FEDERAL RECEIPTS AND COLLECTIONS

3. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Government's sovereign or governmental powers. The difference between receipts and outlays determines the surplus or deficit.

Growth in receipts.—Total receipts in 1998 are estimated to be $1,566.8 billion, an increase of $61.4 billion or 4.1 percent relative to 1997. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. Receipts are projected to grow at an average annual rate of 4.9 percent between 1998 and 2002, rising to $1896.7 billion.

As a share of GDP, receipts are projected to remain fairly constant, declining from 19.1 percent in 1998 to 19.0 percent in 2002.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1996 actual	Estimate					
		1997	1998	1999	2000	2001	2002
Individual income taxes	656.4	672.7	691.2	721.6	755.6	795.2	839.8
Corporation income taxes	171.8	176.2	189.7	199.6	212.0	220.5	227.8
Social insurance taxes and contributions	509.4	535.8	557.8	585.2	614.4	642.2	673.1
(On-budget)	(141.9)	(146.9)	(152.8)	(160.0)	(167.5)	(174.5)	(183.2)
(Off-budget)	(367.5)	(388.9)	(404.9)	(425.2)	(446.9)	(467.6)	(489.9)
Excise taxes	54.0	57.2	61.2	64.5	64.9	66.2	67.4
Estate and gift taxes	17.2	17.6	18.8	20.0	21.4	22.9	24.6
Customs duties	18.7	17.3	18.3	18.5	19.6	20.5	22.0
Miscellaneous receipts	25.5	28.6	29.8	34.0	39.4	40.8	42.0
Total receipts	**1,453.1**	**1,505.4**	**1,566.8**	**1,643.3**	**1,727.3**	**1,808.3**	**1,896.7**
(On-budget)	(*1,085.6*)	(*1,116.5*)	(*1,161.9*)	(*1,218.1*)	(*1,280.4*)	(*1,340.7*)	(*1,406.8*)
(Off-budget)	(*367.5*)	(*388.9*)	(*404.9*)	(*425.2*)	(*446.9*)	(*467.6*)	(*489.9*)

Table 3–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1997	1998	1999	2000	2001	2002
Receipts under tax rates and structure in effect January 1, 1997 [1]	1,503.8	1,572.4	1,639.7	1,722.5	1,801.4	1,884.7
Social security (OASDI) taxable earnings base increases:						
$65,400 to $68,700 on Jan. 1, 1998	....	1.4	3.8	4.2	4.6	5.1
$68,700 to $71,400 on Jan. 1, 1999	....	....	1.1	3.1	3.4	3.8
$71,400 to $74,100 on Jan. 1, 2000	....	....	....	1.2	3.1	3.4
$74,100 to $76,800 on Jan. 1, 2001	....	....	....	....	1.2	3.2
$76,800 to $79,800 on Jan. 1, 2002	....	....	....	....	....	1.3
Proposals [2]	1.6	–7.0	–1.4	–3.7	–5.5	–4.9
Total, receipts under existing and proposed legislation	**1,505.4**	**1,566.8**	**1,643.3**	**1,727.3**	**1,808.3**	**1,896.7**

[1] These estimates assume a social security taxable earnings base of $65,400 through 2002.
[2] Net of income offsets.

ENACTED LEGISLATION

Several laws were enacted in 1996 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

Tax Benefits for Members of the Armed Forces Performing Peacekeeping Services in Bosnia and Hercegovina, Croatia, and Macedonia.—Current law provides various forms of tax relief to military personnel serving in combat zones. Under this Act that relief is extended to military personnel serving in and around the former republic of Yugoslavia. Such tax relief includes the exclusion from income of all of the military pay of enlisted personnel and part of the pay of officers serving in the former republic of Yugoslavia, and the extension of filing and payment deadlines. The Act also extends for three years, through September 30, 2003, the Internal Revenue Service's (IRS') authority to charge fees for written responses to questions from individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. These fees were scheduled to expire effective with requests made after September 30, 2000.

Taxpayer Bill of Rights 2.—This Act contains a number of provisions that provide taxpayers with increased protection in their dealings with the IRS. Taxpayer protection provisions include the establishment of a taxpayer advocate within IRS; modification of installment agreement provisions when agreements are terminated; expansion of IRS' authority to abate interest, and to award costs and certain fees in taxpayer disputes; and relief from retroactive regulations. To offset the receipt losses associated with these provisions, changes are provided in the "failure to pay" penalty assessed against taxpayers who fail to file a tax return and penalties are imposed on tax-exempt organizations under certain circumstances.

Personal Responsibility and Work Opportunity Reconciliation Act.—This Act provides an historic opportunity to transform our broken welfare system in a manner that promotes work, responsibility, and dignity. The major provisions of the Act that affect receipts include changes designed to improve earned income tax credit (EITC) compliance and to target EITC benefits to needy working families. These provisions, which are generally effective for taxable years beginning after December 31, 1995, are described below.

Deny EITC to individuals not authorized to be employed in the United States.—Individuals who do not have proper documentation for employment purposes are not eligible to claim the EITC.

Allow the IRS to use mathematical error procedures for certain EITC-related errors.—The IRS is permitted to use mathematical error procedures to deny claims for the EITC if a correct taxpayer identification number is not provided. The IRS can also use mathematical error procedures to impose the proper amount of self-employment tax if it is not paid on net self-employment earnings used to claim the credit.

Modify the definition of adjusted gross income (AGI) for phasing out the EITC.—The definition of AGI used for phasing out the credit is modified by disregarding net capital losses, net losses from trusts and estates, net losses from royalties, and 50 percent of net losses from businesses and rents.

Expand the definition of disqualified income for purposes of determining eligibility for the EITC.—Under prior law, taxpayers with more than $2,350 in taxable investment income were disqualifed from claiming the EITC. This Act lowers the limit to $2,200 and expands the definition of investment income to include capital gain net income and net passive income. The threshold is indexed for inflation beginning in 1997.

Health Insurance Portability and Accountability Act.—This Act, which represents an important step toward strengthening the health security of the American people, improves the portability of health insurance and makes a number of changes designed to simplify the administration of health insurance and to reduce waste, fraud, and abuse in health insurance and health care delivery. A number of tax incentives, which are offset by revenue increases, are also provided. The major changes that affect receipts are described below.

Increase deductibility of health insurance premiums for self-employed individuals.—The 30-percent deduction for health insurance expenses of self-employed individuals and their dependents is increased to 40 percent in 1997, 45 percent in 1998, 50 percent in 2003, 60 percent in 2004, 70 percent in 2005 and 80 percent in 2006 and later years.

Establish a four-year medical savings account (MSA) demonstration project.—Beginning January 1, 1997, MSAs are available to individuals who are covered by a high deductible health plan and who either are self-employed or are employed in a firm with 50 or fewer employees. The four-year demonstration project is limited to 750,000 policies for individuals who had health insurance and who work for a small employer or are self-employed. Contributions to an MSA (whether made by an employer, employee or self-employed individual) generally are deductible, up to a maximum of 65 percent of the deductible for high-deductible individual coverage and 75 percent of the deductible for high-deductible family coverage. Contributions to an MSA made by an employer on behalf of an employee up to the same limits are excluded from the employee's wages for income and payroll tax purposes. Earnings on amounts in an MSA and distributions from an MSA for medical expenses are generally excluded from gross income. Distributions for non-medical expenses are taxed and are subject to a 15-percent additional tax unless made after age 65, or for reasons of death or disability. Unless Congress votes to expand the program, no new contributions may be made to MSAs after

December 31, 2000 except by or on behalf of individuals who previously had MSA contributions and individuals employed by certain participating employers. Self-employed individuals who made contributions prior to December 31, 2000 also may continue to make contributions after that date.

Clarify taxation of qualified long-term care insurance premiums, expenses and benefits.—Effective with respect to contracts issued after December 31, 1996, a qualified long-term care insurance contract generally is treated as an accident and health insurance contract. Provisions include the following: (1) Amounts (other than policyholder dividends or premium refunds) received under a qualified long-term care insurance contract generally are excluded from gross income, subject to a cap of $175 per day, or $63,875 annually in the case of a per diem policy. Beginning in 1998, the per diem cap is indexed annually for inflation based on the medical care cost component of the consumer price index. (2) The cost of employer-provided qualified long-term care insurance generally is deductible for the employer and excluded from the employee's gross income. (3) Unreimbursed expenses for qualified long-term care services are deductible as medical expenses, subject to the present-law floor of 7.5 percent of adjusted gross income (AGI). (4) Qualified long-term care insurance premiums (subject to specified dollar limits) are deductible as medical expenses, subject to the present-law floor of 7.5 percent of AGI. Beginning in 1998, the dollar limits are indexed annually for inflation based on the medical care cost component of the consumer price index. (5) Self-employed individuals are able to deduct the cost of qualified long-term care insurance premiums up to the limit for health insurance.

Modify taxation of accelerated death benefits under life insurance contracts.—An exclusion from gross income is provided to an insured individual who is terminally or chronically ill for (1) amounts received under a life insurance contract and (2) amounts received for the sale or assignment of a life insurance contract to a qualified viatical settlement provider. For chronically ill individuals, the exclusion is limited to $175 per day or $63,875 annually, or the individual's costs for qualified long-term care services. The exclusion is effective with respect to amounts received after December 31, 1996.

Modify taxation of State-sponsored organizations providing health coverage for high-risk individuals and workers' compensation reinsurance.—An exemption from income tax is provided to any membership organization that is established by a State exclusively to provide coverage for medical care on a nonprofit basis to certain high-risk individuals, provided certain criteria are satisfied. The provision applies to taxable years beginning after December 31, 1996. In addition, tax-exempt status is provided to any membership organization that is establised by a State before June 1, 1996 exclusively to reimburse its members for workers' compensation insurance losses, and that satisfies certain other conditions. The provision applies to taxable years ending after August 21, 1996.

Extend special tax rules provided under Section 833 to certain health insurance organizations.—Under prior law a special deduction equal to 25 percent of the claims and expenses incurred during the year, less the adjusted surplus at the beginning of the year, was provided to certain eligible health organizations. Eligible organizations included: (1) Blue Cross or Blue Shield organizations existing on August 16, 1986, which had not experienced a material change in structure or operation since that date. (2) Other organizations that met certain community-service-related requirements and substantially all of whose activities involved the provision of health insurance. Effective for taxable years ending after December 31, 1996, these special rules are applied to any organization that (1) is not a Blue Cross or Blue Shield organization existing on August 16, 1986 and (2) otherwise meets the requirements of Section 833, including the requirement of no material change in operations or structure since August 16, 1986. An organization qualifies for this treatment only if it is not a health maintenance organization and it is organized under and governed by State laws specifically and exclusively applicable to not-for-profit health insurance or health service type organizations.

Allow penalty-free withdrawals from individual retirement accounts (IRAs) for medical expenses.—Effective for taxable years beginning after December 31, 1996, penalty-free withdrawals are permitted from IRAs for medical expenses in excess of 7.5 percent of AGI. Penalty-free withdrawals generally are also permitted for medical insurance premiums (without regard to the 7.5 percent floor) of individuals unemployed for at least 12 consecutive weeks.

