General Explanations of the Administration's Fiscal Year 2002 Tax Relief Proposals

Department of the Treasury
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THE PRESIDENT'S AGENDA FOR TAX RELIEF PRESENTED TO CONGRESS ON FEBRUARY 8TH

CREATE NEW 10-PERCENT INDIVIDUAL INCOME TAX RATE BRACKET

Current Law

The tax rate on the first amounts of income of individuals that become taxable is 15 percent. The 15-percent tax bracket covers the first $27,050 of taxable income (for calendar year 2001) for single taxpayers, the first $36,250 for taxpayers who file as heads of household, and the first $45,200 for married taxpayers filing joint returns ($22,600 for married taxpayers filing separate returns). The widths of each of the tax brackets are adjusted annually for the effects of inflation.

Reasons for Change

Families often need additional resources to help pay for education, child care, and other costs associated with supporting children and maintaining a family. An income tax reduction would provide families with additional resources which could be used to meet the specific needs of each family.

Low- and moderate-income families are particularly burdened by high marginal tax rates that result from the combined effect of income taxes, payroll taxes, and the phaseout of the earned income tax credit. Reducing the marginal income tax rate from 15 percent to 10 percent, in combination with the proposed doubling of the child tax credit, would significantly reduce the marginal Federal tax rate faced by low-income families with children.

Proposal

The current 15-percent tax rate bracket would be divided into two rate brackets, 10 percent and 15 percent. The 10-percent tax rate would apply to the first $6,000 of taxable income for single taxpayers (and married taxpayers filing separate returns), the first $10,000 for unmarried heads of household, and the first $12,000 for married taxpayers filing jointly. Taxable income above those amounts which is currently taxed at the 15-percent rate would continue to be taxed at the 15-percent rate. The new rate bracket would be phased in. The rate would be 14 percent in 2002 and would decline by one percentage point per year until it reached 10 percent in 2006 and thereafter. The width of the 10-percent rate bracket would be indexed for inflation beginning in 2007.

REDUCE INDIVIDUAL INCOME TAX RATES

Current Law

There are five statutory marginal tax rate brackets, ranging from 15 percent to 39.6 percent, applicable to individual taxpayers. Generally, the widths of the tax rate brackets depend on the filing status of the taxpayer. For married taxpayers filing joint returns, tax brackets are wider, but not twice as wide, as for single taxpayers. The widths of the brackets for unmarried heads of household fall between the widths of the brackets for single and joint filers. The bracket widths for married taxpayers filing separately are exactly one-half as wide as for married taxpayers filing jointly. However, the 39.6 percent tax bracket begins at the same level of taxable income for single, unmarried head of household, and joint returns. The beginning and ending points of the tax brackets are adjusted annually for the effects of inflation. Individual income tax rates also apply to estates and trusts.

Reasons for Change

Lower tax burdens will enable taxpayers to spend or invest more of what they earn, will promote a healthy economy, and will provide resources for additional investment which, in turn, will increase income levels in the future. High marginal tax rates tend to reduce the incentives to work and invest and distort economic decisions. Lowering tax rates will reduce such impacts and promote more rapid economic growth, entrepreneurship and higher income levels.

Proposal

The five current tax rate brackets ranging from 15 percent to 39.6 percent would be replaced with four tax brackets ranging from 10 percent to 33 percent. The lower tax rates would be phased in between 2002 and 2006.

The current 15-percent tax rate bracket would be split into two rate brackets, 10 percent and 15 percent. The 10-percent tax rate would apply to the first $6,000 of taxable income for single taxpayers, the first $10,000 for unmarried heads of household, and the first $12,000 for married taxpayers filing jointly. The tax rate in the new bracket would be 14 percent in 2002 and decline by one percentage point per year until it reached 10 percent in 2006 and thereafter.

The tax rates in the current 28-percent and 31-percent brackets would be reduced to 25 percent between 2002 and 2006. The 31-percent rate would be reduced to 30 percent in 2002, 29 percent in 2003, 28 percent in 2004, 27 percent in 2005, and 25 percent in 2006 and thereafter. The 28-percent rate would be reduced to 27 percent in 2002 and 2003, 26 percent in 2004 and 2005, and 25 percent in 2006 and thereafter.

The tax rates in the current 36-percent and 39.6-percent brackets would be reduced to 33 percent between 2002 and 2006. The 36-percent rate would be reduced to 35 percent in 2002 and 2003, 34 percent in 2004 and 2005, and 33 percent in 2006 and thereafter. The 39.6-percent rate would be reduced to 38 percent in 2002, 37 percent in 2003, 36 percent in 2004, 35 percent in 2005, and 33 percent in 2006. The tax rate reductions would also apply to estates and trusts.

INCREASE THE CHILD TAX CREDIT

Current Law

Taxpayers may be eligible for a tax credit for qualifying children of up to $500 per child. The credit is reduced by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds $110,000 ($75,000 if the taxpayer is not married and $55,000 if the taxpayer is married but filing a separate return).

The credit is generally nonrefundable. However, taxpayers may be eligible for an additional refundable child tax credit if they have little or no income tax liability. To qualify, taxpayers must have three or more children. The additional credit cannot exceed the taxpayer's share of social security taxes, net of the refundable portion of the earned income tax credit (EITC).

Beginning in 2002, the child tax credit, along with other personal nonrefundable tax credits, will be allowed only to the extent that an individual's regular income tax liability exceeds his or her tentative alternative minimum tax. Also beginning in 2002, the refundable child tax credit and the earned income tax credit will be reduced by the amount of the individual's alternative minimum tax.

To qualify, children must meet four tests. First, they must be a dependent of the taxpayer. Second, they must be under the age of 17. Third, they must be a son or daughter of the taxpayer, or a descendant of either, or an eligible foster child. Fourth, the child dependent must be a U.S. citizen or national. Taxpayers must provide a valid taxpayer identification number (typically, a social security number) for each qualifying child.

