California
Franchise
Tax
Board

SUMMARY OF FEDERAL INCOME TAX CHANGES — 1994

Laws Affected
Personal Income Tax
Bank & Corporation Tax

SUMMARY OF
FEDERAL INCOME TAX CHANGES
1994

Prepared by the Staff of the
FRANCHISE TAX BOARD
State of California

This report is submitted in fulfillment of the requirement in Revenue and Taxation Code Section 19522.

TABLE OF CONTENTS

Section	Title of Section	Page
	Executive Summary	vi
I.	AIRPORT IMPROVEMENT PROGRAM TEMPORARY EXTENSION ACT OF 1994 (PL 103-260)	
108	Expenditures From Airport And Airway Trust Fund	N/A
	Clerical amendment of Section 9502(d)(1)(A) to update cross-reference in provision relating to expenditures from Airport and Airway Trust Fund.	
II.	REVISION OF TITLE 49 OF THE UNITED STATES CODE (PL 103-272)	
5	Conforming Cross-References	N/A
	Clerical amendment of Sections 4064(b)(1)(B), 4261(e) and (f)(2), and 9502(d)(1)(B) to update cross-references in provisions relating to the Gas Guzzler tax, the Air Transportation Tax and transfers of funds to the Airport and Airway Trust Fund.	
III.	SOCIAL SECURITY INDEPENDENCE PROGRAM IMPROVEMENTS ACT OF 1994 (PL 103-296)	
108	Additional Conforming Amendments	Clerical
	Clerical amendments to the Internal Revenue Code to change references to Secretary of Health and Human Services to "Commissioner of Social Security."	
309	Repeal Of The Facility-Of-Payment Provision	N/A
311	Authorization for disclosure of Social Security information for purposes of public or private epidemiological and similar research	N/A

TABLE OF CONTENTS

Section	Title of Section	Page
316	Cross-Matching Of Social Security Account Number Information And Employer Identification Number Information Maintained By The Department Of Agriculture	N/A
320	Extension Of The FICA Tax Exemption And Certain Tax Rules To Individuals Who Enter The United States Under A Visa Issued Under Section 101 Of The Immigration And Nationality Act	N/A

IV. <u>TITLE IV: EXTENSION OF AIRPORT AND AIRWAY TRUST FUND EXPENDITURE AUTHORITY OF THE FEDERAL AVIATION ADMINISTRATION ACT OF 1994 (PL 103-305)</u>

401 Expenditures From Airport And Airway Trust Fund N/A

Makes clerical and cross-reference changes and extends by one year the authority to expend funds contained in Section 9502(d)(1) of the Internal Revenue Code relating to expenditures from Airport and Airway Trust Fund.

V. <u>VIOLENT CRIME CONTROL AND LAW ENFORCEMENT ACT OF 1994 (PL 103-322)</u>

20415 Reporting Of Cash Received By Criminal Court Clerks 56

VI. <u>NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 1995 (PL 103-337)</u>

1677 Amendments To Other Laws - Internal Revenue Code N/A

Clerical cross-reference change to update Section 219(g)(6)(A) of the Internal Revenue Code, relating to deductions for contributions to an Individual Retirement Account by a member of a reserve component of the Armed Forces to reflect the new section number which contains the definition of a member of a reserve component of the Armed Forces.

TABLE OF CONTENTS

Section	Title of Section	Page
VII.	TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) (PL 103-465)	
Withholding Tax Provisions		
701	Withholding on distributions of Indian casino profits to tribal members.	1
702	Voluntary withholding on certain federal payments and on unemployment compensation.	4
Provisions Relating to Estimated Taxes and Payments and Deposits of Taxes		
711	Treatment of Subpart F and Section 936 income of taxpayers using annualized method for estimated taxes.	6
712	Time for payments and deposits of certain taxes.	12
713	Reduction in rate of interest paid on certain corporate overpayments.	14
Earned Income Tax Credit		
721	Extension of earned income tax credit to military personnel stationed outside the United States.	16
722	Certain nonresident aliens ineligible for earned income tax credit.	16
723	Income of prisoners disregarded in determining earned income tax credit.	16
Provisions Relating To Retirement Benefits		
731	Treatment of excess pension assets used for retiree health benefits.	21
732	Rounding rules for cost-of-living adjustments.	24

TABLE OF CONTENTS

Section	Title of Section	Page
733	Increase in inclusion of social security benefits paid to nonresidents.	26
Other Provisions		
741	Partnership distributions of marketable securities.	29
742	Taxpayer identification numbers required at birth.	41
743	Extension of Internal Revenue Service user fees.	43
744	Modification of substantial understatement penalty for corporations participating in tax shelters.	44
745	Modification of authority to set terms and conditions for savings bonds.	47
Pension Plan Funding and Premiums		
PART I.A.	AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1986	
751	Minimum funding requirements.	49
752	Limitation on changes in current liability assumptions.	49
753	Anticipation of bargained benefit increases.	49
754	Modification of quarterly contribution requirement.	49
755	Exceptions to excise tax on nondeductible contributions.	49
PART I.B.	AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974	
761	Minimum funding requirements.	49
762	Limitation on changes in current liability assumptions.	49

TABLE OF CONTENTS

Section	Title of Section	Page
763	Anticipation of bargained benefit increases.	49
764	Modification of quarterly contribution requirement.	49
PART I.C.	OTHER FUNDING PROVISIONS	
766	Prohibition on benefit increases where plan sponsor is in bankruptcy.	49
767	Single sum distributions.	49
768	Adjustments to lien for missed minimum funding contributions.	49
769	Special funding rules for certain plans.	49
PART II.	AMENDMENTS RELATED TO TITLE IV OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974	
771	Reportable Events.	49
772	Certain information required to be furnished to PBGC.	49
773	Enforcement of minimum funding requirements.	49
774	Computation of additional PBGC premium.	49
775	Disclosure to participants.	49
776	Missing participants.	49
777	Modification of maximum guarantee for disability benefits.	49
778	Procedures to facilitate distribution of termination benefits.	49
	Exhibit A - Expiring Tax Provisions	A-1

Executive Summary

During 1994, the Internal Revenue Code was changed by:

PUBLIC LAW	TITLE
103-260	AIRPORT IMPROVEMENT PROGRAM TEMPORARY EXTENSION ACT OF 1994 (Signed May 26, 1994)
103-272	REVISION OF TITLE 49 OF THE UNITED STATES CODE (Signed July 5, 1994)
103-296	SOCIAL SECURITY INDEPENDENCE PROGRAM IMPROVEMENTS ACT OF 1994 (Signed August 15, 1994)
103-305	FEDERAL AVIATION ADMINISTRATION ACT OF 1994 (Signed August 23, 1994)
103-322	VIOLENT CRIME CONTROL AND LAW ENFORCEMENT ACT OF 1994 (Signed September 13, 1994)
103-337	NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 1995 (Signed October 5, 1994)
103-465	TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) (Signed December 12, 1994)

This report examines each provision by explaining federal law prior to the change, current California law, a discussion of the new federal law (extracted from the House, Senate and Conference Committee reports, if any), the effective date of the federal change and the impact on California revenue were California to conform to the change in federal law. The explanations also contain citations to the section numbers of the Public Law as well as the Internal Revenue Code and California Revenue and Taxation Code sections impacted by the change. The Table of Contents lists the provisions contained in the above Public Laws with the page number in the detailed explanation where the provision is discussed or indicates that the change is either clerical in nature or not applicable to California by stating "Clerical" or "N/A" in place of a page number.

Exhibit A contains a list of expiring provisions in both California and federal law for the years 1994 through 1999. As shown in Exhibit A, the following California provisions expired in 1994:

Exclusion	-	Energy conservation subsidies
Exclusion	-	Employer-provided educational assistance
Deduction	-	Contributions of stock for which market quotations are readily available
Deduction	-	Expensing of clean fuel property
Exclusion	-	Sale of stock to an ESOP
Exclusion	-	Interest on loans to ESOPs
Exclusion	-	Dividends paid to an ESOP
Administration	-	Authority for Franchise Tax Board to waive penalties and allow perfection of elections relating to new provisions of law.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII A. - WITHHOLDING TAX PROVISIONS

Public Law: 103-465

Act Section: 701

Section Title: Withholding on distributions of Indian casino profits to tribal members

Federal Law Before Change (None)

Generally, Indian tribes are not subject to federal income tax on their income. In ordinary matters not governed by treaties or remedial legislation, however, Indians are subject to the payment of federal income tax as are other citizens.

Gaming activities conducted by Indian tribes are classified in 25 U.S.C. 2703. Class I gaming activities are social games solely for prizes of minimal value or traditional forms of Indian gaming engaged in as part of tribal ceremonies. Class II gaming activities generally are bingo, games similar to bingo (e.g., pull tabs, punchboards, tip jars, and instant bingo) and card games either (1) explicitly authorized by the state or (2) not explicitly prohibited by the state, played at any location in the state, and conducted in conformity with any state regulations regarding periods of operation or wagering limitations. Class II gaming activities do not include any banking card games (e.g., baccarat, chemin de fer, or blackjack), slot machines or any electronic or electromagnetical facsimiles of games of chance. Class III gaming activities are all forms of gaming that are not classified as Class I or Class II.

Net revenues from certain gaming activities conducted or licensed by an Indian tribe may be used to make taxable distributions to members of the Indian tribe. The tribe must notify its members of the tax liability at the time the payments are made (25 U.S.C. 2710(b)(3) and (d)(1)). The tribe is not required to withhold on such payments except to the extent backup withholding rules apply under Code section 3406.

Current California Law (None)

California does not require withholding on these distributions.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

New Federal Law (Sec. 3402(r) NEW)

An Indian tribe that distributes net revenues from gaming activities (except for class I gaming activities as defined in 25 U.S.C. 2703(6) as in effect on the date of enactment of this provision) to its members is required to withhold on such payments in accordance with the following schedule:

(1) The withholding rate is zero to the extent the payment, when annualized, does not exceed the sum of one personal exemption and the standard deduction for a single person for the calendar year in which the payment is made.

(2) The withholding rate is 15% to the extent the payment, when annualized, exceeds the highest amount to which the zero percent withholding rate applies under (1) but does not exceed the sum of that amount and the amount of taxable income to which, in the case of a single person, the 15% tax rate would apply for the calendar year in which the payment is made.

(3) The withholding rate is 28% to the extent the payment, when annualized, exceeds the highest amount to which the 15% withholding rate applies under (2) but does not exceed the sum of that amount and the amount of taxable income to which, in the case of a single person, the 28% tax rate would apply for the calendar year in which the payment is made.

(4) The withholding rate is 31% to the extent the payment, when annualized, exceeds the highest amount to which the 28% withholding rate applies under (3).

Alternatively, at the election of the Indian tribe, the tribe is allowed to withhold on such payments in accordance with such tables or computational procedures as the Secretary may prescribe.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

Effective Date

The change is effective for payments made after December 31, 1994.