Expand penalties provided under the Consolidated Omnibus Budget Reconciliation Act of 1995 (COBRA) to enforce group health plan portability, access, and renewability requirements.—Under COBRA, most employer-sponsored group health plans must offer qualified beneficiaries the opportunity to continue to participate for a specified period of time after the occurrence of certain events (such as termination of employment) that otherwise would have terminated such participation. A tax is imposed on the failure of a plan to satisfy these health care continuation rules. Effective for taxable years beginning after December 31, 1996, the tax for failure to satisfy health continuation rules is extended to apply to failure to satisfy the expanded coverage provisions provided in this Act.

Disallow the deductibility of interest on corporate owned life insurance (COLI) policy loans.—Generally, for interest paid or accrued after December 31, 1995, no deduction is allowed for interest on any COLI policy loan, except for "key person policies" that cover up to 20 key persons. Interest with respect to key person policies is deductible only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average-Monthly Average Corporates for each month interest is paid or accrued. Special phase-in rules are provided with respect to any otherwise deductible interest paid or accrued after October 13, 1995 and before January 1, 1999 with respect to debt incurred before January 1 1996. An exception from the general disallowance is also provided to interest on debt with respect to contracts purchased on or before June 20, 1986.

Eliminate the interest allocation exception for certain nonfinancial corporations.—For foreign tax credit purposes, taxpayers generally are required to allocate and apportion interest expenses between U.S. and foreign source income based on the proportion of the taxpayer's total assets in each location. Such allocation and apportionment is required to be made for affiliated groups as a whole rather than on a subsidiary-by-subsidiary basis. However, certain types of financial institutions that are members of an affiliated group are treated as members of a separate affiliated group for purposes of the allocation and apportionment of interest expense. The Tax Reform Act of 1986 included a targeted rule that treated certain nonfinancial corporations as financial institutions for this purpose. The targeted exception for certain nonfinancial corporations is repealed, generally effective for taxable years beginning after the date of enactment.

Modify expatriation tax.—Under prior law, citizens who relinquished their citizenship for tax avoidance purposes were subject to special tax provisions for ten years after such loss of citizenship. This Act expands the prior law provisions in several ways, generally with respect to individuals who expatriate on or after February 6, 1995: (1) The provision subjecting U.S. citizens to tax for ten years following expatriation is extended to apply to certain long-term residents whose residency is terminated. A long-term resident generally is any individual who was a lawful permanent resident of the United States for at least eight out of the 15 taxable years ending with the year in which termination occurs. (2) Certain individuals are subject to the expatriation tax without inquiry as to their motive for losing U.S. citizenship or residency, but certain categories of citizens are allowed to show an absence of tax-avoidance motive if they request a ruling from the IRS as to whether the loss of citizenship had a principal purpose of tax avoidance. (3) The categories of income and gain that are treated as U.S. source (and, therefore, subject to tax) is expanded and the ability to engage in transactions that partially or completely circumvent the ten-year reach of the law is curtailed. (4) Relief from double taxation is provided in circumstances where another country imposes tax on items that would be subject to U.S. tax under the expatriation tax provisions. (5) Information reporting requirements are applied to U.S. citizens and long-term residents whose citizenship or residency is terminated.

Small Business Job Protection Act of 1996.—This Act increases the minimum wage and makes numerous changes in the tax code to provide relief to small businesses, simplify pension plans, and extend certain expiring provisions. The reduction in receipts associated with these changes is offset by a number of revenue increases. The major provisions of the Act affecting receipts are described below.

Increase expensing for small business.—The amount of depreciable tangible personal property that a small business can elect to expense each year is increased from $17,500 in 1996 to $18,000 in 1997, $18,500 in 1998, $19,000 in 1999, $20,000 in 2000, $24,000 in 2001, and to $25,000 in 2003 and later years. The amount that a small business may elect to expense is reduced by the amount by which the cost of qualifying property exceeds $200,000.

Simplify and expand pension plans.—The major provisions affecting pension plans include the following: (1) Effective for taxable years beginning after December 31, 1999, lump-sum distributions from qualified plans are no longer eligible for special five-year forward averaging. (2) The $5,000 exclusion provided employer-provided death benefits is repealed, effective with respect to decedents dying after the date of enactment. (3) The method for determining the taxable portion of qualified annuity payments is simplified, effective with respect to annuity starting dates beginning 90 days after the date of enactment. (4) Employees (other than 5 percent owners) who continue working after age 70½ can delay beginning their pensions until they actually retire. (5) A simplified retirement plan for small business, called the savings incentive match plan for employees (SIMPLE) is created. A SIMPLE plan can either provide an individual retirement account (IRA) for each employee or be part of a qualified cash or deferred arrangement (401(k) plan). SIMPLE plans use lower contribution limits than regular 401(k) plans and Salary Reduction Simplified Employee Pensions (SARSEPs), and specify employer contribution levels in lieu of the nondiscrimination and top-heavy rules that normally apply to employer retirement plans. All contributions to the plan are fully vested. Contributions to a SIMPLE plan generally are deductible by the employer and excluded from the employee's income. The rules regarding the availability and taxation of distributions from a SIMPLE IRA or SIMPLE 401(k) plan are the same as the rules that apply to distributions from regular IRAs or 401(k) plans, respectively, except that during the first two years after the individual first participates in any SIMPLE IRA maintained by the individual's employer, rollovers to regular IRAs are not available and the additional tax on early distributions is increased from 10 percent to 25 percent. SIMPLE IRA plans are subject to simplified reporting requirements. SIMPLE plans are available for plan years beginning after December 31, 1996. (6) Effective for plan years beginning after December 31, 1996, tax-exempt organizations (including Indian tribal governments) are permitted to establish qualified cash or deferred arrangements. (7) The availability of spousal IRAs is increased by permitting deductible IRA contributions of up to $2,000 on behalf of each spouse if the combined compensation of both spouses is at least equal to the contributed amount. This provision is effective for taxable years beginning after December 31, 1996. (8) Nondiscrimination rules are modified by simplifying the definitions of highly compensated employees, compensation and retirement age; changing the minimum participation rule; and modifying the nondiscrimination tests applicable to qualified cash or deferred arrangements and matching contributions. (9) Effective for plan years beginning after December 31, 1998, instead of applying nondiscrimination tests, employers may use simple safe harbors for certain 401(k) plans under which the employer contributes at least a stated minimum to each employee account. (10) The rules that apply to nonqualified plans for tax-exempt and governmental employers have been simplified and, in the case of governmental employers, the assets under those plans must be kept in trust. (11) The vesting period for multiemployer plans is reduced from ten to five years for plan years beginning after December 31, 1996. (12) The combined plan limit is repealed, effective with respect to limitation years beginning after December 31, 1998, and the excise tax on large distributions is suspended for the years 1997 through 1999. (13) The excise tax applicable to prohibited transactions is increased from five percent to ten percent. (14) Alternative nondiscrimination tests are provided to certain plans that allow employees to participate before they complete one year of service or reach age 21. These tests promote pension portability by encouraging employers to offer pensions to new hires.

Simplify tax laws affecting Subchapter S (closely-held) corporations.—A number of changes in the tax laws affecting Subchapter S corporations are provided. The major changes increase the maximum number of shareholders in an S corporation from 35 to 75, permit S corporations to hold subsidiaries, allow financial institutions to qualify as S corporations, and permit certain tax-exempt organizations to be S corporation shareholders.

Provide adoption assistance.—Effective for taxable years beginning after December 31, 1996, the following adoption assistance is provided: (1) A maximum nonrefundable tax credit of $5,000 per child ($6,000 per child in the case of domestic special needs adoptions) is provided for qualified adoption expenses paid or incurred by the taxpayer. The credit for adoptions other than domestic special needs adoptions expires with respect to expenses paid or incurred after December 31, 2001. (2) A maximum exclusion from income of $5,000 per child ($6,000 per child in the case of domestic special needs adoptions) is provided for certain employer-paid adoption expenses. The exclusion is repealed with respect to employer-paid adoption expenses provided after December 31, 2001. Both the credit and exclusion are phased out ratably for taxpayers with modified adjusted gross income above $75,000 and are fully phased out at $115,000 of modified adjusted gross income.

Replace targeted jobs tax credit with a temporary work opportunity tax credit.—Prior to January 1, 1995, the targeted jobs tax credit was available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The credit generally was equal to 40 percent of up to $6,000 in qualified first-year wages, for a maximum credit of $2,400 per employee. The targeted jobs tax credit of prior law is replaced with the work opportunity tax credit effective for wages incurred or paid to a qualified individual who begins work after September 30, 1996 and before October 1, 1997. The new credit is available on an elective basis for employers hiring individuals from one or more of seven targeted groups and is generally equal to 35 percent of the first $6,000 in qualified first-year wages. No credit is allowed for wages paid unless the eligible individual is employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 400 hours (120 hours in the case of a qualified summer youth employee).

Extend exclusion for employer-provided educational assistance.—For taxable years beginning before January 1, 1995, certain amounts paid by an employer for educational assistance provided to an employee were excluded from the employee's gross income for income and payroll tax purposes. The exclusion was limited to $5,250 of educational assistance with respect to an individual during a calendar year and applied whether or not the education was job related. The exclusion is extended to apply to undergraduate courses beginning after December 31, 1994 and before mid-1997; for graduate courses, the exclusion applies to courses beginning after December 31, 1994 and before mid-1996.

Extend research and experimentation tax credit with modifications.—Under prior law, a 20 percent tax credit was provided for certain research and experimentation expenditures made before July 1, 1995. This credit is extended, with modifications, to apply to expenditures paid or incurred during the 11-month period July 1, 1996 through May 31, 1997.

Extend orphan drug tax credit.—Prior to January 1, 1995, a 50-percent nonrefundable tax credit was provided for qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions (generally known as "orphan drugs"). The credit is extended for 11 months to apply to qualified expenses paid or incurred from July 1, 1996 through May 31, 1997.

Extend deduction for contributions of stock to private foundations.—The deduction for a contribution to a private foundation is generally limited to the adjusted basis of the contributed property. However, under prior law, a taxpayer who contributed qualified appreciated stock to a private foundation before January 1, 1995 was allowed to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock. The special rule for contributions of qualified appreciated stock to private foundations is extended to apply to contributions made during the period July 1, 1996 through May 31, 1997.

Extend tax credit for producing fuel from a nonconventional source.—Certain fuels produced from nonconventional sources and sold to unrelated parties are eligible for an income tax credit equal to $3 per barrel or BTU oil barrel equivalent. Qualified fuels must be produced within the United States and include: (1) oil produced from shale and tar sands; (2) gas produced from geopressured brine, Devonian shale, coal seams, tight formations, or biomass; and (3) liquid, gaseous, or solid synthethic fuels produced from coal (including lignite). The credit generally is availabe only with respect to qualified fuels produced and sold before January 1, 2003 from wells drilled or facilities placed in service after December 31, 1979 and before January 1, 1993. Under prior law, an exception allowed the credit to be claimed for gas from biomass and synthetic fuel from coal produced or sold before January 1, 2008 from facilities placed in service before January 1, 1997, pursuant to a binding contract entered into before January 1, 1996. This Act extends both the binding contract date and the placed in service date for facilities producing synthetic fuels from coal and gas from biomass. Specifically, synthetic fuels from coal and gas from biomass produced or sold before January 1, 2008 are eligible for the credit if produced from facilities placed in service before July 1, 1998, pursuant to a binding contract entered into before January 1, 1997.