Reasons for Change

Many families with children need additional resources to help pay for education, child care, and the other costs associated with child rearing. Increasing the child tax credit would reduce families' tax burdens and allow each family to determine how best to use the additional resources to meet their particular needs.

Low- and moderate-income families are particularly burdened by high marginal tax rates that result from the combined effect of income taxes, payroll taxes, and the phase-out of the earned income tax credit. Doubling the child tax credit, in combination with the establishment of the new 10-percent income tax bracket, would significantly reduce the marginal Federal tax rate faced by low-income families with children.

Proposal

The amount of the child tax credit would be doubled to $1,000 per child, and the credit would phase out more slowly and at higher incomes. The credit would be reduced by $20 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the income threshold. For unmarried filers and married couples filing joint returns, the income threshold would be increased to $200,000. The threshold would increase to $100,000 if the taxpayer is married but filing a separate return. The taxpayer would be allowed to offset both the

regular tax and minimum tax by the child tax credit. In addition, refundable credits would no longer be reduced by the amount of the alternative minimum tax.

The proposal generally would be effective for taxable years beginning after December 31, 2001. The increase in the amount of the child tax credit would be phased in over five years, rising to $600 in 2002, $700 in 2003, $800 in 2004, $900 in 2005, and $1,000 in 2006 and thereafter. The increase in the modified adjusted gross income threshold would be gradually implemented in $18,000 annual increments ($25,000 annual increments if the taxpayer is not married and $9,000 annual increments if the taxpayer is married and filing a separate return) between 2002 and 2006. The reduction in the credit phase-out rate would be effective for taxable years beginning after December 31, 2005.

REDUCE THE MARRIAGE PENALTY

Current Law

A couple has a marriage penalty if they owe more income tax filing a joint return than the spouses would pay if they were unmarried and each filed a separate return. Marriage penalties often arise because the standard deduction and rate brackets for joint filers are less than twice the corresponding amounts for single filers or head of household filers.

Reasons for Change

Under the current tax system, two-earner couples often pay higher income taxes filing joint returns than if each spouse were taxed on his or her income. Marriage penalties tend to be greatest when the division of earnings between the spouses is relatively even. Moreover, two-earner couples may also be subject to higher marginal tax rates on their combined income than each spouse would face if they were unmarried and filing separate returns. Higher marginal tax rates discourage participation in the work force, particularly by the second earner in a family.

Proposal

To reduce marriage penalties, the two-earner deduction that was in effect between 1982 and 1986 would be restored. Joint filers would be allowed to deduct 10 percent of the first $30,000 of the earned income of the lower paid spouse.

Earned income would be defined as the sum of wages, salaries, and net income from self-employment less certain deductions for IRA, Keogh, SEP, and SIMPLE plan contributions, self-employed health insurance, MSA contributions, one half of self-employment taxes, supplemental unemployment compensation, and certain trade and business expenses.

The proposal would be effective for taxable years beginning after December 31, 2001. The limitation on eligible earnings would be phased in over five years, increasing from $6,000 in 2002 to $12,000 in 2003, $18,000 in 2004, $24,000 in 2005, and $30,000 in 2006 and thereafter.

PROVIDE CHARITABLE CONTRIBUTION DEDUCTION FOR NON-ITEMIZERS

Current Law

Individual taxpayers who itemize their deductions may claim a deduction for contributions made to qualified charitable organizations. Total deductible contributions may not exceed 50 percent of the taxpayer's adjusted gross income (AGI), and lower deductibility limits apply in the case of contributions of appreciated property and contributions to certain private foundations. Under current law, taxpayers who elect the standard deduction ("non-itemizers") may not claim a deduction for charitable contributions.

Reasons for Change

A combination of government and private efforts is needed to help people in need. It is important that government not discourage support for the activities of charitable organizations in dealing with important community problems. Approximately two-thirds of tax filers are non-itemizers, and thus are not allowed to claim tax deductions for their charitable contributions. Allowing non-itemizers to deduct their charitable contributions would help increase support for charitable organizations by rewarding and encouraging giving by all taxpayers.

Proposal

Taxpayers who do not itemize would be allowed to deduct charitable contributions in addition to their standard deduction. The non-itemizer deduction would not be a preference item for alternative minimum tax purposes, and would not affect the calculation of AGI. Deductible contributions of non-itemizers would be limited to the amount of a taxpayer's standard deduction. Charitable contributions in excess of the standard deduction could not be carried forward to future years. Deductions of contributions by non-itemizers would be subject to the existing rules governing itemized charitable contributions, such as substantiation requirements and the percentage-of-AGI limitations. The proposal would be effective for charitable contributions in taxable years beginning after December 31, 2001, and would be phased in between 2002 and 2006. Non-itemizers would be allowed to deduct 20 percent of contributions in 2002, 40 percent in 2003, 60 percent in 2004, 80 percent in 2005, and 100 percent of contributions in 2006 and thereafter.

PERMIT TAX-FREE WITHDRAWALS FROM INDIVIDUAL RETIREMENT ACCOUNTS (IRA'S) FOR CHARITABLE CONTRIBUTIONS

Current Law

Eligible individuals may make deductible contributions to a traditional individual retirement arrangement (traditional IRA). Other individuals with taxable income may make nondeductible contributions to a traditional IRA. Earnings and pre-tax contributions in a traditional IRA are includible in income when withdrawn. Withdrawals made before age 59½ are subject to an additional 10-percent excise tax, unless an exception applies.

Individuals with adjusted gross incomes (AGI) below certain levels may make nondeductible contributions to a Roth IRA. Amounts withdrawn from a Roth IRA as a qualified distribution are not includible in income. A qualified distribution is a distribution made (1) after 5 years and (2) after the holder has attained age 59½, died, or become disabled or is made for first-time homebuyer expenses of up to $10,000. Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent the distributions are attributable to earnings, and are also subject to the 10-percent early withdrawal tax (unless an exception applies).