Impact on California Revenue

Not Applicable.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII A. - WITHHOLDING TAX PROVISIONS

Public Law: 103-465

Act Section: 702

Section Title: Voluntary withholding on certain federal payments and on unemployment compensation

Federal Law Before Change (Sec. 85, 86, 3302 & 3304)

Taxpayers may not have income taxes voluntarily withheld from Social Security payments or other taxable federal payments (e.g. crop disaster payments, Commodity Credit Corporation loans). Any amount received under a federal or state law that is in the nature of unemployment compensation is includible in the gross income of an individual. In general, there is no withholding on unemployment compensation under present law.

Under Code section 3402(o)(1)(A), any supplemental unemployment compensation benefits paid to an individual are subject to withholding as if they were wages paid by the employer to the employee for a payroll period. Supplemental unemployment compensation benefits are defined as amounts paid to an employee (pursuant to a plan to which the employer is a party) because of the employee's involuntary separation from employment directly resulting from a reduction in force, plant closing, or similar condition, but only to the extent that the benefits are includible in the employee's gross income.

Current California Law (R&T Sec. 17081, 17083, 17087 & 18661-18667)

California conforms to the federal definition of gross income and the items included in gross income but specifically does not conform to the federal taxation of Social Security benefits or unemployment compensation.

New Federal Law (Sec. 3304 & 3402)

The Act requires that taxpayers who receive specified federal payments be given the option of requesting that the federal agency making the payments withhold federal income taxes from the payments. Specified federal payments subject to the withholding option include:

(1) Social Security benefits;

(2) crop disaster payments;

(3) Commodity Credit Corporation loans; and

(4) other federal payments specified by the Secretary of the Treasury.

The a taxpayer requests that the federal agency making the payments withhold federal income taxes, the taxpayer also would select the percentage of the payment that is to be withheld. The taxpayer may select withholding at 7%, 15%, 28%, or 31%. Treasury regulations also may specify additional percentage rates for withholding. Federal agencies making the payments will not receive any additional information regarding the taxpayer's income as a consequence of this provision.

The Act also requires states to allow recipients of unemployment benefits to elect to have federal income tax withholding from their benefits at a 15% rate. The Act also permits (but does not require) states to allow applicants for unemployment benefits to elect to have state and local income tax to be withheld from their benefits. Administrative expenses for which states can be reimbursed pursuant to section 302 of the Social Security Act could include the cost of conducting federal income tax withholding.

<u>Effective Date</u>

The provision is effective for payments made after December 31, 1996.

<u>Impact on California Revenue</u>

Not Applicable.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII B. - PROVISIONS RELATING TO ESTIMATED TAXES AND PAYMENTS AND DEPOSITS OF TAXES

Public Law: 103-465

Act Section: 711

Section Title: Treatment of Subpart F and Section 936 income of taxpayers using annualized method for estimated tax

Federal Law Before Change (Sec. 6654(d)(2) & 6655(e))

Estimated tax rules -- in general

Taxpayers are subject to an addition to tax for any underpayment of estimated tax. A corporation does not have an underpayment of estimated tax if it makes four equal, timely estimated tax payments that total at least 100% of the tax liability shown on its return for the current taxable year. A corporation that is not a "large corporation" (i.e., one that did not have taxable income of $1 million or more for any of the three preceding taxable years) generally may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25% of the tax liability shown on its return for the preceding taxable year. In addition, any corporation may base its first quarterly installment on its prior-year tax liability in order to avoid the addition to tax.

Individuals generally do not have an underpayment of estimated tax if timely estimated tax payments are made that are at least equal to (1) 100% of the tax shown on the individual's return for the preceding year, or (2) 90% of the tax shown on the return for the current year. A safe harbor of 110% of last year's liability applies, in lieu of the general 100% safe harbor, if the taxpayer had adjusted gross income of more than $150,000 for the prior taxable year.

Estimated tax installments based on annualized income

If estimated tax installments fall short under the foregoing rules, a taxpayer may nevertheless be treated as not having made an underpayment of estimated tax if the installments are based on a fraction of the "annualized" amount of actual income earned over a specified period (within the current taxable year) that ends before the due date of the installment. For individuals, annualization periods end with the month ending immediately before the estimated tax installment due date. For corporations, annualization periods exclude the last month of the corporation's taxable year.

Taxable income is placed on an annualized basis under regulations prescribed by the Secretary of the Treasury. Treasury regulations provide guidelines for the treatment of certain partnership items by individuals. Under the regulation, in determining an individual's taxable income for an annualization period, an individual partner must take into account certain partnership items for any partnership taxable year ending with or within the partner's taxable year to the extent these items are attributable to months in the partnership taxable year preceding the installment due date.

Subpart F inclusions

Under the rules of subpart F (Code sec. 951-964), if a U.S. shareholder owns the stock of a controlled foreign corporation (CFC) on the last day of the corporation's taxable year, then the U.S. shareholder may be required to include in its own income certain income or earnings of the CFC. For purposes of computing required installments of estimated tax under the annualization method, the IRS has ruled that a taxpayer may treat certain income inclusions under subpart F as income actually earned by the U.S. shareholder on the last day of the CFC's taxable year. The ruling involved a U.S. corporation that owned all of the stock of a number of controlled foreign corporations. All of the corporations involved used the calendar year as their taxable years. As a result, the U.S. taxpayer was not required to take its pro-rata share of subpart F income into account in determining its estimated tax installments based on the annualization method.

Inclusions pursuant to section 936(h)

Certain domestic corporations with business operations in the U.S. possessions may elect the use of the section 936 credit. This credit generally eliminates some or all of the U.S. tax on certain income related to their operations in the possessions. If such a corporation (a "936 corporation") is to receive the full benefit of the section 936 credit, and the business operations in the possession relate to certain types of intangible property, then certain shareholders and affiliates of the 936 corporation generally must include in their taxable incomes certain amounts relating to income from the intangible property, either under a general rule that requires all intangible property income to be allocated to the corporation's U.S. shareholders, or under either a profit split or cost sharing approach.

Intangible property income inclusions of a 936 corporation's shareholders or amounts allocated to shareholders or affiliates under either the profit split or cost sharing rules may be deemed to occur either at the close of the 936 corporation's taxable year, or on the last day of the taxable year of the shareholder or affiliate in which or with which the taxable year of the 936 corporation ends. Accordingly, in some cases, a shareholder or affiliate of a 936 corporation may utilize the annualization method to avoid penalties for underpayment of estimated tax, yet delay paying tax on intangible property income inclusions until as late as the due date of its annual tax return.

Current California Law (Sec. 18151, 19004, 19010, 19023-19027, 19142-19151, 23051.5(b)(2), 24995 and 25110)

In general, California does not conform to the federal rules relating to controlled foreign corporations or possession corporations. However, for California water's edge purposes, a controlled foreign corporation (CFC) is required to be included in the water's edge combined report if the CFC has Subpart F income defined in Section 952 of the Internal Revenue Code. In addition, possession corporations (Section 936 corporations) may be included in the water’s edge combined report if their U.S. located factors are 20 percent or greater. Possession corporations are, however, generally excluded.

With respect to a "water's-edge election" the income subject to California apportionment is generally the income for federal purposes of the corporations within the electing group. The income and factors of a CFC with Subpart F income are required to be included in the combined report based upon the ratio of Subpart F income to Earnings and Profits for the year. However, California does not follow the Foreign Sales Corporation (FSC) and Domestic International Sales Corporation (DISC) exemption/deferral of income provisions. All of the income and factors of FSCs and DISCs are required to be included in the water's-edge combined report.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

In 1992, AB 2425 and SB 617 modified California law, effective for income years beginning on or after January 1, 1993, to provide that a corporation is required to base its estimated tax payments on 95% of the tax show on its return for the current year. California has not conformed to the 1993 federal increase to 100% which was contained in the Revenue Reconciliation Act of 1993.

With respect to individuals, California has not conformed to the 110% safe harbor contained in the Revenue Reconciliation Act of 1993, but remains conformed to the federal rules prior to the 1993 change. In addition, California did not increase the amount of tax required to be paid in installments from 80% to 90%. Also, California has unique exceptions to the imposition of the penalty for underpayment of estimated tax on individuals when at least 80% of their adjusted gross income consists of wages subject to withholding.

New Federal Law (Sec. 6654(d)(2) & 6655(e))

The Act changes the treatment of inclusions under subpart F and inclusions of section 936 intangible property income for taxpayers that pay estimated tax installments based on the annualized-income method.

Under the Act, amounts includible under subpart F are taken into account for estimated tax purposes in a manner similar to the manner under which items of partnership income are taken into account. Foreign tax credits allocable to such inclusions under subpart F also are taken into account for estimated tax purposes similarly to tax credits allocable to partnership income inclusions. It is intended that foreign tax credits allocable to current-year subpart F inclusions be taken into account for estimated tax purposes under the annualized-income method, notwithstanding the fact that all requirements may not be satisfied for the accrual of the foreign taxes (because the CFC's taxable year for foreign tax purposes may not yet have closed).

Similarly, under the Act, intangible property income, profit-split amounts, and cost-sharing amounts includible in taxable income under section 936 are taken into account for estimated tax purposes in a manner similar to the manner under which items of partnership income are taken into account.

To compute the annualized income installment for a particular taxable year of the taxpayer, the taxpayer is required, under the Act, to take into account items that arise during the taxable year of the controlled foreign corporation or 936 corporation that is relevant to the final computation of tax for that taxable year of the taxpayer. However, to compute any particular installment, generally taken into account are only those items that arise during that portion of such taxable year of the controlled foreign corporation or 936 corporation that precedes the close of the taxpayer's annualization period. It is anticipated that, in prescribing rules for determining amounts on an annualized basis, the Secretary may provide, where appropriate, for the computation of items of income under subpart F or section 936 based on facts in existence for that period.

Thus, under the Act, estimated tax payments generally will be required to be made throughout the year for subpart F inclusions and certain amounts includible under section 936 for the year.

Prior-year safe harbor

For purposes of estimating subpart F income inclusions and section 936 intangible property income, profit-split amounts, and cost-sharing amounts under the annualized-income method, the Act permits taxpayers to use a safe harbor based on a certain percentage of amounts included in taxable income under subpart F and section 936 as shown on the taxpayer's returns for its first or second preceding taxable years. Under the prior-year safe harbor, subpart F amounts that were included in income in the relevant prior year, along with credits allocable to such inclusions, are treated for estimated tax purposes as earned ratably during the current taxable year. The relevant prior year is the second preceding year in the case of the first and second quarterly installments, and the first preceding year in the case of the third and fourth quarterly installments. Similarly, under the prior-year safe harbor, intangible property income inclusions of a 936 corporation's shareholders for the relevant prior year and amounts allocated to shareholders or affiliates under either the profit-split or the cost-sharing rules for that year are treated for estimated tax purposes as earned ratably during the current taxable year.

In the case of a corporate taxpayer, the safe harbor for subpart F inclusions and section 936 inclusions generally is based on 115% of the relevant prior-year inclusions. However, the safe harbor is based on 100% of the relevant prior-year inclusions with respect to any controlled foreign corporation or 936 corporation that the taxpayer does not control as of the beginning of the taxpayer's current taxable year. The taxpayer is treated as controlling a corporation for this purpose if it owns (directly or indirectly, within the meaning of sec. 958(a)) or is treated as owning (constructively, within the meaning of sec. 958(b)) more than 50% (by vote or value) of the stock in the corporation.