Suspend imposition of excise tax on diesel fuel used in recreational motorboats.—The 24.4-cents-per-gallon excise tax on diesel fuel used in recreational motorboats is suspended during the period beginning on August 27, 1996 through December 31, 1997.

Permanently extend the Federal Unemployment Tax (FUTA) exemption for alien agricultural workers.—Generally, the Federal unemployment tax is imposed on farm operators who (1) employ 10 or more agricultural workers for some portion of 20 different days, each being in a different calendar week or (2) have a quarterly payroll for agricultural services of at least $20,000. Under prior law, effective for labor performed before January 1, 1995, an exclusion from FUTA was provided for labor performed by an alien admitted to the United States to perform agricultural labor under the Immigration and Nationality Act. The exemption from FUTA for alien agricultural workers is permanently extended, effective with respect to labor performed on or after January 1, 1995.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. This program, which had expired after July 31, 1995, is temporarily extended for the period August 1, 1995 through May 31, 1997.

Extend airport and airway excise taxes.—The excise taxes levied on domestic air passenger tickets, international departures, domestic air cargo and noncommercial aviation fuels, which had expired after December 31, 1995 under prior law, are reinstated effective August 27, 1996 through December 31, 1996.

Extend and phase out the excise tax on luxury automobiles.—Under prior law, the ten-percent luxury excise tax levied on the retail price of a passenger vehicle in excess of an inflation-adjusted threshold ($34,000 in 1996) was scheduled to expire after December 31, 1999. The tax is extended through December 31, 2002, at the following rates: 1996 (effective August 28, 1996), nine percent; 1997, eight percent; 1998, seven percent; 1999, six percent; 2000, five percent; 2001, four percent; and 2002, three percent.

Modify Puerto Rico and possessions tax credit.—Under prior law, domestic corporations with business operations in U.S. possessions were allowed to elect the Section 936 credit, which generally eliminated the U.S. tax on certain income related to their possession-based operations. Income exempt from U.S. tax under this provision fell into two broad categories: (1) possession business income derived from the active conduct of a trade or business within a possession or from the sale or exchange of substantially all of the assets used in such a trade or business; and (2) possession source investment income (QPSII) attributable to investment in the possession or in certain Caribbean Basin countries. The credit attributable to QPSII is repealed, effective for QPSII earned after June 30, 1996. The credit with respect to possession business income also generally is repealed, effective with respect to taxable years beginning after December 31, 1995. However, grandfather rules are provided under which a corporation that elected the credit by October 13, 1995 is eligible to claim credits with respect to possession business income during a transition period effective for taxable years beginning after December 31, 1995 and before January 1, 2006. The credit is eliminated for taxable years beginning after December 31, 2005.

Repeal 50-percent interest exclusion for financial institution loans to employee stock option plans (ESOPs).—Under prior law a bank, insurance company, regulated investment company, or a corporation actively engaged in the business of lending money was generally allowed to exclude from gross income 50 percent of interest received on an ESOP loan. The 50-percent exclusion generally is repealed, effective with respect to loans made after the date of enactment, other than loans made pursuant to a written binding contract in effect before June 10, 1996.

Reform depreciation under the income forecast method.—All estimated income from the use of property or the sale of merchandise is to be taken into account in determining depreciation under the income forecast method. In applying this rule, income expected to be generated after the close of the tenth taxable year after the year the propery is placed in service generally need not be taken into account. In the case of a film, television show or similar property, such income includes, but is not necessarily limited to, income from foreign and domestic theatrical, television, and other releases and syndications; and video tape releases, sales, rentals, and syndications. In the case of television and motion picture films, the income from the property shall include income from the financial exploitation of characters, designs, scripts, scores, and other incidental income associated with such films, but only to the extent income is earned in connection with the ultimate use of such items by, or the ultimate sale of merchandise to, persons who are not related to the taxpayer. These changes generally are effective for property placed in service after September 13, 1995.

Modify exclusion of damages received on account of personal injury or sickness.—The Act specifies that the exclusion from gross income of damages received on account of personal injury or sickness does not apply to compensatory damages received on account of non-physical personal injury or sickness or to punitive damages received in connection with a personal injury or sickness. This change generally applies with respect to amounts received after August 20, 1996.

Modify basis adjustment rules under Section 1033.—When a taxpayer acquires a controlling interest in the stock of a corporation as replacement property after an involuntary conversion, the corporation generally will reduce its adjusted bases in its assets by the same amount as the taxpayer is required to reduce its basis in the acquired stock. The corporation's adjusted bases in its assets will not be reduced, in the aggregate, below the taxpayer's basis in its stock. In addition, the basis of any individual asset will not be reduced below zero. This provision, which allows deferral of gain recognition, but not the avoidance of that gain, is generally effective with respect to involuntary conversions occurring after August 20, 1996.

Allow the IRS to use mathematical error procedures to deny dependency exemptions.—If an individual fails to provide a correct taxpayer identification number (TIN) for a dependent, the IRS is allowed to use mathematical error procedures to deny the dependency exemption. This change generally is effective for tax returns for which the due date (without regard to extensions) is 30 days or more after August 20, 1996.

Modify rules for taxing foreign trusts.—This Act strengthens information reporting and penalties related to foreign trusts, and tightens tax planning rules involving foreign trusts, their beneficiaries, and grantors.

Repeal bad debt reserve deduction for thrift institutions.—Under prior law, certain thrift insitutions were allowed deductions for bad debts under rules more favorable than those granted to commercial banks. Generally effective for taxable years beginning after December 31, 1995, thrifts must account for bad debts in the same manner as banks.

ADMINISTRATION PROPOSALS

Provide Tax Relief and Extend Expiring Provisions

The President's plan targets tax relief to middle-income Americans through his Middle Class Bill of Rights. His plan also includes a targeted home-ownership tax cut, a new welfare-to-work incentive, a District of Columbia tax incentive program, estate tax relief for small businesses and family farms, initiatives for economically distressed areas, and the extension of certain expiring tax provisions.

Middle Class Bill of Rights.—The Administration is again proposing, with certain modifications and enhancements, the three features of its Middle Class Bill of Rights designed to give middle-income families the tax relief they need to help them raise their children, save for the future and pay for postsecondary education.

Provide tax credit for dependent children.—A nonrefundable credit would be allowed for each dependent child under the age of 13. The credit would equal $300 for 1997, 1998 and 1999, and would rise to $500 for 2000 and subsequent years. The credit would be phased out for taxpayers with adjusted gross income (AGI) between $60,000 and $75,000. Both the credit amount and the phase-out range would be indexed for inflation beginning in 2001. The credit would be applied before the earned income tax credit but could not be used to offset alternative minimum tax liability.

Expand Individual Retirement Accounts (IRAs).—Under present law, eligibility for deductible IRAs is phased out for single taxpayers with AGI between $25,000 and $35,000 and for couples filing a joint return with AGI between $40,000 and $50,000, if the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan. Under the Administration's proposal, the AGI thresholds and phase-out ranges would be doubled over time. For 1997 through 1999, eligibility would be phased out for single taxpayers with AGI between $45,000 and $65,000, and for couples filing a joint return with AGI between $70,000 and $90,000. For 2000 and later years, eligibility would be phased out for single taxpayers with AGI between $50,000 and $70,000 and for couples filing a joint return with AGI between $80,000 and $100,000. These thresholds and the present law annual contribution limit of $2,000 would be indexed for inflation. Withdrawals from IRAs would not be subject to the ten percent early withdrawal tax if the proceeds were used to pay post-secondary education costs, to buy or build a first home, or to cover living expenses if unemployed for at least 12 consecutive weeks. (Prior versions of the Administration's proposal would also have permitted early withdrawal to pay catastrophic medical expenses (including nursing home or other costs associated with caring for an incapacitated parent or grandparent); this provision was enacted in the Health Insurance Portability and Accountability Act, effective for distributions after 1996.) In addition, each individual eligible for a deductible IRA would have the option of contributing an amount up to the contribution limit to a traditional deductible IRA or to a new back-loaded special IRA. Contributions to this special IRA would not be tax deductible, but distributions of the contributions would be tax-free. If the contributions remained in the account for at least five years, earnings on the contributions also would be tax-free when withdrawn. Withdrawals of account balances from special IRAs during the five-year period would be subject to ordinary income tax and a ten-percent early withdrawal tax. However, withdrawals during the five-year period for the purposes described above (or upon death or disability of the taxpayer) would not be subject to the early withdrawal tax. Individuals whose AGI for a year fell within the eligibility thresholds would be allowed to convert an existing IRA into a special IRA, and for conversions before 1999, income inclusion would be spread over four years.

Provide tax incentive for education and training.— The Administration's proposed HOPE scholarship plan would make 14 years of education—at least two years of college—the standard for all Americans. A taxpayer could claim a $1,500 per-student nonrefundable tax credit for tuition and required fees for enrollment of the taxpayer, the taxpayer's spouse or the taxpayer's dependent in a post-secondary degree or certificate program. The credit would be available for payments made during 1997 and thereafter for education commencing on or after July 1, 1997. The amount of the credit would be reduced by any other non-taxable Federal educational grants received by the student. The credit could be claimed twice (i.e., in two different years) for a student, provided the credit was claimed in a year in which the student was enrolled at least half-time in the thirteenth or fourteenth year of post-secondary education. The credit would be available for a second year, however, only if the student had obtained a B-average for all prior post-secondary course work. No credit would be available for a student who had been convicted of a drug-related felony. A deduction would be permitted for up to $5,000 per family in annual tuition and required fees for post-secondary education and job training for the taxpayer, the taxpayer's spouse and dependents. The maximum allowable deduction would increase to $10,000 effective January 1, 1999. A taxpayer could claim either the credit or the deduction for a student's expenses, but not both in the same taxable year. In addition, both the credit and deduction would be phased out for taxpayers filing a joint return with AGI (before the proposed deduction) between $80,000 and $100,000. For taxpayers filing a head-of-household or single return, the credit and deduction would be phased out for those with AGI between $50,000 and $70,000. The phase-out ranges would be indexed for inflation beginning in 2000. Education expenses qualifying for the credit and deduction include tuition and fees paid to institutions and programs eligible to participate in Federal student aid programs. No deduction or credit would be available for expenses for meals, lodging, books or transportation. In addition, to provide assistance with education-related debt to graduates entering public service, the current exclusion from income for the discharge of certain student loans would be expanded to cover discharge of certain direct loans made by the Federal government and certain loans made by charitable and educational institutions.

Provide targeted welfare-to-work tax credit.— The Administration proposes a targeted welfare-to-work credit designed to create new job opportunities for long-term welfare recipients. The credit would enable employers to claim a 50-percent credit on the first $10,000 of annual wages paid to long-term welfare recipients. The credit could be claimed for up to two years and employers would be able to treat education and training assistance, health care, and dependent care expenses as eligible wages. The credit would be available for wages paid or incurred effective the date of enactment through September 30, 2000. The Administration also proposes to expand the existing Work Opportunity Tax Credit to include adults age 18 to 50 who are subject to more rigorous work requirements for food stamps under the Administration's proposal to amend last year's welfare reform law.

