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REVENUE RECONCILIATION ACT OF 1990

(H.R. 5835) PUB. L. 101-___, ____ STAT. ____ (1990)
(EFFECTIVE NOVEMBER 5, 1990)

— by **Neil E. Harl***

1. Individual income tax rates. The legislation imposes a 31 percent marginal tax rate above the 15 and 28 percent marginal tax rate brackets. The phase-outs of the benefits from the 15 percent rate and the personal exemption amounts (creating the so-called "bubble") are repealed. The new 31 percent rate begins at the same level of taxable income as the phase-out range of prior law.

Rate	Married filing jointly	Head of household	Unmarried individual	Married filing separately
15	0– 32,450	0 – 26,050	0 – 19,450	0 – 16,225
28	Over 32,450 and not more than 78,400	Over 26,050 but not more than 67,200	Over 19,450 but not over 47,050	Over 16,225 but not over 39,200
31	Over 78,400	Over 67,200	Over 47,050	Over 39,200

The above bracketsa have not been indexed for inflation for 1991. **RRA 1990, Sec. 11101, amending I.R.C. § 1(a),(d).**

2. Trust and estate tax rates. Estates and trusts are subject to the same three marginal tax rates with a repeal, also, of the phaseout of benefits from the 15 percent rate and the personal exemption amounts. The relevant brackets are as follows before the inflation adjustment for 1991—

Rate	Brackets
15	Not over 3,300
28	Over 3,300 but not over 9,900
31	Over 9,900

RRA 1990, Sec. 11101(a), amending I.R.C. § 1(e).

The conference report states that modification of the rates for trusts and estates was necessary to prevent the incentive to create multiple trusts.

3. Long term capital gains rate. Net long term capital gains for individuals are taxed at a maximum marginal tax rate of 28 percent. The calculation of income subject to long term capital gains treatment and the netting procedure are all drawn from pre-1987 law. **RRA 1990, Sec. 11101(c), amending I.R.C. § 1(j).**

The above provisions (1 through 3) are all effective for taxable years beginning after December 31, 1990. **RRA 1990, Sec. 11101(e)**.

4. Alternative minimum tax rate. The individual alternative minimum tax rate is increased from 21 percent to 24 percent. The rate has been set at 75 percent of the maximum regular marginal tax rate of 28 percent. The 24 percent rate is at 77.4 percent of the 31 percent rate, a slight increase over prior law.

The AMT is payable to the extent it exceeds the taxpayer's regular income tax liability. **RRA 1990, Sec. 11102(a), amending I.R.C. § 55(b)(1)(A)**.

The change is effective for taxable years beginning after December 31, 1990. **RRA 1990, Sec. 11102(b)**.

No change is made in the 20 percent alternative minimum tax rate for corporations. I.R.C. § 55(b)(1)(A).

5. General limitation on itemized deductions. The allowable itemized deductions (other than medical expenses) and other expenses deductible under I.R.C. § 213, casualty and theft losses and investment interest are reduced by an amount equal to three percent of the amount a taxpayer's adjusted gross income exceeds $100,000. The threshold amount is $50,000 in the case of a married taxpayer filing a separate return. In no event, however, are total otherwise allowable deductions (other than for medical expenses, casualty and theft losses and investment interest) reduced by more than 80 percent.

For taxable years beginning after 1991, the $50,000 and $100,000 threshold amounts will be adjusted for inflation. This provision is applied after the application of any other limitation on the allowance of any itemized deduction.

This limitation does not apply to estates and trusts.

The limitation on itemized deductions does not apply for purposes of alternative minimum tax calculations.

The provision is effective for taxable years beginning after December 31, 1990; however, the legislation does not apply to any taxable year beginning after December 31, 1995. **RRA 1990, Secs. 11103(a), 11103(e)**.

Note: By statutory reference, the new statute refers to casualty and wagering losses, not casualty and theft losses although the Conference report refers to the latter.

6. Contributions of appreciated tangible personal property. In recent years, the amount of appreciation with respect to a charitable contribution of capital gain property has been treated as a tax preference item

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for purposes of the alternative minimum tax computation. The provision has been repealed with respect to some items of tangible personal property but only for taxable years beginning in 1991. The former rule continues to apply to other property contributions and to even tangible personal property contributions in taxable years beginning after 1991.

The change, as noted, applies only to tangible personal property and, further, does not apply to inventory property, other ordinary income property or short-term capital gain property. **RRA 1990, Sec. 11344, amending I.R.C. § 57(a)(6)(B)**.

7. Unnecessary cosmetic surgery.

Expenses paid. Expenses paid for cosmetic surgery or other procedures that are similar are not deductible medical expenses unless the surgery or other procedure is necessary to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma or disfiguring disease. Cosmetic surgery, for this purpose, is defined as any procedure directed at improving the patient's appearance and does not meaningfully promote the proper functioning of the body or prevent or treat illness or disease. **RRA 1990, Sec. 11342(a), amending I.R.C. § 213(d)**.

The amendment is effective for taxable years beginning after December 31, 1990. **RRA 1990, Sec. 11342(b)**.

The Conference report states that amounts paid for insurance are not deductible and reimbursement for such expenses is not excludable from an individual's gross income under an employee health plan. **Conf. Rep. ____, 101st Cong., 2d Sess. 1990**.

8. Earned income tax credit. The legislation increases the amount of the earned income tax credit, adjusts the credit for family size and modifies the phase-out percentage as shown in the following table—

	Credit percentage	Phase-out percentage
For 1991 —		
1 qualifying child	16.7	11.93
2 or more qualifying children	17.3	12.36
For 1992 —		
1 qualifying child	17.6	12.57
2 or more qualifying children	18.4	13.14
For 1993 —		
1 qualifying child	18.5	13.21
2 or more qualifying children	19.5	13.93
For 1994 and later years —		
1 qualifying child	23	16.43
2 or more qualifying children	25	17.86

The amount of the credit that may be received on an advanced basis is limited to the credit that the taxpayer could receive if the taxpayer had only one qualifying child.