Individuals who itemize their deductions may claim a deduction for contributions made to qualified charitable organizations. Total deductible contributions may not exceed 50 percent of the taxpayer's AGI, and lower deductibility limits apply in the case of contributions of appreciated property and contributions to certain private foundations. Excess amounts may be carried forward and deducted in future years. In addition, the total of most categories of itemized deductions, including charitable contributions, is reduced by 3 percent of AGI in excess of a certain threshold ($132,950 for most filers in 2001).

Reasons for Change

Under current law, a taxpayer who wishes to donate otherwise taxable IRA assets to charity must first include the taxable amounts in income and then claim a deduction for charitable contributions. Because not all taxpayers can deduct the full amount of their charitable contributions, current law effectively discourages some taxpayers from contributing their IRA assets to charity. Allowing taxpayers to exclude from income direct transfers from IRAs to qualified charities will stimulate additional charitable giving by simplifying the required tax calculations and eliminating the current-law tax disincentives.

Proposal

Individuals would be allowed to exclude from gross income (and thus from AGI for all purposes under the Code) distributions made after age 59 ½ from a traditional or Roth IRA directly to a qualified charitable organization. The exclusion would be available without regard to the percentage of AGI limits that apply to deductible contributions. An amount transferred directly to a charitable organization would be counted as a distribution for purposes of the required minimum distribution rules. The exclusion for transfers to charitable organizations would apply only to the extent the individual does not receive any benefit in exchange for the transfer. No charitable deduction would be allowed with respect to any amount that is excludable from

income under this provision. If an amount transferred from the IRA would otherwise be nontaxable, such as a qualified distribution from a Roth IRA or the return of nondeductible contributions from a traditional IRA, the normal charitable contribution deduction rules would apply.

The proposal would be effective for distributions after December 31, 2001.

RAISE THE CAP ON CORPORATE CHARITABLE CONTRIBUTIONS

Current Law

Corporations are allowed to deduct charitable contributions up to a limit equal to 10 percent of net income calculated before the deduction of the charitable contributions and certain other deductions. The limit was increased in 1982 from the previous level of 5 percent of net income. Contributions in excess of the limit can be carried forward for up to five years.

Reasons for Change

A combination of efforts by the government, non-profit and private sectors is needed to help people in need and to deal with community problems. Corporate charitable donations are an important source of support for charitable and other non-profit organizations that deal with important community problems and interests. Raising the limit on the charitable deduction would provide an incentive for corporations to increase their support for charitable organizations.

Proposal

The limit on corporate deductions for charitable contributions would be increased from 10 percent to 15 percent. The proposal would be effective for contributions deductible in taxable years beginning after December 31, 2001.

INCREASE AND EXPAND EDUCATION SAVINGS ACCOUNTS

Current Law

Taxpayers may elect to contribute up to $500 per year to an education savings account for beneficiaries under age 18. The contribution limit is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint filers). Contributions are not deductible, but earnings on contributions accumulate tax-free. Distributions are excludable from gross income to the extent they do not exceed qualified higher education expenses incurred during the year the distributions are made. The earnings portion of a distribution not used to cover qualified education expenses is includible in the gross income of the beneficiary and is generally subject to an additional 10-percent tax. When a beneficiary reaches age 30, the account balance is deemed to have been distributed for nonqualified purposes. However, prior to the beneficiary reaching age 30, tax-free (and penalty-free) rollovers of account balances may be made to an education savings account benefiting another family member. If any portion of a distribution from an education savings account is excluded from gross income, an education tax credit may not be claimed with respect to the same student in the same taxable year.

Reasons for Change

Encouraging parents to save on a tax-free basis for education expenses at the elementary and secondary level will help ensure that children get the best education possible and promote accountability in education. In addition, the low annual contribution limits and restrictions on availability of the education tax credits under current law discourage the use of education savings accounts to save for higher education.

Proposal

Education savings accounts would be expanded to allow tax-free and penalty-free distributions for certain elementary, secondary, and after-school program expenses. Eligible expenses would include tuition, fees, academic tutoring, special needs services, books, supplies, and computer equipment incurred in connection with the enrollment of the beneficiary as an elementary or secondary school student at a public, private, or religious school, as well as any expenses for room and board, uniforms, and transportation required or provided by the school in connection with such enrollment. The annual contribution limit would also be raised, to $1,000 in 2002, $2,000 in 2003, $3,000 in 2004, $4,000 in 2005 and $5,000 in 2006 and thereafter. In addition, an education tax credit and a tax-free distribution from an education savings account would be allowable with respect to the same student in the same taxable year, provided the distribution is not used for the same qualified higher education expenses for which an education tax credit is claimed.

The proposal would be effective for contributions and distributions made after December 31, 2001.

PERMANENTLY EXTEND THE RESEARCH AND EXPERIMENTATION (R&E) TAX CREDIT

Current Law

The research and experimentation (R&E) tax credit is 20 percent of qualified research expenses above a base amount. The base amount is the product of the taxpayer's "fixed base percentage" and the average of the taxpayer's gross receipts for the four preceding years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for the 1984-88 period. The base amount cannot be less than 50 percent of the taxpayer's qualified research expenses for the taxable year. Taxpayers can elect into a three-tiered alternative credit that has lower credit rates (ranging from 2.65 to 3.75 percent) and lower statutory fixed base percentages (ranging from 1 to 2 percent). The R&E credit is scheduled to expire on June 30, 2004.

Reasons for Change

The R&E credit encourages technological developments that are an important component of economic growth. However, uncertainty about the future availability of the R&E credit diminishes the incentive effect of the credit because it is difficult for taxpayers to factor the credit into decisions to invest in research projects that will not be initiated and completed prior to the credit's expiration. To improve the credit's effectiveness, the R&E credit should be made permanent.

Proposal

The proposal would make the R&E credit permanent.

PHASE OUT DEATH TAX

Current Law

The estate, gift and generation-skipping taxes form a unified system of taxes on the transfer of property, directly or in trust, during life and at death.