In the case of an individual taxpayer, the safe harbor is based on 100% of the relevant prior-year inclusions.

A taxpayer may elect annually whether to use the safe harbor for subpart F and section 936 inclusions. Such an election will apply to all such inclusions of the taxpayer.

Effective Date

The provision is effective for purposes of determining estimated tax payments for taxable years beginning after December 31, 1994.

Impact on California Revenue

Pending.

TITLE VII B. - PROVISIONS RELATING TO ESTIMATED TAXES AND PAYMENTS AND DEPOSITS OF TAXES

Public Law: 103-465

Act Section: 712

Section Title: Time for payments and deposits of certain excise taxes

Federal Law Before Change (Sec. 4261, 4271, 5061, 5703, & 6302)

Federal excise taxes are imposed on a variety of products and services, including the following: alcoholic beverages; tobacco products; firearms; telephone service; air transportation (passengers and freight); highway, rail, aviation, and inland waterway fuels; crude oil, certain chemicals, certain imported chemical substances, and certain ozone depleting chemicals; ship passenger charges; coal; childhood vaccines; and certain automobiles.

Subject to limited exceptions, these excise taxes must be remitted to the federal Government on a semi-monthly basis, generally within a period of nine to 30 days after the end of the semi-monthly period.

Current California Law (Unemployment Insurance Code)

The Franchise Tax Board does not administer California excise taxes relating to the products and services which are the subject of the federal change. The Board of Equalization, however, collects California taxes relating to the taxes which are the subject of the federal change.

New Federal Law (Sec. 4261, 4271, 5061, 5703, & 6302)

In the case of excise taxes that must be remitted to the federal Government on a semi-monthly basis, the Act accelerates the due date for deposit of taxes for the period September 16 through September 26 to September 29 (rather than in October, which is in the subsequent fiscal year). Special rules apply to the taxes on ozone-depleting chemicals, communications services, and air transportation. In the case of the tax on ozone-depleting chemicals, deposits of taxes for the second semi-monthly period in August and for the period beginning on September 1 and ending on September 11 are due on or before September 29. In the case of communications services and air transportation taxes deposited on the basis of amounts considered collected, the tax included in amounts billed or tickets sold during the period beginning on September 1 and ending on September 11 must be deposited on or before September 29. It is expected that the Treasury Department will modify existing regulatory safe harbors relating to excise tax deposits to reflect these changes.

In the case of taxes on distilled spirits, wine and beer, and on tobacco products and cigarette papers and tubes, the tax for the period beginning on September 16 and ending on September 26 is due on or before September 29. Under a safe harbor, however, this requirement is satisfied if the taxpayer pays an amount equal to 11/15th of the taxpayer's liability for the first semi-monthly period in September. The new requirement does not apply to wine excise taxes that are remitted on an annual basis.

If September 29 is a Saturday, deposits and payments of taxes otherwise due on that date would be due on or before September 28. If September 29 is a Sunday, deposit and payments of taxes otherwise due on that date would be due on or before September 30.

Special rules apply to taxpayers that are not required to remit taxes by electronic funds transfer for the calendar year. For those taxpayers, deposits of taxes for the period beginning on September 16 and ending on September 25 are due on or before September 28. In addition, the other rules described above are modified to reflect the shorter deposit period and earlier due date applicable to such taxpayers.

Effective Date

The provision is generally effective on January 1, 1995, for taxes other than the taxes on air transportation, and on January 1, 1997, for the commercial air passenger and freight excise taxes.

Impact on California Revenue

Not applicable to California franchise or income taxes.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII B. - PROVISIONS RELATING TO ESTIMATED TAXES AND PAYMENTS AND DEPOSITS OF TAXES

Public Law: 103-465

Act Section: 713

Section Title: Reduction in rate of interest paid on certain corporate overpayments

Federal Law Before Change (Sec. 6621)

The rate of interest that IRS pays to taxpayers on overpayments of tax is the sum of the federal short-term rate plus 2 percentage points (sec. 6621(a)(1)).

Current California Law (R&T Sec. 19521)

California is conformed to federal law except that California, for income tax purposes, specifically did not conform to the concept that the rate of interest the government pays on overpayments of tax should be less than the rate of interest the government charges for underpayment of tax. Thus, California specifies that the interest rate the state pays to taxpayers on overpayments of tax is equal to the rate the state charges taxpayers on underpayments.

New Federal Law (Sec. 6402)

The interest rate paid by the IRS to corporate taxpayers on overpayments is reduced to the sum of the federal short-term rate plus one-half percentage point for any portion of an overpayment of tax for a taxable period that exceeds $10,000. (The overpayment rate is the same as under present law for the first $10,000 of any overpayment of tax by a corporation.)

Under present law, the Secretary of the Treasury has the authority to credit the amount of any overpayment against any liability under the Code (section 6402). To the extent a portion of tax due is satisfied by a credit of an overpayment, no interest is imposed on that portion of the tax (section 6601(f)). The Secretary is directed to implement the most comprehensive crediting procedures under section 6402 that are consistent with sound administrative practice and as rapidly as is practicable.

Effective Date

The provision is effective for purposes of determining interest for periods after December 31, 1994, regardless of the taxable period (if any) to which the underlying tax may relate.

Impact on California Revenue

Not Applicable.

TITLE VII C. - EARNED INCOME TAX CREDIT PROVISIONS RELATING TO ESTIMATED TAXES AND PAYMENTS AND DEPOSITS OF TAXES

Public Law: 103-465

Act Section: 721- 723

Section Title: Earned Income Tax Credit Provisions

Federal Law Before Change (Sec. 32)

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit an eligible taxpayer may claim depends upon whether the taxpayer has one, more than one, or no qualifying children and is determined by multiplying the credit rate by the taxpayer's earned income up to an earned income threshold. The maximum amount of the credit is the product of the credit rate and the earned income threshold. For taxpayers with earned income (or adjusted gross income, if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or adjusted gross income, if greater) in excess of the phaseout threshold. The credit is not allowed if earned income (or adjusted gross income, if greater) exceeds the phaseout limit.
The parameters for the EITC depend upon the number of qualifying children the taxpayer has. For 1994 the parameters are as follows:

	One qualifying child--	Two or more qualifying children--	No qualifying children--
Credit rate	26.30%	30.00%	7.65%
Phaseout rate	15.98%	17.68%	7.65%
Earned income threshold	$ 7,750	$ 8,425	$ 4,000
Maximum credit	$ 2,038	$ 2,528	$ 306
Phaseout threshold	$ 11,000	$ 11,000	$ 5,000
Phaseout endpoint	$ 23,753	$ 25,299	$ 9,000

The earned income threshold and the phaseout threshold are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates and phaseout rates for the EITC change over time under present law, as shown in the following table.

Year	One qualifying child-- Credit rate	One qualifying child-- Phaseout rate	Two or more qualifying children-- Credit rate	Two or more qualifying children-- Phaseout rate	No qualifying children-- Credit rate	No qualifying children-- Phaseout rate
1994	26.30	15.98	30.00	17.68	7.65	7.65
1995	34.00	15.98	36.00	20.22	7.65	7.65
1996 and after	34.00	15.98	40.00	21.06	7.65	7.65

In order to claim the EITC, a taxpayer must either have a qualifying child or must meet other requirements. A qualifying child must meet a relationship test, an age test, and a residence test. Part of the residence test requires that a qualifying child must have the same principal place of abode as the taxpayer for more than one-half of the taxable year (for the entire taxable year in the case of a foster child), and that this principal place of abode must be located in the United States.

In order to claim the EITC without a qualifying child, a taxpayer must not be a dependent and must be over age 24 and under age 65. In addition, the taxpayer's principal place of abode must be located in the United States for more than one-half of the taxable year.

Nonresidents and the EITC

The EITC may be claimed by a taxpayer meeting the above requirements regardless of whether the taxpayer is a U.S. citizen, a resident alien, or a nonresident alien.

Section 7701(b) defines a resident alien for income tax purposes. Aliens who do not meet this definition are nonresident aliens. For income tax purposes, an individual is generally considered a resident if the individual:

(1) has entered the United States as a lawful permanent U.S.

resident (the "green card test"); or

(2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for 183 or more days during a three-year period weighted toward the present year (the "substantial presence test").

(An individual who is present in the United States for fewer than 183 days and establishes that he has a closer connection with a foreign country than with the United States is generally not subject to tax as a resident alien on account of the substantial presence test.)

A nonresident alien may elect to be taxed as a resident alien if one of several elections is made:

(1) Under section 6013(g), a nonresident alien who is married to an individual who is either a citizen or resident alien of the United States at year end may elect to be treated as a resident for the entire year. The election applies to the year for which it is made and all subsequent years until terminated. However, the election will be suspended if neither spouse is a U.S. citizen or resident at any time during a taxable year.

(2) An election under section 6013(h) to be taxed as a resident alien for the entire taxable year may be made by an individual who is a nonresident alien at the beginning of the year and a resident alien at the end of the year and who is married to an individual who is either a citizen or resident of the United States at year end. Thus, this election can be made by a foreign married couple who arrived in the United States during the taxable year and who are resident aliens at year end.

(3) Under section 7701(b)(4), an alien individual may make the so-called "first-year election" to be treated as a resident for a calendar year in which he individual is not otherwise treated as a U.S. resident. To qualify for this election, each of several requirements must be met. The individual must not have been a U.S. resident during the preceding year and must satisfy the substantial presence test for U.S. residency in the following calendar year. The individual must also be present in the United States for at least 31 consecutive days during the year to which the election

applies, and be present in the United States, during the period beginning with the first day of that 31-day period and ending with the last day of the election year, for at least 75% of the days in that period. An individual who makes the first-year election is treated as a U.S. resident only for that portion of the year that begins on the first day of the period for which the individual satisfies both the 31 day and the 75-% tests.

Current California Law (R&T Sec. None)

California has no credit comparable to the federal Earned Income Tax Credit.

New Federal Law (Sec. 32)

1. EXTENSION OF THE EARNED INCOME TAX CREDIT TO MILITARY PERSONNEL STATIONED OUTSIDE THE UNITED STATES (SEC. 721 OF THE ACT)

The Act requires that members of the Armed Forces receive annual reports from the Department of Defense of earned income (which includes nontaxable earned income such as amounts received as basic allowances for housing and subsistence).

The Act extends the EITC to United States military personnel stationed overseas. For purposes of determining whether a qualifying child meets the residence test, for any period during which a member of the Armed Forces is stationed outside the United States while serving on extended active duty, the member would be considered as maintaining a place of abode in the United States, thus satisfying the present-law requirement that the principal place of abode for a qualifying child and the member be in the United States. For purposes of determining whether an individual without a qualifying child meets the residence test, a member of the Armed Forces stationed outside the United States on extended active duty would be considered as maintaining a place of abode in the United States.

2. CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EARNED INCOME TAX CREDIT (SEC. 722 OF THE ACT)

The Act makes individuals who are nonresident aliens for any portion of the taxable year ineligible to claim the EITC unless an election under

Code section 6013(g) or (h) is in effect for the taxable year. Thus, nonresident aliens are prevented from claiming the EITC unless they are married and agree to subject their worldwide income to U.S. individual income tax by virtue of making the election under sections 6013(g) or (h).

3. INCOME OF PRISONERS DISREGARDED IN DETERMINING EARNED INCOME TAX CREDIT (SEC. 723 OF THE ACT)

The Act removes from the definition of earned income in section 32 any amount received for services provided by an individual while the individual is an inmate at a penal institution.

Effective Date

1. EXTENSION OF THE EARNED INCOME TAX CREDIT TO MILITARY PERSONNEL STATIONED OUTSIDE THE UNITED STATES

The increased information reporting is effective for remuneration paid after December 31, 1994. Extension of the EITC to members of the Armed Forces stationed overseas is effective for taxable years beginning after December 31, 1994.

2. CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EARNED INCOME TAX CREDIT

The provision is effective for taxable years beginning after December 31, 1994.

3. INCOME OF PRISONERS DISREGARDED IN DETERMINING EARNED INCOME TAX CREDIT

The provision is effective for taxable years beginning after December 31, 1993.

Impact on California Revenue

Not applicable to California.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII D. - PROVISIONS RELATING TO RETIREMENT BENEFITS

Public Law: 103-465

Act Section: 731

Section Title: Treatment of Excess Pension Assets Used For Retiree Health Benefits

Federal Law Before Change (Sec. 420)

Under present law, defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Certain procedural requirements also must be met. Any assets that revert to the employer upon such termination are includible in the gross income of the employer and subject to an excise tax. The rate of the excise tax varies depending upon whether the employer maintains a replacement plan or makes certain benefit increases, and can be as high as 50% of the amount of the reversion. Upon plan termination, the accrued benefits of all plan participants are required to be 100-% vested.

Under present law, a pension plan may provide medical benefits to retirees through a section 401(h) account that is part of such plan. Present law permits certain qualified transfers of excess assets from the pension assets in a defined benefit pension plan (other than a multiemployer plan) to the section 401(h) account that is a part of such plan to pay for qualified current retiree health liabilities. The assets transferred are not includible in the gross income of the employer and are not subject to the excise tax on reversions.

Assets transferred in a qualified transfer cannot exceed certain limits. The amount that can otherwise be transferred is reduced by amounts previously contributed to a health benefits account or welfare benefit fund to pay for the qualified current retiree health liabilities. The transferred assets (and any income thereon) are required to be used to pay qualified current retiree health liabilities (either directly or through reimbursement) for the taxable year of the transfer. Transferred amounts are generally required to benefit all participants in the pension plan who are entitled upon retirement to receive retiree medical benefits (other than key employees) through the section 401(h) account.

Retiree health benefits of key employees may not be paid (directly or indirectly) our of transferred assets. In order for the transfer to be qualified, accrued retirement benefits under the pension plan must be nonforfeitable as if the plan terminated on the date of transfer. Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned at the end of the taxable year to the general pension assets of the plan.

Under a maintenance of effort requirement, an employer that makes a transfer to a section 401(h) account from the defined benefit plan assets is required to maintain employer-provided retiree health expenditures for covered retirees at a minimum dollar level for the taxable year of the transfer and the following 4 taxable years. The minimum dollar level is the higher of the applicable employer costs for each of the 2 taxable years immediately preceding the taxable year of the transfer.

The provision permitting the transfer of excess pension assets to pay current retiree health benefits expires for taxable years beginning after December 31, 1995.

Current California Law (R&T Sec. 17501)

California is fully conformed to the federal law but does not impose an excise tax on reversions.

New Federal Law (Sec. 420)

The present-law provision permitting excess defined benefit pension plan assets to be used to provide retiree health benefits under a section 401(h) account is extended for 5 years, with a modification to the maintenance of effort requirement and a clarification of the rules relating to amounts previously set aside to pay qualified retiree health liabilities. Under the Act, the employer is required to maintain substantially the same level of employer-provided retiree health coverage for the taxable year of the transfer and the following 4 taxable years. The level of coverage that must be maintained will be based on coverage provided in the year immediately preceding the taxable year of the transfer. For purposes of determining whether there are excess assets in a defined benefit pension plan, the interest rates required to be used under the Act for purposes of minimum funding requirements would apply.

The Act clarifies how amounts that can otherwise be transferred are reduced by amounts previously set aside to pay retiree health liabilities. Under the Act, for transfers occurring after December 31, 1995, in determining qualified retiree health liabilities with respect to a taxable year, such liabilities are reduced by the percentage that the amounts previously set aside are the total future qualified retiree health liabilities. For example, assume that on December 31, 1995, an employer has a welfare benefit fund that has $2 million in assets to pay retiree health liabilities, the present value of future qualified retiree health liabilities is $10 million, and qualified retiree health liabilities for 1996 (without regard to any offset) are $1 million. In determining the amount that can be transferred in 1996, the $1 million is reduced by 20%. No inference is intended as to the proper reduction in transferred amounts under present law.

Effective Date

The provision generally is effective with respect to taxable years beginning after December 31, 1995, and before January 1, 2001. The modification to the maintenance of effort requirement is effective for transfers occurring after the date of enactment.

Impact on California Revenue

Pending.

TITLE VII D. - PROVISIONS RELATING TO RETIREMENT BENEFITS

Public Law: 103-465

Act Section: 732

Section Title: Rounding Rules For Cost-of-living Adjustments

Federal Law Before Change (Sec. 401, 402, 408 & 415)

Under present law, the dollar limit on benefits under a defined benefit pension plan ($118,800 for 1994), the limit on elective deferrals under a qualified cash or deferred arrangement ($9,240 for 1994), and the minimum compensation limit for determining eligibility for participation in a simplified employee pension (SEP) ($396 for 1994) are adjusted annually for inflation. The dollar limit on annual additions to a defined contribution plan is the greater of $30,000 or 25% of the dollar limit for benefits under defined benefit pension plans. Thus, the dollar limit will be $30,000 until the defined benefit pension plan dollar limit exceeds $120,000. The dollar limit on annual compensation that generally may be taken into account for qualified plan purposes is $150,000. The $150,000 limit is indexed in $10,000 increments.

Current California Law (R&T Sec. 17501, 17504, 17507, 17508 & 23701p)

California is conformed to federal law as it read prior to the dollar limit reductions contained in the Revenue Reconciliation Act of 1993. Thus, California statute would allow higher limits before plan disqualification. Since federal limits are lower, however, actual contributions to pension plans will be governed by the federal limits.

New Federal Law (Sec. 401, 402, 408 & 415)

The provision provides that (1) the dollar limit on benefits under a defined benefit pension plan is indexed in $5,000 increments, (2) the dollar limit on annual additions under a defined contribution plan is indexed in $5,000 increments, (3) the limit on elective deferrals is indexed in $500 increments, and (4) the minimum compensation limit for SEP participation is indexed in $50 increments. In addition, the provision provides that the cost-of- living adjustment with respect to any calendar year is based on the increase in the applicable index as of the close of the calendar quarter ending September 30 of the preceding calendar year so that the adjusted dollar limits would be available before the beginning of the calendar year to which they apply. No limit is reduced below the limit in effect for plan years beginning in 1994.

Effective Date

The provision is effective for years beginning after December 31, 1994.

Impact on California Revenue

Pending.

TITLE VII D. - PROVISIONS RELATING TO RETIREMENT BENEFITS

Public Law: 103-465

Act Section: 733

Section Title: Increase in Inclusion of Social Security Benefits Paid to Nonresidents

Federal Law Before Change (Sec. 871)

Treatment of taxpayers generally. — A portion of Social Security and Railroad Retirement Tier 1 benefits is includible in gross income for taxpayers whose provisional incomes exceed a threshold amount (the "base amount"). For taxpayers whose provisional incomes exceed a second threshold amount (the "adjusted base amount"), a larger portion of such benefits is includible in gross income. For purposes of these computations, a taxpayer's provisional income includes modified adjusted gross income (adjusted gross income plus tax-exempt interest plus certain foreign source income) plus one-half of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit. The base amount is $32,000 for married taxpayers filing joint returns, $25,000 for unmarried taxpayers, and $0 for married taxpayers filing separate returns. The adjusted base amount is $44,000 for married taxpayers filing joint returns, $34,000 for unmarried taxpayers, and $0 for married taxpayers filing separate returns.

If the amount of provisional income exceeds the base amount but does not exceed the adjusted base amount, then the amount of the inclusion is the lesser of (1) 50% of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit, or (2) 50% of the excess of the taxpayer's provisional income over the base amount.

If the amount of provisional income exceeds the adjusted base amount, then the amount of the inclusion is the lesser of:

(1) 85% of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit or

(2) the sum of:

(a) 85% of the excess of the taxpayer's provisional income over the adjusted base amount, plus

(b) the smaller of

(i) the amount of benefits that would have been included if the 50-% inclusion rule (the rule in the previous paragraph) were applied, or

(ii) one-half of the difference between the adjusted base amount and the base amount of the taxpayer.

Beginning in 1983 (when benefits were included in income pursuant to the Social Security Amendments of 1983 (the "1983 Act")) and continuing until the Omnibus Budget Reconciliation Act of 1993 (the "1993 Act"), in all cases where provisional income was over the base amount, the amounts included were limited by the lesser of 50% of the taxpayer's benefits, or 50% of the excess of provisional income over the base amount.

Treatment of nonresident alien individuals. — If a nonresident alien individual is engaged in a trade or business within the United States during the taxable year, the individual is subject to tax under the Code, at the normal graduated rates, on net taxable income that is effectively connected with the conduct of the trade or business. U.S. source fixed or determinable annual or periodical income of a nonresident alien individual (for example, salary, wages, annuities, compensation, remuneration, and emoluments) that is not effectively connected with the subject to tax under the Code at a rate of 30% of the gross amount paid. This latter tax generally is collected by means of withholding (hence this tax is often called a "withholding tax"). Withholding taxes are often reduced or eliminated in the case of payments to residents of countries with which the United States has an income tax treaty.

Under rules that have been in the Code since the 1983 Act, for purposes of taxing the income of nonresident alien individuals, the income thresholds for including Social Security and Railroad Retirement Tier 1 benefits do not apply. Instead, 50% of any such benefit is included in gross income. Thus, a nonresident alien individual typically may be subject to U.S. withholding tax under the Code at an effective rate of 15% on the gross amount of U.S. social security benefits. This tax may be reduced or eliminated under some treaties. Although the 1993 Act increased the inclusion of benefits in some cases, for taxpayers other than nonresident aliens, to up to 85% of the benefits, the 1993 Act did not amend the rule that a nonresident alien individual is required to include 50% (and only 50%) of these benefits in gross income.

Current California Law (R&T Sec. None)

California has no rules similar to Section 871 of the Internal Revenue Code relating to nonresident aliens.