For a taxpayer with a qualifying child who has not reached age 1 as of the close of the calendar year in which or with which the taxpayer's taxable year ends, the credit percentage is increased by 3.57 percentage points as explained in item (1). If the taxpayer elects to take a child into account under this special rule for those under age 1, the child may not also be taken into account for purposes of the credit for expenses for household and dependent care services necessary for gainful employment (I.R.C. § 21). **RRA 1990, Sec. 11111(a), amending I.R.C. § 32**.

The amendment is effective for taxable years beginning after December 31, 1990. **RRA 1990, Sec. 11111(f)**.

For 1990, the earned income tax credit is equal to 14 percent of the first $6,810 of earned income. The credit phases out at a rate of 10 percent of the adjusted gross income (or, if greater, earned income, exceeding $10,730). The $6,810 and $10,730 amounts are adjusted annually for inflation. **I.R.C. § 32(a)(i)**.

9. Eligibility rules for earned income tax credit. In order to qualify for the earned income tax credit, the taxpayer must meet the earned income and adjusted gross income thresholds and must have a qualifying child. To be a qualifying child, an individual must satisfy—(1) a relationship test; (2) a residency test; and (3) an age test.

Relationship test. The relationship test is satisfied if the individual is a son, stepson, daughter or stepdaughter of the taxpayer, a descendant of a son or daughter of the taxpayer or a foster or adopted child of the taxpayer. A foster child is defined as an individual whom the taxpayer cares for as the taxpayer's own child. An adopted child includes a child who is legally adopted, or who is placed with the taxpayer by an authorized placement agency for adoption by the taxpayer.

An individual who is married at the close of the taxpayer's year generally must be entitled to a dependency deduction for the taxable year with respect to the individual in order to claim the earned income tax credit.

Residency test. The residency test is satisfied if the individual has the same principal place of abode as the taxpayer for more than half the taxable year (the entire year for foster children). The determination of whether the residency requirement is met is made under rules similar to those applicable with respect to whether an individual meets the requirements for head-of-household filing status. The residency must be in the United States.

Under the residency test, certain temporary absences because of education or illness are disregarded for purposes of determining whether the child had the same principal place of abode as the taxpayer for over half the year.

Age test. The age test is satisfied if the individual (1) has not attained the age of 19 at the close of the taxable year; (2) is a full-time student who has not attained the age of 24 at the close of the taxable year; or (3) is permanently and totally disabled. Whether a child is a full-time student is determined under the rules relating to the dependency exemption under I.R.C. § 151(c)(4). An individual is permanently and totally disabled if the requirements are met for the credit for the disabled, I.R.C. § 22(e)(3).

If an individual is a qualifying child with respect to more than one taxpayer, only the taxpayer with the highest adjusted gross income may claim the earned income tax credit with respect to the child for that year. A taxpayer may not claim the earned income tax credit if the taxpayer is a qualifying child.

Married taxpayers, as under prior law, may claim the earned income tax credit only if a joint return is filed.

If the earned income tax credit is claimed, taxpayers are required to obtain and supply a taxpayer identification number (TIN) for each qualifying child who has attained the age of 1 as of the close of the taxpayer's taxable year.

To claim the earned income tax credit, the taxpayer is to complete and attach a separate schedule to the income tax return. The schedule is to include the name and age of any qualifying children. Adequate proof of the existence of health insurance may be required if the taxpayer has claimed the supplemental earned income tax credit for health insurance. **RRA 1990, Sec. 11111(a), amending I.R.C. § 32**.

10. Supplemental young child credit. An additional credit is allowed if any of the taxpayer's qualifying children are under the age of 1 at the close of the taxable year of the taxpayer. The supplemental young child credit is available in addition to the amount of the earned income tax credit determined by family size and is in addition to the supplemental credit for health insurance.

The supplemental young child credit provides an additional credit percentage of 5 percent and an increased phaseout percentage of 3.57 percent. The maximum supplemental young child credit for 1991 is projected to be $355.

A child qualifying for the supplemental young child credit is not a qualifying individual under the dependent care credit (I.R.C. § 21).

The portion of the credit available under the supplemental young child credit is not available on an advance basis. **RRA 1990, Sec. 11111(a), amending I.R.C. § 32(b)(1)(D)**.

The provision is effective for taxable years.beginning after December 31, 1990. **RRA 1990, Sec. 11111(f)**.

11. Supplemental credit for health insurance premiums. A credit is available for qualified health insurance expenses that includes coverage for a qualifying child. The credit is refundable but not on an advance basis.

The expenses for which the credit is available include premium amounts paid during the taxable year for health insurance coverage that includes one or more qualifying children as defined for purposes of the earned income tax credit. Only the cost of coverage (premium amounts) are deductible; expenses such as co-payments or deductibles under the insurance coverage as well as other out-of-pocket medical expenses are not eligible for the credit as qualified health insurance expenses. Amounts paid by an employee who contributes to an employer-sponsored health plan on a pre-tax basis are likewise not eligible for the credit. Employee contributions are eligible if paid on an after-tax basis.

The same eligibility criteria, income phase-in and income phase-out requirements apply as for the earned income tax credit. However, there is no family size adjustment for the health credit.

