Distributing or Controlled corporation (and one of the exceptions does not apply) within two years before or after the distribution, the acquisition of control and the distribution are presumed to be part of the common plan unless it is established that they are not. The statute of limitations never runs on assessment of deficiencies attributable to gain recognized under § 355(e) unless the taxpayer files a notice with the Service in the manner prescribed by regulations.

Intragroup Distributions

Under § 355(f), where a distribution within an affiliated group (under § 1504(a)) is part of a plan (or series of related transactions) that includes a distribution described in the operative provision of § 355(e), § 355 does not apply to the intragroup distribution (i.e., it is a § 301 distribution to the recipient and a § 311 distribution to the distributing corporation). The Controlled corporation distributed in the intragroup distribution need not be the same Controlled corporation distributed in the distribution described in § 355(e), so long as they are all distributed pursuant to a common plan or as related transactions.

The Service and Treasury have authority to issue regulations changing the statutory results in intragroup distributions under § 355(f) (i.e., where § 355(e) also applies) and under § 358 (even where § 355(e) does not also apply).

Control Requirement for "D" Reorgs and Section 351 Exchanges

The control requirement for "D" reorganizations and § 351 exchanges in the context of § 355 transactions is amended to conform to the 50 percent vote or value standard of § 355(e).

Effective Date

The new provisions apply if both the distribution and the acquisition of 50 percent control occur after April 16, 1997 (however, the changes to the control requirements are effective on August 5, 1997).

There is an exception for certain transactions if on April 16, 1997, and all times thereafter, there was a binding contract for the transaction, or a private letter ruling request, public announcement, or SEC filing describing the transaction. The agreement, ruling request, announcement, or filing must identify the acquiror. A binding contract need not be in writing, but there must be some form of contemporaneous written evidence to support its existence.

Tax Treatment of Redemptions Involving Related Corporations Sec. 1013

If a corporation purchases stock of a related corporation, the transaction is generally considered a redemption, which can be treated either as a sale or exchange or as a dividend. If the redemption is treated as a dividend, the transferor and acquiring corporation are treated as if:

- the transferor transferred the stock to the acquiring corporation in a tax-free exchange under § 351 in exchange for newly issued acquiring corporation stock, and

- the acquiring corporation redeemed the stock it is treated as having issued.

Acquiring foreign corporations are limited in the amount of earnings and profits available to determine the amount of the transferor's dividend. The earnings and profits are available if:

- attributable to stock of the acquiring corporation that is held by a corporation or individual that is the transferor (or a related party) that is a U.S. shareholder of the acquiring corporation, and

- accumulated during periods in which such stock was owned by the transferor or a related party and the acquiring corporation was a controlled foreign corporation.

The rules under § 1248(d) apply for excluding earnings and profits.

If a redemption is treated as a dividend subject to the dividends received deduction, it will be treated as an extraordinary dividend. Only the basis of the acquiring corporation shares treated as issued and redeemed under § 304 will be taken into account when applying § 1059.

Effective for distributions or acquisitions after June 8, 1997.

The new provisions will not apply if any distribution or acquisition is:

- made pursuant to a written binding agreement in effect on June 8, 1997, and at all times subsequent,

- described in a private letter ruling submitted to the Internal Revenue Service on or before June 8, 1997, or

- described in a public announcement or filing with the Securities and Exchange Commission (SEC) on or before June 8, 1997.

Certain Preferred Stock Treated as Boot
Sec. 1014

Non-recognition rules are amended, in general, to treat the receipt of certain "nonqualified" preferred stock as "boot" or taxable consideration in the exchange. These provisions apply when there is an exchange for nonqualified preferred stock in a:

- transfer of assets to a controlled corporation (§ 351),

- distribution of stock and securities to a controlled corporation (§ 355),

- corporate reorganizations (§ 354 and § 356), or

- to an exchange of, or for, nonqualified preferred stock for stock of the same corporation (§ 1036).

Nonqualified Preferred Stock

For this purpose, stock is preferred stock if it is limited and preferred to dividends and does not participate in corporate growth to any significant event. It is nonqualified preferred stock if:

- the holder has the right to require the issuer or a related person to redeem or buy the stock;

- the issuer or a related person is required to redeem or buy the stock;

- the issuer or related person has the right to redeem or purchase the stock and, as of the issue date, the right will more likely than not be exercised; or

- the dividend rate on the stock varies in whole or part with reference to interest rates, commodity prices, or other indexes;

Provided:

- the right or obligation to redeem or buy may be exercised within 20 years of the date the instrument is issued; and

- such right or obligation is not subject to a contingency that as of the date of issue that will make the likelihood of a redemption or purchase remote.

There are two situations where obligations or rights to redeem or buy are disregarded in determining status as nonqualified preferred stock:

- if the right or obligation can only be exercised on the death, disability, or mental incompetency of the holder, provided no stock received or relinquished in the exchange is in a corporation if that corporation or any related person has outstanding any class of publicly traded stock; and

- for stock transferred in connection with the performance of services for the issuer or a related person (and which represents reasonable compensation), if the right or obligation can be exercised only on the holder's separation from service.

Reorganizations

Reorganization exchanges excluded from gain recognition:

- exchanges of nonqualified preferred stock for nonqualified preferred stock;

- exchanges of nonqualified preferred stock for common stock or other types of preferred stock;

- exchanges of debt securities for nonqualified preferred stock; and

- exchanges of stock in certain recapitalization of family owned corporations (where a family owns at least 50 percent of the voting power and value of all stock for five years preceding and three years following the recapitalization).

Section 351

Although nonqualified preferred stock is treated as boot in determining a transferor's treatment under § 351 and gain may be recognized, it is considered stock received by a transferor for qualifying the entire transaction under § 351.

Effective Date

Effective for transactions after June 8, 1997.

The new provisions will not apply if any transaction is:

- made pursuant to a written binding agreement in effect on June 8, 1997, and at all times subsequent;

- described in a private letter ruling submitted to the Internal Revenue Service on or before June 8, 1997; or

- described on or before June 8, 1997 in a public announcement or filing with the Securities and Exchange Commission (SEC) required solely by reason of the transaction.

Holding Period Applicable to Dividends Received Deduction Sec. 1015

The rules for the holding period are modified. It was believed that a corporate shareholder should not receive a deduction when there is no risk of loss at or near the time of the distribution.

A taxpayer does not receive a dividends-received deduction if the holding period for the dividend-paying stock is not satisfied over a period immediately before or immediately after the taxpayer becomes eligible for the receipt of the dividend. Previously, the holding period had to be satisfied only once rather than with respect to each dividend received.

Generally effective for dividends paid or accrued after the 30th day after August 5, 1997 (September 4, 1997).

The new provision will not apply to dividends received within two years of August 5, 1997 if:

- the dividend is paid on stock held on June 8, 1997, and until the dividend is received;

- the stock is continuously subject to a position described in §246(c)(4) (relating to contracts diminishing the risk of loss) on June 8, 1997, and until the dividend is received; and

- the stock and related position are identified by the taxpayer within 30 days after August 5, 1997, or September 4, 1997.

Interest Rate on Large Corporate Underpayments Sec. 1463

For determining the period to which the large corporate underpayment rate applies, any letter or notice is disregarded if:

- the amount of deficiency;
- proposed deficiency;
- assessment; or
- proposed assessment

in the letter or notice is $100,000 or less. Interest, penalties, or additions to tax are not considered when determining the dollar threshold of $100,000.

Effective for determining interest for periods after December 31, 1997.

Waiver of Estimated Tax Penalties Sec. 1 (d)

No estimated tax penalty will be assessed with respect to individuals or corporations for any payment due before January 16, 1998, on an underpayment created or increased by the Taxpayer Relief Act of 1997.

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12. ESTATE, GIFT and TRUST

Cost of Living Adjustments
Sec. 501

Annual Exclusion

For gifts made after 1998, multiply the $10,000 exclusion times the adjustment and round down to the nearest $1,000.

Generation Skipping Tax Exemption

For date of deaths after 1998, multiply the $1,000,000 exemption times the adjustment and round down to the nearest $10,000.

Reduction in Value Under Special Farm Use Valuation

For date of deaths after 1998, multiply the $750,000 reduction times the adjustment and round down to the nearest $10,000.

Maximum Amount Used in Deferred Estate Tax

For date of deaths after 1998, multiply the $1,000,000 maximum amount times the adjustment and round down to nearest $10,000.

Unified Credit Increase

The $192,800 current unified credit is increased according to the following schedule:

Year	Unified Credit	Credit Equivalent in Taxable Estate or Taxable Gifts
1997	$192,800	$600,000
1998	$202,050	$625,000
1999	$211,300	$650,000
2000 & 2001	$220,550	$675,000
2002 & 2003	$229,800	$700,000
2004	$287,300	$850,000
2005	$326,300	$950,000
2006 and after	$345,800	$1,000,000

Surtax Rate Adjustment

Due to the increasing unified credit, the phaseout of the graduated estate and gift tax rate and unified credit will now phase out between $10 million and the amount at which the tax rate reaches 55 percent.

Qualified Business Exclusion
Sec. 502

Exclusion for Qualified Business Interests

Effective for decedents dying after December 31, 1997, a limited exclusion is allowed for the value of a decedent's family owned business interests.

Requirements

Among the requirements for the exclusion are:

- the estate must elect the benefits of the exclusion;

- the business family owned business must be predominantly family owned, various percentage benchmark are used if more than one family owns the business;

- the family owned business interest must be more than 50 percent of the decedent's estate;

- the exclusion decreases as the value of the united estate and gift credit increases, so that the total value of both is limited to $1,300,000; and

- the decedent or member of the decedent's family must have owned the business interest and materially participated in the business for five of the eight years prior to the date of death.

Recapture Requirement

All, or a portion, of the tax savings are recaptured if within ten years after the date of death any of the following occurs:

- the heir disposes of any portion of the business interest to other than a family member;

- the heir losses his or her American Citizenship;

- the heir or member of the heir's family ceases to materially participate in the business; or

- the principle place of business ceases to be located in the U. S.

Exclusions

The exclusion does not apply to:

- an interest in the trade or business if the business' stock or securities were publicly traded at any time within the last three years of the decedent's death;

- the gift tax;

- the portion of the business value represented by cash or marketable securities in excess of the amount of "reasonably expected day-by-day working capital needs" of the business;

- business with significant amounts of personal holding company income;

- decedents who are not U. S. citizens or residents; and
- businesses whose principle place of business is outside the U.S.

Extensions of Time to Pay for Closely-held Businesses
Sec. 503

New Interest Rate The special four percent interest rate on the deferred tax is reduced to two percent. In addition, any additional estate tax deferred under § 6166 is computed at 45 percent of the normal interest rate for deficiencies.

Deduction of Interest No estate tax or income tax deduction is allowed for the interest paid on the deferred estate tax.

Effective Dates The two percent interest rate applies to estates of decedents dying:

- after December 31, 1997; or
- before January 1, 1998 if the executor makes an irrevocable election to have the new law apply and the election is made before January 1, 1999.

Expansion of the 2032A Exception Sec. 504 The rental exception that previously applied to surviving spouses is expanded to include all lineal descendants of a decedent. After December 31, 1997, there will be no cessation of qualified use if:

- the surviving spouse or lineal descendant leases the property on a cash basis, and
- the lessee is a member of the surviving spouse's or lineal descendant's family.

Declaratory Judgments Sec. 505 Because there must be a deficiency for the Tax Court to resolve a tax dispute, there has been no ready forum to handle disagreements relating only to an extension of time to pay election under § 6166. A new declaratory judgment action is established to give the Tax Court jurisdiction to resolve such cases.

Effective for estates of decedents dying after August 5, 1997.

Statute of Limitations for Gifts and Declaratory Judgements
Sec. 506

Expansion of Exception

Beginning with gift tax returns filed for calendar year 1997, additional gift tax may be assessed at any time (without regard to the normal three year statute of limitations) if the gift is not shown on a gift tax return or described in a manner adequate to apprise the IRS of the nature of the item.

Adjusted Taxable Gift Calculations

As of August 5, 1997, the adjusted taxable gift amount may not be adjusted in the estate tax computation if the statute of limitations for assessing gift tax has expired.

Declaratory Judgments

Because there must be a deficiency for the Tax Court to obtain jurisdiction over a tax dispute, there has been no ready forum to handle gift tax valuation disagreements when the amount of additional tentative tax is offset by the available unified credit. For transfers after the effective date of the act, a new declaratory judgment procedure gives the Tax Court jurisdiction to resolve gift tax valuation issues even where the redetermination value of the gifts will not result in any additional gift taxes being owed.

Throwback Rule
Sec. 507

Except for certain exceptions which relate to foreign trusts and older multiple trusts, the throwback rules have been repealed for tax years beginning after August 5, 1997.

Qualified Conservation Easements
Sec. 508

Valuation of Real Property

For purposes of the estate tax, real property is valued at its fair market value (§2031) or its special use value (§2032A). In addition, a charitable deduction is allowed for the value of conservation easements.