Provide capital gains exclusion on sale of principal residence.—Under current law gains on the sale of a taxpayer's principal residence are subject to the capital gains tax; however, taxes on the gain can be deferred through the purchase of a new home of equal or greater value within a specified period of time. Taxpayers over 55 may elect to take a one-time exclusion of up to $125,000 of gain from the sale of their home. The Administration proposes to exclude up to $500,000 of gain from the sale of a taxpayer's principal residence ($250,000 for a single taxpayer) effective for sales on or after January 1, 1997. The proposal would repeal the current-law exclusion for taxpayers over age 55 and the section 1034 deferral for purchasing a more expensive home, with transition relief. Gain recognition would be required on the sale of a principal residence to the extent of any depreciation allowable after December 31, 1996. The proposal would exempt over 99 percent of home sales from the capital gains tax and would dramatically simplify taxes and record keeping for over 60 million homeowners.

Establish District of Columbia (DC) tax incentive program.—To encourage employment of disadvantaged DC residents and to revitalize those DC areas where development has been inadequate, tax incentives are proposed.

Provide estate tax relief for small business.—Estate tax attributable to certain interests in closely held businesses may be paid in installments over a period of up to 14 years. A special four percent interest rate is provided for the tax deferred on the first $1 million of value. The $1 million cap has been in effect since 1976. To address the liquidity problems that may arise upon the death of a farmer or small business owner, and to adjust for inflation, the Administration proposes to increase the amount of property eligible for the special interest rate from $1 million to $2.5 million. The proposal also simplifies current law by eliminating distinctions based on the form of ownership, providing alternatives to the estate tax lien, and reducing the interest rate by 50 percent or more in exchange for making the interest payments nondeductible. The proposal would be effective for decedents who die after December 31, 1997.

Provide tax incentives for distressed areas.—The Administration is proposing tax incentives for the clean-up of polluted urban and rural areas and is proposing an expansion of the empowerment zone and enterprise community program, as described below.

Provide tax incentives to clean up environmentally contaminated areas known as brownfields in distressed communities.—To encourage the cleanup of polluted urban and rural areas known as brownfields, the Administration proposes to allow a current deduction for certain costs incurred by businesses to remediate environmentally contaminated land in certain areas. Qualified sites generally would be limited to those properties located in or next to high-poverty areas, Federal empowerment zones and enterprise communities, and areas subject to certain Environmental Protection Agency (EPA) Brownfields Pilots. To claim this incentive, taxpayers would be required to obtain from the appropriate State or local agency, or the EPA in certain circumstances, verification that the site satisfies the geographic and contamination requirements. The proposal would be effective for qualified expenses incurred after the date of enactment.

Expand Empowerment Zone and Enterprise Community program.—Under the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), certain tax incentives were provided for nine empowerment zones and 95 enterprise communities. The tax incentives were a 20-percent employer wage credit, increased Section 179 expensing, and a new category of tax-exempt financing. Qualifying businesses in empowerment zones were eligible for all three incentives, while businesses in enterprise communities were eligible for the tax-exempt financing. Over 500 communities submitted applications for these 104 designations that were announced in December 1994. The Administration proposes a three-part expansion of this program. First, the designation of two additional urban empowerment zones would be authorized, to be made within 180 days of enactment. Second, the restrictions on the tax-exempt financing would be loosened to make this incentive more accessible. Third, the designation of 20 additional empowerment zones (15 urban, 5 rural) and 80 additional enterprise communities (50 urban, 30 rural) would be authorized. Businesses in the new enterprise communities would be eligible for the current-law tax-exempt financing, as revised, as well as the brownfields tax incentive described above (including an additional 1,000 acres). Businesses in the new empowerment zones would be eligible for the OBRA 93 increased section 179 expensing, the brownfields tax incentive (including an additional 2,000 acres), and tax-exempt financing that would not be subject to the current-law State volume caps, but rather would only be subject to zone-by-zone volume caps. The current-law wage credit would not be applicable in these 100 new zones and communities. The designations of these new zones and communities would be required to occur before 1999, and the designations would generally be effective for ten years.

Provide tax credit for investment in community development financial institutions (CDFI).—The Community Development Banking and Financial Institutions Act of 1994 created a Federal Community Development Financial Institution (CDFI) Fund to provide grants, loans, and technical assistance to qualifying lenders. As part of its comprehensive strategy to increase investment in distressed communities, the Administration proposes to provide $100 million in non-refundable tax credits to the CDFI Fund to be allocated among equity investors in community development banks. The allocation of credits would be determined by the CDFI Fund using a competitive process similar to the one used to allocate grants. The maximum amount of credit allocable to a particular investment would be 25 percent of the amount invested, though a lower percentage could be negotiated. The full credit would be available the year the investment is made. In order to ensure long-term investment, the credit would be recaptured if the investment were sold or redeemed within five years.

Toll statute of limitations for incapacitated taxpayers.—The time limit within which claims for refund must be made would be extended for the period of time a taxpayer was subject to disability, in effect extending the stututory time by the period of disability. "Disability" would be defined to include judicial determinations of incompetency, commitment to mental institutions or hospitals, or other debilitating physical, mental, or psychological conditions that prevent the taxpayer from managing his or her financial affairs. The proposal would be effective for tax years ending after the date of enactment.

Allow Foreign Sales Corporation (FSC) benefits for computer software licenses.—The Administration proposes to extend FSC benefits to licenses of computer software for reproduction abroad. The FSC provisions, which provide a limited exemption from U.S. tax for income arising in certain export transactions, currently are not available for most exports of intangible property, including computer software copyrights. Because FSC benefits are currently available for copyrights to "films, tapes, records, and similar reproductions," the Administration proposes to extend benefits to a category of nearly indistinguishable property.

Extend the income exclusion for employer-provided educational assistance and provide credit for small business.—The Administration proposes to extend the exclusion for employer-provided educational assistance from its expiration in mid-1997 through December 31, 2000. The proposal would also reinstate and extend through December 31, 2000 the expired exclusion for employer-provided graduate education. In addition, for taxable years after December 31, 1997, small businesses would be allowed a ten-percent income tax credit with respect to amounts paid under an employer-provided educational assistance program. The credit would be available to employers with average annual gross receipts of $10 million or less for the prior three years.

Extend for one year the R&E tax credit.—The tax credit provided for certain research and experimentation expenditures, which is scheduled to expire after May 31, 1997, is proposed to be extended for one year through May 31, 1998.

Extend for one year the orphan drug tax credit.—The 50-percent nonrefundable tax credit provided for qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions is proposed to be extended for one year through May 31, 1998.

Extend for one year the work opportunity tax credit.—The work opportunity tax credit, generally equal to 35 percent of up to $6,000 in qualified first-year wages, is proposed to be extended for one year beyond its expiration date of September 30, 1997.

Extend for one year the deduction provided for contributions of appreciated stock to private foundations.—The special rule that allows a taxpayer to deduct the full fair market value of qualified stock donated to a private foundation is proposed to be extended to apply to contributions made during the period June 1, 1997 through May 31, 1998. The current law deduction expires with respect to contributions made after May 31, 1997.

Extend and modify Puerto Rico economic-activity tax credit (Section 30A).—Although the Puerto Rico and possession tax credit generally was repealed in 1996, both the income-based option and the economic-activity option under the credit remain available for existing business operations through 2005, subject to base-period caps. To provide a more efficient and effective tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity credit that was begun in OBRA 93, the Administration proposes to modify the economic-activity credit for Puerto Rico by (1) extending it indefinitely, (2) opening it to newly established business operations, effective for taxable years beginning after December 31, 1997, and (3) removing the base-period cap.

Eliminate Unwarranted Benefits and Adopt Other Revenue Measures

The President's plan cuts unwarranted corporate tax subsidies, closes tax loopholes, improves tax compliance and adopts other revenue measures.

Deny interest deduction on certain debt instruments.—If an instrument qualifies as equity, the issuer generally does not receive a deduction for dividends paid. If an instrument qualifies as debt, the issuer may receive a deduction for accrued interest and the holder generally includes interest in income, subject to certain limitations. The line between debt and equity is uncertain and it has proven difficult to formulate general rules of classification. Taxpayers have exploited this lack of guidance by issuing instruments that have substantial equity features, but for which they claim interest deductions. Effective for instruments issued on or after the date of first committee action, the Administration proposes that no deduction be allowed for interest or original issue discount (OID) on an instrument issued by a corporation that has a maximum term of more than 40 years, or is payable in stock of the issuer or a related party. The proposal also modifies the rules for certain indebtedness that is reflected as equity on the issuer's financial statements.

Defer original issue discount deduction on convertible debt.—If a debt instrument is convertible into stock of the issuer or a related party and provides no payment of, or adjustment for, accrued interest on conversion, no deduction is allowed for accrued but unpaid stated interest. In contrast, the accrued but unpaid discount on a convertible debt instrument with OID generally is deductible, even if the instrument is converted before the issuer pays any OID. The Administration proposal would defer the deduction for all interest, including OID, on convertible debt until payment and would be effective for convertible debt issued on or after the date of first committee action.

Reduce dividends-received deduction to 50 percent and eliminate dividends-received deduction for certain preferred stock.—A corporate holder of stock generally is entitled to a deduction for dividends received on stock in the following amounts: 70 percent if the recipient owns less than 20 percent of the stock of the payor, 80 percent if the recipient owns 20 percent or more of the stock, and 100 percent if the recipient owns 80 percent or more of the stock. The Administration proposes to replace the 70- and 80-percent dividends-received deduction with a 50-percent deduction for dividends on common stock and most preferred stock, effective for dividends paid or accrued more than 30 days after the date of enactment. In addition, the Administration proposes to eliminate the 70- and 80-percent dividends-received deduction for dividends on certain limited-term preferred stock, effective for stock issued after the date of enactment.

Modify holding period for dividends-received deduction.—The dividends-received deduction is allowed to a corporate shareholder only if the shareholder satisfies a 46-day holding period for the dividend-paying stock or a 91-day period for certain dividends on preferred stock. The 46- or 91-day holding period generally does not include any time in which the shareholder is protected from the risk of loss otherwise inherent in the ownership of an equity interest. However, the holding period requirement does not have to be proximate to the time the dividend distribution is made. Effective for dividends paid or accrued more than 30 days after the date of enactment, the Administration proposes that for a dividend to be eligible for the dividends-received deduction, the holding period requirement must be satisfied with respect to that dividend over a period immediately before or immediately after the taxpayer becomes entitled to receive the dividend.

Extend pro rata disallowance of tax-exempt interest expense to all corporations.—No income tax deduction is allowed for interest on debt used directly or indirectly to acquire or hold investments the income on which is tax-exempt. The determination of whether debt is used to acquire or hold tax-exempt investments depends on the holder of the instrument. For financial institutions and dealers in tax-exempt investments, debt generally is treated as financing all of the taxpayer's assets proportionately. For corporations, other than financial institutions and dealers, and for individuals, deductions are disallowed only when indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt investments. These corporations are therefore able to reduce their tax liabilities inappropriately through the double Federal tax benefits of interest expense deductions and tax-exempt interest income. Effective for taxable years beginning after the date of enactment, with respect to obligations acquired on or after the date of first committee action, the Administration proposes that all corporations other than insurance companies be treated the same as financial institutions are treated under current law with regard to deductions for interest on debt used directly or indirectly to acquire or hold tax-exempt obligations. The proposal also would expressly apply these rules to related parties, by treating all members of a consolidated group (other than members that are insurance companies) as a single entity and by tracing debt and tax-exempt holdings among other related parties.