The maximum amount of the credit is calculated based on a percentage of earned income. When fully phased in, the credit percentage is 5.5 percent of earned income (up to the maximum amount of creditable earned income in effect for the earned income tax credit) and the phase-out rate is 3.9 percent. The credit is phased in so that the credit percentage is 1.1 percent for 1991, 2.475 percent for 1992, 2.5 percent for 1993 and 5.5 percent for 1994 and thereafter. The phase-out percentage is 0.8 percent in 1991, 1.8 percent in 1992 and 1993 and 3.9 percent in 1994 and later years.

The maximum credit after application of the phase-out requirement is limited to no more than the actual cost of coverage to the taxpayer of family coverage. Therefore, the credit is limited to the lesser of the maximum amount of the credit as phased out with respect to the taxpayer and the actual qualified health insurance expenses.

The amount of any expenses eligible for the medical expense deduction or health insurance deduction for the self-employed is reduced dollar-for-dollar by the amount of the allowable credit under this provision. **RRA 1990, Sec. 11111(a), amending I.R.C. § 32(b)(2)**.

The Conference report provides an example of the interrelationship with the medical expense deduction. If a taxpayer pays a $3,000 premium for health insurance coverage for the taxpayer and family (including at least one qualifying child), and is entitled to a $200 credit under the health insurance provision, the amount of expenses available to be considered for the medical expense deduction would be limited to $2,800 ($3,000 – $200). **Conf. Rep. _____, 102d Cong., 2d Sess. 1990**.

12. Treatment of earned income tax credit for means-tested programs. The earned income tax credit (including the child health insurance portion) is not taken into account as income (for the month in which the refund or payment is made or any month thereafter) or as a resource (for the month in which the refund or payment is made or the following month) for purposes of determining the eligibility or amount of benefit of the individual for AFDC, Medicaid, SSI, low-income housing programs and for purposes of determining the eligibility or amount of benefit of the individual for purposes of the food stamp program and for purposes of certain other housing programs. Effective January 1, 1991, the earned income tax credit is not counted as income for purposes of applying the AFDC gross income limit for applicants and recipients of AFDC. A state may waive any AFDC overpayment based on the failure to count the earned income tax credit toward the gross income limit between October 1, 1989, and December 31, 1990. **RRA 1990, Sec. 11111(a), amending I.R.C. § 32(j)**.

The provision is effective for taxable years beginning after December 31, 1990.

13. Taxpayer identification numbers. As noted above, taxpayers are required to obtain and supply a taxpayer identification number (TIN) for each qualifying child who has attained the age of 1 as of the close of the taxable year of the taxpayer. This requirement is solely for purposes of the earned income tax credit. **RRA 1990, Sec. 11112(a), amending I.R.C. § 6109(e)**.

The provision is effective for taxable years beginning after December 31, 1990. **RRA 1990, Sec. 11112(b)**.

14. Fuel tax. The highway and motorboat fuels taxes are increased by 5 cents per gallon, effective December 1, 1990. A tax of 2.5 cents per gallon is imposed on fuels used in rail transportation, again effective December 1, 1990. The excise tax exemption for gasohol made from ethanol and qualified ethanol fuel is reduced to 5.4 cents per gallon. The excise tax exemption for partially exempt ethanol and methanol fuels remains at 50 percent of the applicable tax rate (7 cents per gallon).

Except for the tax on rail transportation noted above, the increased tax rates are not applicable to fuels used in rail transportation, fuels used in off-highway business uses, in farming, by states and local governments, by school buses and by other persons whose use has been fully exempt from the highway and motorboat fuels taxes. **RRA 1990, Sec. 11211, amending I.R.C. § 4081**.

15. "Gas guzzler" excise tax. The legislation doubles the tax rates on automobiles that do not meet the statutory standard for fuel economy. Accordingly, the tax begins at $1,000 for automobile models that do not get 22.5 miles per gallon and increases to $7,700 for automobile models with fuel economy ratings of less than 12.5 miles per gallon. There is no tax on automobiles getting 22.5 miles per gallon or more. Limousines are subjected to the "gas guzzler" tax regardless of weight. **RRA 1990, Sec. 11216(a), (b), amending I.R.C. §§ 4064(a), 4064(b)(1)**.

The provision is effective for sales after December 31, 1990. **RRA 1990, Sec. 11216(e)**.

16. Telephone excise tax. The 3 percent telephone excise tax is permanently extended. **RRA 1990, Sec. 11217(a), amending I.R.C. § 4251(b)(2)**.

The provision is effective for payments of taxes considered collected during semi monthly periods beginning after December 31, 1990.

17. Telephone excise tax exemption. Recipients of communications services who are exempt from the telephone excise tax by reason of being a qualified international organization, nonprofit hospital, nonprofit educational organization or a state or local government need no longer file annual certificates of exemption after filing an initial certificate of exemption. Annual certificates of exemption effective on the date of enactment remain effective until the end of the annual period. **RRA 1990, Sec. 11217(c), adding I.R.C. § 4253(k).**

The provision is effective for any claim for exemption made after the date of enactment. **RRA 1990, Sec. 11217(c)(2)**.

18. Luxury excise tax. A 10 percent excise tax is imposed on the portion of the retail price of the following items that exceeds the threshold limits specified —

Automobiles above $30,000 — an "automobile" is defined as any passenger vehicle manufactured primarily for use (as well as sold primarily for use or actually used predominantly) on public streets, roads and highways that is rated at 6,000 pounds gross vehicle weight or less. This includes trucks and vans of 6,000 pounds unloaded gross vehicle weight or less. Limousines are subject to the tax regardless of weight.

The tax does not apply to the sale or leasing of any passenger vehicle for use by the purchaser or lessee exclusively (other than a de minimis amount) in the active conduct of a trade or business of transporting persons or property for compensation or hire. The trade or business of transporting persons or property for compensation or hire does not include the leasing or rental of an automobile without a hired driver.