Estate Tax. The estate tax is levied on property owned by the decedent at the time of death. In computing the taxable estate, deductions are allowed for funeral and administrative expenses, debts and mortgages, certain losses, charitable bequests, bequests to the surviving spouse and qualifying family-owned business interests.

The statutory marginal tax rate ranges from 18 percent on the first $10,000 of the taxable estate to 55 percent on the taxable estate in excess of $3,000,000. In addition, there is a 5-percent surtax levied on amounts between $10,000,000 and $17,184,000. The surtax phases out the benefit of the graduated rate schedule. The estate tax rate brackets are not indexed.

Every estate is allowed a unified credit. For persons dying in 2001, the unified credit is $220,550. At that value, the unified credit effectively exempts the first $675,000 of property from tax. The unified credit is not indexed. However, under the Tax Reform Act of 1997, the unified credit is scheduled to increase, so that property of $700,000 will be exempt from tax in 2002 and 2003, $850,000 will be exempt in 2004, $950,000 will be exempt in 2005 and $1,000,000 will be exempt for persons dying in 2006 and thereafter. Other credits against estate tax include credits for state and foreign death taxes and for taxes on certain prior transfers.

There are a number of provisions designed to ease the burden of the estate tax on family- owned farms and businesses. These provisions include the qualified family-owned business interest (QFOBI) deduction, which, together with the unified credit, can be used to exempt up to $1,300,000 in assets from tax. The special use valuation provision allows eligible farm and business owners to reduce the value of real property by up to $800,000 (in 2001, indexed), if the value of the property when it is used in the farm or business is less than the fair market value. Business owners also may be eligible to defer the estate tax and pay it in installments over a period of 14 years, at favorable interest rates.

An inherited asset receives a new basis equal to the fair market value of the asset on the date of the decedent's death (or, if the alternative valuation date is elected, the earlier of the date that the property is sold or distributed by the estate or six months after the date of death). Although this is commonly referred to as a “stepped-up” basis, market conditions could result in a stepped-down basis. Thus, when an inherited asset is sold, only capital gains (or losses) realized between the time of the transferor’s death and the time of sale by the transferee are subject to federal income taxation.

Gift Tax. The gift tax rate schedule and unified credit are the same as the estate tax provisions. Annual gifts of up to $10,000 (in 2001, indexed) per donor, per donee are exempt from tax. Each year, the current year’s taxable gifts (that is, those in excess of the annual exclusion) are added to taxable gifts made in prior years. The tax on the cumulative gifts is then computed, and gift taxes payable for prior-year gifts are subtracted from the total tax (to eliminate double

taxation). When the donor dies, taxable lifetime gifts are added to the property owned at death. The estate tax is computed on that base, and gift taxes payable for prior gifts are again subtracted from the total tax. Gifts receive a partial step-up in basis to reflect gift tax paid on the unrealized appreciation in the property.

Generation-Skipping Transfer (GST) Tax. Property transferred to individuals two or more generations younger than the transferor is subject to the GST tax, in addition to estate or gift tax. Each taxpayer has a $1,060,000 (in 2001, indexed) lifetime exemption from GST. The GST tax rate is set equal to the highest estate tax rate, currently 55 percent. Gifts subject to GST tax receive a partial step-up in basis to reflect GST tax paid on the unrealized appreciation in the property.

Reasons for Change

The Administration believes that death should not trigger a tax, and the existence of an estate tax raises issues of fairness. Income that is saved rather than consumed may be taxed twice under the current system, once when it is earned and again when the owner dies. For example, income invested in bonds or dividend paying stocks or deposited into savings accounts is taxed when it is initially earned, and it produces interest or dividend income that also is taxable under the income tax system. The estate or gift tax is a second tax levied on both the principal and the interest or dividend income. Capital gains income that is not realized before death is not taxed under the current income tax system. However, the basis of the investment (that is, the funds used to purchase the asset) may have been taxed under the income tax system. Thus the estate tax amounts to double taxation on the basis. Income should be taxed once–when it is earned–and not again when it is passed on to the next generation.

In addition, combined federal income and estate or gift tax rates can approach 70 percent. High marginal tax rates reduce the benefits of working, saving and investing, and can thereby reduce economic efficiency. High tax rates also increase the incentive to engage in economically unproductive avoidance techniques.

The estate tax reduces the amount of capital available to smaller businesses. There are provisions in current law designed to reduce the burden of the estate tax on family-owned farms and businesses. However, these provisions require the heirs who inherit the property to meet certain requirements for up to ten years after inheriting the business, or face additional estate taxes. During this period, the business is subject to a lien for potential estate taxes, which can reduce the value of the business and make it more difficult for the business to raise capital.

Proposal

The estate, gift and generation-skipping transfer taxes would be phased out between 2002 and 2008 and repealed in 2009.

Provisions in Effect During Phase-Out Period. Each estate and gift tax rate would be reduced by 5 percentage points in 2002, 10 percentage points in 2004, 15 percentage points in 2005, 20 percentage points in 2006, 30 percentage points in 2007, and 40 percentage points in 2008; however, no estate tax rate applicable to amounts of taxable estate in excess of $1.3 million

would fall below the highest statutory individual income tax rate generally applicable to long-term capital gains (20 percent).[1] In addition to the rate reductions, the exemption equivalent for U.S. citizens and residents would be increased to $1.3 million in 2008. Since the GST tax is set equal to the highest statutory estate tax rate, it would be phased down automatically along with the estate tax, and repealed in 2009.

Technical changes would be made to the GST tax. These changes are designed to ensure that a taxpayer does not unfairly or inadvertently lose the benefit of the exemption from GST tax provided under current law.

The 5-percent surtax would be repealed in 2002. State death tax and GST tax credit rates would be reduced to maintain the current relationship between the credit rates and the federal tax rates.

Provisions in Effect After December 31, 2008. Effective for decedents dying after, and gifts made after, December 31, 2008, the estate, gift and GST taxes would be repealed.