Require average-cost basis for stocks, securities, etc.—A taxpayer who sells stock or other securities is allowed to account for the transaction by specifically identifying the stock or securities or by using an accounting system such as first-in, first-out or last-in, first-out. The Administration proposes to require taxpayers to determine their basis in substantially identical securities using the average of all their holdings in the securities. Holding period would be determined on a first-in, first-out basis. The method of determining basis and holding period would apply to all securities, including stocks, notes, bonds, and derivative financial instruments. The proposal would be effective 30 days after the date of enactment.

Require recognition of gain on certain stocks, indebtedness and partnership interests.—Gain and loss are generally taken into account for tax purposes when realized. Gain or loss is usually realized with respect to a capital asset at the time the asset is sold or exchanged. Many transactions designed to reduce or eliminate risk of loss and opportunity for gain on financial assets generally do not cause realization. For example, taxpayers may lock in gain on securities by entering into a "short sale against the box," that is, the taxpayer owns securities that are the same as or substantially identical to the securities borrowed and sold short. It is inappropriate for taxpayers to be able to dispose of the economic risks and rewards of owning appreciated property without realizing income for tax purposes. Therefore, the Administration proposes to require a taxpayer to recognize gain (but not loss) upon entering into a constructive sale of any appreciated position in stock, a debt instrument, or a partnership interest. A taxpayer would be treated as making a constructive sale of an appreciated position when the taxpayer (or in certain limited circumstances, a person related to the taxpayer) substantially eliminates risk of loss and opportunity for gain by entering into one or more positions with respect to the same or substantially identical property. The proposal would generally be effective for constructive sales entered into after the date of enactment.

Change the treatment of gains and losses on extinguishment.—The tax law distinguishes between the sale of a right or obligation to a third party and the extinguishment or retirement of the right or obligation. A sale to a third party can give rise to capital treatment while an extinguishment is ordinary. Extinguishment treatment has been eliminated for all debt instruments except those issued by natural persons and for most options and other positions in actively traded property. The application of the extinguishment doctrine in other contexts is unclear. The extinguishment doctrine allows taxpayers to control whether gain or loss is capital or ordinary by deciding whether to sell or extinguish a contract. The Administration proposes to eliminate the remaining portions of the extinguishment doctrine so that gain or loss attributable to the cancellation, lapse, expiration, or other termination of any right or obligation with respect to property that is or would be a capital asset in the hands of the taxpayer would be treated as gain or loss from the sale or exchange of a capital asset. In addition, the proposal would repeal the natural person exception for debt instruments. The proposal would be effective 30 days after the date of enactment.

Require reasonable payment assumptions for interest accruals on certain debt instruments.—The original issue discount (OID) rules do not measure income appropriately for certain debt instruments that are prepayable without interest or at reduced interest rates. If the instruments are held in large pools, it can be statistically predicted that a certain portion will prepay. Prepayment assumptions are used to account for certain debt instruments with payments based on mortgages, but the OID rules otherwise ignore these probabilities. The proposal would require taxpayers that hold prepayable debt instruments in large pools to use prepayment assumptions similar to the rules that apply for debt instruments with payments based on mortgages. The proposal would be effective for taxable years beginning after the date of enactment.

Require gain recognition for certain extraordinary dividends.—A corporate shareholder is generally allowed to deduct a percentage of dividends received from another domestic corporation. Certain dividends and dividend equivalent transactions are treated as "extraordinary" dividends. If a corporate shareholder receives an extraordinary dividend, the corporate shareholder must reduce the basis of the stock to which the distribution relates by the amount of the nontaxed portion of the dividend (generally the amount of the dividend that was deducted). If the nontaxed portion of the dividend exceeds the basis of the stock, the excess is deferred and recognized on a later disposition of the stock. If a shareholder's stock is redeemed, the redemption may be treated as a dividend if the shareholder's interest in the corporation has not been meaningfully reduced. In determining if a shareholder's interest has been meaningfully reduced, the ownership of options to purchase stock may be treated as actual stock ownership. The exclusion of a substantial portion of the amount received by a corporate shareholder on the redemption of its stock is inappropriate in certain cases when options are used to create stock ownership. Also, it is inappropriate to defer gain recognition when the portion of the distribution that is excluded due to the dividends received deduction exceeds the basis of the stock with respect to which the extraordinary dividend is received. The Administration proposes that corporate shareholders will recognize gain on redemptions of stock that are treated as dividends because of options when the nontaxed portion of the dividend exceeds the basis of the shares surrendered. In addition, immediate gain recognition would be required whenever the basis of stock with respect to which any extraordinary dividend was received was reduced below zero. The proposed change generally would be effective for distributions after May 3, 1995.

Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands.—Taxpayers are allowed to deduct a reasonable allowance for depletion relating to certain mineral deposits. The depletion deduction for any taxable year is calculated under either the cost depletion method or the percentage depletion method, whichever results in the greater allowance for depletion for the year. The percentage depletion method is viewed as an incentive for mineral production rather than as a normative rule for recovering the taxpayer's investment in the property. This incentive is excessive with respect to minerals mined on Federal and formerly Federal lands under the 1872 mining act, in light of the minimal costs of acquiring the mining rights ($5.00 or less per acre). Effective for taxable years beginning after the date of enactment, the Administration proposes to repeal percentage depletion for non-fuel minerals mined both on Federal lands where the mining rights were originally acquired under the 1872 law, and on private lands acquired under the 1872 law.

Modify loss carryback and carryforward rules.—Net operating losses (NOLs) generally can be used to offset taxable income from the prior three taxable years (carrybacks) and the succeeding 15 taxable years (carryforwards). Because of the increased complexity and administrative burden associated with carrybacks, the carryback period should be shortened. The carryforward period could be lengthened, however, to allow taxpayers more time to utilize their NOLs without increasing either complexity or administrative burdens. The Administration proposes to limit carrybacks of NOLs to one year and to extend carryforwards to 20 years, effective for NOLs arising in taxable years beginning after the date of enactment.

Treat certain preferred stock as "boot."—In reorganization transactions, no gain or loss is recognized except to the extent "other property" (boot) is received; that is, property other than certain stock, including preferred stock. Upon the receipt of "other property," gain but not loss can be recognized. Because preferred stock has an enhanced likelihood of recovery of principal or of maintaining a dividend or both, such tax-free treatment is inappropriate. The Administration therefore proposes to treat certain preferred stock as "other property," subject to certain exceptions. The proposal would be effective for transactions on or after the date of first committee action.

Repeal tax-free conversions of large C corporations to S corporations (Section 1374).—A corporation can avoid the existing two-tier tax by electing to be treated as an S corporation or by converting to a partnership. Converting to a partnership is a taxable event that generally requires the corporation to recognize any built-in gain on its assets and requires the shareholders to recognize any built-in gain on their stock. By contrast, the conversion to an S corporation is generally tax-free, except that the S corporation generally must recognize the built-in gain on assets held at the time of conversion if the assets are sold within ten years. Under the Administration's proposal, the conversion of a C corporation with a value of more than $5 million into an S corporation would be treated as a liquidation of the C corporation followed by a contribution of the assets to an S corporation by the recipient shareholders. Thus, the proposal would require immediate gain recognition by both the corporation (with respect to its appreciated assets) and its shareholders (with respect to their stock). This proposal makes the tax treatment of conversions to an S corporation generally consistent with conversions to a partnership. The proposal would apply to elections that are first effective for a taxable year beginning on or after January 1, 1998 and to acquisitions of a C corporation by an S corporation made after December 31, 1997.

Require gain recognition on certain distributions of controlled corporation stock.—A corporation is generally required to recognize gain on a distribution of property (including stock of a controlled corporation) unless the distribution meets certain requirements. If various requirements are met, including restrictions relating to acquisitions and dispositions of stock of the distributing corporation or the controlled corporation, a distribution of the stock of a controlled corporation will be tax-free to the distributing corporation. Certain distributions may effectively be dispositions of a business, in which case tax-free treatment for the distributing corporation is inappropriate. Accordingly, the Administration proposes to adopt additional restrictions on acquisitions and dispositions of the stock of a distributing corporation or controlled corporation that are related to the distribution. Under this proposal, the distributing corporation would recognize gain on the distribution of the stock of the controlled corporation if the shareholders of the distributing corporation do not retain a sufficient stock interest (generally 50 percent) in the distributing and controlled corporations during the four-year period commencing two years prior to the distribution. For this purpose, unrelated transactions (such as public trading on the stock market) would be disregarded. This proposal would be effective for distributions occurring on or after the date of first committee action.

Reform the treatment of certain stock transfers.—Certain sales of stock to a related corporation are treated as the payment of a dividend by the purchaser. In cases where the seller is a corporation that does not actually own stock in the purchaser, taxpayers may take the position that the transaction produces tax benefits that would be unavailable if the purchaser distributed a dividend to its actual shareholders. For example, if a foreign-controlled domestic corporation sells the stock of a subsidiary to a foreign sister corporation, the domestic corporation may take the position that it is entitled to credit foreign taxes that were paid by the foreign sister corporation. In such cases, the Administration proposes to limit the amount treated as a dividend (and the associated foreign tax credits) from the purchaser to the amount of the purchaser's earnings and profits attributable to stock owned by U.S. persons related to the seller. If the purchaser is a domestic corporation, taxpayers may take the position that stock basis need not be reduced by the nontaxed portion of the dividend. The proposal would also clarify that a deemed dividend from a purchaser that is a domestic corporation should generally be treated as an extraordinary dividend requiring a basis reduction. The proposal would further require gain recognition to the extent that the nontaxed portion exceeds the basis of the shares transferred. The proposal would be effective for transactions on or after the date of first committee action.

Expand Subpart F provisions regarding income from notional principal contracts and stock lending transactions.—Subpart F income includes income from notional principal contracts referenced to foreign currency, commodities, or interest rates, or to indices based thereon. It also includes income with respect to the lending of debt securities. Subpart F income does not include income from equity swaps or other types of notional principal contracts or income from transfers of equities. Subpart F income should include income from all types of notional principal contracts and from stock-lending transactions, because such income is indistinguishable on policy grounds from other types of highly mobile income already targeted by Subpart F. The Administration is proposing to include in Subpart F income the net income from equity swaps and certain categories of notional principal contracts that are not reached by current law, as well as income from stock lending transactions. An ordinary-course-of-business exception would be provided for regular dealers in property, forwards, options, notional principal contracts, and similar financial instruments. The proposal would be effective for taxable years beginning after the date of enactment.

Modify taxation of captive "insurance" companies.—For tax purposes, "insurance" has been defined by the courts to require "risk shifting" or "risk distribution." In the case of a "captive" insurance company, one court has held that risk-shifting and risk-distribution requirements are satisfied even if the captive's "related person insurance income" accounts for nearly 70 percent of its total business. The Administration proposes that an insurance arrangement between a captive insurer and a large shareholder of the captive generally would not be respected as a valid insurance arrangement if more than 50 percent of the captive's net written premiums were attributable to the insurance or reinsurance of large-shareholder risks. In addition, such a captive would not be considered an insurance company for tax purposes. The proposal would be effective for taxable years beginning after the date of enactment.