The tax does not apply to the use of an automobile exclusively for demonstration purposes while a potential customer is present. In that case, the tax is due on sale of the vehicle to the customer.

The tax will apply to a vehicle purchased or leased by a business and used to transport its employees or officers, for example. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4001**.

Boats and yachts above $100,000 — boats and yachts used exclusively (other than a de minimis amount) in a trade or business (except for entertainment or recreation purposes, including the trade or business of providing entertainment or recreation) are exempt from the tax. Also, boats and yachts used exclusively in the trade or business of commercial fishing or of transporting persons or property for compensation or hire are exempt from the tax. The transporting of persons or property for compensation or hire includes transportation by a cruise ship regardless of destination or by a boat chartered with a pilot. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4002**.

Aircraft above $250,000 — exemptions are provided for aircraft used exclusively (other than a de minimis amount) in the trade or business of transporting persons or property for hire; aerial application "of fertilizers and other substances"; certain helicopters used exclusively in transporting individuals, equipment or supplies in the exploration, development or removal of oil, gas or hard minerals or in planting or cutting of trees; and aircraft used exclusively for flight training purposes.

A special rule applies to aircraft used at least 80 percent in a trade or business. A taxpayer who purchases or leases an aircraft with respect to which the taxpayer reasonably anticipates that at least 80 percent of the use will be in a trade or business may file a certificate so stating and avoid paying the tax. On its tax return for the next two years, the taxpayer must demonstrate that at least 80 percent of the use of the aircraft was in a trade or business. If this cannot be demonstrated, the taxpayer must pay the tax with interest. If the taxpayer does not demonstrate business use and does not pay the tax, no depreciation deductions are allowed on the aircraft. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4003**.

For passenger vehicles, boats and aircraft used exclusively by the federal government or a state or local government for public works purposes (police, firefighting, search and rescue or other law enforcement or public safety activities or in public works activities) are not subject to the tax. Likewise, vehicles, boats and aircraft used exclusively in providing emergency medical services are exempt. Transportation of a government executive does not qualify for the exemption. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4004(a)**.

The tax on passenger automobiles, aircraft and boats applies to the retail sales price paid by the retail customer including any charge incident to placing the item in a condition ready for use such as preparation charges, dealer add-ons and delivery charges. Parts and accessories are included. Retail rules taxes, if separately stated, are excluded as is the 10 percent tax. The retail sales price is determined without subtraction for any trade in. Thus, the total price paid, whether in cash, in a trade-in or otherwise, is the retail sales price. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4011(d)**.

The manufacturer's suggested retail price is not the basis on which the price is computed. The House Report indicates that a significant variation from general retail market prices of comparable items may be considered by IRS to be an indication of an attempt to avoid the tax. Similarly, the IRS may consider published guides to the value of used property (such as automobile "blue books") in considering whether the value of used property exchanged for new property subject to the tax was understated with the result that the 10 percent tax is improperly reduced.

The tax applies to import items unless the item is being imported by someone in the trade or business for subsequent retail sale or lease (in which event the retail sale or lease would be subject to tax). The tax does not apply to imports if the first sale or lease occurred outside the United States prior to January 1, 1991. If the first sale occurred outside the United States on or after January 1, 1991, the tax applies to the value of the item at the time of import.

Rebates that are fixed at the time of sale and that go directly to the customer are not included in the base for purposes of calculation of the tax. **H. Rep. ______, 101st Cong., 2d Sess. 1990**.

Jewelry above $10,000 — the tax applies on an item-by-item basis to manufactured jewelry and to custom fabricated jewelry (from new or used materials). However, repairs and slight modifications to jewelry are not subject to the tax. Watches are included as jewelry. **RRA 1990, Sec. 11221, adding I.R.C. § 4006**.

Furs above $10,000 — the tax applies to items made from fur "on the hide or pelt" or in which fur is "a major component." The tax does not apply to leather or to artificial fur.

If a person, in the course of a trade or business, produces an article of a kind subject to the tax from fur on the hide or pelt furnished, directly or indirectly, by a customer, and the article is for use of and not for resale by the customer, the delivery of the item to the customer is treated as the first retail sale for a price equal to the fair market value at the time of delivery. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4007**.

General rules. The tax applies only to the first retail sale after manufacture, production or importation of items. The tax does not apply to subsequent sales. As the House report notes, if a jeweler sells a new brooch for $10,000, that item is subject to the tax. If, however, the jeweler sells an antique brooch for $10,000, that item is not subject to the tax.

If the sale is voided, the tax is refunded. Upon return of goods for a refund of the purchase price, the tax should also be refunded.

In general, the retailer must collect the tax and remit it to IRS in accordance with the rules generally applicable to excise taxes.

For automobiles, boats and airplanes, any part or accessory installed within 6 months after the article was first placed in service to the extent that item, the original sale and other parts and accessories raise the price above the threshold. The tax is not imposed on parts and accessories if it is a replacement part or accessory or the item does not exceed $200 in price including installation. Installers are secondarily liable for the tax, if due.

If no tax is imposed on the first retail sale because it is an exempt use, resale by the purchaser within 2 years or substantial non-exempt use during the 2 year period subjects the item to tax on the resale or occasion of non-exempt use by the purchaser at the fair market value at the time of the sale or non-exempt use. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4004(b), (c)**.

The tax does not apply to exported items. **RRA 1990, Sec. 11221(b)**.

In general, lease of an article is considered as a sale at retail. However, special rules apply to the sale of a passenger vehicle, boat or aircraft to a person engaged in a leasing or rental trade or business if it is a qualified lease. The sale of an item to a person involved in leasing is not treated as the first retail sale of the item. The term "qualified lease" means any lease in the case of a boat or aircraft and any long term lease in the case of a passenger vehicle. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4011(c)**.