Qualified Conservation Easements

For decedent’s dying after December 31, 1997, an elective reduction in fair market value is allowed for qualified charitable conservation easements. A qualified conservation easement is an easement restricting the use of the land for certain purposes, if the land is located within:

- 25 miles of an area which is a metropolitan area (as defined by the

Office of Management and Budget);

- 25 miles of a national park or wilderness area; or
- 10 miles of an Urban National Forest (as designated by the Forest Service).

The decedent or member of the decedent's family must have owned the property at all times during the three year period ending on the decedent's date of death

Reduction in Value

40 percent of the value of the land with the easement (less any amount already qualifying for a charitable deduction) may be excluded from the taxable estate subject to the following dollar limitations:

Year	Maximum Reduction
1998	$100,000
1999	$200,000
2000	$300,000
2001	$400,000
2002 or after	$500,000

The percentage reduction is reduced if the value of the easement is worth less than 30 percent of the fair market value of the property.

Effective Date

Effective for estates of decedent's dying after December 31, 1997.

Basis

To the extent of the exclusion, the heir or devisee receives a carryover basis in the property.

Predeceased Parent Exception for Generation Skipping Tax Sec. 511

For decedents dying after December 31, 1997, the "predeceased parent exception" applies to the following additional situations:

- all taxable terminations and distributions if the parent of a beneficiary who was a lineal descendant of the transferor dies before the date of the original transfer; or
- all generations skipping tax events for beneficiaries who are members of the transferor's family but not lineal descendants of

the transferor if:

- the transferor had no living lineal descendants on the date of the original transfer; and

- the member of the transferor's family who is the parent of the beneficiary dies before the original transfer.

Limitations on Charitable Remainder Trust Eligibility for Certain Trusts Sec. 1089

The value of the charitable remainder for a charitable remainder annuity trust or remainder unitrust is required to be at least 10 percent of the net fair market value of the property transferred in trust on the date of the contribution to the trust. The 10 percent is measured on each transfer to the charitable remainder trust.

The trust is treated as meeting the 10 percent rule in a transfer made after July 28, 1997, to a charitable remainder trust that failed the 10 percent test, if the governing instrument of the trust is changed by reformation, amendment, construction, or reducing the payout rate or duration an any noncharitable beneficiary's interest to satisfy the requirement. It will qualify as long as the reformation is commenced within the period permitted for reformations of charitable remainder trusts under § 2055(e)(3).

The statute of limitations applicable to a deficiency of any tax resulting from reformation of the trust shall not expire before the date one year after the Treasury Department is notified that the trust is reformed.

A transfer to a trust is treated as if the transfer never had been made when a court having jurisdiction over the trust subsequently declares it void and judicial proceedings to revoke the trust are commenced within the period permitted for reformation of charitable remainder trusts under § 2055(e)(3).

When "unwinding" the trust, any transactions made by the trust with respect to property transferred is income and capital gain of the donor, and the donor is not permitted a charitable deduction on the transfer.

The statute of limitations applicable to a deficiency of any tax resulting from "unwinding" the trust shall not expire before the date one year after the Treasury Department is notified that the trust has been revoked.

If an additional contribution is made after July 28, 1997, to a charitable remainder unitrust created before July 29, 1997, and that unitrust does not meet the 10 percent requirement with respect to the additional contribution, the additional contribution:

- will be treated as if it had been made to a new trust that does not meet the 10 percent requirement, but

- does not affect the status of the original unitrust as a charitable remainder trust.

The requirement that the payout rate not to exceed 50 percent is effective for transfers to a trust after June 18, 1977.

The requirement that the value of the charitable remainder with respect to any transfer to a qualified remainder trust be at least 10 percent of the fair market value of the assets transferred in trust is effective for transfers to a trust made after July 28, 1997. It does not apply to a charitable remainder trust created by a testamentary instrument executed before July 29, 1997, if the instrument is not modified after that date and the settlor dies before January 1, 1999, or could not be modified after July 28, 1997, because the settlor was under a mental disability on that date and all times after.

Transition Rule for Certain Trusts Sec. 1161	The Secretary of the Treasury is granted the authority to allow non-grantor trusts in existence on 8/20/96 that have been treated as U.S. trusts prior to 1996 to elect to continue to be treated as U.S. trusts, notwithstanding the new criteria for qualification as a U.S. trust. Effective for tax years starting after December 31, 1996.
Gift Tax Returns for Gifts to Charity Sec. 1301	A gift to charity is not subject to the gift tax filing requirements as long as the entire value of the transferred property qualifies for the gift tax charitable deduction under § 2522. Effective for gifts made after August 5, 1997.
Rights of Recovery Sec. 1302	For individuals dying after the enactment, the right of recovery for tax allocable to QTIP property will be waived only if the language of the will or trust specifically indicates that the waiver is intended. Effective for estates of decedents dying after August 5, 1997.
Transition Rule Under Section 2056A Sec. 1303	Certain trusts created before 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.

	Effective for estates of decedents dying after November 10, 1988 (as if included in the Omnibus Budget Reconciliation Act of 1990).
Treatment of Short-term Obligations held by Nonresident Aliens Sec. 1304	The income from any debt obligation that would be eligible for the exemption for short-term OID is treated as property located outside the U. S. for determining the estate tax liability of a nonresident alien. Effective for estates of decedents dying after August 5, 1997.
Combination of Revocable Trusts and Probate Estates Sec. 1305	At the election of the Trustee and Executor, a decedent's estate and revocable trust may be combined for income tax reporting purposes. Effective for estates of decedents dying after August 5, 1997.
Distributions During First 65 Days Sec. 1306	The 65 day rule for computing the distribution deduction now applies to estates. Effective for taxable years beginning after August 5, 1997.
Separate Share Rules Sec. 1307	The separate share rule used for allocation of DNI now applies to estates. Effective for estates of decedents dying after August 5, 1997.
Executor and Beneficiaries Treated as Related Sec. 1308	Except for distributions in satisfaction of a pecuniary bequest, an estate and a beneficiary of that estate are treated as related persons for purposes of the loss deferral rules of §267 and gain recharacterization rules of §1239. Effective for taxable years beginning after August 5, 1997.
Treatment of Funeral Trusts Sec. 1309	Instead of accounting for a pre-need funeral trust's earnings on the taxpayer's income tax return as a grantor trust, the Secretary may establish rules allowing the trustee of a qualified trust to elect special tax treatment. As part of the rulemaking process, a trustee may be allowed to file a single annual trust return for all of its trusts. Effective for estates of decedents dying after August 5, 1997.

Jalkut-type Transactions Sec. 1310	There has been a great deal of controversy concerning the tax treatment of gifts from revocable trusts that are made within three years of death. The act clarifies this area. Transfers from a revocable trust that are made after the enactment date will be treated as the direct transfers of the trustor. If the trustor dies within three years of a transfer made after the enactment date, the transferred amount will not be included in the trustor's gross estate by §2035(d). Effective for estates of decedents dying after August 5, 1997.
Survivor Annuities Under Qualified Terminable Interest Rules Sec. 1311	The marital deduction is available in a community property state to any interests a nonparticipant spouse has in a qualified pension plan where he or she predeceases the participant spouse. The interest that passes to the surviving participant spouse may qualify for treatment as qualified terminable interest property. Effective for estates of decedents dying after August 5, 1997.
Treatment of Forms of Ownership Which are Not Trusts Sec. 1312	The Treasury is given regulatory authority to treat as trusts, for purposes of qualifying as a qualified domestic trust under § 2056A, legal arrangements that have the same effect as a trust. Effective for estates of decedents dying after August 5, 1997.
Required Documents and Signatures for Sec. 2032A Elections Sec. 1313	If the notice of election is incomplete or signatures are missing from the agreement, the §2032A election is still valid if the required information or signatures is provided by the executor within a reasonable period (not to exceed 90 days) Effective for estates of decedents dying after August 5, 1997.
Authority to Waive U. S. Trustee Requirement for Qualified Domestic Trusts Sec. 1314	The Treasury is given authority to waive the requirement that a qualified domestic trust have a U. S. trustee. Effective for estates of decedents dying after August 5, 1997.

13. EXCISE TAX

Fuel Tax Deposits Sec. 901

Deposits of fuel taxes on gasoline, diesel fuel, kerosene, and special motor fuels which would be required to be made after July 31, 1998 and before October 1, 1998, are due on or before October 5, 1998.

Recreational Boats Sec. 902

The temporary suspension of the tax on diesel fuel used in recreational boats is made permanent.

Imported Recycled Halon Sec. 903

The exemption of imported recycled halon-1211 from ozone-depleting chemical excise tax scheduled to take effect on January 1, 1998, is repealed.

Tax on Vaccines Sec. 904

The rate of tax on vaccines has been standardized at 75 cents per dose and the list of taxable vaccines has been expanded.

Definitions

A taxable vaccine means any of the following vaccines manufactured or produced in the United States or entered into the U.S. for consumption, use or warehousing any vaccine:

- containing diphtheria toxoid.
- containing tetanus toxoid
- containing pertussis bacteria, extracted or partial cell bacteria, or specific pertussis antigens.
- against measles.
- against mumps.
- against rubella.
- containing polio virus.
- any HIB vaccine.
- against hepatitis B.
- against chicken pox.

Combined Vaccines

If any taxable vaccine is combined with one or more additional taxable vaccines, the amount of tax is the sum of the amounts for vaccines included in the combination.

Effective August 6, 1997.

Wholesale Distributor Sec. 905	For the purpose of claiming gasoline tax refunds, the definition of "Wholesale Distributors" has been amended to include any operator of 10 or more retail gasoline stations effective August 6, 1997.

Electric and Other Clean-fuel Motor Vehicles
Sec. 906

The luxury tax threshold in 1997 is $36,000 and is adjusted annually. Effective after August 5, 1997, the luxury tax threshold is raised for electric and clean-fuel motor vehicles:

- the electric vehicle threshold is 150 percent of the luxury tax threshold;

- the clean-fuel motor vehicle threshold is the luxury tax threshold plus an amount equal to the increase in the price of the vehicle attributable to the retrofit parts and components installed that permit the vehicle to be clean burning.

Also effective for vehicles sold after August 5, 1997, parts or accessories added to a luxury automobile within six months of the initial purchase are only taxable if the aggregate price of the additions is more than $1,000.

Liquefied Petroleum Gas and Liquefied Natural Gas
Sec. 907

Rate of Tax

Effective October 1, 1997, the rate of tax for the following fuels will be:

- 13.6 cents per gallon in the case of liquefied petroleum gas, and

- 11.9 cents per gallon in the case of liquefied natural gas.

Partially Exempt Methanol or Ethanol Fuel

Partially exempt methanol or ethanol fuel means any liquid at least 85 percent of which consists of methanol or ethanol, or other alcohol produced from natural gas.

Effective October 1, 1997, the rate of tax for the following fuels will be:

- 9.15 cents per gallon in the case of methanol, and

- in any other case, 11.3 cents per gallon.

Aviation Excise Tax
Sec. 1031

Domestic Air Transportation

The tax on transportation of persons by air will change to the following rates shown below for transportation beginning on or after 10/1/97:

Date of Purchase	Rate of Tax
10/1/97 through 9/30/98	9 percent
10/1/98 through 9/30/99	8 percent
10/1/99 and thereafter	7.5 percent

In addition to the 7.5 percent tax, each domestic segment will be taxed as follows:

Date of Segments	Tax Rate
After 9/30/97 and before 10/1/98	$1.00
After 9/30/98 and before 10/1/99	$2.00
After 9/30/99 and before 1/1/2000	$2.25
During 2000	$2.50
During 2001	$2.75
During 2002	$3.00
2003 and thereafter	$3.00 multiplied by the cost of living adjustment determined under § 1(f)(3)

Definition of Domestic Segment

A domestic segment is any segment consisting of one takeoff and one landing which is taxable transportation (begins and ends in the United States or the 225-mile zone).

Changes in Segments

If transportation between two locations is purchased on specified flights and there is a change in route which changes the number of domestic segments, but there is no change in the amount charged for such transportation, the tax shall be determined without regard to such change in route.

Rate on International Travel

For amounts paid after 8/12/97, for international flights beginning on or after 10/1/97, the tax rate on any amount paid for transportation of any person by air, which begins or ends in the United States will be $12 for each arrival and departure, whether paid within or without the United States.

The rate will be indexed to inflation for amounts paid after 12/31/98.