After repeal of the estate tax, the basis of property acquired from or passed from a decedent, in the hands of the person acquiring or receiving it, generally would be the lower of the fair market value on the date of the decedent's death or the adjusted basis of the property immediately before the death of the decedent. For purposes of recapture, the character of the gain on the sale of the inherited assets would remain the same as it was in the hands of the decedent. Thus, real estate that has been depreciated and would be subject to recapture tax if sold by the decedent would be subject to recapture tax if sold by the heir.

For every estate of a U.S. citizen or resident, there would be three potential adjustments to basis, so that taxpayers who are not currently subject to estate tax generally would not be subject to capital gains tax on assets held until death. First, each estate would receive $1.3 million of basis to be added to the carryover basis of any one or more of the assets held at death. Second, an estate generally would receive additional basis equal to the sum of (1) the decedent's unused capital loss carryforwards, (2) the decedent's unused net operating loss carryforwards, and (3) the difference between the decedent's basis and fair market value on assets that are assigned a fair market value basis. Other than with respect to net operating losses, this additional basis could not be assigned to depreciable or ordinary income assets. Third, estates would be allowed an additional $3 million of basis, to be allocated among the assets passing to a surviving spouse. No addition to basis could increase the new basis of any asset beyond its fair market value on the date of death. The allowable amounts of additional basis would be indexed for inflation after 2009.[2]

In addition, the current-law exclusion of gain on the sale of a principal residence would be extended to heirs. Thus, an heir who sells the decedent’s principal residence within 3 years of

[1] For nonresident aliens, the 20-percent rate floor would apply to taxable estates in excess of $60,000.

[2] Estates of nonresident aliens would be given additional basis on U.S. property of $60,000 (rather than $1.3 million), corresponding to the exemption amount of nonresident aliens under current law. Surviving spouses of nonresident aliens would be entitled to the additional basis of $3 million only if the spouse is a U.S. citizen.

the decedent’s death could use the 2-out-of-5-years rule with respect to the decedent’s use of the residence while alive, and claim a capital gain exclusion.

Property would be considered to pass to the surviving spouse and be eligible to receive an additional basis allocation if it passes outright to the surviving spouse, or if it passes in a “qualified marital trust.” A qualified marital trust would be a trust in which the surviving spouse is entitled to all of the income from the trust property, payable annually or at more frequent intervals, and no person has a power to appoint any part of the property to any person other than the surviving spouse during the surviving spouse's lifetime. This provision would adopt the definition of “qualified terminable interest property” under current law; however, no election to treat property as passing to the spouse would be required. In addition, the qualified domestic trust (QDOT) rules would be repealed so that a non-citizen surviving spouse (of a decedent who died before repeal) would not owe any estate tax upon death or a withdrawal from the QDOT.

Basis could be added to property acquired from the decedent only if the property was owned by the decedent. Property owned by the decedent and another person as joint tenants, tenancy by the entireties, or community property, would be considered “owned” by the decedent, but only to the extent of 50 percent of the property if the co-owner is the spouse, or in proportion to the amount attributable to contributions by the decedent, if the co-owner is other than the spouse. Property transferred by the decedent during life to a revocable trust, to pay the income for life to or on the direction of the decedent would also be considered “owned” by the decedent. However, property over which the decedent had only a power of appointment would not be considered “owned” by the decedent. Powers, rights or interests of another person in the decedent's property would be taken into account when determining the fair market value (beyond which basis could not be stepped up) of the decedent's property. In no event could basis be added to (1) property acquired by the decedent by gift (other than from a spouse) during the 3-year period ending on the date of the decedent's death, (2) property that constitutes a right to receive income in respect of a decedent under section 691, or (3) stock of certain foreign entities (for example, foreign personal holding companies and domestic international sales corporations).

A donor would be required to report to the IRS the basis and character of any gifted property with a value in excess of $25,000, along with the name and social security number of the donee. The donor also would be required to report the basis to the donee. Gifts of cash would be excluded from this requirement, as would gifts to charity (other than split-interest gifts). For transfers at death of non-cash assets in excess of $1.3 million, the executor of the estate would report to the IRS the basis in each property, the character of the property, any additional basis allocated to the property, the fair market value of the property on the decedent’s date of death, and the name and social security number of the heir receiving the property. Basis information would also have to be reported to the heir. For estates with non-cash assets of less than $1.3 million, this reporting generally would not be required (unless the decedent had received a non-cash gift in excess of $25,000 within 3 years of death). The filing requirements would be indexed for inflation after 2009. The reporting to the IRS would be done in connection with the filing of the decedent’s final income tax return, with liberal extensions of time available. Penalties would apply if a donor or executor failed to meet the reporting requirements with respect to the IRS or recipients.

Upon the sale of inherited or gifted property, the taxpayer would be required to substantiate the basis of the property. If the basis is unknown but the date of acquisition by the decedent is known, then the basis would be presumed to be the fair market value at the time of acquisition (with any appropriate adjustments, for example, due to improvements or depreciation).

In the absence of a gift tax, and with a general rule of carryover basis, there are many potential circumstances in which the income or capital gains tax and related rules could be avoided. The proposal would include several provisions to limit the potential for avoidance of the income tax. First, the proposal would modify the treatment of transfers to nonresident aliens. Second, the proposal would amend the application of the private foundation rules to non-exempt trusts. Third, the proposal would include a general anti-abuse rule.

The proposal also would include technical and conforming changes, including an amendment to provide that distribution by an estate of an asset secured by indebtedness would not be a disposition, limitations on income tax deductions of the estate, elimination of the disparate treatment of pecuniary, fractional and formula bequests, provision for disclaimer of bequests within 9 months of death, and treatment of art inherited from the artist as a capital asset.

ADDITIONAL TAX INCENTIVES

Strengthen and Reform Education

ALLOW TEACHERS TO DEDUCT OUT-OF-POCKET CLASSROOM EXPENSES

Current Law

Individual taxpayers who itemize their deductions may claim a deduction for unreimbursed, job-related expenses to the extent those expenses and other miscellaneous deductions exceed 2 percent of adjusted gross income. Such deductions may not be allowed for purposes of the alternative minimum tax.