The provisions are effective on January 1, 1991, unless the purchaser was under a binding contract on September 30, 1990. **RRA 1990, Sec. 11221(f)**.

The tax does not apply to any sale or use after December 31, 1999. **RRA 1990, Sec. 11221(a), adding I.R.C. § 4012**.

19. Reporting of cash received in a trade or business. To the extent provided in regulations, except for personal checks any monetary instrument (whether or not in bearer form) with a face amount of not more than $10,000 is included in the definition of cash. **RRA 1990, Sec. 11318, amending I.R.C. § 6050I(d)**.

The penalty is increased for intentional disregard of the reporting requirements to the greater of $25,000 or the amount of cash received in the transaction (but not more than $100,000).

20. IRS user fees. The legislation extends for 5 years the IRS program requiring the payment of a fee for most requests for a letter ruling, determination letter, opinion letter or similar ruling or determination. **RRA 1990, Sec. 11319(a)**.

The provision applies to requests made after September 29, 1990, except that no advance payment is required for any fee for requests filed after September 29, 1990, and before the 30th day after the day of enactment. **RRA 1990, Sec. 11319(b)**.

21. Corporate tax on divisive transactions. The legislation requires recognition of corporate-level gain on a distribution of subsidiary stock qualifying under I.R.C. § 355 if, immediately after the distribution, a shareholder holds disqualified stock that constitutes 50 percent or more of the vote or value of the distributing corporation or of a distributed subsidiary. Disqualified stock is stock that was acquired by purchase within the preceding 5-year period and after October 9, 1990. **RRA 1990, Sec. 11321(a), amending I.R.C. § 355(c)**.

The provision generally applies to distributions of stock after October 9, 1990. **RRA 1990, Sec. 11321(c)**.

22. Preferred stock issued with redemption premium. If preferred stock is considered to have an unreasonable redemption premium, the portion of the premium considered to be unreasonable is deemed to be distributed to the preferred shareholder ratably over the time during which the stock cannot be called for redemption. The legislation applies the economic accrual rule and the de minimis rule applicable to debt instruments issued with original issue discount to preferred stock that is subject to mandatory redemption or is puttable at a premium, regardless of whether the stock is callable. **RRA 1990, Sec. 11322(a), amending I.R.C. § 305(c)**.

The provision is generally applicable to stock issued after October 9, 1990. **RRA 1990, Sec. 11322(b)**.

23. Information reporting for acquisitions. Special allocation and information reporting rules apply to asset acquisitions under I.R.C. § 1060. The information reporting rules do not apply to an acquisition of a trade or business which is structured as a stock acquisition if the transferee does not elect under I.R.C. § 338 to treat the stock purchase as an asset acquisition. It is unclear, however, whether the reporting rules apply to a stock acquisition if an I.R.C. § 338 election or an I.R.C. § 338(h)(10) election is made.

Under the legislation, in the case of a stock purchase where an I.R.C. § 338(h)(10) election is made, the purchasing corporation and the seller must report the specified information. The legislation also makes it clear that if a lender is required to report under I.R.C. § 6050J upon the foreclosure of property, no reporting is required under I.R.C. § 1060 by the lender, provided no allocation is required to be made to goodwill or going concern value. **RRA 1990, Sec. 11323(a), amending I.R.C. § 1060(a)**.

The amendments in this provision apply to acquisitions after October 9, 1990. **RRA 1990, Sec. 11323(d)**.

24. Net operating loss carrybacks by corporations. The ability of a C corporation to obtain refunds of taxes paid in prior years by carrying back net operating losses is limited to cases where the losses are created by interest deductions allocable to a corporate equity reduction transaction (CERT). A CERT includes the acquisition of 50 percent or more of the vote or value of the stock of another corporation. However, a CERT does not include the acquisition of the stock of another corporation—(1) that, immediately before the acquisition was a subsidiary of an affiliated group or (2) with respect to which an election under I.R.C. § 338 was made to treat the stock acquisition as an asset acquisition.

The legislation repeals the exception to the definition of a CERT relating to the acquisition of the stock of another corporation which, immediately before the acquisition, was a member of an affiliated group. **RRA 1990, Sec. 11324, amending I.R.C. § 172(m)(3)(B)**.

25. Exchanges of debt or stock for indebtedness. For purposes of determining the amount of cancellation of indebtedness income on issuance of a new corporate debt instrument in satisfaction of an old debt, the debtor is treated as having satisfied the old debt with the amount of money equal to the issue price of the new debt.

The legislation also repeals the stock-for-debt exception for bankruptcy cases and insolvent debtors for taxpayers issuing disqualified stock in exchange for debt. Disqualified stock is any stock with a stated redemption price and that either has a fixed redemption date, is callable by the issuer or is puttable by the holder. **RRA 1990, Sec. 11325(a), amending I.R.C. § 108(e)**.

In general, the provision is effective for debt instruments issued or stock transferred after October 9, 1990 in satisfaction of debt. **RRA 1990, Sec. 11325(c)**.

26. Interest paid by corporations on tax obligations. Individuals are not permitted to deduct personal interest and that includes interest on underpayment of income tax even if part or all of the income is from a trade or business. Corporations are permitted an income tax deduction for all interest paid or accrued including interest on tax obligations.

Under the legislation, a special interest rate equal to the sum of the short term applicable federal rate plus 5 percentage points is applicable to C corporations for purposes of determining the rate of interest attributable to unpaid tax. The new rate does not apply to any underpayment of $100,000 or less. **RRA 1990, Sec. 11341(a), adding I.R.C. § 6621(c)**.