Alaska and Hawaii	If a domestic segment begins or ends in Alaska or Hawaii, a tax of $6 will apply only to departures. The rate will be indexed to inflation for amounts paid after 12/31/98.
Exception for Segments Beginning or Ending at Rural Airports	In general, if any domestic segment begins or ends at an airport which is a rural airport for the calendar year in which the segment begins, the segment tax shall not apply to that segment. In addition, the phase-in of the tax rate on domestic transportation does not apply to domestic segments beginning or ending at rural airports. Thus, amounts paid after 9/30/97 for rural segments beginning after 9/30/97 are taxed at 7.5 percent.
Definition of Rural Airport	The term "rural airport" means any airport if there were fewer than 100,000 commercial passengers departing by air during the second preceding calendar year from such airport, and such airport: - Is not located within 75 miles of another airport which had 100,000 or more commercial passengers departing by air during the second preceding calendar year, or - Is receiving essential air service subsidies as of August 5, 1997.
Multiple Segments	Where a flight involves multiple segments and at least one segment does not begin or end at a rural airport, the 7.5 percent rate shall be applied by allocating the amount paid based on the ratio of great circle miles in domestic segments involving a rural airport to total great circle miles. Guidance is provided in Rev. Proc. 97-46.
Free or Reduced Rate Air Transportation Frequent Flyer Miles in General	Amounts paid after 9/30/97 to an air carrier for the right to provide mileage awards or other reductions in the cost of any transportation of persons shall be treated as an amount paid for taxable transportation.
Mileage Awards Paid by a Controlled Group	Any amount paid by a member of a controlled group after 6/11/97 and before 10/1/97 for a right described above, which is furnished by another member of the group after 9/30/97, shall be treated as paid after September 30, 1997.

Secondary Liability of Carrier

If the tax is not paid at the time payment for transportation is made, the carrier providing the initial segment beginning or ending in the United States, shall be liable for the tax. This provision applies to amounts paid on or after 10/1/97, for domestic travel on or after 10/1/97. The provision applies to amounts paid after August 12, 1997, for international air transportation after 9/30/97.

Deposit Due Date Extension

Deposits of taxes for transportation of persons by air which would be required to be made are extended as follows:

If the due date were:	Then the due date is:
after 8/14/97 and before 10/1/97	10/10/97;
after 8/14/98 and before 10/1/98	10/5/98.

Deposit of taxes on transportation of property by air, aviation gasoline, and aviation fuel (other than gasoline), which would be required to be made after 7/31/98 and before 10/1/98, are due on or before October 5, 1998.

Kerosene Taxed as Diesel Fuel Sec. 1032

The term "taxable fuel" is expanded to include kerosene, which will be taxed at the same rate as diesel fuel.

An exemption from the tax, however, is allowed for kerosene which is indelibly dyed in accordance with IRS regulations.

Exceptions to Dyeing Requirement

Tax-free removals, entries, or sales of un-dyed kerosene are generally permitted for:

- aviation-grade kerosene, if the person receiving the kerosene is registered;

- kerosene to be used for non-fuel feedstock purposes; and

- removal, entries, or sales to a wholesale distributor, if the distributor satisfies registration and compliance measures as IRS may prescribe and the wholesaler sells kerosene exclusively to retailers eligible for refunds with respect to undyed kerosene sold for nontaxable use.

Effective Date

The rules covering kerosene are effective July 1, 1998.

Floor Stock Taxes on Kerosene	Generally, in the case of kerosene which is held on July 1, 1998, past the terminal rack, a floor stocks tax of 24.4 cents per gallon is imposed. The floor stock tax imposed is due by August 31, 1998.
Exception for Di Minimis Amount	If the aggregate amount of kerosene held by a person on July 1, 1998 does not exceed 2,000 gallons, the floor stocks tax generally doesn't apply. Any fuel which is exempt by reason of being held for an exempt purpose, or in a fuel tank of a motor vehicle or motorboat, will **not** be taken into account when computing the aggregate gallons held by a person.
LUST Tax Extension Sec. 1033	The 0.1 cent per gallon Leaking Underground Storage Tank Trust Fund (LUST) tax, which expired on December 31, 1995, has been extended effective after September 30, 1997.
Prepaid Telephone Cards Sec. 1034	For communications services acquired by a prepaid telephone card, a 3 percent excise tax is imposed on the face amount of the card when the card is transferred by a telecommunications carrier to any person who is not a carrier. Effective on November 1, 1997.
Addition of Parts and Accessories to Heavy Vehicles and Luxury Autos Sec. 1401	Parts and accessories installed within six months of the initial purchase will not be taxable, unless the aggregate price of the parts and accessories exceeds $1,000 (previously $200). Effective for installations on vehicles sold after August 5, 1997.
Credit for Tax Paid on Tires Sec. 1402	A credit against the retail tax on heavy highway vehicles is allowed for excise tax imposed on tires sold on or in connection with the vehicle. This replaces the exclusion from the amount subject to the heavy vehicle tax allowed for tire value. Effective after December 31, 1997.

Authority to Grant Exemptions from Registration Requirements Sec. 1431	Authority is given to the Internal Revenue Service to waive, by regulations, the registration requirement under § 4222 of purchasers and second purchasers to obtain exemption from manufacturers or retailers excise taxes. This does not apply to fuel taxes or coal tax. Effective after August 5, 1997.
Tax on Bows and Arrows Sec. 1433	The tax on arrows has been changed to a tax on arrow components. The new tax is 12.4 percent of the manufacturer's, importer's, or producer's sale price of any shaft, point, nock, or vane of a type used in the manufacture of any arrow which, after its assembly: - measures 18 inches overall or more in length, or - measures less than 18 inches overall in length, but is suitable for use with a taxable bow. Effective for arrow components sold by the manufacturer, producer or importer after September 30, 1997.

Heavy Highway Vehicle Retail Tax
Sec. 1434

Repairs and Modifications on Heavy Trucks	Effective January 1, 1998, any repairs or modifications to a heavy vehicle (including any modification which changes the transportation function of the article, or restores a wrecked article to a functional condition) is excluded from excise tax if the cost of such repairs and modifications does not exceed 75 percent of the retail price of a comparable new article.
Exception	If the repairs or modifications change a non-taxable vehicle to a taxable vehicle, the exclusion from tax does not apply.
Sales for Resale or for Long Term Lease Certification	The Secretary shall prescribe regulations which permit persons who are purchasing articles taxable under § 4051 for resale or leasing in a long term lease, to execute a statement (under penalties of perjury) on the sale invoice that such sale is for resale in lieu of any other certification (registration cannot be required as a condition of using this procedure). Effective January 1, 1998.

Skydiving Flights Exemption Sec. 1435

Amounts paid for flights which are exclusively for the purpose of skydiving are exempt from the air transportation excise tax after September 30, 1997. However, aviation fuel taxes apply to these flights.

Refund for Tax-paid Aviation Fuel Purchased by Registered Producer Sec. 1436

A refund is allowed for the excise tax previously paid to the government on aviation fuel if a registered producer buys the fuel, resells the fuel, and pays tax on the second sale.

Effective for tax-paid fuel purchased by registered producers after September 30, 1997.

14. FOREIGN

Definition of Foreign Personal Holding Company Income. Sec. 1051

The definition of foreign personal holding company income is expanded to include:

- net income from all types of notional principal contracts; and
- payments in lieu of dividends derived from equity securities lending transactions.

An exception is also provided from foreign personal holding company income for income, gain, deduction, or loss from transactions (including hedging transactions) entered into in the ordinary course of a CFC's business as a regular dealer in property, forward contracts, options, notional principal contracts, or similar financial instruments.

Effective for taxable years beginning after August 5, 1997.

Like Kind Property Outside the U. S. Sec. 1052

Personal property predominantly used within the United States and personal property predominantly used outside the U.S. are not like-kind properties.

Effective for exchanges after June 8, 1997.

Holding Period Requirement for Certain Foreign

A minimum holding period is imposed for a shareholder to be eligible for a foreign tax credit related to a dividend paid on stock.

Taxes
Sec. 1053

No foreign tax credit is allowed with respect to any common stock if it is held by the recipient of the dividend for 15 days or less during the 30 day period beginning on the date which is 15 days before the date on which the shares become ex-dividend. The minimum holding period is 46 days.

Effective for dividends paid or accrued more than 30 days after August 5, 1997.

Denial of Treaty Benefits for Certain Payments Through Hybrid Entities
Sec. 1054

A foreign person is not entitled to a reduced rate of withholding tax under a treaty with a foreign country on income derived through an entity that is treated as a partnership (or is otherwise treated as fiscally transparent) for U.S. tax purposes, if:

- such income is not treated for purposes of taxation of the foreign country as income of the foreign person;
- the foreign country does not impose tax on the actual distribution of income from the partnership to the foreign person; and
- the treaty itself does not address the applicability of the treaty to income derived through a partnership.

In addition, the Secretary has regulatory authority to deny treaty benefits to hybrid entities or taxpayers deriving income through hybrid entities as may be necessary or appropriate in situations not described above. See §1.894-1T(d).

Effective on August 5, 1997.

Interest on Underpayments Not Reduced by Foreign Credit Carrybacks
Sec. 1055

If underpayment for a taxable year is reduced or eliminated by a foreign tax credit carryback from a subsequent taxable year, the carryback does not affect the computation of the interest on the underpayment for the period ending with the filing date for the taxable year in which the foreign taxes were paid or accrued. In the case of an underpayment for a taxable year that is reduced or eliminated by a foreign tax credit carryback attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, the carryback does not affect the computation of the interest on the underpayment for the period ending with the filing date for the taxable year in which the net operating loss carryback or capital loss carryback arose.

If an overpayment is created by a foreign tax credit carryback from a subsequent taxable year, the overpayment will be deemed not to have been made before the filing date for the taxable year in which the foreign taxes were paid or accrued. In the case of an overpayment created by a tax credit carryback attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, the overpayment will be deemed not to have been made before the filing date for the taxable year in which the net operating loss carryback or a capital loss carryback arose.

Effective for foreign tax credit carrybacks arising in taxable years beginning after August 5, 1997.

Clarification of Period of Limitations on Claim for Credit or Refund Attributable to Foreign Tax Carryforward Sec. 1056

In the case of a claim relating to an overpayment attributable to foreign tax credits, the ten year statute of limitations is determined by reference to the year in which the foreign taxes were paid or accrued (and not the year to which the foreign tax credits are carried).

Effective for foreign taxes paid or accrued in taxable years beginning after August 5, 1997.

Exception to Alternative Minimum Foreign Tax Credit Limit Sec. 1057

The special exception previously available regarding the use of foreign tax credits for purposes of the alternative minimum tax is repealed.

Effective for taxable years beginning after August 5, 1997.

Foreign Tax Credit Limitation Sec. 1101

Individuals with no more than $300 ($600 for married filing joint returns) of foreign tax credits are exempt from the foreign tax credit limitation rules and will not have to file Form 1116 in order to obtain the benefit of the foreign tax credit. The exemption applies only to individuals who have no foreign source income other than **passive** income, i.e. interest, dividends.

Effective for tax years starting after December 31, 1997.

Exchange Rate for

To translate accrued foreign taxes to U. S. dollars, the rate will generally be

Translating Foreign Taxes Sec. 1102

an average exchange rate for the tax year, rather than the exchange rate at the end of year.

If the U. S. dollar equivalent of the amount paid is different than the average exchange rate amount accrued, a redetermination will not be required if it is paid before two years after the close of the tax year to which such taxes relate and it is not an inflationary currency.

Effective for tax years beginning after December 31, 1997.

Simplified Limitation for Alternative Minimum Tax Sec. 1103

Taxpayers are permitted to elect to use as their AMT foreign tax credit limitation fraction the ratio of foreign source regular taxable income to entire AMT income, rather than the ratio of foreign source AMT income to entire AMT income.

Effective for tax years beginning after December 31, 1997.

Personal Transactions in Foreign Currency Sec. 1104

If an individual acquires foreign currency and disposes of it in a personal transaction and the exchange rate changes between the acquisition and disposition of such currency; a resulting gain will not be taxable if it does not exceed $200.

Effective for tax years beginning after December 31, 1997.

Limitations for Dividends from 10/50 Corporations Sec. 1105

Dividends received from each 10/50 company will no longer be subject to a separate foreign credit limitation.

Dividends paid by 10/50 companies after 12/31/02 out of earnings and profits accumulated in a taxable year beginning before 1/1/03 are subject to a single foreign tax credit limitation.

Dividends paid by 10/50 companies after 12/31/02 out of earnings and profits accumulated in a taxable year beginning after 12/31/02 are subject to look-through treatment for foreign tax limitation purposes.

Any dividend from a 10/50 company is treated as income in a foreign tax credit limitation category in proportion to the ratio of:

- earnings and profits post 2002 attributable to income in such foreign tax credit limitation category, to total earnings and profits.