Reasons for Change

Teachers and other school professionals often incur expenses related to classroom activities or for professional training that are not reimbursed. These expenditures enhance the quality of education received by students but diminish a teacher's properly-measured ability to pay taxes. Allowing school professionals to deduct such expenditures on their federal income tax return would encourage dedicated teachers who supplement available school resources at their own expense.

Proposal

An above-the-line deduction, not subject to the alternative minimum tax, would be allowed for up to $400 of out-of-pocket expenses incurred by schoolteachers during a taxable year. Eligible teachers would be defined as those employed full time for an academic year ending during the taxable year and who teach in the United States at grade levels K through 12, including elementary and secondary school professionals such as principals, counselors, teacher's aides, librarians and coaches. The provision would apply to teachers employed by public entities or private schools (as determined under State law). Eligible, unreimbursed expenses would include the purchase of books, supplies, and equipment related to classroom instruction that become school property. Teacher training expenses related to current teaching positions also would qualify. Neither travel nor lodging expenses nor expenditures related to religious instruction or activities would be eligible. Expenses claimed as an above-the-line deduction could not be claimed as an itemized deduction. Taxpayers would be required to retain receipts for eligible expenditures along with a certification from a principal or other school official that the expenditures qualified.

The provision would be effective for expenditures made after December 31, 2001.

ALLOW TAX-FREE DISTRIBUTIONS FROM QUALIFIED STATE TUITION PLANS (QSTP'S) FOR CERTAIN HIGHER EDUCATION EXPENSES AND ALLOW PRIVATE COLLEGES TO OFFER PREPAID TUITION PLANS

Current Law

Current law provides tax-exempt status to qualified State tuition programs (QSTPs). These State-sponsored programs generally take one of two forms (a State may sponsor both): (1) prepaid tuition plans, under which an individual may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education expenses at participating educational institutions; and (2) tuition savings plans, under which an individual may make contributions to an account which is established for the purpose of meeting the qualified higher education expenses of a designated beneficiary. Qualified higher education expenses include expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution, as well as certain room and board expenses for any period during which the student is at least a half-time student.

Current law provides two basic tax benefits to contributors to, and beneficiaries of, QSTPs: (1) amounts invested in a QSTP are not subject to tax until a distribution is made (or educational benefits are provided) and (2) distributions made on behalf of a beneficiary are taxed at the beneficiary's (rather than the contributor's) income tax rate. Distributions made from QSTPs for nonqualified expenses generally are subject to a more than de minimis penalty (typically 10 percent of the earnings portion of the distribution). The penalty inures to the benefit of the State-sponsored plan. A change in the designated beneficiary of an account is not treated as a distribution, and therefore is not subject to income tax, if the new beneficiary is a member of the family of the old beneficiary. Neither contributors nor beneficiaries may direct the investment of account balances.

Current law also allows individuals to contribute up to $500 per year to an education savings account on behalf of beneficiaries under age 18. The contribution limit is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint filers). Contributions to education savings accounts are not deductible, but earnings on contributions accumulate tax-free. Distributions are excludable from gross income to the extent they do not exceed qualified higher education expenses of the beneficiary in the year the distributions are made. The earnings portion of a distribution not used to cover qualified education expenses is includible in the gross income of the beneficiary and is generally subject to an additional 10-percent tax. When a beneficiary reaches age 30, the account balance is deemed to have been distributed for nonqualified purposes. However, prior to the beneficiary reaching age 30, tax-free (and penalty-free) rollovers of account balances may be made to an education savings account benefiting another family member. If any portion of a distribution from an education savings account is excluded from gross income, neither the Hope Credit nor the Lifetime Learning Credit may be claimed with respect to the same student in the same taxable year. (See page 10 for a description of the Administration's proposal to expand education savings accounts.)

Unlike education savings accounts, which limit annual contributions, there is no specific dollar cap on annual contributions to a QSTP. In addition, there is no limit on contributions to a QSTP account based on the contributor's income, contributions are allowed at any time during the beneficiary's lifetime, and, unlike education savings accounts, the account can remain open after the beneficiary reaches age 30. However, a QSTP must provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of amounts necessary to provide for the qualified higher education expenses of the beneficiary. In addition, no contributor or designated beneficiary may exercise investment discretion with respect to the investment of amounts contributed to the QSTP.

Reasons for Change

Providing an exclusion from gross income for distributions from qualified tuition plans for qualified higher education expenses, and permitting private colleges and universities to offer prepaid tuition plans, will encourage families and students to save for future education expenses.

Proposal

Distributions from qualified tuition programs would be excludable from the gross income of the designated beneficiary to the extent that such distributions are used to pay qualified higher education expenses of the beneficiary as in the current law treatment of distributions from education savings accounts. The definition of "qualified higher education expenses" would be limited to: (1) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible educational institution; (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance (but not in excess of the allowance for books and supplies included in the "cost of attendance" as determined by the eligible educational institution for purposes of Federal financial aid programs); and (3) room and board expenses of a student enrolled at least half time (but not in excess of the applicable allowance for room and board included in the cost of attendance, as determined by the eligible educational institution for such period). "Qualified higher education expenses" would not include expenses for education involving sports, games, or hobbies, unless the education is part of the student's degree program or is taken to acquire or improve job skills of the individual.

The definition of a "qualified tuition program" would be expanded to allow private educational institutions to establish prepaid tuition (but not savings account) programs. Such institutions would be limited to post-secondary educational institutions that are eligible to participate in Federal financial aid programs under Title IV of the Higher Education Act of 1965. The Secretary of the Treasury would be authorized to require such programs to obtain a ruling regarding qualification.