The provision is effective for purposes of determining interest for periods after December 31, 1990. **RRA 1990, Sec. 11341(b)**.

27. Medicare hospital insurance payroll tax. For wages paid in 1990 to covered employees, the Medicare hospital insurance tax rate is 1.45 percent on both the employer and employee on the first $51,300 of wages. The rate is 2.9 percent for self-employed persons on the same base of $51,300.

The legislation increases the cap on wages and self-employment income considered in calculating Medicare hospital insurance tax liability to $125,000, adjusted in later years for inflation. **RRA 1990, Sec. 11331(a), amending I.R.C. § 3121(a)(1)**.

The provision is effective for 1991 and later calendar years. **RRA 1990, Sec. 11331(e)**.

28. Social security coverage of state and local government employees. With some exceptions, social security coverage is mandated for state and local government employees not covered by a state voluntary agreement or a retirement system in conjunction with their employment. **RRA 1990, Sec. 11332(a), amending 42 U.S.C. § 410(a)(7)**.

The provision is effective for services performed after December 31, 1991.

29. FUTA surtax. The Federal Unemployment Tax Act (FUTA) imposes a gross employer tax of 6.2 percent on the first $7,000 paid annually to each employee. The 6.2 percent rate includes a temporary surtax of 0.2 percent which is scheduled to expire for wages paid after 1990 after which the basic FUTA rate will be 0.6 percent. That's because employees in states meeting certain requirements and with no overdue federal loans are eligible for a 5.4 percentage point credit. The legislation extends the 0.2 percent surtax through 1995. **RRA 1990, Sec. 11333(a), amending I.R.C. § 3301**.

The extension is effective for wages paid after December 31, 1990. **RRA 1990, Sec. 11333(b)**.

30. Payroll tax deposit. The legislation requires that deposits of $100,000 of payroll taxes must be made by the close of the next banking day. **RRA 1990, Sec. 11334(a), amending I.R.C. § 6302(g)**.

The provision is effective for amounts required to be deposited after December 31, 1990. **RRA 1990, Sec. 11334(c)**.

31. Trusts with foreign grantors. The legislation provides that a U.S. person who is a beneficiary of a trust is treated as the grantor to the extent the beneficiary transferred property, directly or indirectly, to a foreign person who otherwise would have been treated as the owner under the long-established "grantor trust" rules. The rule applies even if the beneficiary was not a U.S. person at the time of the transfer. **RRA 1990, Sec. 11343(a), adding I.R.C. § 672(f)**.

The provision applies to any trust created after the date of enactment and any portion of an existing trust attributable to amounts contributed after that date. **RRA 1990, Sec. 11343(b)**.

32. Expiring tax provisions

Research and experimental expenditures. The application of the statutory allocation rule is extended so that it applies to the taxpayer's first two taxable years beginning after August 1, 1989, and on or before August 1, 1991. **RRA 1990, Sec. 11401(a), amending I.R.C. § 864(f)(5)**.

Research and experimentation credit. The 20 percent incremental credit for qualified research expenditures and the university basic research credit are extended through December 31, 1991. The rule requiring proration for 1990 is repealed. **RRA 1990, Sec. 11402, amending I.R.C. § 41(h)**.

Employer-provided educational assistance. The exclusion for employer-provided educational assistance benefits is extended through taxable years beginning before January 1, 1992. The rule limiting the exclusion for taxable years beginning in 1990 is repealed. Also, the restriction on graduate-level courses is repealed, effective after 1990. **RRA 1990, Sec. 11403(a), (b), amending I.R.C. § 127(d)**.

Group legal services plans. The exclusion for employer-provided group legal services and the tax exemption for qualified group legal services organizations are extended through taxable years beginning before January 1, 1992. The rule limiting the exclusion for years beginning in 1990 is repealed. **RRA 1990, Sec. 11404(a), amending I.R.C. 120(e)**.

Targeted jobs credit. The targeted jobs credit is extended through December 31, 1991. **RRA 1990, Sec. 11405(a), amending I.R.C. § 51(e)(4)**.

The Conference report clarifies the point that an individual on probation without a finding of guilt is treated as convicted for purposes of the targeted jobs credit. **Conf. Rep. 101-____, 101st Cong., 2d Sess. 1990**.

Business energy tax credits. The business energy tax credits for solar energy (10 percent credit) and geothermal energy (10 percent credit) are extended for qualified property placed in service after September 30, 1990 and through December 31, 1991. **RRA 1990, Sec. 11406, amending I.R.C. § 46(b)(2)(A)**.

Low income rental housing tax credit. The low-income rental housing tax credit is extended through December 31, 1991, with numerous changes in the eligibility requirements. **RRA 1990, Sec. 11407(a), amending I.R.C. § 42(o)**.

Qualified mortgage bonds. The qualified mortgage bond and mortgage credit certificate programs are extended through December 31, 1991, with several modifications in the programs. **RRA 1990, Sec. 11408(a), amending I.R.C. §§ 25(h), 143(a)(1)(B)**.

Qualified small issue bonds. Authority to issue qualified small issue bonds (which had expired September 30, 1990) is extended through December 31, 1991. Interest on small issues of private activity bonds is exempt from tax if at least 95 percent of the net proceeds is to be used to finance manufacturing facilities or certain land or property for first-time farmers. **RRA 1990, Sec. 11409(a), amending I.R.C. § 144(a)(12)(B)**.

Health insurance costs for self-employeds. The 25 percent deduction for health insurance costs of self-employed individuals is extended through taxable years beginning before January 1, 1992. The rule requiring proration of the credit for 1990 is repealed. **RRA 1990, Sec. 11410(a), amending I.R.C 162(1)(6)**.