	Effective for tax years beginning after December 31, 2002.
Gain on Sales by Controlled Foreign Corporations (CFC) Sec. 1111	Gain by a CFC from the sale or exchange of stock in a foreign corporation is treated as a dividend to the same extent that it would have be so treated under § 1248 if the CFC would have been a U.S. person. Effective August 5, 1997.
Miscellaneous Modifications to Subpart F Sec. 1112	When a lower-tier controlled foreign corporation (CFC) earns subpart F income, and stock in that corporation is later disposed of by an upper-tier CFC, the resulting income inclusion of U.S. 10-percent shareholders is adjusted by previous inclusions. Effective for taxable years of U. S. Shareholders beginning after December 31, 1997.
Indirect Foreign Tax Credit for Certain Lower Tier Companies Sec. 1113	The indirect foreign tax credit is extended to foreign taxes paid or accrued by certain fourth, fifth, and sixth tier foreign corporations. Effective for tax years beginning after August 5, 1997.
10 percent U.S. Shareholders of a Controlled Foreign Corporation not Subject to PFIC Inclusions Sec. 1121	The overlap complication of Subpart F with PFIC rules is eliminated. If a CFC is also a PFIC, it will not be treated as PFIC with respect to certain 10 percent shareholders. This rule is applicable only if the, - foreign corporation is CFC; and - U.S. shareholder is subject to current inclusion rules of Subpart F. Effective for tax years beginning after December 31, 1997.

Election of Mark to Market for Marketable Stock Sec. 1122

A shareholder may elect to mark to market marketable stock of a PFIC. Under such an election the shareholder includes in income each year,

An amount equal to the excess, if any, of the fair market value of the PFIC stock as of the close of the taxable year

The shareholder's adjusted basis in such stock.

The shareholder is allowed a deduction for the excess, if any, of the adjusted basis of the PFIC stock over its fair market value as of the close of the taxable year. However, deductions are allowable only to the extent of any net mark to market gains with respect to the stock included by the shareholder in the prior year.

The mark to market is an alternative to the current inclusion method.

Effective for tax years beginning after December 31, 1997.

Valuation of Assets for Passive Foreign Investment Company Determination Sec. 1123

If the stock of a foreign corporation is publicly traded for the taxable year, then the PFIC asset test is applied using the fair market value for the purpose of measuring the PFIC' assets.

The rules applicable to non-publicly traded foreign corporations for purposes of measurement of assets in applying the PFIC asset test do not change.

CFC's that are not publicly traded continue to be required to measure their assets using adjusted basis and any other foreign corporations that are not publicly traded continue to measure their assets using fair market value unless they elect to use adjusted basis.

Effective for tax years beginning after December 31, 1997.

Repeal of Excise Tax on Transfer to Foreign Entities Sec. 1131

The excise tax and information reporting rules that apply to certain transfers of appreciated property by a U.S. person to a foreign entity are repealed, effective August 5, 1997.

In lieu of the excise tax, the following are imposed:

- Upon transfer of appreciated property by a U.S. person to a foreign estate or trust, gain is recognized to the extent of the excess of the fair market value of the property over the adjusted basis of the property in the hands of the transferor.

- If a U.S. trust becomes a foreign trust, it is being treated as if it had transferred its assets to a foreign trust.

- Upon contribution of appreciated property by a U.S. person to a foreign partnership, regulatory authority is granted under § 367 to deny nonrecognition treatment. The contribution is treated as a sale or exchange of property and gain is recognized to the extent of the excess of the fair market value of the property over the adjusted basis of the property in the hands of the transferor.

Effective for transfers made after August 5, 1997.

Clarification of Application of Return Requirement to Foreign Partnership Sec. 1141

A foreign partnership has to file a U.S. partnership return only if it has:

- gross income from sources within the United States, or

- gross income which is effectively connected with a U.S. trade or business.

Effective for taxable years beginning after August 5, 1997.

Controlled Foreign Partnership Information Reporting Sec. 1142

Reporting rules similar to those now applicable to foreign corporations, will be applicable to controlled foreign partnerships.

A U.S. persons that controls a foreign partnership is required to file an annual information report with respect to such partnership.

A U.S. person is considered to control a foreign partnership if that partner owns directly or indirectly more than 50 percent interest in the capital, profits, or losses of the partnership.

Similar information reporting requirements may be required from a U.S. person that owns 10 percent or more in a foreign partnership which is controlled by U.S. persons each having a 10 percent or more interest.

A $10,000 penalty applies to a failure to comply with the reporting requirements. Additional penalties of up to $50,000 apply in the case of continued noncompliance after notification by the Secretary.

Effective for tax years beginning after August 5, 1997.

Modification for Returns Filed by Reason of Ownership Changes Sec. 1143	Reporting is required by a U.S. person of an acquisition or disposition of an interest in a foreign partnership, but only if such person holds a 10 percent interest before or after such acquisition or disposition. Additionally, reporting is required if there is a change in the person's proportional interest in the partnership, but only if the change is equivalent to at least a 10 percent interest in the partnership. Effective for transfers and changes after August 5, 1997.
Transfers of Property to Foreign Partnerships Subject to Information Reporting Sec. 1144	A U. S. person who contributes property to a foreign partnership must report the transfer under section 6038B which also applies to the reporting of transfers to foreign corporations. The reporting requirements for a transfer to a foreign partnership apply only if the: - U.S. person holds a 10 percent or greater interest in the partnership, or - value of the property transferred to the partnership by the transferor or a related person during a 12 month period exceed $100,000. Failure to comply with the reporting requirement will result in a penalty equal to 10 percent of the value of the property transferred and will cause recognition of the built-in gain on the contributed property. Effective for transfers made after August 5, 1997.
Extension of Statute of Limitations for Foreign Transfers Sec. 1145	In the case of a failure to report required information with respect a foreign corporation, partnership or trust(§ 6038, § 6038A, § 6038B, § 6046, § 6046A or § 6048), the statute of limitation with respect to any event or period to which such information relates will not expire before the date that is three years after the date on which such information is provided to the IRS. Effective for information due to be reported after August 5, 1997.
Filing Thresholds for Organization	The threshold for stock ownership of a foreign corporation that results in reporting obligations under § 6046 is increased from 5 percent based on

of Foreign Corporations Sec. 1146	value to 10 percent based on vote or value. Effective January 1, 1998.
Determination of Foreign or Domestic Status of Partnerships Sec. 1151	Treasury is given authority to issue regulations to provide rules for treating a partnership as domestic or foreign, regardless of where the partnership is organized, when such treatment is more appropriate. Effective for partnerships created or organized after the date determined under section 7805(b) without regard to section 7805(b)(2).
Repeal of Safe Harbor Requirement Sec. 1162	The requirement that the principal office must be outside the United States in order to qualify for the stock and securities safe harbor is eliminated. Effective for tax years beginning after December 31, 1997.

Miscellaneous Clarifications Sec. 1163

Determination of Foreign Taxes Deemed Paid	A foreign corporation's post-1986 foreign income taxes is the sum of the foreign taxes with respect to: - the taxable year in which the dividend is distributed, plus - prior years (beginning after 12-31-86 only to the extent such taxes are not attributable to dividends distributed by the foreign corporation in prior years. Effective August 5, 1997.
Foreign Tax Credit Limitation for Financial Services Income	Clarifies that the exclusion of high taxed income does not apply for the purposes of the separate foreign tax credit limitation applicable to financial services income. Effective August 5, 1997.
Treatment of Computer Software as FSC Export Property	Computer software licensed for reproduction aboard is not excluded from the definition of export property for purposes of the FSC provisions. Effective for gross receipts from computer software licenses attributable to

Sec. 1171	periods after December 31, 1997.
Adjustment of Dollar Limitation on Section 911 Exclusion **Sec. 1172**	The maximum amount U. S. citizens living abroad may exclude from their income is increased from $70,000 to $80,000 in increments of $2,000 each year beginning in 1998 and is indexed for inflation after 2006. Effective for years beginning after December 31, 1997.
U.S. Property does not Include Certain Assets Acquired by Dealers in the Ordinary Course of Trade or Business **Section 1173**	Two additional exceptions from the definition of "U.S. property": - Deposits of collateral or margin by securities or commodities dealer, or receipts of such deposits by a securities or commodities dealer, if such deposits or receipts are in the dealer's ordinary course of business. These deposits of margin apply to, securities loans, notional principal contracts, option contracts, forward contracts, future contracts, and any other financial transaction that the IRS determines that the posting of collateral or margin is customary. - Repurchase agreement transactions and reverse repurchase agreement transactions entered into by or with a securities or commodities dealer in the ordinary course of its business. This exception applies only to the extent that the obligation does not exceed the fair market value of readily marketable securities transferred or posted as collateral. Effective for years beginning after December 31, 1997.
Treatment of Nonresident Aliens Engaged in International Transportation. **Section 1174**	An exemption to the requirement that wages exceeding $3,000 in a taxable year earned by nonresident alien crew members of a foreign ship while the vessel is within U.S. territory are subject to income taxation by the United States is established. All gross 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 is not U.S. source income. Thus, such income is exempt from U.S. income and withholding tax. Effective for taxable years beginning after December 31, 1997.

15. REAL ESTATE INVESTMENT TRUSTS (REITs)

Clarification on Limitation on Maximum Number of Shareholders Sec. 1251

Failing to maintain adequate records showing actual ownership of stock, to verify whether the requirement of at least 100 shareholders is met, will no longer result in the penalty of lost tax benefits of REIT status. The penalty is replaced with the following monetary penalty:

- $25,000 if a REIT fails to comply with rules to determine ownership;
- $50,000 if the failure was intentional; or
- no amount if reasonable cause and no willful neglect is established.

Effective for tax years beginning after August 5, 1997.

De Minimis Rule for Tenant Service Income Sec. 1252

A REIT is permitted to render a de minimis amount of impermissible services to tenants, or for managing property, and still treat other qualifying amounts as rent.

Effective for tax years beginning after August 5, 1997.

Attribution Rules Applicable to Stock Ownership Sec. 1253

For determining whether rents are paid by a related party in applying the attribution rules with respect to a partnership, attribution of stock, assets or net profits from a partner to a partnership is applicable only if the partner owns directly or indirectly 25 percent or more of capital interest or profits interest in the partnership. This same attribution rule is used to determine if rents are paid for services by an independent contractor.

Effective for Tax Years beginning after August 5, 1997.

Credit for Tax Paid by REIT on Retained Capital Gains Sec. 1254

Rather than paying a capital gains dividend to shareholders, an REIT may elect to retain and pay income tax on net long term capital gains received during the year. Shareholders must be notified within 60 days after the close of the REIT's tax year (or with its annual report) the amount of:

- designated long term capital gains to include in their income; and
- tax deemed paid by shareholders to claim on their return as a credit.

	In addition, the shareholders' adjusted basis of shares is increased by the difference between the includible capital gain and the tax deemed to have been paid. Effective for tax years beginning after August 5, 1997.
Repeal of 30 Percent Gross Income Requirement Sec. 1255	The requirement that less than 30 percent of an entity's gross income in order to qualify as a REIT be derived from the sale of certain stock and property is repealed. Effective for tax years beginning after August 5, 1997.
Modifications of Earnings and Profit Rules Sec. 1256	To meet the REIT eligibility requirement that a corporation distribute all accumulated earnings and profits from non-REIT years, a distribution is treated as being made from the earliest accumulated earnings and profits, rather than the most recent. Effective for tax years beginning after August 5, 1997.
Treatment of Foreclosure Property Sec. 1257	The grace period for treatment of property as foreclosure property is extended from two years to three years. The election to treat real property as foreclosure property is no longer an irrevocable election. However, when an election is revoked, no subsequent election is permitted for that real property. Effective for tax years beginning after August 5, 1997.
Payments Under Hedging Instruments Sec. 1258	The treatment as qualifying income for payments made to a REIT under an interest rate swap or cap agreement to hedge against variable rate debt is extended to include other hedging agreements to reduce the risk of interest rate changes. Effective for tax years beginning after August 5, 1997.
Excess Noncash Income Sec. 1259	The definition of excess noncash income for purposes of the distribution requirement is expanded to include debt cancellation income. In addition, the treatment for OID income and coupon interest for cash basis REITs is extended to accrual basis REITS. Effective for tax years beginning after August 5, 1997.

Prohibited Transaction Safe Harbor Sec. 1260

In determining if income is derived from prohibited transactions (for imposing the 100 percent tax), the sale of property that was involuntarily converted is disregarded in determining if the REIT made more than seven sales of property in a year.

Effective for tax years beginning after August 5, 1997.

Shared Appreciation Mortgages Sec. 1261

When determining if a REIT qualifies for the four year holding period exception to the prohibited transaction tax, the REIT is considered as having held for at least four years a shared appreciation mortgage if:

- the mortgage is sold or disposed of under a Title 11 bankruptcy case;
- the seller is under bankruptcy court jurisdiction; and
- the disposition is required or approved by the bankruptcy court.

Effective for tax years beginning after August 5, 1997.

Wholly Owned Subsidiaries Sec. 1262

The definition of a qualified REIT subsidiary is expanded to include any corporation in which 100 percent of the stock of that corporation is owned by a REIT, regardless of whether the corporation had always been owned by the REIT.

Effective for tax years beginning after August 5, 1997.

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16. EMPLOYEE BENEFITS

Pension Accrued Benefit Distributable Without Consent Increased to $5,000 Sec. 1071

An employer is permitted to distribute to a former participant in the employer's retirement plan that individual's interest in the retirement plan, without the consent of the individual, when that interest is $5,000 or less (increased from $3,500). The $5,000 amount is adjusted for inflation in $50 increments beginning after 1998. Parallel amendments are made to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 et seq.