New Federal Law (Sec. 871)

The provision increases from 50% to 85% the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual. Thus, under the provision a nonresident alien individual may be subject to U.S. withholding tax under the Code at an effective rate of 25.5% on the gross amount of U.S. Social Security or Railroad Retirement Tier 1 benefits.

The provision does not impose tax contrary to any treaty obligation of the United States. Thus, in cases where taxation of such a benefit would conflict with an existing treaty, the treaty would continue to prevail.

Effective Date

The provision is effective for benefits paid after December 31, 1994, in taxable years ending after such date.

Impact on California Revenue

Not Applicable.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII E. - OTHER PROVISIONS

Public Law: 103-465

Act Section: 741

Section Title: Partnership Distributions of Marketable Securities

Federal Law Before Change (Sec. 731 & 737)

Neither a partnership nor its partners generally recognize gain upon a distribution of partnership property to a partner (sec. 731(a)(1) and (b)). A partner is required to recognize gain, however, to the extent that the amount of money distributed exceeds the partner's basis in its partnership interest immediately before the distribution (sec. 73 1(a)(1)). Thus, in general, if a partnership distributes cash to a partner in an amount that exceeds the adjusted basis of the partner's interest in the partnership, the partner must recognize gain; but if the partnership distributes marketable securities to the partner in lieu of cash, the partner can defer recognizing gain.

A partner's basis in property distributed in a nonliquidating distribution is the lesser of the partnership's adjusted basis in the distributed property or the partner's adjusted basis in partnership interest (reduced by money distributed in the transaction) (sec. 732(a)). A partner's adjusted basis in its partnership interest is reduced by the amount of money and the basis of property distributed to him in a non-liquidating distribution (sec. 733).

In a liquidating distribution, the partner's basis in the distributed property equals the partner's basis in the partnership interest (reduced by money distributed in the transaction) (sec. 732(b)).

A partner that contributes appreciated property to a partnership is required to include pre-contribution gain in income to the extent that the value of other property distributed by the partnership to that partner exceeds its adjusted basis in its partnership interest (sec. 737). This rule applies if the distribution is made within 5 years after the contribution of the appreciated property.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

Current California Law (R&T Sec. 17851)

California is conformed to federal law with no exceptions.

New Federal Law (Sec. 731 & 737)

The Act generally provides that, for purposes of determining the amount of gain that a partner recognizes upon the distribution of marketable securities by a partnership, the fair market value of the securities is treated as money. Thus, a partner generally recognizes gain under the provision to the extent that the sum of the fair market value of marketable securities and money received exceeds the partner's basis in its partnership interest. The value of the marketable securities is their fair market value as of the date of the distribution.

Definition of marketable securities

Under the provision, marketable securities means financial instruments and foreign currencies that are, as of the date of the distribution, actively traded (within the meaning of section 1092(d)(1)). For purposes of the definition of marketable securities, a financial instrument includes financial products such as stocks and other equity interests, evidences of indebtedness, options, futures and forward contracts, notional principal contracts and derivatives.

In addition, marketable securities include certain other specified items.

First, marketable securities include any interest in a common trust fund or a regulated investment company (RIC) that is offering for sale or has outstanding any redeemable security (within the meaning of the Investment Company Act of 1940). Thus, an interest in an open-ended mutual fund is treated as a marketable security even though, for example, trading in fund shares takes place exclusively through purchase and redemption transactions with the issuer of the fund shares.

Second, marketable securities include any financial instrument that, pursuant to its terms or any other arrangement, is readily convertible into, or exchangeable for, money or marketable securities. For example, under this rule, an in-the-money option to buy marketable securities is treated as a marketable security because the holder can readily convert it to marketable securities by exercising the option.

Third, marketable securities include any financial instrument the value of which is determined substantially by reference to marketable securities. For example, a private notional principal contract that itself is not actively traded, but whose value is determined by reference to a financial instrument that is actively traded, is a marketable security. Similarly, an interest in an index fund that is not itself actively traded, but whose value is determined by reference to an index of securities that are actively traded, is a marketable security. As a further example, privately offered stock whose value is determined by reference to actively traded stock of another class or another issuer, is a marketable security.

Fourth, except to the extent provided in regulations, marketable securities include any interest in a precious metal which as of the date of the distribution is actively traded, unless the precious metal was produced, used, or held in the active conduct of a trade or business by the partnership. Thus, for example, monetized or unmonetized gold coins, and gold or silver ingots or bullion, are marketable securities, if they are not produced, used or held in the active conduct of a trade or business by the partnership.

Fifth, except as otherwise provided in regulations, an interest in any entity is a marketable security if substantially all of the assets of the entity consist (directly or indirectly) of marketable securities, money, or both. As under present law (sec. 704(1)(B) and 737(d), the provision may not be avoided by distributing interests in such an entity that are not actively traded. The entire interest in such an entity is intended to be treated as a marketable security under this rule, even if the entity (directly or indirectly) holds other assets.

Sixth, the Act provides limited regulatory authority permitting the Treasury Department to treat as a marketable security an interest in an entity, even though less than substantially all of the entity's assets (directly or indirectly) consist of marketable securities, money, or both. Such an interest in an entity may not, however, be treated under regulations as a marketable security except to the extent of the value of the interest that is attributable to marketable securities, money, or both.

Actively traded

The term actively traded has the same meaning as under Code section 1092(d). It is intended that Treasury regulations interpreting the meaning of actively traded under section 1092(d) apply.

Exceptions - The Act provides four exceptions to the general rule that gain is recognized upon a partnership distribution of marketable securities to the extent the sum of the value of the marketable securities and money distributed exceeds the partner's basis in its partnership interest.

Securities contributed by the distributee

The provision generally does not apply to the distribution of a marketable security to a partner if the security was contributed to the partnership by the partner. The provision does apply to the extent that the value of distributed security is attributable to marketable securities or money contributed (directly or indirectly) to the entity to which the distributed security relates. For example, if marketable securities are contributed by a partnership to a corporation (or lower tier subsidiary of a corporation) whose stock had been contributed to the partnership by a partner, the provision would apply to the distribution of stock of the corporation back to the contributing partner to the extent the value of such stock is attributable to the marketable securities or money contributed. The provision does not apply (unless otherwise provided in regulations) to the extent that the value of an interest in an entity contributed by the distributee partner is attributable to marketable securities or money that the distributee also contributed to the partnership.

Securities not marketable when acquired

To the extent provided in regulations, the provision does not apply to a distribution of a marketable security that was not a marketable security when the partnership acquired it. For example, under this regulatory authority, the application of the provision may be suspended, in the case of a distribution of stock of a corporation acquired by the partnership in a private placement, if the corporation subsequently went public and its stock is actively traded at the time the partnership distributes it.

Distributions by investment partnerships

The provision does not apply to a distribution of marketable securities by an investment partnership to an eligible partner.

Investment partnership. — An investment partnership is a partnership that (1) has never been engaged in a trade or business and (2) substantially all of whose assets consist of specified investment-type assets. A partnership is not treated as engaged in a trade or business by reason of any activity as an investor, trader or dealer in the specified investment-type assets. These activities are intended to include the receipt of any commitment fees, break-up fees, guarantee fees, director's fees or similar fees that are customary in and incidental to an activity as such an investor, trader or dealer. In addition, regulatory authority is provided to specify other activities in which a partnership may engage without being treated as engaged in a trade or business. For example, it is anticipated that regulations will generally treat the following activities, for purposes of this provision, as not causing a partnership to be treated as engaged in a trade or business: (1) reasonable and customary management services provided to a lower-tier partnership; and (2) incidental services customarily provided in starting up a company in which the partnership holds a significant equity interest.

The specified investment-type assets are (1) money, (2) stock in a corporation, (3) notes, bonds, debentures, or other evidences of indebtedness, (4) interest rate, currency, or equity notional principal contracts, (5) foreign currencies, (6) interests in or derivative financial instruments (including options, forward or futures contracts, short positions, and similar financial instruments) in any other specified investment-type asset or in any commodity traded on a board of trade or commodity exchange, (7) other assets specified in regulations, or (8) any combination of the foregoing.

A look-through rule applies with respect to partnership interests. Except as otherwise provided in regulations, a partnership is treated as holding a proportionate share of the assets of any lower-tier partnership, and as engaging in any trade or business conducted by a lower-tier partnership, and a partner who contributes a partnership interest to another partnership is treated as contributing a proportionate share of the assets of the contributed partnership (and any lower-tier partnerships). Regulations may provide that this look-through rule does not apply (for example, in the case of a limited partnership interest held by a partnership, if the holding partnership does not engage in the management of the limited partnership). The Act provides that if, under regulations, the lookthrough rule does not apply to a partnership interest, then that partnership interest is treated as if it were a specified investment-type asset listed above (i.e., permitted to be held by an investment partnership).

Eligible partner. – An eligible partner is one that, before the date of the distribution, did not contribute to the partnership any property other than specified investment-type assets permitted to be held by an investment partnership. A partner is not treated as failing to be an eligible partner solely by virtue of having contributed services to the partnership. A partner who is not an eligible partner may not remove the taint from his partnership interest by transferring any portion of his interest to another person in a transaction in which gain or loss is not recognized in whole or in part.

Limitation on gain recognized

The Act permits a partner to receive a distribution of marketable securities without recognizing the gain that is attributable to his share of the partnership's net appreciation with respect to securities of the type distributed. For this purpose, a type of securities means a class of securities (for example, residual common stock) of a single issuer.

The Act provides that the amount of marketable securities treated as money is reduced by the excess of (1) the partner's distributive share of any net gain that he would take into account if all the securities (of the type distributed) held by the partnership immediately before the distribution were sold for their fair market value, over (2) the partner's distributive share of any net gain that he would take into account if all the securities (of that type) held by the partnership immediately after the distribution had been sold. In making this determination, the partner's share of net gain is determined immediately before and immediately after the transaction, using the same fair market value for the securities in each case. Thus, in the case of a transaction involving a series of distributions, the partner's share of net gain is unaffected by changes in the value of the distributed securities during the course of the distributions. In addition, the amount of gain allocated to a partner is determined with regard to any basis adjustment under section 743(b) with respect to that partner.

For example, assume that partnership ABC holds 300 shares of the common stock of X corporation, a marketable security, and other assets. A holds a 1/3 interest in the capital and profits of the partnership. Each share of stock held by the partnership has a basis of $10 and a value of $100. A's adjusted basis in its partnership interest is $5,000. Assume that the partnership distributes all the shares of X corporation to A in liquidation of his partnership interest. Under the general rule of new section 731, the $30,000 value of the X stock would be treated as money for purposes of determining A's gain. Under this gain limitation rule, however, the $30,000 amount is reduced by $9,000, the amount of gain that A would have taken into account if the partnership had sold all 300 shares of X stock for a total of $30,000. Thus, A recognizes a gain of $16,000 ($30,000 reduced by $9,000 (or $21,000), further reduced by A's $5,000 basis in his partnership interest).

The Treasury Secretary may issue regulations applying these rules by treating all marketable securities as being of the same type.