Modify foreign tax credit carryback and carryforward rules.—The United States permits taxpayers to credit income taxes paid to a foreign government against U.S. tax on foreign source income. Through the foreign tax credit limitations, the Code prevents the use of foreign tax credits to reduce U.S. tax on U.S. source income. Under the foreign tax credit mechanism, current foreign income taxes in excess of the relevant current-year foreign tax credit limitation are not creditable against current U.S. tax liabilities. However, such excess foreign tax credits generally may be carried back for two years and carried forward for five years, and used as a credit to the extent there is excess foreign tax credit limitation (that is, an excess of the foreign tax credit limitation over creditable foreign taxes) in any of those years. Experience over the years has shown, however, that carrybacks are associated with increased complexity and administrative burdens as compared to carryforwards. Therefore, to reduce such complexity and burdens, the proposal would limit foreign tax credit carrybacks to one year and extend foreign tax credit carryforwards to seven years. The proposal would be effective for foreign taxes paid or accrued or deemed paid or accrued in taxable years beginning on or after January 1, 1998.

Replace sales source rules with activity-based rules.—The foreign tax credit generally reduces U.S. tax on foreign source income, but does not reduce U.S. tax on U.S. source income. Where products are manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of such income generally is treated as earned in production activities, and sourced on the basis of the location of assets held or used to produce income from the sale. The remaining 50 percent of the income is treated as earned in sales activities and sourced based on where title to the inventory transfers. Thus, if a U.S. manufacturer sells inventory abroad, half of the income generally is treated as derived from domestic sources, and half of the income generally is treated as derived from foreign sources. However, the taxpayer may use a more favorable method if it can establish to the satisfaction of the IRS that more than half of its economic activity occurred in a foreign country. This 50/50 rule provides a benefit to U.S. exporters that operate in high-tax foreign countries. Thus, U.S. multinational exporters have a competititive advantage over U.S. exporters that conduct all their business activities in the United States. Because export benefits should be targeted equally to all exporters, the proposal reduces the amount of export sales income that such corporations may treat as derived from foreign sources by requiring that the allocation be based on actual economic activity. The proposal would be effective for taxable years beginning after the date of enactment.

Modify rules relating to foreign oil and gas extraction income.—To be eligible for the U.S. foreign tax credit, a foreign levy must be the substantial equivalent of an income tax in the U.S. sense, regardless of the label the foreign government attaches to it. Under regulations, a foreign levy is a tax if it is a compulsory payment under the authority of a foreign government to levy taxes and is not compensation for a specific economic benefit provided by the foreign country. Taxpayers that are subject to a foreign levy and that also receive (directly or indirectly) a specific economic benefit from the levying country are referred to as "dual capacity" taxpayers and may not claim a credit for that portion of the foreign levy paid as compensation for the specific economic benefit received. The proposal would treat as taxes payments by a dual-capacity taxpayer to a foreign country that would otherwise qualify as income taxes or "in lieu of" taxes, only if there is a "generally applicable income tax" in that country. For this purpose, a generally applicable income tax is an income tax (or a series of income taxes) that applies to trade or business income from sources in that country, so long as the levy has substantial application both to non-dual-capacity taxpayers and to persons who are citizens or residents of that country. Where the foreign country does generally impose an income tax, as under present law, credits would be allowed up to the level of taxation that would be imposed under that general tax, so long as the tax satisfies the new statutory definition of a "generally applicable income tax." The proposal would treat foreign oil and gas income as Subpart F income. It also would create a new foreign tax credit basket within Section 904 for foreign oil and gas income. The proposal would be effective for taxable years beginning after the date of enactment. The proposal would yield to U.S. treaty obligations that allow a credit for taxes paid or accrued on certain oil or gas income.

Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting.—Under the Revenue Act of 1987, family farm corporations were required to change to the accrual method of accounting if their gross receipts exceeded $25 million in any taxable year beginning after 1985. However, in lieu of including in gross income the entire amount of the adjustment attributable to the change in accounting method, a family farm corporation could establish a suspense account. The amount of the suspense account was to be included in gross income if the corporation ceased to be a family corporation or to the extent the gross receipts of the corporation from farming declined. To eliminate the potential indefinite deferral of the adjustment, the Administration proposes to repeal the ability of family farm corporations to establish such suspense accounts. Any taxpayer subsequently required to change to the accrual method of accounting would be required to take the adjustment into account generally over a ten-year period. Any existing suspense accounts would be restored to income ratably over a ten-year period, or sooner to the extent provided under existing law. This provision would be effective for taxable years beginning after September 13, 1995.

Repeal lower of cost or market inventory accounting method.—Taxpayers required to maintain inventories are permitted to use a variety of methods to determine the cost of their ending inventories, including the last-in, first-out (LIFO) method, the first-in, first-out (FIFO) method, and the retail method. Taxpayers not using a LIFO method may determine the carrying values of their inventories by applying the lower of cost or market (LCM) method and by writing down the cost of goods that are unsalable at normal prices or unusable in the normal way because of damage, imperfection or other causes (subnormal goods method). The allowance of write-downs under the LCM and subnormal goods methods is essentially a one-way mark-to-market method that understates taxable income. The Administration proposes to repeal the LCM and subnormal goods methods, effective for taxable years beginning after the date of enactment.

Repeal components of cost inventory accounting method.—Taxpayers that use the LIFO method to determine the cost of their ending inventories may use a variety of dollar-value methods, including double extension, link-chain and other index methods, in order to determine whether an increment has occurred and the cost of that increment. Certain taxpayers are permitted to use simplified LIFO methods based on externally developed price indexes. Some taxpayers that use a dollar-value, double-extension method make their computations with respect to the three components of cost (materials, labor and overhead) of their finished goods and work-in-process inventories (the COC method), rather than the aggregate cost of these goods (the total product cost method). The COC method, in many cases, does not adequately account for technological efficiencies in which skilled labor is substituted for less-skilled labor or where overhead costs replace direct labor costs. The Administration is proposing to repeal the COC method effective for taxable years beginning after the date of enactment.

Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party.—Gain realized by taxpayers from certain involuntary conversions is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified period of time. C corporations (and partnerships with one or more corporate partners that own more than 50 percent of the capital or profits interest in the partnership) generally are not entitled to defer gain if the replacement property is purchased from a related person. The Administration proposes to extend this rule to any other taxpayer, including an individual, that acquires replacement property from a related person, unless the taxpayer has an aggregate realized gain of $100,000 or less during the year as a result of involuntary conversions. In the case of a partnership or S corporation, the $100,000 annual limitation would apply to the entity and each partner or shareholder. The proposal would generally be effective for involuntary conversions occurring after September 13, 1995.

Place further restrictions on like-kind exchanges involving personal property.—An exchange of property, like a sale, is generally a taxable transaction. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like kind that is to be held for productive use in a trade or business or for investment. In general, any kind of real estate is treated as of a like kind with other real property; however real property located in the United States and real property located outside the United States are not of a like kind. For personal property, property of a "like class" is treated as being of a like kind; no restrictions apply with regard to location in or outside the United States. To conform the limitations on exchanges of personal property to the limitations on exchanges of real property, the Administration proposes that effective for exchanges on or after the date of first committee action, personal property located in the United States and personal property located outside the United States would not be treated as like kind.

Require registration of certain confidential corporate tax shelters.—Many corporate tax shelters are not registered with the Internal Revenue Service (IRS). Requiring registration of corporate tax shelters would allow the IRS to make better informed judgments regarding the audit of corporate tax returns and to monitor whether legislation or administrative action is necessary regarding the type of transactions being registered. The Administration is therefore proposing the registration of any investment, plan, arrangement or transaction: (1) a significant purpose of the structure of which is tax avoidance or evasion by a corporate participant, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoter may receive total fees in excess of $100,000. The proposal would be effective for any tax shelter offered to potential participants after the date the Secretary of the Treasury prescribes guidance regarding the filing requirements.

Require reporting of payments to corporations rendering services to Federal agencies.—All persons engaged in a trade or business and making payments of $600 or more to another person in remuneration for services generally must report those payments to the IRS and to the recipient. No reporting is required if the recipient is a corporation, permitting significant amounts of income to escape the tax system. To ensure that corporations that do business with the Federal Government appropriately report as income their payments from the Federal Government, the Administration proposes to require executive agencies to report payments of $600 or more made to corporations for services rendered. The proposal would be effective for returns the due date of which is more than 90 days after the date of enactment.

Increase penalties for failure to file correct information returns.—Any person who fails to file required information returns in a timely manner or incorrectly reports such information is subject to penalties. For taxpayers filing large volumes of information returns or reporting significant payments, existing penalties ($15 per return, not to exceed $75,000 if corrected within 30 days; $30 per return, not to exceed $150,000 if corrected by August 1; and $50 per return, not to exceed $250,000 if not corrected at all) may not be sufficient to encourage timely and accurate reporting. The Administration proposes to increase the general penalty amount, subject to the overall dollar limitations, to the greater of $50 per return or 5 percent of the total amount required to be reported. The increased penalty would not apply if the aggregate amount actually reported by the taxpayer on all returns filed for that calendar year was at least 97 percent of the amount required to be reported. The increased penalty would be effective for returns the due date for which is more than 90 days after the date of enactment.

Tighten the substantial understatement penalty for large corporations.—Currently taxpayers may be penalized for erroneous, but non-negligent, return positions if the amount of the understatement is "substantial" and the taxpayer did not disclose the position in a statement with the return. "Substantial" is defined as ten percent of the taxpayer's total current tax liability, but this can be a very large amount. This has led some large corporations to take aggressive reporting positions where huge amounts of potential tax liability are at stake—in effect playng the audit lottery—without any downside risk of penalties if they are caught, because the potential tax still would not exceed ten percent of the company's total tax liability. To discourage such aggressive tax planning, the proposal considers any deficiency greater than $10 million to be "substantial" for purposes of the substantial understatement penalty, whether or not it exceeds ten percent of the taxpayer's liability. The proposal, which would be effective for taxable years beginning after the date of enactment, affects only taxpayers that have tax liabilities greater than or equal to $100 million.

Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000.—Proceeds of most wagers with odds of less than 300 to 1 are exempt from withholding, as are all bingo and keno winnings. The proposal would impose withholding on proceeds of bingo or keno in excess of $5,000 at a rate of 28 percent, regardless of the odds of the wager, effective for payments made after the date of enactment.

Require tax reporting for payments to attorneys.—Tax information reporting is required for persons engaged in a trade or business making payments of rent, salaries, wages, or other fixed or determinable income in the course of the trade or business. Treasury regulations require a payor to report payments of attorney's fees if the payments are made in the course of a trade or business, although generally a payor is not required to report payments made to corporations. If a payment to an attorney is a gross amount, and it cannot be determined what portion is the attorney's fee (as in the case of lump-sum judgments or settlements made jointly payable to a lawyer and a plaintiff), then no reporting is required. The Administration proposes requiring that any person making a payment in the course of a trade or business to a lawyer or a law firm, whether as sole or joint payee, report the payment to the IRS. When the portion that constitutes fees cannot be determined, the amount paid would be reported as gross proceeds. A lawyer receiving a payment would be required to provide his or her taxpayer identification number to the payor or be subject to backup withholding and applicable penalties. The exception for payments to corporations would not apply to payments of attorney's fees. The proposal would be effective for payments made after December 31, 1997.