Effective August 5, 1997.

Election to

The existing exclusion of up to $170 per month (as adjusted for inflation) of

Receive Taxable Cash Instead of Nontaxable Parking Benefits Sec. 1072	employer provided parking is now available even if the employer offers an employee a choice between cash and parking, and the employee chooses parking. Any excess value of parking is included in income. If cash is chosen, the full amount is included in income. The exclusion of up to $170 per month of parking is also available even if the employer reduces other compensation in order to provide the parking. Effective for taxable years beginning after December 31, 1997.
Repeal of Excess Distribution and Excess Retirement Accumulation Tax Sec. 1073	The 15-percent tax imposed on excess distributions from, or excess accumulations in, retirement plans is repealed. Effective for distributions received and for estates of decedents dying after December 31, 1996.
Increase in Tax on Prohibited Transactions Sec. 1074	The 10-percent tax imposed upon the occurrence of certain prohibited transactions involving retirement plans is increased to 15 percent. Effective for such transactions occurring after August 5, 1997.
Basis Recovery Rules for Annuities Over More Than One Life Sec. 1075	A simplified method is established for determining how much of an annuity is includible in gross income when the payout period is over the lives of more than one individual. Effective for annuity starting dates after December 31, 1997.
Matching Contributions of Self-employed Individuals not Treated as Elective Employer Contributions Sec. 1501	Employer matching contributions made on behalf of self-employed individuals will not be treated as elective deferrals under a §401(k) plan; that is, employer matching contributions are to be treated the same as they are for plan participants who are not self-employed. Section 408(p) is similarly amended to provide that matching contributions made to SIMPLE IRA Plans described in §408(p) are not treated as elective employer contributions. Effective for years beginning after December 31, 1997. The amendment to § 408(p) is effective for years beginning after December 31, 1996.
Modification of Prohibition of	A participant's benefits under an employer-sponsored retirement plan may be reduced to satisfy the participant's liability to the plan due to:

Assignment or Alienation Sec. 1502

- the participant's conviction of a crime involving the plan;
- a judgement, consent order or decree in an action for violation of fiduciary standards; or
- a settlement involving the Department of Labor or the Pension Benefits Guarantee Corporation.

The joint and survivor annuity rights of innocent spouses are preserved. A parallel amendment is made to § 206(d) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 et seq.

Effective for judgments, orders, decrees, and settlements arising on or after August 5, 1997.

Elimination of Paperwork Burdens on Plans Sec. 1503

Several sections of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 et seq., are amended to provide that the written, retirement-plan descriptions given to participants no longer have to be filed with the Secretary of Labor, although such documents must be furnished to the Secretary upon request. No Code provision is affected.

Effective August 5, 1997.

Modification of 403(b) Exclusion Allowance to Conform to 415 Modifications Sec. 1504

For participants in §403(b) annuity arrangements, the definition of "includible compensation" includes a participant's elective deferrals, contributions to a §125 cafeteria plan, and contributions to a §457 nonqualified deferred compensation plan.

Effective for years beginning after December 31, 1997.

In addition, the Secretary of the Treasury is directed to modify the § 403(b) regulations, regarding the exclusion allowance, to reflect the elimination of the § 415(e) combined plan limits, effective for years beginning after December 31, 1999, under the Small Business Job Protection Act of 1996. The direction to the Secretary applies on August 5, 1997.

Extension of Moratorium on Application of

The nondiscrimination and coverage requirements that generally apply to employer-sponsored retirement plans do not apply to plans maintained by State and local governments.

Certain Non-discrimination Rules to State and Local Governments Sec. 1505	The amendments apply to taxable years beginning on or after August 5, 1997. However, for all taxable years beginning prior to that date, these plans are treated as satisfying such coverage and nondiscrimination requirements.
Clarification of Certain Rules Relating to Employee Stock Ownership Plans of S Corporations Sec. 1506	An employee stock ownership plan (ESOP) maintained by an S corporation, or other employer whose stock ownership is restricted, does not have to offer employer stock to participants entitled to distributions from the ESOP. The Act also exempts from the prohibited transaction rules the sale of employer securities to an S corporation ESOP by a shareholder employee, family member of the shareholder employee, or corporation in which the S shareholder employee owns at least 50 percent of the stock. Effective for taxable years beginning after December 31, 1997.
Modification of 10-percent Tax for Nondeductible Contributions Sec. 1507	The 10-percent excise tax, imposed on an employer by § 4972 when retirement-plan contributions are made that exceed the deductible limits specified in § 404, does not apply when the contributions exceed the multiple-plan limits in § 404(a)(7) but do not exceed the amount of matching contributions and elective deferrals made under the plans. Effective for taxable years beginning after December 31, 1997.
Modification of Funding Requirements for Certain Plans Sec. 1508	Section 4972, which imposes a 10-percent tax on employers for nondeductible retirement plan contributions, is amended so that the excise tax does not apply to contributions that are nondeductible solely because of the combined limit on defined benefit plan and defined contribution plan contributions, and that do not exceed the amount of matching contributions and section 401(k) elective deferrals made under the plan. Effective for plan years beginning after December 31, 1996.
Clarification of Disqualification Rules Relating to Acceptance of Rollover Contributions	The Secretary of the Treasury is directed to clarify that a tax-qualified retirement plan receiving what is reasonably believed to be a rollover contribution described in § 402(c), but that in fact does not satisfy § 402(c), will not be disqualified merely because the distributing plan has not received a determination letter from the Service as to its qualified status. No Code section is amended.

Sec. 1509	Effective August 5, 1997.
New Technologies in Retirement Plans Sec. 1510	The Secretaries of the Treasury and Labor are each directed to issue guidance by December 31, 1998, concerning the amenability of the notice, election, consent, disclosure, and time requirements for retirement plans to new technologies. Any final regulations issued pursuant to this guidance cannot be effective until at least 6 months after issuance. No Code section is amended. Effective August 5, 1997.
Increase in Current Liability Funding Limit Sec. 1521	The "full funding limitation," a limit on the amount an employer can contribute to fund its defined-benefit-type retirement plan for a particular year is increased. In addition, § 412(b)(2) is amended to provide that plan contributions prohibited because of the full funding limitation must be contributed at least ratably over 20 years. Parallel amendments are made to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 et seq. Effective for plan years beginning after December 31, 1998.
Special Rules for Church Plans Sec. 1522	Special rules relating to church ministers are amended to provide that if a minister participates in a church plan, as defined in § 414(e), and is employed by an employer that is not otherwise participating in the church plan, then that employer can ignore the minister for purposes of determining whether the nondiscrimination and coverage rules applicable to the employer's retirement plan are satisfied. In addition, contributions on behalf of such minister to a church plan are excludable from gross income to the same extent as if the minister was a church employee. Effective for years beginning after December 31, 1997.
Application of Unrelated Business Income Tax to ESOPs Sec. 1523	The Act provides that IRC section 512(e), which treats certain items as unrelated business taxable income, shall not apply with respect to employer securities held by an ESOP maintained by a subchapter S corporation. Effective for tax years beginning after December 31, 1997.

Diversification of Section 401(k) Plan Investments Sec. 1524

§ 407(b) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 et seq., is amended to provide that, in an employer-sponsored retirement plan, no more than 10 percent of the portion of the plan's assets attributable to elective deferrals can be invested in the employer's securities or in employer real property or both, unless such investment is at the direction of participants. This investment restriction does not apply:

1) if the assets in all the employer's so-called "individual account" plans does not exceed 10 percent of the assets in all the employer's retirement plans;

2) to an employee stock ownership plan defined in § 4975(e)(7); or

3) if, under the terms of the plan, elective deferrals equal to no more than one percent of the participant's compensation must be so invested. No Code section is amended.

Effective for elective deferrals made for plan years beginning after December 31, 1998.

Section 401(k) Plans for Certain Irrigation and Drainage Entities Sec. 1525

Certain irrigation and drainage entities are permitted to have § 401(k) plans even if they would be classified as agencies or instrumentalities of States or local governments, which ordinarily cannot establish § 401(k) plans.

Effective for years beginning after December 31, 1997.

Portability of Permissive Service Credit Under Governmental Pension Plans Sec. 1526

Limits on contributions and benefits in retirement plans are amended to provide that a government employee's contributions to purchase service credit under a defined-benefit-type plan that permits such purchases must satisfy either the benefit limit of § 415(b) or the contribution limit of § 415(c). Purchase of this "permissive service credit" is limited when the service is not attributable to employment with a school, with the Federal government, with a State or local government.

Effective for contributions made in years beginning after December 31, 1997.

Removal of Dollar Limitation on Benefit Payments from a Defined Benefit Plan Maintained for Certain Police and Fire Employees Sec. 1527

§ 415(b)(2) is amended to provide that § 415(b)(2)(C) does not apply to police or firefighters with at least 15 years of service who participate in defined-benefit-type retirement plans maintained by a State or a local government. § 415(b)(2)(C) contains rules to reduce the maximum annual benefit that can be accrued for a participant in a defined benefit plan when payments commence before the participant's social security retirement age.

Effective for years beginning after December 31, 1996.

Survivor Benefits for Public Safety Officers Killed in the Line of Duty Sec. 1528

§ 101 is amended to provide that gross income does not include survivor benefits paid from a governmental retirement plan to a spouse or child of a public safety officer killed in the line of duty.

Effective for amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after such date.

Disability Payments Received by Former Police Officers and Firefighters Sec. 1529

To provide relief in certain States where the exclusion for worker's compensation benefits was not applicable, certain payments made on behalf of full-time employees of any police or fire department organized and operated by a State, or political subdivision, are excludable from income as payments received under a statute in the nature of a workmen's compensation act. Payments must have been:

- for heart disease or hypertension received in 1989, 1990, or 1991;

- pursuant to a State law as amended on May 19, 1992 which irrefutably presumed that the heart disease or hypertension are work related illnesses; and

- to employees separated from service before July 1, 1992.

Effected employees may claim a refund of taxes paid on such benefits if the claim is filed before August 5, 1998, regardless of the statute of limitations.

Effective August 5, 1997.

Gratuitous Transfers for the Benefit of Employees Sec. 1530

§ 664(d) (which defines charitable remainder trusts that are generally exempt from income taxes) is amended to provide that, if the remainder interest is in employer securities, the beneficiary of such interest can be an employee stock ownership plan ("ESOP") defined in § 4975(e)(7). Prior to this amendment, only a charitable organization described in § 170(c) could be the beneficiary of the remainder interest. The amendments made sec. 1530 of the Act apply in limited situations: for example, the employer securities passing to the ESOP must have belonged to a decedent dying before January 1, 1999, whose family members owned no more than 10 percent of the stock of the employer at the time of the transfer to the ESOP, and after the transfer to the ESOP, such plan must own at least 60 percent of the value of the employer's stock. Conforming amendments are made to § 401(a), § 415, and several other Code sections.

Effective for transfers made to ESOPs after August 5, 1997.

Provisions Relating to Plan Amendments Sec. 1541

Formal plan amendments to implement any change made by sections 1071 to 1075 or 1501 to 1541 of the Act are not required until immediately before the first plan year beginning after 1998 (2000 for governmental plans defined in § 414(d)). However, any such plan amendment must apply retroactively to the effective date of the amendment and the plan must have been operated in accordance with the amendment from such effective date. No Code section is amended.

17. ALTERNATIVE MINIMUM TAX REFORM

Exemption From Alternative Minimum Tax for Small Corporations Sec. 401

The corporate alternative minimum tax (AMT) is repealed for small business corporations.

A small business corporation is a corporation that had average gross receipts of less than $5 million for a 3-year period beginning after December 31, 1994. Corporations that qualify under the $5 million test continue to be exempt from AMT as long as its average gross receipts do not exceed $7.5 million.

Effective for taxable years beginning after December 31, 1997.

Separate Depreciation Lives for Minimum Tax Purposes

The depreciation recovery periods on tangible personal property, is the same for alternative minimum tax purposes as it is for regular tax purposes.

Effective for property placed in service dates after December 31, 1998.

Sec. 402

Minimum Tax Not to Apply to Farmer's Installment Sales Sec. 403	Farmers may use the installment method of accounting for alternative minimum tax purposes. Generally effective for dispositions in taxable years beginning after December 31, 1987.