Other rules

Basis of securities distributed. – The Act provides that the adjusted basis of the distributed marketable securities is increased (over the basis as determined under present-law section 732) by the amount of gain recognized by reason of this provision. The amount of gain so recognized is allocated among the distributed marketable securities in proportion to the amounts of unrealized appreciation (determined before the increase in basis under the provision).

For example, assume that a partnership distributes to a partner, in a nonliquidating distribution, marketable security A with a value of $100 and a basis of $60, and marketable security B with a value of $100 and a basis of $40. The distributee partner's basis in his partnership interest is $120. Under present law, no gain is recognized, the partner's basis in security A is $60 and in security B is $40, and his adjusted basis in his partnership interest is $20. Assume that the partner will recognize gain of $40 under the provisions of the Act.

Under the Act, 40% of the gain (i.e., $16) is allocated to security A, and 60% of the gain (i.e., $24) is allocated to security B. Thus, the partner's basis in security A is $76 (i.e., $60 basis plus $16 gain allocated), and in security B is $64 (i.e., $40 basis plus $24 gain allocated). This result is the same whether security A and security B are securities of different issuers, of different classes of the same issuer, or blocks of securities of the same class and issuer but with different adjusted bases in the hands of the partnership.

Other basis rules

The adjusted basis of the partner's partnership interest and the partnership's adjusted basis in its remaining assets are determined without regard to this provision. The bill provides that rules for determining the distributee partner's basis in his partnership interest (sec. 733) are applied as if no gain were recognized, and no adjustment were made to the basis of property, under this provision. Thus, as under present law, the distributee partner's basis in his partnership interest is reduced (in a nonliquidating distribution) by the basis of the distributed securities, as determined under section 732 and without regard to the provisions of the Act. Therefore, in the foregoing example, the distributee's basis in his partnership interest, initially $120, is reduced by the sum of the bases (in the hands of the partnership) of security A ($60) and security B ($40), for a total reduction of $100. After the distribution, his basis in his partnership interest is $20.

The Act also provides that any increase or decrease (under sec. 734) in the basis of undistributed property of a partnership with a section 754 election in effect is made as if no gain were recognized, and no adjustment were made to the basis of property, under new section 731.

Coordination with section 737

The Act coordinates this provision with the provisions of present law relating to recognition of pre-contribution gain by a contributing partner (sec. 737). To the extent that the value of marketable securities distributed is treated as money for purposes of this provision, that amount is also treated as money for purposes of determining the amount of gain recognized under section 737. The amount treated as money may result in gain recognition under new section 721, and may therefore reduce the amount of gain otherwise recognized under section 737.

The basis adjustments resulting from gain recognized by reason of this provision are made in accordance with the rules of this provision, and not under the rules of section 737.

For example, in the case of a distribution of both marketable securities and other property to a partner who contributed appreciated property to the partnership, the partner may recognize gain under both new section 731 and section 737. The gain arising from the distribution of marketable securities increases the basis of the marketable securities in the hands of the distributee, while the section 737 gain arising from the distribution of the other property is allocated as under present law (i.e., to the partner's partnership interest (sec. 737(1)), rather than to the marketable securities or directly to the other distributed property). As a result, the partner's basis in the distributed securities is determined without reference to the step-up in basis under section 737. These rules carry out the intent of the provision not to increase the basis of distributed marketable securities above their fair market value.

For example, assume that partner A contributed property with an adjusted basis of $100 and a value of $200 to partnership X. A's basis in its partnership interest is $100 (sec. 722). Within five years (assuming no other partnership activity), X distributes to A in a nonliquidating distribution a marketable security (which A did not contribute) with an adjusted basis of $100 and a value of $120, together with other property with an adjusted basis of $0 and a value of $20. A recognizes $40 of gain. Assuming that A's $20 of gain on the distribution of the marketable securities is reduced by $5 under the limitation on gain recognized rule of new section 731(3)(B), A recognizes $15 of the gain by reason of new section 731 and $25 by reason of section 737. After the distribution, A's adjusted basis in the marketable security is $115, that is, $100 (as determined under sec. 732(a)(2)), increased by $15 (the gain recognized by reason of new section 731©). A's adjusted basis in its partnership interest is $25 ($100 reduced by $100 (the basis to the partner of the property distributed, computed without regard to section 731), and increased by $25 (the gain recognized under section 737). A's basis in the other property is $0, as under present law (sec. 732(a)). The partnership's adjusted basis in the contributed property is increased by $25 (sec. 737(2)).

Character of gain recognized

The Act provides that, to the extent the basis of any marketable security which is an unrealized receivable or an inventory item (as defined in sec. 751 and 751(d)(2)) is increased by reason of this provision, the gain recognized is ordinary income.

Regulatory authority. — The Act provides that the Treasury Secretary shall promulgate regulations necessary or appropriate to carry out the purposes of this provision, including regulations to prevent the avoidance of the provision. It is intended that these regulations effectively prevent taxpayers from avoiding the intent of this provision and, where appropriate, provide relief from the application of the provision.

It is intended that regulations address avoidance of the provision through, for example, arrangements involving changes in partnership allocations and distribution rights, multiple distributions, related entities, or otherwise. Thus, for example, regulations may provide that exceptions to the provision do not apply if the partnership allocations are changed to increase a partner's share of marketable securities shortly before a distribution, or to achieve the functional equivalent of a distribution (without an actual distribution) by allocating substantially all the items associated with the security to a particular partner or partners. As another example, regulations may address avoidance of this provision in the case in which a partnership distributes substantially all of its assets (other than marketable securities and money) to some partners, with the practical effect of a distribution of the marketable securities to the other partners. As a further example, regulations may address avoidance of the provision through distributions of property in connection with a pre-arranged purchase of the distributed property, or through transactions involving a distribution of property together with the right to dispose of such property at substantially above its fair market value.

Effective Date

The provision generally applies to partnership distributions after the date of enactment, except that the provision does not apply to any marketable security distributed before January 1, 1995 by the partnership that held the security on July 27, 1994. It is intended that this exception for securities held on July 27, 1994 apply to marketable securities acquired by the partnership after that date and distributed before January 1, 1995, if the basis of such securities is determined by reference to the securities held by the partnership on July 27, 1994 (e.g., securities received in a stock split or reorganization). If a partner receives a distribution of marketable securities otherwise eligible for this exception for securities held on July 27, 1994, and such securities are re-contributed to the partnership so that the exception for securities contributed by the distributee partner (described above) arguably might later apply, then this exception (for securities held on July 27, 1994) is intended not to apply.

A transition rule provides that the provision does not apply to a partnership distribution of marketable securities in liquidation of a partner's interest pursuant to a written contract, binding on July 15, 1994 and at all times thereafter before the distribution, to purchase the partner's interest by a date certain for a fixed value of marketable securities that are specified in the contract or for other property; provided that the transition rule does not apply if the partner has the right unilaterally to elect that the distribution be made other than in marketable securities. A fixed value of marketable securities is intended to mean a value fixed in dollars or another currency. This transition rule does not affect whether sections 737 or 707 apply.

The provision does not apply to a distribution of marketable securities by any publicly traded partnership (defined in sec. 7704(b)) that as of December 31, 1987 met the definition of an existing partnership (under sec. 10211(2) of the Revenue Act of 1987, i.e., the effective date rules of sec. 7704), provided certain requirements are met. The requirements are met if the distribution occurs in a qualified partnership liquidation and if (1) the marketable securities were received by the partnership in a nonrecognition transaction in exchange for substantially all of the assets of the partnership, (2) the marketable securities are distributed by the partnership within 90 days after their receipt by the partnership, and (3) the partnership is liquidated before the beginning of the first taxable year of the partnership beginning after December 31, 1997. A qualified partnership liquidation for this purpose is a complete liquidation of a publicly traded partnership described above, or a complete liquidation of a partnership that is related to such a publicly traded partnership if its liquidation is related to the complete liquidation of such publicly traded partnership.

Impact on California Revenue

Pending.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII E. - OTHER PROVISIONS

Public Law: 103-465

Act Section: 742

Section Title: Taxpayer Identification Numbers Required At Birth

Federal Law Before Change (Sec. 32 & 6109)

A taxpayer claiming an exemption for a dependent is required to provide a taxpayer identification number (TIN) on the tax return for any dependent who has attained the age of 1 as of the close of that taxable year (sec. 6109(e)). A parallel requirement applies to taxpayers with qualifying children claiming the earned income tax credit (EITC) (sec. 32(3)(D)). An individual's TIN is, in general, that individual's social security number.

Current California Law (R&T Sec. 18624)

California is conformed to federal requirements for indentifying numbers on tax returns, statements, or other documents except that the California statute specifically does not require the identification numbers of dependents to be shown on the state tax return.

New Federal Law (Sec. 32 & 6109)

Taxpayers claiming dependents must provide a TIN for each dependent, regardless of the dependent's age. A parallel requirement applies to taxpayers with qualifying children claiming the EITC. Some taxpayers may encounter legitimate difficulties in obtaining a TIN within the timeframe necessary for filing a tax return (such as, for example, where a child is being adopted). It is anticipated that the IRS will provide reasonable administrative accommodation in these legitimate situations.

Effective Date

For returns filed with respect to tax year 1995, taxpayers must provide TINs for all dependents and qualifying children for EITC purposes who were born on or before October 31, 1995. For returns filed with respect to tax year 1996, taxpayers must provide TINs for all dependents and qualifying children born on or before November 30, 1996. For returns filed with respect to tax year 1997, and all subsequent years, taxpayers must provide TINs for all dependents and qualifying children, regardless of their age.

Impact on California Revenue

Not applicable.

TITLE VII E. - OTHER PROVISIONS

Public Law: 103-465

Act Section: 743

Section Title: Extension of Internal Revenue Service User Fees

Federal Law Before Change (Sec. 10511 Of The Revenue Act Of 1987)

The Internal Revenue Service (IRS) provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS responds to these inquiries through the issuance of letter rulings, determination letters, and opinion letters. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. The legislation that requires the establishment of this fee program provides that it is not to apply to requests made after September 30, 1995.

Current California Law (R&T Sec. None)

California does not conform to this provision.

New Federal Law (SEC. 10511 OF THE REVENUE ACT OF 1987)

The IRS user fee program is extended for five years.

Effective Date

The provision applies to requests made after September 30, 1995, and before October 1, 2000.

Impact on California Revenue

Not applicable.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII E. - OTHER PROVISIONS

Public Law: 103-465

Act Section: 744

Section Title: Modification of Substantial Understatement Penalty For Corporations Participating in Tax Shelters

Federal Law Before Change (Sec. 6662)

Under present law, a 20-% penalty applies to any portion of an underpayment of income tax required to be shown on a return that is attributable to a substantial understatement of income tax. For this purpose, an understatement is considered "substantial" if it exceeds the greater of (1) 10% of the tax required to be shown on the return, and (2) $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Generally, the amount of an "understatement" of income tax is the excess of the tax required to be shown on the return, over the tax shown on the return (reduced by any rebates of tax). The substantial understatement penalty does not apply if there was a reasonable cause for the understatement and the taxpayer acted in good faith with respect to the understatement (the "reasonable cause exception"). The determination as to whether the taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances.