Orphan drug tax credit. The 50 percent tax credit for qualified clinical testing expenses incurred for human clinical tests of drugs for certain rare diseases or conditions is allowed for expenses incurred after December 31, 1990, and before January 1, 1992. **RRA 1990, Sec. 11411, amending I.R.C. § 28(e)**.

33. Alcohol fuels. At present, an income tax credit of 60 cents per gallon (190 or greater proof) is allowed to producers and blenders of alcohol used as fuel, sold at retail for use as fuel or mixed with fuel in a mixture for motor vehicles on the highway. The credit is scheduled to expire after December 31, 1992.

In lieu of the credit, an excise tax exemption against the federal fuel tax of 6 cents per gallon is allowed on the sale of an alcohol-fuel mixture consisting of 10 percent alcohol fuel. The excise tax exemption is scheduled to terminate after September 30, 1993.

A tariff of 15.85 cents per liter (60 cents per gallon) on imported alcohol fuel is levied to offset the domestic credit and exemption. Imports of ETBE (ethyl tertiary butyl ether) have a duty rate of 6.66 cents per liter.

The 1990 legislation authorizes a new 10 cent per gallon income tax credit for production of up to 15 million gallon per year of ethanol by eligible small ethanol producers (productive capacity for alcohol not in excess of 30 million gallons of alcohol per year). Anti-abuse rules are included (1) to recapture the credit in the event of failure to use ethanol or an ethanol-fuel mixture as fuel and (2) to prevent the credit from benefitting directly or indirectly any producer with a productive capacity in excess of 30 million gallons of alcohol per year or any person with respect to more than 15 million gallons of ethanol per year. The anti-abuse rules, for flow through entities, apply to both the entity and interest holder levels.

The income tax credit of 60 cents per gallon for ethanol fuels or fuel mixtures is reduced to 55 cents per gallon for 190 or greater proof. The excise tax exemption is reduced from 6 cents to 5.5 cents per gallon for a 10 percent ethanol mixture. The credit is extended through December 31, 2000 and the excise tax exemptions through September 30, 2000.

The tariff on ethanol is reduced from 15.85 cents per liter to 14.53 cents per liter and terminates after September 30, 2000. **RRA 1990, Sec. 11502(a), amending I.R.C. § 40**.

The amendments are effective for taxable years beginning after December 31, 1990.

34. Alternative minimum tax relief for energy operations. A special energy deduction is enacted for purposes of computing alternative minimum taxable income. The deduction is based on a specified portion of the various oil and gas related tax preference items. **RRA 1990, Sec. 11531, adding I.R.C. § 56(h)**.

35. Estate freezes—repeal of 1987 legislation. The highly controversial estate freeze provision, enacted in 1987 and amended substantially in 1988, was repealed retroactive to the date of enactment. The provision was replaced with a set of rules to govern the valuation of estate freezes at the inception. The approach in the 1987 legislation, I.R.C. § 2036(c), was to pull back into the gross estate the value of property transferred under circumstances in which the transferor was considered to have retained an interest because of transferring a disproportionately large share of the potential appreciation in the person's interest in an enterprise while retaining an interest or right in the enterprise. That approach is abandoned in the 1990 legislation with attention given to valuing interests accurately. **RRA 1990, Sec. 11601(a), repealing I.R.C. § 2036(c)**.

The repeal is effective for property transferred after December 17, 1987. **RRA 1990, Sec. 11601(c)**.

36. Valuation rules applicable to estate freezes. The rules enacted in 1990 apply in determining the value of a residual interest (obtained by first establishing the value of preferred interests and subtracting that value from the overall value of the partnership, corporation or other business enterprise) that is transferred to or for the benefit of a family member.

In determining the value of residual interests, the legislation establishes valuation rules for retained interests. In general, a retained liquidation right, put, call, conversion or similar right is valued at zero, unless the right must be exercised at a specific time and for a specific amount. The assumption is that such rights are unlikely to be recognized to the detriment of family members. If a right to receive a "qualified payment' is involved, the retained interest is valued on the assumption that each right is exercised in a manner resulting in the lowest value for all such rights. A qualified payment is a dividend payable on a periodic basis and at a fixed rate (including one bearing a fixed relationship to a specified market rate) on cumulative preferred stock or a comparable payment under a partnership agreement.

Example (1): Mother retains a cumulative preferred stock carrying a dividend of $100 per year. The stock may be redeemed at any time after two years for $1,000. The value of the cumulative preferred stock is the lesser of — (a) the present value of two years of $100 in dividends plus the present value of the redemption for $1,000 in the second year, or (b) the present value of the value of $100 paid every year in perpetuity.

Example (2): Mother and son are partners in a partnership to which the mother contributes an existing business. The mother is entitled to 80 percent of the net cash receipts of the partnership until she receives $1 million after which mother and son each receive 50 percent of the partnership's cash flow. The mother's liquidation preference is $1 million. Under the legislation, the mother's right to $1 million is valued at zero unless the mother elects to treat it as a right to receive qualified payments in the amounts and at the times specified in the election. If the mother elects such treatment, amounts not paid at the times specified in the election become subject to the corresponding rules.

The 1990 amendment exempts from these rules — (a) a retained interest that is publicly traded, (b) an interest that is of the same class as the transferred interest, (c) an interest that is of the same class as the transferred interest except for nonlapsing differences in voting power or (d) interests that possess proportionately the same rights as the transferred interest.

The amount of estate or gift tax on a subsequent transfer of the retained preferred interest is increased by the time value of accumulated distributions. The amount of accumulated distributions and interest subject to gift or estate tax is capped at an amount equal to— (1) the excess of the fair market value of the residual interests in the corporation or partnership at the date of the subsequent transfer over the fair market value of the interests at the date of the initial transfer multiplied by (2) a fraction the numerator of which is the value of the preferred interests in the corporation or partnership held by the transferor and the denominator of which is the value of all such interests.