18. EXTENSIONS

Research Tax Credit Sec. 601	The credit, which expired on May 31, 1997, is extended for 13 months, generally for the period of June 1, 1997 through June 30, 1998. The credit is generally effective for qualified research expenditures paid or incurred during the period of June 1, 1997, through June 30, 1998. Taxpayers may elect the alternative incremental research credit regime under § 41(c)(4) for any taxable year beginning after June 30, 1996. The election will apply to that taxable year and all subsequent years unless revoked with the consent of the Secretary of Treasury. If a taxpayer elects the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, the credit will be available the entire 24 month period beginning with the first month of the taxable year. The 24 month period must be reduced by the number of full months, if any, after June 1996 (and before the first month of such first taxable year), which the taxpayer claimed research credit amounts under the regular 20 percent research credit rules.
Contributions of Stock to Private Foundations Sec. 602	The special rule allowing a deduction equal to the fair market value of qualified appreciated stock contributed to a private foundation, which expired on May 31, 1997, is extended from June 1, 1997, through June 30, 1998. Effective for contributions of qualified appreciated stock to private foundations made between June 1, 1997, and June 30, 1998.
Work Opportunity Credit	A work opportunity credit (WOC) is an elective credit available to employers who hire individuals from eight targeted groups. The work opportunity credit is not available to tax exempt organizations, other than

Sec. 603

farmers' cooperatives. All targeted group members must be certified by a State governmental agency as belonging to that group.

Targeted Groups

The following are targeted groups (the eighth being newly added):

1. families receiving AFDC, or successor program payments for any nine months during the 18 month period ending on the hiring date;
2. qualified felons;
3. high-risk youth;
4. vocational rehabilitation referrals;
5. summer youth, ages 16-17 who live in empowerment zones or enterprise communities;
6. qualified veterans;
7. individuals age 18-24 who are members of families receiving food stamps; and
8. recipients of supplemental security income (SSI) benefits for any month within the 60 day period ending on the date hired for individuals beginning work after September 30, 1997.

Credit Eligibility

No credit is allowed to the employer for wages paid to the targeted individual unless employed for the specified time. As amended, there are different rates for employees beginning work after September 30, 1997, depending on how long the employee works.

For those employees who work:

- at least 400 hours, the employer can claim a credit at the 40 percent rate;

- 120-399 hours, the employer can claim a credit at the 25 percent rate; and

- less than 120 hours, the employer cannot claim the credit.

WOC Wage Credit Rates

Percentages are computed on wages paid up to $6,000 for each member in the targeted group in the first year. For summer youth, the credit is computed on wages paid up to $3,000 (i.e. $3,000 X 25% = $750, or $3,000 X 40% = $1200 in the case of a summer youth who has worked at least 400 hours).

Percentage	Employees Beginning	Maximum

	Work Between	Credit
25%	10-1-97 and 6-30-98	1,500
40%	10-1-97 and 6-30-98	2,400

Effective Date

Applicable to wages paid to qualified employees who begin work between October 1, 1997 and June 30, 1998, a nine month extension.

Orphan Drug Tax Credit Sec. 604

The orphan drug tax credit, which expired on May 31, 1997, is permanently extended retroactive to May 31, 1997.

Effective for qualified clinical testing expenses paid or incurred after May 31, 1997.

19. ECONOMIC DEVELOPMENTS

Incentives for Revitalization of the District of Columbia Sec. 701

Congress is designating certain areas of the District of Columbia as an "enterprise zone" which allows tax incentives to businesses and individuals. The new enterprise zone includes the existing enterprise communities plus census tracts where the poverty rate is 20 percent or more. These incentives include:

- wage credit;
- expensing;
- zero-percent capital gains; and
- first-time home buyer credit.

Wage Credit

A 20 percent wage credit is available to businesses for the first $15,000 of wages paid to D.C. residents working in the enterprise zone. In addition, the scheduled reduction in the wages on which the credit is based does not apply to the D.C. enterprise zone.

Expensing

An additional $20,000 of § 179 expensing is available to an enterprise zone business for qualified zone property placed in service in taxable years beginning after December 31, 1997, and before January 1, 2003.

Zero-Percent Capital Gains Rate

Gain from the sale or exchange of a qualified D.C. Zone asset is subject to a zero percent gain rate. Qualified D.C. Zone assets are stock or partnership interests held in or tangible property held by a D.C. Zone business. To qualify for zero gain rate, the asset must be held for five years. Sales must occur on or after December 31, 1997 and before January 1, 2008.

First-time Home Buyer Credit

A taxpayer who is a first-time home buyer of a principle residence located in the District of Columbia is permitted a credit of up to $5,000 of the purchase price of the residence. Purchase price includes new construction.

The principal residence must be purchased between August 6, 1997 and December 31, 2000 within the District of Columbia (D.C.).

First-time Home Buyer Defined

First-time home buyers do not include:

- a taxpayer and the taxpayer's spouse, if married, who had a present ownership interest in a principal residence in the District of Columbia for the one- year period before the date the taxpayer purchases the D.C. residence. The person may own another home outside of D.C.

- military personnel and certain individuals with tax homes outside the U.S., who qualified for suspension of the running of any § 1034 (in effect before August 5, 1997) time period.

The principle residence cannot be acquired from related parties. Related parties include the taxpayer's family (spouse, ancestors and lineal descendants, but not brother and sisters), as well as various other relationships specified in § 267 and § 707(b).

Tax Treatment

The D.C. first-time homeowners credit is not refundable, but reduces income tax liability in the year of purchase. Any excess credit may only be carried forward until absorbed by the succeeding year's income tax. A carry-back of the credit is not authorized. This credit can only be taken once in the taxpayer's life-time.

Property Basis

The taxpayer's basis in the property, generally its cost, must be reduced by the amount of credit claimed. The new owners basis of the property can not be determined by reference to the seller's basis or the basis of property acquired from a decedent.

Allocation of Dollar Limit

Married taxpayers filing separately can each claim a maximum credit of $2,500. For unmarried co-owners, IRS is authorized to issue regulation for allocation since the Act was not specific. However, the total amount of credits allowed to all unmarried co-owners may not exceed $5,000.

Phase-out Credit

The allowable amount of credit is ratably reduced to zero by the amount of modified AGI between $70,000 and $90,000 ($110,000 and $130,000, joint filers). The reduction is $250 for each $1,000 of modified adjusted gross income above $70,000 for an individual ($110,000 for joint filers). Modified AGI is adjusted gross income including the exclusions for foreign earned income or possession income.

Formula, phase-out: $\$5,000 \times \frac{\text{modified AGI} - \$70,000(\$110,000^*)}{\$20,000}$

*joint return filers

Expensing of Environmental Remediation Costs Sec. 941

An election is allowed to deduct as an expense in the year paid or incurred instead of capitalizing certain environmental remediation costs. To qualify for the election, the expenses must be for the abatement or control of hazardous substances at a qualified contaminated site.

A qualified contaminated site is property:

- held for use in a trade or business;
- certified by a State as being in a "targeted area"; and
- contains, or potentially contains, hazardous substances.

A targeted area is defined as:

- empowerment zones or enterprise communities;
- one of the 75 Brownfield pilot sites announced by the EPA before February, 1997;
- any population census tract with a poverty rate of 20 percent or more; and
- certain commercial and industrial areas adjacent to population census tract with a poverty rate of 20 percent or more.

Effective for eligible expenditures incurred after August 5, 1997 and until December 31, 2000.

Additional Empowerment Zones Sec. 951	Two additional urban empowerment zones are authorized to be designated by the Secretary of HUD. The wage credit in these two new zones is modified. The percentage of wages taken into account for determining the wage credit is: - 20 percent for years 2000 through 2004; - 15 percent for 2005; - 10 percent for 2006; and - 5 percent for 2007. No credit is available in the year 2008. Effective January 1, 2000. However, the two new zones must be designated within 180 days of August 5, 1997.
New Empowerment Zones Sec. 952	An additional 20 empowerment zones are with expanded eligibility criteria are authorized. The Secretary of HUD is authorized to designate up to 15 urban empowerment zones, while the Secretary of Agriculture is authorized to designate up to five rural empowerment zones. However, the Empowerment Zone Employment Credit will not be available in the 20 new zones. Effective August 5, 1997 and before January 1, 1999.
Volume Cap Not to Apply to Facility Bonds Sec. 953	New empowerment zone facility bonds are allowed to be issued for qualified enterprise zone businesses in the 20 new zones. The bonds are not subject to State private activity bond volume caps or the current limits on issue size applicable to qualified enterprise zone facility bonds. Effective for bonds issued after August 5, 1997.
Modification of Enterprise Zone Eligibility for Alaska and Hawaii Sec. 954	A nominated enterprise zone in Alaska and Hawaii is considered to meet the requirements for economic distress, size, contiguity, absence of a central business district, and poverty rate if, for each census track or block group, 20 percent or more of families have income that is 50 percent or less of the statewide mediam family income. Effective August 5, 1997.
Modifications to	The requirement that 95 percent or more of the proceeds of bond issue be

Enterprise Zone Facility Bond Rules Sec. 955

used by a qualified enterprise zone business is waived until the end of a "startup period". Also waived are the requirements of an enterprise zone business, other than that 35 percent of employees be residents, for all years after the first three after the startup period.

Effective for obligations issued after August 5, 1997.

Modifications to Enterprise Zone Business Definition Sec. 956

The present requirement that an entity may qualify as an enterprise zone business only if at least 80 percent of the entity's gross income be derived from the active conduct of a qualified business within an empowerment zone or enterprise community is reduced to 50 percent.

The "substantially all" test, requiring that substantially all the use of property and performance of services take place in the empowerment zone or enterprise community is replaced with a less stringent "substantial portion" test. Further, the requirement that the intangible property be "exclusively related to" the active conduct of the enterprise zone business has been eliminated.

Effective for tax years beginning on or after August 5, 1997.

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20. FINANCIAL PRODUCTS

Constructive Sales Treatment for Appreciated Financial Positions Sec. 1001

A taxpayer must recognize gain, not loss, that enters into a constructive sale of any appreciated financial position in:

- stock;
- a partnership interest; or
- certain debt instruments.

The gain recognized is as if the position were sold at its fair market value on the date of sale and immediately repurchased. Gain or loss from the position realized later is adjusted for the gain recognized on the constructive sale. The holding period for the position would begin on the date of the constructive sale.

A constructive sale of an appreciated position takes place when a taxpayer enters into:

- a short sale of the same property;
- an offsetting notional principal contract with the same property; or
- a futures or forward contract to deliver the same property.

A constructive sale also can occur if a taxpayer acquires a financial position in the same property as an open short sale, notional principle contract, or futures or forward contract. A constructive sale, using one or more appreciated financial positions and offsetting transactions, is generally determined as of the date of the last position or transaction is entered into. More than one appreciated financial position or offsetting transaction can be aggregated in determining if a constructive sale has occurred.

If only a pro rata portion of an appreciated financial position is a qualified constructive sale, only that portion is considered a constructive sale. If a constructive sale is of less than all of any type of property held by the taxpayer, the specific property considered sold is determined under the rules for actual sales.

A constructive sale does not occur, however, if the transaction is closed on or before the 30th day after the end of the taxable year, provided the taxpayer holds the appreciated financial position for 60 days after closing the transaction, and, with a limited exception, the taxpayer is subject to the risk of loss on the appreciated financial position.

If a closed transaction is reestablished in a substantially similar position, it is exempt if the reestablished position is closed prior to the end of the 30th day after the close of the taxable year and the two requirements of the exclusion discussed above are met.

An appreciated financial position is any position relating to any stock, partnership interest, or debt instrument, if there would be gain upon a taxable disposition of the position at its fair market value. A position is an interest, including short sale, option, or futures or forward contract. Certain debt instruments that provide an unconditional principal amount and meet other requirements are excluded.

A trust instrument actively traded is generally treated as stock for purposes of determining if the instrument is an appreciated financial position. A trust instrument will not be treated as stock if substantially all the value of the property held by the trust is debt that qualifies for an exception to the definition of an appreciated financial position.

A notional principal contract is treated as an offsetting notional principal contract results in a constructive sale of an appreciated financial position if:

- it requires the holder of the appreciated financial position to pay all or substantially all of the investment yield and appreciation on the position and

- gives the holder a right to be reimbursed all or substantially all of any decrease in the value of the position.

A forward contract is a constructive sale only if the forward contract provides for delivery of:

- a substantially fixed amount of property; and

- a substantially fixed price.

Effective for constructive sales entered into after June 8, 1997. For transactions on or before June 8, 1997, that would have been constructive sales, they will not be considered in determining if a constructive sales occurred provided the offsetting positions of the earlier transaction has been identified within 30 days after August 5, 1997.

The constructive sale provisions apply to hedging and straddle transactions but do not apply to positions that are marked to market. A contract to sell an appreciated financial position that is not a marketable security is not a constructive sale if the contract settles within one year after it is entered into.

Marked to Market

Traders in securities and traders and dealers commodities may elect the market-to-market rules for accounting. The definition of a commodity is expanded to include:

- any actively traded commodity;
- any option with respect to a commodity;
- forward contract with respect to a commodity;
- futures contract with respect to a commodity;
- short position with respect to a commodity;
- notional principal contract with respect to a commodity;
- derivative instrument that references;
- a commodity; or
- hedging transaction with respect to a commodity.

The election is made separately to the entire business of the taxpayer as a:

- securities trader;
- commodities trader; or
- commodities dealer.

If a taxpayer is both a commodities dealer and a securities trader, the election can be made for either or both businesses.