The proposal would allow a qualified tuition program to permit up to three qualified account transfers (with or without a change in designated beneficiaries) with respect to any account without violating the prohibition on investment direction. A "qualified account transfer" is any transfer of credits (or other amounts) between (1) a prepaid tuition program and a State savings program, (2) a savings program in one State and a savings program in a different State, or (3) two investment options offered within the same State savings program. A mere change in the designated beneficiary of an account, without any change in programs or investment options, is

not subject to this limit. In the case of a transfer from one account to another account in the same qualified tuition program or a different program, the transferee account would assume the lesser of the number of qualified account transfers remaining in the transferor account or number of qualified account transfers remaining in the transferee account.

A first cousin of the original designated beneficiary would be defined as a “member of the family” eligible to benefit from a tax-free “rollover” of a qualified tuition program account.

The proposal would provide tax-free treatment for amounts distributed from a qualified tuition program for qualified higher education expenses of the designated beneficiary, and allow an education tax credit and a tax-free distribution from an education savings account to be claimed for the same taxable year with respect to the same student, as long as the distribution from the qualified tuition program is not used for the same expenses for which either a credit or a tax-free distribution from an education savings account is claimed.

Following current law with respect to education savings accounts, the proposal generally would impose an additional tax (equal to 10 percent of the earnings portion) on any distribution not used for qualified higher education expenses. This tax would be collected by the qualified tuition programs and remitted to the IRS. If taxable earnings from nonqualified distributions exceed $5,000 in any year, the excess taxable earnings would be subject to a second 10-percent additional tax collected by the IRS (for a total 20 percent additional tax on such amounts).

The proposal would limit the aggregate amount of earnings (taxable and tax-free) received by any beneficiary from one or more qualified tuition program accounts. For any beneficiary, the cumulative lifetime earnings limit would equal 50 times the maximum grant authorized under the Federal Pell Grant Program, determined for the year in which the distribution is made. All distributions of account earnings in excess of this cumulative lifetime earnings limit would be taxable to the beneficiary even if used for qualified higher education expenses (though not, if so used, subject to the additional tax described above). Beginning with the first distribution on behalf of a designated beneficiary, a qualified tuition program would report annually to the IRS both the amount of earnings distributed and cumulative earnings distributions. This reporting would be required with respect to each designated beneficiary for which distributions have been made.

This proposal would be effective for taxable years beginning after December 31, 2001.

ALLOW STATES TO ISSUE TAX-EXEMPT PRIVATE ACTIVITY BONDS FOR SCHOOL CONSTRUCTION

Current Law

Interest on State or local bonds is generally excluded from gross income. However, this exclusion generally does not apply to "private activity bonds." In general, a bond is a private activity bond if either: (1) more than ten percent of its proceeds is used for a private business use and more than ten percent of its debt service is secured by or payable from property used for a private business use; or (2) more than the lesser of $5 million or five percent of the proceeds is loaned to a nongovernmental person.

The Code contains several exceptions under which interest on private activity bonds is excluded from gross income. For example, eligible activities of educational and other charitable organizations described in section 501(c)(3) may be financed with tax-exempt private activity bonds known as "qualified 501(c)(3) bonds." Another category of tax-exempt private activity bonds is "exempt facility bonds," which includes, for example, bonds for airports, small manufacturing facilities, and low-income rental housing. Under current law, exempt facility bonds may not be issued to finance school facilities.

The volume of most tax-exempt private activity bonds is restricted by per-State limits. The annual volume limits for 2001 are the greater of $62.50 per resident of the State or $187.5 million. In 2002, the volume limits will increase to the greater of $75 per resident or $225 million. Beginning in 2003, the annual limits will be adjusted for inflation. Qualified 501(c)(3) bonds and certain exempt facility bonds are not subject to these volume limitations.

Reasons for Change

Some public school systems may find it desirable to enter into agreements with private entities under which a private entity agrees to build, own, and maintain school facilities. Under some circumstances, those agreements might render any bonds issued by a State or local government to finance the facilities to be non-exempt private activity bonds under current law. Allowing a limited amount of tax-exempt private activity bonds to be issued for these purposes outside the current law volume cap will encourage innovative public/private partnerships for the provision of school facilities.

Proposal

A new category of exempt facility bond would be authorized to finance "qualified public educational facilities." The facilities would be owned by a for-profit entity under a public-private partnership agreement with a State or local educational agency. The private entity would construct, rehabilitate, refurbish or equip an elementary or secondary public school facility, and would agree to transfer the facility to the State or local educational agency at the end of the agreement for no additional consideration. Facilities eligible to be financed with these bonds would consist of school buildings, including functionally related and subordinate facilities and land, and depreciable personal property used at the facilities. The facilities would have to be operated by a public educational agency as part of a system of public schools.

Issuance of these bonds would be subject to a separate annual per-State volume limit equal to the greater of $10 per resident or $5 million. States would allocate bond authority to State and local government agencies that would issue the bonds. Issuers could carry forward any unused limitation for up to two years after the year in which the authority arose.

The proposal would be effective for bonds issued after December 31, 2001.

Invest in Health Care

REFUNDABLE TAX CREDIT FOR THE PURCHASE OF HEALTH INSURANCE

Current Law

Under present law, the tax treatment of health insurance premiums depends on whether an individual has medical expenses that exceed a certain threshold, whether the individual is covered under a health plan paid for by an employer, and whether an individual has self-employment income.

Individuals who purchase their own health insurance may claim an itemized deduction for the premiums only to the extent that the premiums, when combined with other unreimbursed medical care expenses, exceed 7.5 percent of AGI. Other medical care expenses include expenses of the taxpayer, a spouse, or a dependent for basic medical care, qualified long-term care services, and premiums for qualified long-term care insurance (subject to a dollar limit).

Employer-provided health coverage and reimbursements for medical care are generally excluded from gross income for income tax and from wages for employment tax purposes. Active employees participating in a cafeteria plan may pay their employee share of premiums and other medical care expenses on the same tax-preferred basis.

Premiums for health insurance (or an arrangement having the effect of health insurance) paid by self-employed individuals are deductible in computing their AGI. For self-employed individuals who are not eligible for subsidized employer coverage, premiums for health insurance are 60 percent deductible for 2001, 70 percent deductible for 2002, and 100 percent deductible for 2003 and thereafter.