Extend oil spill excise tax.—Before January 1, 1995, a five-cents-per-barrel excise tax was imposed on domestic crude oil and imported oil and petroleum products. The tax was dedicated to the Oil Spill Liability Trust Fund to finance the cleanup of oil spills and was not imposed for a calendar quarter if the unobligated balance in the Trust Fund exceeded $1 billion at the close of the preceding quarter. The Administration proposes to reinstate this tax for the period after the date of enactment and before October 1, 2007. The tax would be suspended for a given calendar quarter if the unobligated Trust Fund balance at the end of the preceding quarter exceeded $2.5 billion.

Impose excise taxes on kerosene as diesel fuel.—A 24.3-cents-per-gallon excise tax is imposed on diesel fuel upon removal from a registered terminal facility unless the fuel is indelibly dyed and is destined for a nontaxable use. Treasury regulations provide that kerosene is not treated as a diesel fuel for this purpose; thus, undyed kerosene is not subject to the diesel fuel excise tax when it is removed from a terminal. Undyed kerosene is subject to tax, however, when it is blended with previously taxed diesel fuel. Some producers of this blended fuel may not be paying the tax, thereby placing complying taxpayers at a competitive disadvantage and resulting in revenue losses to the Federal government. Effective July 1, 1998, the Administration proposes to tax kerosene as diesel fuel when it is removed from a terminal. Exceptions would be provided for aviation fuel and, to the extent provided in regulations, for feedstock uses. In addition, special refund rules would apply in certain cases of kerosene used for heating purposes.

Limit extension of tax credit for producing fuel from a nonconventional source.—The Small Business Job Protection Act extended the $3 per barrel synthetic fuels tax credit to apply to synthetic fuels from coal and gas from biomass sold before January 1, 2008, if produced from facilities placed in service before July 1, 1998, pursuant to a binding contract entered into before January 1, 1997. The prior law placed in service and binding contract dates had been January 1, 1997 and January 1, 1996, respectively. The Administration proposes to modify the extension of the placed-in-service date by moving it to July 1, 1997; the binding contract date would not be modified.

Extend and modify Federal Unemployment Act (FUTA) provisions.—The temporary unemployment surtax of 0.2 percent imposed on employers, which is scheduled to expire with respect to wages paid after December 31, 1998, is proposed to be extended through December 31, 2007. Beginning in 2002, the Administration proposes to require an employer to pay Federal and State unemployment taxes monthly (instead of quarterly) in a given year, if the employer's FUTA tax liability in the immediately prior year was $1,100 or more.

Other Provisions That Affect Receipts

Extend environmental tax on corporate taxable income deposited in the Hazardous Substance

Superfund Trust Fund.—A tax equal to 0.12 percent of alternative minimum taxable income (with certain modifications) in excess of $2 million is levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. The Administration proposes to reinstate this tax, which expired on December 31, 1995, for taxable years beginning after December 31, 1996 and before January 1, 2008.

Extend excise taxes deposited in the Hazardous Substance Superfund Trust Fund.—The excise taxes that are levied on petroleum, chemicals, and imported substances and deposited in the Hazardous Substance Superfund Trust Fund, are proposed to be reinstated for the period after the date of enactment and before October 1, 2007. These taxes expired on December 31, 1995.

Extend excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—The excise taxes that are levied on gasoline, other motor fuels, methanol and ethanol fuels, aviation fuel, and on fuels used in inland waterways and deposited in the LUST Trust Fund, expired on December 31, 1995. The Administration proposes to reinstate these taxes for the period after the date of enactment and before October 1, 2007.

Extend excise taxes deposited in the Airport and Airway Trust Fund/assess fees for Federal Aviation Administration (FAA) services.—The excise taxes that are levied on domestic air passenger tickets, international departures, domestic air cargo and non-commercial aviation fuels and deposited in the Airport and Airway Trust Fund, are proposed to be reinstated for the period April 1, 1997 through September 30, 2007. These taxes expired on December 31, 1996. The Administration will propose legislation to completely replace these taxes, effective October 1, 1998, with cost-based user fees, as part of the Administration's effort to create a more business-like Federal Aviation Administration.

Extend the Generalized System of Preferences (GSP) and modify other trade provisions.—Under GSP duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. The Administration proposes to extend the program, which expires May 31, 1997. The Administration also proposes to provide expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria to prepare for a future free trade agreement with the U.S. The program is proposed to expire on September 30, 2005. The Administration also proposes to implement the OECD Shipbuilding Agreement.

Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect).—The Administration proposes to require the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to assess fees for examination of FDIC-insured banks and bank holding companies. The Federal Reserve currently funds the costs of such examinations from earnings; therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, will increase by the amount of the fees.

Modify method of reimbursing Federal Reserve Banks.—Beginning in fiscal year 1998 and thereafter, the Administration proposes to appropriate such sums as may be necessary to reimburse Federal Reserve Banks in their capacity as depositaries and fiscal agents for the United States for all services required or directed by the Secretary of the Treasury to be performed by such banks on behalf of the Treasury or other fiscal agencies. These payments to the Federal Reserve Banks would be deficit neutral because they would result in corresponding increases in deposits of earnings by the Federal Reserve.

Establish IRS continuous levy.—The Administration seeks to strengthen the enforcement tools available to the IRS to recover delinquent tax debt. New authority is proposed for the IRS to effect a continuous levy on non-means tested Federal payments, such as Federal salaries and pensions, received by individuals who owe delinquent tax debt.

Assess fees for National Transportation Safety Board (NTSB) aviation accident investigation activities.—Beginning in 1998, the Administration proposes to charge a fee on commercial air carrier operations to offset a portion of the NTSB's growing cost of commercial aviation accident investigations.

Establish alien labor certification fee.—To protect U.S. workers, the Employment and Training Administration of the Department of Labor administers the Alien Labor Certification program. This program determines the admissibility of aliens to work in the United States. Consistent with a recommendation by the National Performance Review, the Administration proposes to charge employers who benefit from the program a fee for alien labor certification services.

Exempt Federal vaccine purchases from the payment of the vaccine excise tax.—The Administration proposes to exempt vaccine purchases paid through grants from the Centers for Disease Control and Prevention and the Health Care Financing Administration from payment of the vaccine excise tax. The proposal is effective for purchases after September 30, 1997 and before September 30, 1998.

Extend and increase Food and Drug Administration (FDA) user fees.—To finance FDA activities, the Administration proposes to reauthorize the Prescription Drug User Fee Act (PDUFA) of 1992 and the Mammography Quality Standards Act (MQSA), which are currently authorized through fiscal year 1997. PDUFA authorizes the collection of fees paid by the pharmaceutical industry to expedite FDA's review of human drug applications and MQSA authorizes the collection of fees for the inspection of mammography facilities. Along with the continued collection of these fees, the Administration proposes new fees effective October 1, 1997 for medical device reviews, animal drug approvals, import inspections, food additive petition reviews, generic/over-the-counter drug applications, and the postmarket surveillance of products.

Initiate Health Care Financing Administration (HCFA) Medicare survey and certification fee.—In order to participate in the Medicare program (or the Medicaid program for dually-participating providers), providers must demonstrate that they comply with Federal health and safety standards. Program certification allows them to provide services to Medicare and Medicaid beneficiaries. Beginning in fiscal year 1998, the Administration would require State survey agencies to impose fees on health care providers for initial surveys required as a condition of participation in the Medicare program. The proposal would allow State survey agencies to collect and retain fees from health care providers to cover the cost of conducting initial surveys.

Increase employee contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS).—The Administration proposes to increase employee contributions to CSRS and FERS by 0.5 percent of base pay in three steps. Contributions would increase by 0.25 percent of base pay on January 1, 1999, another 0.15 percent on January 1, 2000 and a final 0.10 percent on January 1, 2001. These higher contribution rates would be effective through 2002; on January 1, 2003, contribution rates would return to the levels in effect on December 31, 1998.

Modify Federal pay raise (receipt effect).—The Administration is proposing a pay raise of 2.8 percent for 1998, less than the raise that would take effect under normal operation of the law. This raise would cover both the national schedule and the locality pay adjustments. The lower proposed pay raise affects Federal employees' contributions to CSRS and FERS.

Tax Simplification and Taxpayers' Rights

The Administration continues to support revenue-neutral initiatives designed to promote sensible and equitable administration of the tax laws. These include simplification, technical corrections, and taxpayer compliance measures. The Administration will propose to Congress in the near future a package of measures to simplify the tax laws and enhance taxpayers' rights. In addition to legislative initiatives, the Administration is committed to taking appropriate administrative action to simplify tax laws and enhance procedural safeguards for taxpayers.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In billions of dollars)

	Estimate						
	1997	1998	1999	2000	2001	2002	1998–2002
Provide tax relief and extend expiring provisions:							
Middle Class Bill of Rights:							
Provide tax credit for dependent children	–0.7	–9.9	–6.8	–8.6	–10.4	–10.4	–46.0
Expand Individual Retirement Accounts (IRAs)	....	–1.5	–0.5	–0.8	–1.2	–1.7	–5.5
Provide tax incentive for education and training	–0.1	–4.0	–6.2	–7.8	–8.6	–9.4	–36.1
Subtotal, Middle Class Bill of Rights	–0.8	–15.4	–13.5	–17.2	–20.2	–21.4	–87.6
Provide targeted welfare-to-work tax credit	....	–0.1	–0.1	–0.2	–0.1	–0.1	–0.6
Provide capital gains exclusion on sale of principal residence	–0.1	–0.3	–0.3	–0.3	–0.3	–0.2	–1.4
Establish DC tax incentive program	....	–*	–*	–0.1	–0.1	–0.1	–0.3
Provide estate tax relief for small business	....	–*	–0.2	–0.2	–0.2	–0.2	–0.7
Provide tax incentives for distressed areas	–*	–0.4	–0.5	–0.5	–0.5	–0.4	–2.3
Provide tax credit for investment in community development financial institutions (CDFI)	....	–*	–*	–*	–*	–*	–*
Toll statute of limitations for incapacitated taxpayers	....	....	....	....	–*	–*	–0.1
Allow Foreign Sales Corporation (FSC) benefits for computer software licenses	–*	–0.1	–0.1	–0.1	–0.1	–0.1	–0.6
Extend exclusion for employer-provided educational assistance	–0.1	–0.6	–0.7	–0.8	–0.2	....	–2.3
Extend R&E tax credit	–0.4	–0.8	–0.5	–0.2	–0.1	–*	–1.7
Extend orphan drug tax credit	–*	–*	–*	–*	–*	–*	–*
Extend work opportunity tax credit	....	–0.1	–0.2	–0.1	–*	–*	–0.4
Extend deduction for contributions of appreciated stock	....	–*	–*	....	....	....	–0.1
Extend and modify Puerto Rico economic-activity tax credit	....	–*	–0.1	–0.1	–0.1	–0.1	–0.4
Subtotal, Provide tax relief and extend expiring provisions	–1.4	–17.9	–16.2	–19.6	–21.9	–22.8	–98.4
Eliminate unwarranted benefits and adopt other revenue measures:							
Deny interest deduction on certain debt instruments	*	0.1	0.1	0.2	0.2	0.3	0.8
Defer original issue discount deduction on convertible debt	....	*	*	*	*	0.1	0.2

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In billions of dollars)