The special rule will cease to apply the date the taxpayer ceases to hold any of the offsetting positions identified. For a decedent dying after June 8, 1997, a position will be treated as property constituting rights to receive income in respect of a decedent under § 691, if

- a constructive sale of an appreciated financial position occurred before June 8, 1997,

- the transaction remain open at some time during a three year period ending on the decedent's date of death,

- the transaction remains open at least two years, and

- the transaction is not closed in a taxable transaction within 30 days after August 5, 1997.

Gain related to a position that accrues after the transaction is closed is not considered income in respect of a decedent.

The provision for mark-to-market accounting rules applies to taxable years ending after August 5, 1997.

For taxpayers making the election, for the first taxable year ending after August 5, 1997, permission to change accounting method is automatic and the § 481 adjustment is required to be taken into income ratably over a four year period, beginning with the year of change.

For elections made for the first taxable year after August 5, 1997, the securities or commodities not subject to the election must be identified by September 4, 1997.

Limitation on Exception for Investment Companies Under Code Section 351
Sec. 1002

The definition of an investment company is expanded to include not only a RIC or REIT, but also any corporation or partnership if more than 80 percent of the value of its assets consist of:

- money;
- stock and other equity interests in a corporation;
- evidences of indebtedness;
- options;
- forward or futures contracts;
- notional principal contracts or derivatives;
- foreign currency;

- certain interests in precious metals;
- interests in REITs;
- interests in RICs;
- interests in common trust funds;
- interests in publicly traded partnerships;
- other interests in non-corporate entities that are convertible into or exchangeable for certain assets set out above; or
- interests in any entity if substantially all of the assets of such entity consists of any assets described above.

Effective for transfers after June 8, 1997, in taxable years ending after such date, with an exception for certain binding written contracts in effect on that date.

Gains and Losses from Certain Terminations with Respect to Property
Sec. 1003

Extension of Relinquishment Rule to All Types of Property

The treatment of gain or loss from the cancellation, lapse, expiration, or other termination of a right or obligation with respect to a capital asset as gain or loss from the <u>sale</u> of a capital asset is extended to all types of property, i.e.:

- real property; and

- actively and non-actively traded personal property.

Character of Gain on Retirement of Debt Obligations Issued by Natural Persons

The retirement of a debt instrument issued by natural persons after June 8, 1997, now qualifies for exchange treatment. The retirement of a debt instrument issued by a natural person before June 9, 1997, or a debt instrument issued by a noncorporation or a nongovernmental taxpayer before July 2, 1982, also qualifies for exchange treatment if the instrument is purchased after June 8, 1997.

Short Sale of Property That Becomes Worthless

If a taxpayer enters into a short sale of property and the property becomes substantially worthless, gain is recognized as if the short sale was closed when the property becomes substantially worthless.

The statute of limitations on the gain recognition due to property becoming substantially worthless is extended to the earlier of:

- three years after the Secretary of Treasury is notified that the property has become substantially worthless; or

- six years after the date the return is filed for the taxable year during which the property became substantially worthless.

Effective for property that becomes substantially worthless after August 5, 1997.

OID Where Pooled Debt Obligations Subject to Acceleration Sec. 1004

Existing special rules, applicable to interests in or mortgages held by a REMIC, for determining the amount of OID allocated to a period that apply to certain instruments subject to prepayment now also apply to any pool of debt instruments which the yield may be affected because of prepayments.

For example, the rules now apply to a pool of credit card receivables that require interest to be paid if accounts are not paid by a specific date. Under the rules, the holder of the pool is required to accrue interest or OID on the pool on the basis of a reasonable assumption with regard to the timing of the payments of the accounts in the pool.

Effective for taxable years beginning after August 5, 1997.

Denial of Interest Deductions on Certain Debt Instruments Sec. 1005

Interest or OID on certain debt instruments is no longer deductible. This rule applies to a debt instrument that is issued by a corporation if the debt instrument is payable in stock of the issuer or related party.

A debt instrument is treated as payable in stock if:

- a substantial portion of the principal or interest is required to be paid in or converted into, or at the option of the issuer or a related party is payable in or convertible into, stock of the issuer or a related party,

- a substantial portion of the principal or interest is required to be determined, or determined at the option of the issuer or related party, with reference to the value of the stock of the issuer or related party, or

- it is part of an arrangement designed to result in payments in stock of the issuer or related party or determined by reference to such stock.

Effective for instruments issued after June 8, 1997. However, it will not apply to instruments:

- issued pursuant to a written agreement binding on June 8, 1997, and at all times after,

- described in a ruling request submitted to the IRS on or before June 8, 1997, or

- described in a public announcement or filing with the Securities and Exchange Commission (SEC) on or before June 8, 1997.

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21. ADMINISTRATIVE

Reporting of Payments Made to Attorneys Sec. 1021

Gross proceeds on all payments to an attorney in connection with legal services are required to be reported. It is anticipated at this time that the reporting will be on Form 1099 B. This applies to payments made to attorneys regardless if the attorney is the exclusive payee. Payments to law firms are payments to attorneys and must be reported. Attorneys are required to promptly supply their tax identification numbers (TINs) to persons required to file information returns. Failure to do so can result in penalties to the attorney and backup withholding on the payments.

Payments made to corporations that provide legal services are no longer exempt and must be reported

Amounts reported on Form 1099 Misc for payments of income or Form W-2 for wages are exempt from this requirement.

Effective for payments made after December 31, 1997.

Threshold for Reporting Payments to Corporations Performing Services for Federal Agencies Sec. 1022

The requirement of Federal executive agencies to file a return on contract information the agency entered into is reduced from $25,000 to $600 or more. A copy of the information return is required to be given to the recipient of the payment by the Federal agency.

The exception to information reporting requirements for payments to corporations is removed when those payments are made by a Federal executive agency.

Effective for returns that are due more than 90 days after August 5, 1997, without regard to extensions.

Disclosure of Return Information for Administration of Certain Veterans Program Sec. 1023

The current DVA disclosure provision with Internal revenue Service, scheduled to expire after September 30, 1998, is extended through September law 30, 2003.

Effective on August 5, 1997.

Continuous Levy on Certain Payments Sec. 1024

A continuous levy is permitted on specified Federal payments. This is a Federal payment which the eligibility is not based on the income and/or assets of a payee. The levy can attach up to 15 percent of any specified payment due to a taxpayer.

The 15 percent also applies to unemployment benefits and means-tested public assistance. Confidential tax return information may be disclosed to the Treasury Department's Financial Management Service only for implementation of these levy provisions.

Effective for levies issued after August 5, 1997.

Modification on Levy Exemption Sec. 1025

The following property are not exempt from levies if the Secretary of Treasury or delegate approves the levy on the property:

- workmen's compensation payments;
- annuity or pension payments under the Railroad Retirement Act;
- benefits under the Railroad Unemployment Insurance Act;
- unemployment benefits; and
- means-tested public assistance.

Effective for levies issued after August 5, 1997.

Returns of Beneficiaries Required to File Consistent with Estate or Trust

A beneficiary of an estate or trust is required to file its return consistent with the information received from the estate or trust. If the beneficiary does not file in a consistent manner, a statement of notification must be included in its return identifying the inconsistency.

Return
Sec. 1027

Effective for returns filed after August 5, 1997.

Registration and Other Provisions Relating to Confidential Corporate Tax Shelters
Sec. 1028

Tax Shelter Registration

A promoter of a corporate tax shelter is required to register the shelter no later than the business day on which the shelter is first offered to potential users. If the promoter is not a U.S. person, or if a required registration is not made, then any U.S. participant is required to register the tax shelter. However, registration is not required if the U.S. participant notifies the promoter in writing no later than 90 days after discussions began that the U.S. participant will not participate in the shelter and the U.S. person does not in fact participate in the tax shelter.

A corporate tax shelter is any investment, plan, arrangement or transaction:

- a significant purpose of which the avoidance or evasion of taxes by a corporate participant;

- that is offered to any potential participant under conditions of confidentiality; and

- the total fees that may be received by the tax shelter promoters exceed $100,000.

A transaction is offered under conditions of confidentiality if:

- an offeree or person acting on behalf of the offeree has an understanding or agreement with or for the benefit of any promoter to restrict or limit its disclosure of the transaction or any significant tax features of the transaction; or

- the promoter claims, knows, or has reason to know that the transaction or one or more aspects of the transaction is proprietary to the promoter or any party other than the offeree, or is protected from disclosure or use.

Promoters are required to maintain lists of those that have signed confidentiality agreements, or have been subjected to nondisclosure requirements on particular tax shelters and must retain lists of those paying fees related to plans or arrangements previously registered. All registrations will be treated as taxpayer information under § 6103 and will not be disclosed to the public.

The penalty for failing to timely register a corporate tax shelter is the greater of:

- $10,000; or

- 50 percent of the fees payable to any promoter on offerings prior to the date of the late registration.

The penalty to actual participants in any corporate tax shelter who did not register when required is:

- $10,000; or

- 50 percent of the fees paid by the participant.

Intentional disregard increases the 50 percent penalty to 75 percent of the applicable fees.

Substantial Understatement Penalty

Two modifications are made to the substantial understatement penalty:

- in no event would a corporation have a reasonable basis for its tax treatment of an item attributable to a multi-party financing transaction if the treatment does not clearly reflect income of the corporation; and

- a significant purpose, rather than principal purpose, of the entity must be the avoidance or evasion of income taxes for the entity to be considered a tax shelter.

Effective for tax shelters offered to potential participants after the date Treasury Department issues guidance on the filing requirements. The provisions on the modifications to the substantial understatement penalty apply to items with respect to transactions entered into after August 5, 1997.

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22. TAX-EXEMPT ENTITIES

Exclusion from Unrelated Business Income Tax
Sec. 965

Rules are established which permit qualified sponsorship payments to tax-exempt organizations to be excluded from unrelated business income tax (UBIT).

Effective for qualified sponsorship payments solicited or received after December 31, 1997.

Taxation of Timeshare Associations Sec. 966

For tax years beginning after December 31, 1996, timeshares associations are permitted to elect to be taxed as homeowner associations. Electing associations are taxed on their "net timeshare association income" at the rate of 32 percent. To qualify, the following three tests must be met:

1. 60 percent test - Sixty percent of the association's income received must be from membership dues, fees or assessments from owners of either timeshare:

   a. rights to use, or

   b. ownership interest in

   property of the timeshare association.

2. 90 percent test - At least 90 percent of the expenditures of the timeshare association must be for the acquisition, construction, management, maintenance, and care of association property, or for activities provided to or on behalf of members of the timeshare association.

3. Organizational and operational tests -

   a. No part of the net earnings of the timeshare association can inure to the benefit of any private shareholder or individual. Exceptions to the inure clause are rebating excess dues, fees, or assessments; and acquiring, constructing, or providing care, management or maintenance of timeshare association property;

   b. Timeshare association property includes property in which the association or members of the association, have rights arising out of recorded easements, covenants, and other recorded instruments to use property related to the timeshare project;

   c. A qualified timeshare association cannot be a condominium management association; and

   d. The timeshare association must make the election.

Receivables Purchased by Cooperative

Clarification is provided for hospital cooperative services organizations under § 501(e) that billing and collection services include the purchase of patron accounts receivable on a recourse basis.

Service Organizations Sec. 974

Effective for taxable years beginning after December 31, 1996.

Expansion of Look-thru Rule for Certain Income Derived by Subsidiaries of Tax-exempt Organizations Sec. 1041

The amount of interest, rent, annuity or royalty payment made by a controlled entity to a tax-exempt organization is unrelated business taxable income (UTBI) to the extent that the payment reduces the net unrelated income, or increases the net loss, of the controlled entity. The requirement that a taxable or tax-exempt subsidiary be 80 percent controlled by the parent tax-exempt organization for rent, royalty, annuity, and interest income to be included in UBTI is reduced to more than 50 percent control. Also, the constructive ownership rules of § 318 apply.

Effective for taxable years beginning after August 5, 1997, with a two-year transition rule for contracts binding on June 8, 1997.

Exempt Organizations which Provide Commercial Type Insurance Sec. 1042

The existing exception to rules which permitted two otherwise taxable organizations (the Teachers Insurance Annuity Association-College Retirement Equities Fund and Mutual of America) to conduct pension business through the issuance of annuities without being taxed as commercial-type insurance companies is repealed.

A fresh start is provided to the two organizations for asset basis and for changes in accounting methods resulting from the change to taxable status.

Effective for taxable years beginning after December 31, 1997.

Extension of Estimated Tax for Private Foundations Sec. 1461

The due date of a private foundation's first quarter estimated tax payment is changed from April 15TH to May 15TH.

Effective for taxable years beginning after August 5, 1997.

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23. TAX-EXEMPT BONDS

Virgin Island Bonds Sec. 967

If the Virgin Islands debt provisions are changed to repeal the current priority first lien requirement, one additional advance refunding is permitted for government bonds issued by the Virgin Islands which were advance refunded prior to June 9, 1997.