In determining whether an understatement is substantial, the understatement generally is reduced by the portion of the understatement that is attributable to an item for which there was substantial authority or adequate disclosure. In the case of tax shelter items, however, the understatement is reduced only by the portion of the understatement that is attributable to an item for which there both was substantial authority and with respect to which the taxpayer reasonably believed that the claimed treatment of the item was more likely than not the proper treatment. Disclosure made with respect to a tax shelter item does not affect the amount of an understatement.

A tax shelter is any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement if the principal purpose of such partnership, entity, plan or arrangement is to avoid or evade

Federal income tax. An item of income, gain, loss, deduction or credit is a tax shelter item if the item is directly or indirectly attributable to the principal purpose of the tax shelter.

Current California Law (R&T Sec. 19164)

California is conformed, by reference, to federal rules that relate to penalties imposed on taxpayers and tax preparers with regard to the substantial understatement of tax.

New Federal Law (Sec. 6662)

With respect to corporate taxpayers, the Act eliminates the exception to the substantial understatement penalty regarding tax shelter items for which the taxpayer had substantial authority and reasonably believed that its treatment was more likely than not the proper treatment. Thus, if a corporate taxpayer has a substantial understatement that is attributable to a tax shelter item, the substantial understatement penalty applies with respect to the understatement, unless the "reasonable cause exception" applies.

A determination by a taxpayer or a professional tax advisor that the substantial authority and more likely than not standards are satisfied will be an important factor in assessing whether the "reasonable cause exception" applies, but it will not be enough, by itself, to establish that the "reasonable cause exception" does in fact apply. For example, reliance on the opinion of a professional tax advisor may be unreasonable where the advisor makes inappropriate legal or factual assumptions, does not address all relevant issues, or inappropriately relies on representations or agreements to take certain actions made by the taxpayer or other parties.

It is the intent of the provision that the standards applicable to corporate shelters be tightened; consequently, in no instance would this modification result in a penalty not being imposed where a penalty would have been imposed under prior law.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

Effective Date

The provision applies to transactions occurring after the date of enactment.

Impact on California Revenue

Not Appicable.

TITLE VII E. - OTHER PROVISIONS

Public Law: 103-465

Act Section: 745

Section Title: Modification of Authority to Set Terms And Conditions For Savings Bonds

Federal Law Before Change (Sec. 3105 of the United States Code)

The Department of Treasury has the authority to issue savings bonds and to design the key features of those bonds, including their investment yield. The Treasury also has the authority to change the investment yield for outstanding bonds, although never below the minimum investment yield guaranteed at issuance through the original maturity date. For Series E bonds, the investment yield must be at least four percent per year compounded semiannually. (Series EE bonds are the only Series E bonds currently issued.)

Series EE savings bonds are noncallable, nontransferable, registered securities redeemable anytime after six months from the date of issue. Prior to March 1993, Treasury regulations provided for investment yields that exceeded four percent per year and increased with holding periods of between 6 months and 5 years. Currently, bonds held less than five years pay the statutory minimum investment yield of four percent per year. Bonds held five years or longer pay a market-based investment yield of 85% of an average of applicable yields for the holding period on outstanding Treasury securities with approximately five years remaining to maturity or four percent, whichever is greater.

Current California Law

The Franchise Tax Board does not administer the issuance of bonds.

New Federal Law (Sec. 3105 of the United States Code)

The Act repeals the present-law requirement that United States Series E savings bonds pay investment yields of at least four percent per year, compounded semiannually.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

Effective Date

The provision is effective for bonds issued on or after October 31, 1994.

Impact on California Revenue

Not applicable.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

TITLE VII F. - PENSION PLAN FUNDING AND PREMIUMS

Public Law: 103-465

Act Section: 750 - 778

Section Title: Pension Plan Funding And Premiums

Federal Law Before Change (Sec. 401, 412, 411, 415 & 417)

Defined benefit pension plans. — A defined benefit pension plan is a type of employer-sponsored retirement plan that provides benefits to participants based upon a formula specified in the plan. For example, a defined benefit pension plan could provide a benefit equal to a percentage of an employee's average compensation multiplied by the number of years of service with the employer. A defined benefit pension plan could also provide a flat dollar benefit based on years of service, or a specified percentage of final or average compensation. The key feature of such a plan is that the benefit promised is based on the plan formula, not on the assets or investment experience of the plan.

In order to help ensure that the promised benefits are paid to plan participants, defined benefit pension plans are subject to minimum funding requirements under both the Internal Revenue Code (the Code) and title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), which require the employer sponsoring the plan to make certain contributions to fund the plan. These requirements are discussed in detail below.

Pension Benefit Guaranty Corporation. — As enacted in ERISA, as well as under present law, the minimum funding requirements permit an employer to fund defined benefit pension plan benefits over a period of time. Thus, it is possible that a plan may be terminated at a time when plan assets are not sufficient to provide all benefits earned by employees under the plan. In order to protect plan participants from losing retirement benefits in such circumstances, the Pension Benefit Guaranty Corporation (PBGC), a corporation within the Department of Labor, was created in 1974 by ERISA to provide an insurance program for benefits under most defined benefit pension plans maintained by private employers. According to the PBGC's annual report for fiscal year 1993, the single-employer insurance program covers more than 32 million participants in about 64,000 defined benefit pension plans.

Termination of underfunded pension plans. — Prior to 1986, an employer generally could, subject to contractual obligations, terminate a single-employer defined benefit pension plan at any time without regard to the financial health of the employer and without regard to the level of assets in the plan. If a single-employer defined benefit pension plan was terminated with assets insufficient to pay benefits at the level guaranteed by the PBGC, the employer was liable to the PBGC for the lesser of the insufficiency or an amount equal to 30% of the employer's net worth.

Under these rules, employers that wanted to rid themselves of unfunded liabilities could simply terminate the plan, and the PBGC would be liable for benefits. The PBGC was in some cases prevented from recouping its liability from the employer, even if the employer was financially sound. The plan termination rules were amended to prevent such transferring of liabilities to the PBGC by the Single-Employer Pension Plan Amendments Act of 1986 (SEPPAA) and were modified further by the Pension Protection Act of 1987.

Under present law, a defined benefit pension plan with assets insufficient to provide for benefit liabilities can be terminated voluntarily by the employer only if the employer and members of the controlled group of the employer are in financial distress (a distress termination). In general, benefit liabilities include all fixed and contingent liabilities to plan participants and beneficiaries. Following a distress termination, the PBGC pays out all benefits under the plan, including guaranteed benefits and those not guaranteed. The amount of benefits in excess of guaranteed benefits that are paid to plan participants depends on the level of plan funding and the amount the PBGC is able to recover from the employer. The employer is liable to the PBGC for the full amount of unfunded benefit liabilities.

Guaranteed benefits. — The PBGC guarantees vested retirement benefits (other than those that vest solely on account of the plan termination), up to a maximum benefit of $2,556.82 per month for plans terminating in 1994. The dollar limit is indexed annually for inflation. The guarantee is reduced for benefits starting before age 65, and does not apply to certain types of ancillary benefits. In the case of a plan or a plan amendment that has been in effect for less than 5 years before a plan termination, the amount guaranteed is generally phased in by 20% a year.

Sources of PBGC funding. – The PBGC is funded by assets in terminated plans, amounts recovered from employers who terminate underfunded plans, premiums paid with respect to covered plans, and investment earnings. All covered plans are required to pay a flat per-participant premium and underfunded plans are subject to an additional variable premium based on the level of underfunding.

As initially enacted in ERISA, covered plans were required to pay an annual flat premium to the PBGC of $1.00 per plan participant. The flat-rate per-participant premium has been increased several times since the enactment of ERISA, and is currently $19 per participant in 1994. The variable rate premium was enacted by the Pension Protection Act of 1987.

It was believed that underfunded plans should bear a greater share of the premium than well-funded plans because they pose a greater risk of exposure to the PBGC. The amount of the variable rate premium is $9.00 per each $1,000 of unfunded vested benefits, up to a maximum of $53 per participant. Thus, the maximum total per-participant premium for an underfunded plan is $72 per year.

Financial status of the PBGC. – As of September 30, 1993, the PBGC reported a deficit of $2.9 billion in the single-employer insurance program. This is an increase over the $2.7 billion deficit reported as of the end of the prior fiscal year. The PBGC also estimated in its 1993 annual report that approximately $53 billion in unfunded liabilities existed in single-employer defined benefit pension plans in 1992. Approximately 72% of this underfunding, or approximately $38 billion, is concentrated in single-employer plans sponsored by just 50 companies, primarily in the steel, automobile, tire, and airline industries.

The PBGC has estimated its future financial status under a variety of assumptions. The single-employer program deficit could range from $1.9 billion by the end of 2003 if losses are relatively low, to $13.8 billion by the end of 2003 if losses are high.

In a study released by the U.S. General Accounting Office (GAO) in December 1992, GAO reported that the 44 plans with the largest claims against the PBGC for calendar years 1986-88 had aggregate unfunded liabilities at termination of $2.7 billion. These unfunded liabilities were $990 million, or 58%, higher than the $1.7 billion in unfunded liabilities reported by the 44 plans on their last, pretermination annual filing with the Internal Revenue Service (IRS). GAO termed this additional unfunded liability a "hidden liability" to the PBGC because it was not reported by plans before termination.

Hidden liabilities can result from several causes. Most of the $990 million in hidden liability reported in the GAO study was due to PBGC's higher estimate of plan liabilities as a result of PBGC's use of actuarial assumptions that were different than the assumptions used by plan sponsors. Hidden liabilities also can result because of the payment of shutdown or special early retirement benefits, earlier than anticipated retirements, and PBGC's receipt of fewer assets than reported by the plans.

Reasons for PBGC's financial status. — The chronic underfunding of some defined benefit pension plans poses a significant risk to the PBGC. The PBGC's single-employer insurance program has a $2.9 billion deficit. Furthermore, the overall level of underfunding is rapidly increasing among single-employer plans and now exceeds $50 billion. Of this amount, reasonably possible future claims against the PBGC exceed $13 billion. These claims, and the continued underfunding of pension benefits threaten the future solvency of the PBGC and may lead to a taxpayer bailout if the Federal Government is required to pay pension benefits to participants of underfunded pension plans which terminate.
There is concern that the sponsors of underfunded defined benefit pension plans continue to promise additional pension benefits without funding the plans' existing unfunded pension liabilities. Under present law, new pension liabilities can be added to an underfunded defined benefit pension plan before old liabilities are funded. Companies in financial difficulty sometimes use benefit increases as a means to increase compensation when they cannot afford to pay higher current wages. Workers may be willing to accept such unfunded future pension promises because they are at least partially insured by the PBGC and workers recognize that the immediate costs to their employers of higher wages makes such wage increases unlikely. Under present law, sponsors of underfunded defined benefit pension plans are not required to fund their plans within a reasonable time. Under present law, plan sponsors are allowed to fund their pension liabilities over an extended period of

time. Some companies have taken advantage of the flexibility under the present-law rules and have chosen to maintain their plans at significantly underfunded levels. Some companies have used this funding flexibility to maintain chronically underfunded plans whose financial condition has not improved since the passage of ERISA nearly 20 years ago. In a few cases, companies have terminated plans with no remaining assets without ever violating present-law minimum funding standards. The PBGC lacks sufficient information from defined benefit pension plan sponsors with which to determine the risks it bears as the result of underfunded defined benefit pension plans. Under present law, the PBGC can subpoena information from plans and plan sponsors for the purpose of carrying out its responsibilities under ERISA. However, this subpoena process is rarely used because it is costly, labor intensive and time consuming. As a result, the PBGC has used this authority only in cases involving negotiations with financially troubled plan sponsors. The PBGC has not used its subpoena authority for purposes of day-to-day policy or operational reviews of ongoing plans.