	Estimate						
	1997	1998	1999	2000	2001	2002	1998–2002
Limit dividends-received deduction (DRD):							
Reduce DRD to 50 percent	....	0.3	0.3	0.4	0.4	0.4	1.7
Eliminate DRD for certain stock	....	*	*	*	*	0.1	0.2
Modify holding period for DRD	....	*	*	*	*	*	0.1
Interaction	....	–*	–*	–*	–*	–*	–*
Extend pro-rata disallowance of tax-exempt interest expense to all corporations	....	*	*	*	0.1	0.1	0.2
Require average-cost basis for stocks, securities, etc.	....	0.6	0.6	0.6	0.6	0.6	3.0
Require recognition of gain on certain stocks, indebtedness and partnership interests	....	*	0.1	0.1	0.1	0.1	0.3
Change the treatment of gains and losses on extinguishment	....	*	*	*	*	*	*
Require reasonable payment assumptions for interest accruals on certain debt instruments	....	0.1	0.2	0.3	0.3	0.2	1.1
Require gain recognition for certain extraordinary dividends	0.4	0.6	*	*	*	*	0.6
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	*	0.1	0.1	0.1	0.1	0.1	0.5
Modify loss carryback and carryforward rules	*	0.1	0.6	0.8	0.7	0.6	2.9
Treat certain preferred stock as ‘‘boot’’	*	0.1	0.2	0.2	0.2	0.1	0.8
Repeal tax-free conversions of large C corporations to S corporations	....	*	*	*	*	*	0.1
Require gain recognition in certain distributions of controlled corporation stock	*	0.1	0.1	0.1	0.1	0.1	0.3
Reform treatment of certain stock transfers	*	0.1	0.1	0.1	0.1	0.2	0.7
Expand Subpart F provisions regarding certain income	....	*	*	*	*	*	0.2
Modify taxation of captive ‘‘insurance’’ companies	....	*	*	*	*	*	0.1
Modify foreign tax credit carryback and carryforward rules	....	*	0.3	0.3	0.3	0.3	1.2
Replace sales source rules with activity-based rules	....	0.9	1.5	1.6	1.8	1.9	7.5
Modify rules relating to foreign oil and gas extraction income	....	*	0.1	0.1	0.1	0.1	0.4
Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting	*	0.1	0.1	0.1	0.1	0.1	0.6
Initiate inventory reform:							
Repeal lower of cost or market method	*	0.2	0.4	0.4	0.4	0.2	1.5
Repeal components of cost method	*	0.1	0.2	0.2	0.2	0.2	0.9
Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party	....	*	*	*	*	*	*
Place further restrictions on like-kind exchanges involving personal property	*	*	*	*	*	*	0.1
Require registration of certain corporate tax shelters	....	*	*	*	*	*	*
Require reporting of payments to corporations rendering services to Federal agencies	....	*	*	*	*	0.1	0.2
Increase penalties for failure to file correct information returns	....	*	*	*	*	*	0.1
Tighten substantial understatement penalty for large corporations	....	*	*	*	*	*	0.2
Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000	*	*	*	*	*	*	*
Require tax reporting for payments to attorneys	....	....	*	*	*	*	*
Extend oil spill excise tax [1]	*	0.2	0.2	0.2	0.2	0.2	1.1
Impose excise taxes on kerosene as diesel fuel [1]	*	*	*	*	*	*	0.2
Limit extension of tax credit for producing fuel from a nonconventional source	*	0.1	0.1	0.1	0.1	0.1	0.5
Extend and modify FUTA provisions:							
Extend FUTA surtax [1]	....	....	0.9	1.2	1.3	1.3	4.7
Accelerate deposit of unemployment insurance taxes	....	....	....	....	....	1.3	1.3
Subtotal, Eliminate unwarranted benefits	0.6	4.1	6.3	7.3	7.6	8.9	34.3
Other provisions that affect receipts:							
Extend corporate environmental tax [2]	....	1.1	0.7	0.8	0.8	0.8	4.2
Extend Superfund excise taxes [1]	0.1	0.7	0.7	0.7	0.7	0.7	3.4
Extend LUST excise taxes [1]	*	0.1	0.1	0.1	0.1	0.1	0.6
Extend aviation excise taxes/new user fees [1, 3]	2.3	5.0	6.7	6.6	6.8	7.0	32.2
Extend GSP and modify other trade provisions [1]	....	–0.7	–0.5	–0.6	–0.7	–0.8	–3.3
Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect) [1]	....	0.1	0.1	0.1	0.1	0.1	0.4
Modify method of reimbursing Federal Reserve Banks (receipt effect)	....	0.1	0.1	0.1	0.1	0.1	0.6
Establish IRS continuous levy	....	0.4	0.4	0.4	0.3	0.2	1.6
Assess fees for NTSB aviation accident investigation activities [1]	....	*	*	*	*	*	*
Establish alien labor certification fee [1]	....	*	*	*	*	*	0.2
Exempt Federal vaccine purchases from the payment of vaccine excise taxes [1]	....	–0.1	....	....	....	....	–0.1
Extend and increase FDA user fees [1]	....	0.2	0.2	0.2	0.2	0.2	1.0
Initiate HCFA Medicare survey and certification fee [1]	....	*	*	*	*	*	*
Increase employee contributions to CSRS and FERS	....	....	0.2	0.4	0.6	0.6	1.8
Modify Federal pay raise (receipt effect)	....	–0.2	–0.2	–0.2	–0.2	–0.2	–1.0
Subtotal, Other	2.4	6.8	8.5	8.6	8.8	9.0	41.7
Subtotal, Eliminate unwarranted benefits and other provisions that affect receipts	3.0	10.9	14.9	15.9	16.4	17.9	76.0

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In billions of dollars)

	Estimate						
	1997	1998	1999	2000	2001	2002	1998–2002
Total effect of proposals [1]	**1.6**	**–7.0**	**–1.4**	**–3.7**	**–5.5**	**–4.9**	**–22.4**

* $50 million or less.
[1] Net of income offsets.
[2] Net of deductibility for income tax purposes.
[3] The aviation excise taxes are proposed to be reinstated effective April 1, 1997. In addition, the Administration proposes that aviation excise taxes be repealed effective October 1, 1998 and replaced with cost-based user fees.

Table 3–4. RECEIPTS BY SOURCE
(In millions of dollars)

Source	1996 actual	1997 estimate	1998 estimate
Individual income taxes (federal funds):			
Existing law	656,417	674,342	708,356
Proposal (PAYGO)		−1,659	−17,178
Proposal (non-PAYGO)			21
Total individual income taxes	**656,417**	**672,683**	**691,199**
Corporation income taxes:			
Federal funds:			
Existing law	171,501	176,196	187,009
Proposal (PAYGO)		−1	1,280
Proposal (non-PAYGO)			4
Total Federal funds corporation income taxes	171,501	176,195	188,293
Trust funds:			
Hazardous substance superfund	323	4	
Proposal (PAYGO)			1,369
Total corporation income taxes	**171,824**	**176,199**	**189,662**
Social insurance taxes and contributions (trust funds):			
Employment taxes and contributions:			
Old-age and survivors insurance (Off-budget)	311,869	334,139	349,435
Disability insurance (Off-budget)	55,623	54,764	55,509
Hospital insurance	104,997	109,180	114,167
Railroad retirement:			
Social Security equivalent account	1,510	1,496	1,486
Rail pension and supplemental annuity	2,362	2,384	2,375
Total employment taxes and contributions	476,361	501,963	522,972
On-budget	108,869	113,060	118,028
Off-budget	367,492	388,903	404,944
Unemployment insurance:			
State taxes deposited in Treasury [1]	22,706	23,517	24,496
Federal unemployment tax receipts [1]	5,854	5,920	5,976
Railroad unemployment tax receipts [1]	24	28	67
Total unemployment insurance	28,584	29,465	30,539
Other retirement contributions:			
Federal employees' retirement—employee contributions	4,389	4,266	4,370
Proposal (non-PAYGO)			−164
Contributions for non-Federal employees [2]	80	72	66
Total other retirement contributions	4,469	4,338	4,272
Total social insurance taxes and contributions	**509,414**	**535,766**	**557,783**
On-budget	141,922	146,863	152,839
Off-budget	367,492	388,903	404,944
Excise taxes:			
Federal funds:			
Alcohol taxes	7,220	7,171	7,119
Tobacco taxes	5,795	5,694	5,661
Transportation fuels tax	7,468	7,669	7,835
Telephone and teletype services	4,234	4,485	4,746
Ozone depleting chemicals and products	320	113	47
Other Federal fund excise taxes	410	1,363	1,341
Proposal (PAYGO)		−327	952
Proposal (non-PAYGO)			−24
Total Federal fund excise taxes	25,447	26,168	27,677
Trust funds:			
Highway	24,651	24,880	25,332
Proposal (PAYGO)		2	−617
Airport and airway	2,369	1,439	
Proposal (PAYGO)		3,384	6,391
Aquatic resources	315	324	331
Black lung disability insurance	614	604	613
Inland waterway	108	117	121
Hazardous substance superfund	313		
Proposal (PAYGO)		147	881
Oil spill liability	34		
Proposal (PAYGO)		34	296
Vaccine injury compensation	115	125	125
Proposal (non-PAYGO)			−73
Leaking underground storage tank	48		
Proposal (PAYGO)		23	162
Total trust funds excise taxes	28,567	31,079	33,562
Total excise taxes	**54,014**	**57,247**	**61,239**
Estate and gift taxes:			
Existing law	17,189	17,588	18,818
Proposal (PAYGO)			−1
Total estate and gift taxes	**17,189**	**17,588**	**18,817**
Customs duties:			
Federal funds	17,910	16,545	18,271
Proposal (PAYGO)			−799
Trust funds	760	783	835
Total customs duties	**18,670**	**17,328**	**18,307**
MISCELLANEOUS RECEIPTS: [3]			
Miscellaneous taxes	110	123	127
United Mine Workers of America combined benefit fund	304	311	280
Deposit of earnings, Federal Reserve System	20,477	23,184	22,788
Proposal (PAYGO)			96
Proposal (non-PAYGO)			122
Fees for permits and regulatory and judicial services	2,896	3,456	4,533
Proposal (PAYGO)			278
Fines, penalties, and forfeitures	1,744	1,412	1,435
Gifts and contributions	122	139	187
Refunds and recoveries	−119	−11	−11
Total miscellaneous receipts	**25,534**	**28,614**	**29,835**
Total budget receipts	**1,453,062**	**1,505,425**	**1,566,842**
On-budget	1,085,570	1,116,522	1,161,898
Off-budget	367,492	388,903	404,944
MEMORANDUM			
Federal funds	916,802	938,126	973,677
Trust funds	353,105	366,155	396,764
Interfund transactions	−184,337	−187,759	−208,543
Total on-budget	**1,085,570**	**1,116,522**	**1,161,898**
Off-budget (trust funds)	**367,492**	**388,903**	**404,944**

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1996 actual	1997 estimate	1998 estimate
Total	**1,453,062**	**1,505,425**	**1,566,842**

[1] Deposits by States are State payroll taxes that cover benefit part of the program. Federal unemployment tax receipts cover administrative costs at both the Federal and State level. Railroad unemployment tax receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are 1996: $557 million; 1997: $663 million; and 1998: $687 million.