Effective on August 5, 1997.

Repeal of $100,000 Limitation on Unspent Proceeds Sec. 1441	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 is repealed. Effective for bonds issued after August 5, 1997.
Rebate for Earnings on Bona Fide Service Fund Sec. 1442	Earnings on bond proceeds invested in bona fide debt service funds are exempt from the arbitrage rebate requirement and the penalty requirement of the 24 month exception if the spending requirements are otherwise satisfied. Effective for bonds issued after August 5, 1997.
Debt-serviced Limitation on Investment Sec. 1443	The 150 percent limitation on debt service yield restriction is repealed. Effective for bonds issued after August 5, 1997.
Repeal of Expired Provisions Sec. 1444	Exceptions to arbitrage rebate and pooled financing temporary period rules for certain qualified student loan bonds applied to bonds issued prior to January 1, 1989 are repealed. Effective for bonds issued after August 5, 1997.

24. TAX COURT PROCEDURES

Overpayment Determinations of Tax Court Sec. 1451	An order to refund an overpayment is appealable in the same manner as a decision of the Tax Court. The Tax Court does not have jurisdiction over the validity or merits of certain credits or offsets that reduce or eliminate the refund determined. Effective August 5, 1997.
Redetermination of Interest Pursuant to Motion Sec. 1452	A taxpayer must file a motion, rather than a petition, to seek a redetermination of interest by the Tax Court. The Tax Court's jurisdiction to redetermine the amount of interest does not depend on whether the interest is underpayment or overpayment interest. Effective August 5, 1997.

Application of Net Worth Requirement for Awards of Litigation Costs Sec. 1453

The net worth limitations that apply to individuals also apply to estates and trusts. In addition, individuals that file a joint return are treated as separate individuals for purposes of computing the net worth limitations.

Effective for proceedings commenced after August 5, 1997.

Proceedings for Determinations of Employment Status Sec. 1454

The Tax Court is given jurisdiction over actual controversies involving IRS employment tax determinations made as part of an examination, that:

- one or more individuals performing services for the taxpayer are employees of the taxpayer or

- the taxpayer is not entitled to relief under § 530 of the Revenue Act of 1978.

The new law provides for de novo review rather than a review of the administrative record. Assessment and collection of taxes is suspended until a decision is rendered by the Tax Court. (New procedures for processing these cases were transmitted to the field on September 8, 1997).

Effective on August 5, 1997.

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25. CERTAIN HEALTH ACTS

Amendments to the Internal Revenue Code Sec. 1531

The provisions relating to group health plans contained in the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996 are incorporated into the Internal Revenue Code.

Effective for plan years beginning on or after January 1, 1998. The Mental Health Parity provisions cease to be effective September 30, 2001.

Special Rules Relating to Church Plans Sec. 1532

Rules prohibiting group health plans from discriminating against individuals based on health status are amended to provide that a church plan, as defined in 414(e), can require evidence of good health for coverage of certain individuals, but only if such evidence was required by a provision contained in the plan on July 15, 1997.

Effective as if contained in the Health Insurance Portability and

Accountability Act of 1996.

26. TECHNICAL CORRECTIONS

(Not every correction contained in the Act is summarized)

Amendments to Small Business Job Protection Act of 1996
Sec. 1601

Returns Related to Purchases of Fish	Every person filing an informational return relating to the purchase of fish must furnish a statement to each person whose name is required to be disclosed on the return showing the filer's name, address, phone number, and amount shown on the return .
Charitable Remainder Trusts Not Eligible to be Electing Small Business Trusts	Charitable remainder annuity trusts and charitable remainder unitrusts may not be electing small business trusts.
Post-Termination Transition Period Provisions	The effective date for the Small Business Job Protection Act provisions affecting the post termination transition period is for determinations after December 31, 1996, not to taxable years beginning after December 31, 1996.
Treatment of Qualified Subchapter S Subsidiaries	The Secretary of Treasury may issue regulations to provide instances when the separate corporate existence of a qualified subchapter S subsidiary may be taken into account for purposes of the Code.
Salary Reduction Simplified Employee Pensions	New employees hired after December 31, 1996 may participate in a SARSEP that an employer established before January 1, 1997.

SIMPLE Retirement Plans

The time for furnishing annual account statements to individuals for a SIMPLE IRA is the same as for other IRAs, January 31;

A SIMPLE IRA of a participant in a SIMPLE IRA Plan is permitted to accept contributions up to the sum of the participant's elective deferrals and the required employer contribution under the terms of the SIMPLE IRA Plan;

An employer can maintain a SIMPLE IRA Plan covering nonunion employees even if the employer has another qualified plan that covers only union employees. § 408(p)(2)(D) is also amended to provide that, if an employer maintaining a SIMPLE IRA Plan fails to satisfy an eligibility requirement because of an acquisition or disposition, then the employer has until the end of the next calendar year to cure the problem;

A SIMPLE § 401(k) plan meeting the requirements of § 401(k)(11) shall not be considered a top-heavy plan under 416 provided the plan accepts only contributions described in § 401(k)(11). The $6,000 limit on a participant's elective deferrals under a SIMPLE 401(k) plan is adjusted for inflation. Finally, the notice and the 60-day election periods applicable to SIMPLE IRA Plans described in § 408(p) also apply to SIMPLE 401(k) plans;

The limit on deductible contributions made by an employer to a SIMPLE §401(k) plan is increased to the amount such employer is required to contribute under the terms of the plan; and

Except for the amendment to § 401(k)(11) relating to notice and election requirements, which is effective beginning with the 1998 calendar year, effective as if included in the Small Business Job Protection Act of 1996.

Self-Employed Ministers

Clarification is provided that church ministers who are self-employed or who work for an organization not described in § 501(c)(3) are considered church employees and as employed by a § 501(c)(3) organization.

Measurement of Controlled Foreign Corporations Earnings

Accumulated earnings and profits of a CFC to determine the CFC's earnings invested in U.S. property do not include current earnings.

Transfers to Foreign Trusts at

For purposes of determining whether a U.S. person's transfer to a trust is for fair market value consideration, the related persons whose obligations are

Fair Market Value	disregarded include any owner of the trust and certain persons related to any owner.
Treatment of Trust as U. S. Person	A trust is treated as a U.S. person as long as one or more U.S. persons have the authority to control all substantial decisions of the trust.
Treatment of Certain Reserves of Thrift Institutions	Rules are provided to clarify the § 593(e) treatment of pre-1988 bad debt reserves for thrift and former thrift institutions that become S corporations.
"FASIT" Technical Corrections	The requirement of a "regular interest" must be met on or after the startup date. The cross reference in § 860L(d) is corrected from § 860I(c)(2) to § 860I(b)(2). The tax on prohibited transactions would not apply to dispositions of foreclosure property or hedges using the similar exception applicable to REMICs.
Qualified State Tuition Programs	If a State program under which a person may purchase tuition credits or certificates or make contributions on behalf of a designated beneficiary comes into compliance with the requirements of a "qualified State tuition program", then the program will be treated as a qualified State tuition program with respect to contributions and earnings allocable to such contributions pursuant to contracts entered into under the program before the first date on which the program meets the requirements.
Adoption Credit	Conforms the treatment of expenses incurred in years after the year adoption becomes final to the treatment of expenses in the year adoption becomes final.
Phaseout of Adoption Assistance Exclusion	Conforms the phaseout range of the adoption assistance exclusion to the phaseout range of the credit.

Amendments Relating to Health Insurance Portability and Accountability Act of 1996
Sec 1602

Medical Savings Accounts	The 15 percent tax on nonmedical withdrawals is not treated as tax liability for minimum tax purposes. Medicare supplemental plans are deleted from the types of permitted coverage a person may have and still qualify for a medical savings account. In any year for which a contribution is made, withdrawals are excludable from income only if the individual for whom expenses were incurred was covered under a high deductible health plan in the month the expenses were incurred. The $25 penalty for trustees of an MSA failing to provide required reports does not apply to information returns.
Definition of Chronically Ill Individual	For purposes of determining whether a contract is a qualified long-term care insurance contract, the requirement that the contract take into account at least five activities of daily living applies only if an individual is certified as being chronically ill under the activities of daily living trigger.
Deduction of Long-Term Care Insurance of Self-Employed Individuals	The rules for deducting health insurance expenses apply to a self-employed individual separately with respect to plans that provide for long-term care services or long-term insurance contracts and plans that do not include long-term care services and are not long-term care insurance contracts.
Reporting Requirements of Long-Term Care Contracts and Accelerated Death Benefits	The reporting requirements include the need to report the address and phone number of the information contact.
Consumer Protection Provisions for Long-Term Care Insurance Contracts	Changes to nonforfeiture benefits may be adjusted only to reflect changes in claims, persistency, and interest as reflected in changes in rates for premium paying contracts approved by the appropriate State regulatory agency for the same contract form. The nonforfeiture provisions may include those described in the statute and similar offerings approved by the State regulatory agency.

Interest Paid on Life Insurance Indebtedness Under COLI Rules	The COLI rules relate to life insurance policies, or annuity or endowment contracts covering any individual who is or was an officer or employee of, or is or was financially interested in any trade or business carried on currently or formerly by the taxpayer.
Period for Applying Interest Rate for a Variable Rate Contract Under COLI Rules	The applicable period election can be made no later than the 90TH date after the date of enactment of the proposal, and applies to the taxpayer's first taxable year ending on or after October 13, 1995. If no election is made, the applicable period is the policy year, which is the 12 month period beginning on the anniversary date of the policy.
Definition of 20 Percent Owner for Key Person Exception Under COLI Rules	In determining a key person, if the taxpayer is not a corporation, a 20 percent owner is an individual who owns 20 percent or more of capital or profits interest of the taxpayer.
Effective Date of Interest Rate Cap on Key Persons	The interest rate cap on key persons and pre-1986 contracts applies to interest paid or accrued for any month beginning after December 31, 1995.
Contract Lapses under Effective Date Provisions of COLI Rule	Under the transition relief provided under the COLI rule, the 4-out-of-7 rule, and the single premium rule of present law, are not to apply solely by reason of a lapse occurring by reason of no additional premiums being received under the contract after October 13, 1995.
Expatriation Tax - Requirement of Gain Recognition on Certain Exchanges	Under the expatriate tax provisions, the period to which the general rule requiring gain recognition on certain exchanges applies is the 10 year period beginning on the date of loss of U.S. citizenship or residency status. Any gain required to be recognized from exchanges occurring during the five year period before the loss of citizenship must be reported immediately after the date of loss of citizenship. The 10 year period beginning on the date of loss of U.S. citizenship or residency status also applies to the rule suspending such period in the case of substantial diminution of risk of loss, and the rule regarding contributions to foreign corporations. The foreign tax credit is limited to the lesser of the foreign estate taxes

attributable to property includible in the expatriate's U.S. estate; or the U.S. estate tax attributable to property subject to the foreign country estate tax and includible in the expatriate's U.S. estate.

Amendments Related to Taxpayer Bill of Rights 2 Sec. 1603

The Internal Revenue Service is given authority to abate the first-tier excise taxes on excess benefit transactions in cases where it is established that the violation was due to reasonable cause, not willful neglect, and the violation was corrected within the specified period.

In addition, § 501(c)(3) organizations are required to report any excise taxes for excess or disqualifying lobbying expenditures, political expenditures, or engaging in any excess benefit transaction that are imposed on the organization or any organization manager, as well as any reimbursement by an organization to an organization manager for excise taxes imposed. No reporting is required if the excise tax is abated.

Miscellaneous Provisions Sec. 1604

A typographical error is corrected in § 412(m), which contains requirements for quarterly contributions to defined-benefit-type plans.

Effective as if included in the Uruguay Round Agreements Act.

Correction of GATT Interest and Mortality Rate in the Retirement Protection Act

Determinations under § 415(b)(2)(E) before the earlier of the date a plan amendment is adopted or made effective, whichever is later, or the first day of the first limitation year beginning after December 31, 1999, are made with respect to benefits accrued before such earlier date on the basis of § 415(b)(2)(E) and the plan terms as in effect on December 7, 1994.

Related Parties Determined by Reference to Section 267

Any reference in the Internal Revenue Code of 1986 referring to a relationship that would result in a loss disallowance under § 267 also refers to relationships where a loss is deferred, where such relationship is applicable to the provision.

Definition of Indian Reservation Under Section 168(j)(6)

The definition of "Indian reservation" under § 168 (j) (6) is clarified. The term "former reservations in Oklahoma" is treated as including only lands which are within the jurisdiction area of an Oklahoma Indian tribe (as determined by the Secretary of the Interior) and are recognized by the Secretary as eligible for trust land status under 25 C.F.R. Part 51.

The provision generally is effective as if included in OBRA '93.

CODE SECTION TABLE

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Sec. 2	7213A; 7213(a)(2)
Sec. 3	7431(a),(b),(c),(e),(f)
Sec. 101	24; 32(m)(3); 501(c)(3); 6213(g)(2)(1)
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