As reported by the GAO, following plan termination, plan underfunding typically is nearly 60% greater than previously reported by the plan sponsor on its latest Form 5500 filed with the IRS. In addition, the level of underfunding tends to rise rapidly shortly before termination of a defined benefit pension plan. In these situations, the PBGC is unable to take prompt action to protect the Government and plan participants from further loss because it lacks necessary financial information. Thus, the PBGC needs full and timely access to the records of the defined benefit pension plans that it insures, in much the same manner as the Federal Deposit Insurance Corporation (FDIC) has access to information on the financial institutions it insures. The PBGC's deficit has increased, in part, because premiums paid to the PBGC are not sufficient to cover its operations. The PBGC's premium income continues to be insufficient to cover the costs of actual and expected plan terminations for which the PBGC is responsible. Further, the PBGC's variable rate premium does not properly reflect the risk assumed by the PBGC in providing insurance for severely underfunded defined benefit pension plans.

Under present law, plan participants are not fully aware of the extent to which their defined benefit pension plans are underfunded and that not all benefits are fully insured by the PBGC. There are certain disclosure requirements applicable to defined benefit pension plan sponsors which allow participants to monitor and understand benefits under their plan. Plans are required to provide participants with a summary plan description, which typically provides a boilerplate summary of pension benefit guarantees and a summary annual report, which should indicate whether minimum funding standards have been met and the extent of underfunding if a plan is less than 70% funded. Despite these varied reporting requirements, participants are not given clear and understandable information about (1) the extent to which their plan is underfunded and (2) which of their benefits are insured by the PBGC, and the extent to which such benefits are insured, should their underfunded plan terminate.

Current California Law (R&T Sec. 17501, 23701p & 24601)

California is conformed by reference to federal law and does not have a state duplication of federal enforcement and regulation of pension plans by the Internal Revenue Service or the Department of Labor enforcement and regulation under ERISA.

New Federal Law (Sec. 401, 412, 411, 415 & 417)

The Act is designed to improve the funding of single-employer defined benefit pension plans and reduce the potential exposure of the PBGC. The Act also is intended to reduce or eliminate the PBGC's operating deficit and to reduce the defined benefit pension system's unfunded liabilities for which the federal Government is potentially responsible.

Under the Act, pension plan sponsors will be required to meet their existing pension commitments in a reasonable period of time. The funding requirements will ensure that sponsors of underfunded defined benefit pension plans contribute amounts sufficient to improve the financial condition of the plans or, at a minimum, prevent plan funding from deteriorating. Further, the Act will allow employers that sponsor both underfunded defined benefit pension plans and defined contribution plans to fully fund their underfunded defined benefit plans more rapidly.
It is important to require that plan sponsors provide participants in defined benefit pension plans that are underfunded with a simple notice each year stating the extent to which the plan is underfunded, and an explanation of which benefits will or will not be guaranteed by the PBGC and the extent of the PBGC's guarantee, if the plan is terminated.

TITLE VII: GENERAL AGREEMENT ON TARIFFS AND TRADE

The Act provides the PBGC with better access to the records of certain troubled plans that it insures. This will allow the PBGC to take prompt action to protect participants, the PBGC, and taxpayers from any additional losses.

The provision which phases out the present-law cap on the additional premium for underfunded plans contained in the Act will require poorly funded plans, which pose the greatest risk to the PBGC, to pay their fair share of premiums. The phase out also will encourage underfunded plans to contribute more or otherwise reduce underfunding in order to avoid the payment of additional premiums.

Effective Date

In general, the provisions apply to plan years beginning after December 31, 1994.

Impact on California Revenue

Not Applicable.

VIOLENT CRIME CONTROL AND LAW ENFORCEMENT ACT OF 1994

Public Law: 103-322

Act Section: 20415

Section Title: Reporting of Cash Received by Criminal Court Clerks

Federal Law Before Change (Sec. 6050I & 6724)

Cash of more than $10,000, including certain cash equivalents (e.g. cashier's checks, foreign currency), received in connection with a trade or business must be reported by the recipient to the Internal Revenue Service on Form 8300. A penalty is imposed for any failure to file the required information return unless there is reasonable cause for the failure to file the information return.

Current California Law (Sec. 18645 & 19183)

California conforms to this provision and specifies that a copy of the federal information return is to be filed with the Franchise Tax Board. The statute grants the Attorney General of California, upon court order, access to these information returns and allows the information obtained to be given to district attorneys having specific reasons for believing that a felony offense has been committed to which the information is related. The information is confidential and may be used only for investigative or prosecutorial purposes.

New Federal Law (Sec. 6050I & 6724)

The Act expands the information reporting requirement to include every clerk of a federal or state criminal court who receives more than $10,000 in cash as bail for any individual charged with federal criminal offense (or any equivalent state criminal offense) involving a controlled substance, racketeering and money laundering.

Effective Date

This provision take effect 60 days after the date that the Treasury Department prescribes temporary regulations to implement this provision.

Impact on California Revenue

No impact.

EXHIBIT A

EXPIRING TAX PROVISIONS

California Expiration*	Calif. Section	Federal Expiration*	Federal Section	Description and Comments
12/31/94	17139 24326	Permanent	136	Exclusion: Energy conservation subsidies
12/31/94	17151	12/31/94	127	Exclusion: Employer-provided educational assistance
12/31/94	17201	12/31/94	170	Deduction: Contributions of stock for which market quotations are readily available
12/31/94	17256 24356.5	12/31/04	179A	Deduction: Expensing of clean fuel property
12/31/94	18042 24954	Permanent	1042	Exclusion: Sale of stock to an ESOP
12/31/94	24306	Permanent	133	Exclusion: Interest on loans to ESOPs
12/31/94	24611	Permanent	404	Deduction: Dividends paid to an ESOP
12/31/94	18405	N/A	N/A	Authority for FTB to waive penalties and allow perfection of elections relating to new provisions of law
12/31/95	17041	N/A	N/A	Tax rates: Temporary 10 and 11 percent brackets for regular tax (permanently capped at 9.3 percent)
12/31/95	17052.11 23603	12/31/04	30	Credit: Clean fuel vehicles
12/31/95	17053 23605	N/A	N/A	Credit: Employer sponsored ridesharing
12/31/95	17053.1	N/A	N/A	Credit: Employer sponsored vanpool
12/31/95	17053.5	N/A	N/A	Credit: Renters (no credit for 1994 or 1995, but credit resumes in 1996 without any limitation based upon AGI)
12/31/95	17062	N/A	N/A	Tax rates: Temporary 8.5 percent bracket for alternative minimum tax (permanent rate is 7.0 percent)
12/31/95[1]	18706	N/A	N/A	Voluntary Contribution: Election Campaign Fund
12/31/95[1]	18715	N/A	N/A	Voluntary Contribution: Children's Trust Fund

EXHIBIT A

EXPIRING TAX PROVISIONS

California Expiration*	Calif. Section	Federal Expiration*	Federal Section	Description and Comments
12/31/95[1]	18724	N/A	N/A	Voluntary Contribution: Senior Citizens
12/31/95[1]	18734	N/A	N/A	Voluntary Contribution: Veterans' Memorial
12/31/95[1]	18745	N/A	N/A	Voluntary Contribution: Fish, Wildlife, and Plants
12/31/95[1]	18766	N/A	N/A	Voluntary Contribution: Alzheimer's Disease
12/31/96	17053.8 17053.11 17276.2 23622 23623 24416.2	N/A	N/A	Apportionment Formula: Enterprise Zones and Program Areas
12/31/96[2]	18796	N/A	N/A	Voluntary Contribution: Breast Cancer
12/31/96[2]	18834	N/A	N/A	Voluntary Contribution: Olympic Fund
12/31/97	17052.15 23612.6	N/A	N/A	Credit: Sales and Use taxes paid in the LA Revitalization Zone
12/31/97	17052.17 23617	N/A	N/A	Credit: Employer constructed child care facilities
12/31/97	17052.18 23617.5	N/A	N/A	Credit: Employer paid child care program
12/31/97	17053.10 17053.17 23623.5 23625	N/A	N/A	Credit: Hiring in the LA Revitalization Zone
12/31/97	17233 24385	N/A	N/A	Deduction: Interest earned on loans made to businesses in the LA Revitalization Zone
12/31/97	17266 24356.4	N/A	N/A	Deduction: Expensing of business property in the LA Revitalization Zone
12/31/97	17276.2 24416.2	N/A	N/A	Deduction: Net Operating Losses in the LA Revitalization Zone
12/31/97[3]	18804	N/A	N/A	Voluntary Contribution: Firefighters' Memorial Fund

EXHIBIT A

EXPIRING TAX PROVISIONS

California Expiration*	Calif. Section	Federal Expiration*	Federal Section	Description and Comments
12/31/97[3]	18816	N/A	N/A	Voluntary Contribution: Library Protection Fund
12/31/98	18152.5	Permanent	1202	Exclusion: Capital Gain on Sale of Small Business Stock
12/31/98	19283	N/A	N/A	Collection of Amounts Due a Court
12/31/99	17053.66 23666	N/A	N/A	Credit: Restoration of Habitat for Salmon and Steelhead Trout
12/31/99	17091 24272.3	Permanent	865	Sourcing Rules: Unprocessed timber
12/31/99[4]	18824	N/A	N/A	Voluntary Contribution: Mexican American Veterans' Memorial Account
12/31/99	25135	N/A	N/A	Apportionment Formula: Sales of Unprocessed Timber

* In general, this is the last calendar year to which the provision applies. Fiscal years beginning within this calendar year are, in general, also covered by the provision. In some cases, the expiration applies to transactions occurring after this date.

[1] The actual date this provision expires is 1/1/97, prior to the due date of the 1996 tax return (4/15/97).

[2] The actual date this provision expires is 1/1/98, prior to the due date of the 1997 tax return (4/15/98).

[3] The actual date this provision expires is 1/1/99, prior to the due date of the 1998 tax return (4/15/99).

[4] The actual date this provision expires is unknown at this time. The law provides that this voluntary contribution will not appear on the tax return until construction has been completed on the Veterans' Memorial. It will continue to be on the tax return for a total of three (3) taxable years.

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