The limitation on the amount of unpaid dividends and interest subject to subsequent transfer tax equals (1) the excess of the fair market value of equity interests that are junior to any retained preferred interests at the date of the later transfer over such values at the date of the prior transfer of the junior interest multiplied by (2) a fraction (determined immediately before the later transfer), the numerator of which is the number of shares of preferred interests held by the transferor and the denominator of which is the number of all shares of the same class of preferred shares. This limitation applies with respect to each class of preferred held by the transferor or family members.

The aggregate value of the junior equity interests in a corporation or partnership can be no less than 10 percent of the sum of the total equity in the corporation or partnership plus any debt which the corporation or partnership owes to the transferor or members of the family.

Any redemption, recapitalization, contribution to capital or other change in the capital structure of a corporation or partnership is treated as a transfer of an interest in the entity if an individual or family member receives a retained right affected by the legislation, except as provided otherwise in regulations. Regulations may also provide that such an event results in a transfer if the individual or applicable family member holds such an interest.

The gift tax statute of limitations runs for transfers subject to the rules governing preferred interests in corporations and partnerships and to increases in taxable gifts with respect to cumulative preferred stock only if the transfer is disclosed on a gift tax return with sufficient detail to apprise IRS of the nature of the transferred and retained interests.

Retained interests in trust or term interests in property generally are valued at zero for federal gift tax purposes unless in the form of an annuity or unitrust interest.

If two or more members of the same family acquire interests in the same transaction or series of related transactions, the person or persons acquiring the term interests in the property are treated as having acquired the entire property and then transferred to the other persons the interests acquired by the other persons in the transaction or transactions. The transfer is treated as made in exchange for the consideration, if any, provided for the acquisition of interests in the property. This could involve joint purchase of a life estate and remainder.

Relative to buy-sell agreements, the legislation provides that the value of property is determined without regard to any option, agreement, right or restriction unless—

(1) the option, agreement, right or restriction is a bona fide business arrangement;

(2) the option, agreement, right or restriction is not a device to transfer the property to members of the decedent's family for less than full and adequate consideration; and

(3) the terms of the option, agreement, right or restriction are comparable to those obtained in similar arrangements entered into by persons in an arm's length transaction.

The Conference report indicates that it is not the intent that a buy-sell agreement be ignored merely because its terms differ from those used by another, similarly situated firm. General business practice may recognize more than one valuation approach even within the same industry.

Under the legislation, the value of property is determined without regard to any restriction other than a restriction which by its terms will never lapse. In addition, any right held by the decedent with respect to property includible in the gross estate which lapses on the decedent's death would, in valuing the property in the estate, be considered to be exercisable by the estate. Any restriction that effectively limits the ability of a corporation or partnership to liquidate is ignored in valuing a transfer among family members if—(1) the transferor and family members control the corporation or partnership and (2) the restriction either lapses after the transfer or can be removed by the transferor or members of the family, either alone or collectively. This rule does not apply to a restriction arising as part of a financing with an unrelated party (which is commercially reasonable) or a restriction required under state or federal law. Regulatory authority is given to disregard other restrictions which reduce the value of the transferred interest for transfer tax purposes but which do not ultimately reduce the value of the interest to the transferee. **RRA 1990, Secs. 11601, 11602, adding I.R.C. § 2701 *et seq*.**

The amendments apply to gifts after October 8, 1990; transfers after October 8, 1990; to agreements, options, rights or restrictions entered into after October 8, 1990; to agreements, options, rights or restrictions which are substantially modified after October 8, 1990; and to restrictions or rights created after October 8, 1990.

36. Disabled access credit. An eligible small business is allowed a nonrefundable income tax credit equal to 50 percent of the amount of eligible public accommodations access expenditures for any taxable year that exceed $250 but do not exceed $10,250.

An eligible small business is defined as a person with gross receipts for the preceding taxable year that did not exceed $1 million or had no more than 30 full-time employees during the preceding taxable year.

Eligible access expenditures generally include amounts paid or incurred–

(1) for the purpose of removing architectural, communication, physical or transportation barriers which prevent a business from being accessible to or usable by individuals with disabilities;

(2) to provide qualified interpreters or other effective methods of making orally delivered materials available to those with hearing impairments;

(3) to provide qualified readers taped texts and other effective methods of making visually delivered materials available to individuals with visual impairments;

(4) to acquire or modify equipment or devices for individuals with disabilities; and

(5) to provide other similar services, modifications, materials or equipment.

All expenditures must be reasonable and necessary to accomplish the stated purposes.

The disabled access credit is included as a general business credit. The portion of any unused business credit attributable to the disabled access credit may not be carried back to any taxable year ending before the date of enactment.

The provision is effective for expenditures paid or incurred after the date of enactment.

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

GENERAL

EXEMPTIONS. The debtor's interest in a retirement plan was not excluded from the bankruptcy estate as a spendthrift trust because the debtor could receive the funds in the plan upon termination of employment. The debtor's interest in the plan, totaling over $12,000, was exempt under Mo. Rev. Stat. § 513.430(10(e), as necessary for the debtor's support where the debtor's income was insufficient for the debtor's and the debtor's child's support and no evidence was shown that the debtor would have any significant increase in income. The court indicated that the amount of the interest in the retirement plan was also a factor favoring the exemption. ***In re* Boykin, 118 B.R. 716 (Bankr. W.D. Mo. 1990)**.

The debtor was not allowed an exemption for IRA and Keogh accounts under Ohio Rev. Code § 2329.66(a)(10)(c) because the funds were not necessary for the debtor's support. The court found that the debtor was a 59 year old attorney