Reimbursements made to an individual from accident or health insurance (or an arrangement having the effect of accident or health insurance) for injuries or sickness are excluded from gross income.

Reasons for Change

An additional incentive is needed to encourage individuals who do not have public or employer-provided health coverage to purchase health insurance. Any incentive should assist low-income individuals and families with little or no income tax liability to purchase health insurance, but should not discourage earning additional income. In addition, incentives need to be made available in advance so that uninsured individuals receive financial help at the time of purchase of health insurance.

Proposal

The proposal would create a refundable income tax credit for health insurance purchased for individuals under age 65. The credit would equal 90 percent of the health insurance premium. However, the maximum credit would be $1,000 per individual covered by a policy, up to a maximum of $2,000. Individuals participating in public or employer-provided health plans

would not be eligible for the tax credit. Eligible health insurance plans would be required to meet minimum coverage standards, including coverage for high medical expenses.

Individuals without dependents filing a single return with AGI up to $15,000 would be eligible for the maximum credit. Above that income level, the maximum credit would be phased out ratably for individuals without dependents filing a single return who have AGI between $15,000 and $30,000. All other filers with AGI up to $30,000 would be eligible for the maximum credit and, above that income level, the maximum credit for these other filers would be phased out ratably between $30,000 and $45,000 of AGI in the case of a policy covering only one individual and would be phased out ratably between $30,000 and $60,000 of AGI in the case of a policy or policies covering more than one individual. These dollar amounts would be indexed by the Consumer Price Index for all-urban consumers.

Individuals could claim the tax credit for premiums paid as part of the normal tax-filing process. As an alternative to claiming the tax credit on the individual's tax return, the tax credit would be available at the time the individual purchases health insurance through a credit that could be applied to the purchase. A mechanism would be developed to allow the health insurance issuer to realize the value of the credits it receives in payment of premiums. Eligibility for a credit that could be applied to the purchase of insurance would be based on the individual's prior year tax return.

The health insurance tax credit would be effective for taxable years beginning after December 31, 2001. The credit would be phased in by limiting the credit to $750 per individual up to a maximum of $1,500 for 2002 and 2003. The full $1,000 credit for individuals and the $2,000 credit for families would be effective for taxable years beginning after December 31, 2003.

PROVIDE AN ABOVE-THE-LINE DEDUCTION FOR LONG-TERM CARE INSURANCE PREMIUMS

Current Law

Under present law, the tax treatment of long-term care insurance premiums depends on whether an individual has medical expenses that exceed a certain threshold, whether the individual is covered under a qualified long-term care insurance plan paid for by an employer, and whether an individual has self-employment income.

Individuals who purchase their own qualified long-term care insurance may claim an itemized deduction for the premiums, up to certain dollar limits that are based on age, but only to the extent that the premiums, when combined with other unreimbursed medical care expenses, exceed 7.5 percent of AGI.

For self-employed individuals who are not eligible for subsidized employer long-term care insurance coverage, premiums for qualified long-term care insurance (up to the applicable dollar limit) are 60 percent deductible for 2001, 70 percent deductible for 2002, and 100 percent deductible for 2003 and thereafter. Contributions by self-employed individuals are deductible in determining AGI and, thus, are not limited by the 7.5 percent of AGI applying to other individuals.

Employer-provided qualified long-term care insurance coverage and reimbursements for qualified long-term care services generally are excluded from gross income for income and employment tax purposes.

Reimbursements made to an individual from qualified long-term care insurance are generally excluded from gross income, regardless of whether the insurance is purchased by the individual or by the individual's employer.

Reasons for Change

Favorable tax treatment for the purchase of long-term care insurance generally provides an incentive for individuals to take greater financial responsibility for their long-term care needs. Allowing all individuals to deduct the cost of purchasing long-term care insurance will encourage the use of long-term care insurance. With the incorporation of tax deductibility for policies that meet eligibility standards, quality long-term care insurance will play a larger role in the financial security of older Americans.

Proposal

The proposal would allow individuals purchasing qualified long-term care insurance a deduction in determining AGI up to the annual dollar limitations that currently apply to the deductibility of long-term care insurance. The deduction would be available for the employee's share of the cost of employer-provided coverage if the employee pays at least 50 percent of the cost. In addition, qualified long-term care insurance policies would be required to meet new minimum standards for quality coverage.

The deduction would be effective for taxable years beginning on or after January 1, 2002, but would be phased in so that 25 percent of the premium would be deductible for 2002 through 2004, 35 percent for 2005, 65 percent for 2006, and 100 percent for 2007 and thereafter.

ALLOW UP TO $500 IN UNUSED BENEFITS IN A HEALTH FLEXIBLE SPENDING ARRANGEMENT TO BE CARRIED FORWARD TO THE NEXT YEAR

Current Law

A flexible spending arrangement ("FSA") is a reimbursement account or other arrangement under which an employee is reimbursed for qualified benefits. An FSA for medical care (or other qualified benefits) may be part of a salary reduction cafeteria plan. Under such a plan, an employee reduces current compensation and the employer agrees to provide the employee with qualified benefits. If the arrangement meets the cafeteria plan requirements of section 125, the compensation that was available is not included in the employee's gross income or wages for employment tax purposes. Section 125 prohibits cafeteria plans from providing deferred compensation. Proposed regulations under section 125 include rules that prevent FSAs from being used to provide deferred compensation, and require that FSAs have risk-shifting and risk-distribution characteristics similar to traditional health insurance. These rules include a "use it or lose it" provision that prevents the carry forward to future years of amounts in a cafeteria plan that are not used for medical expenses incurred by the end of a year.

Reasons for Change

Participation in FSAs can help employees to save for unexpected medical expenses. Requiring employees to forfeit the entire FSA account balance that has not been used at the end of the year discourages the use of FSAs. Further, without the ability to carry forward small amounts, employees may accelerate expenses or incur unnecessary costs (e.g., extra eyeglasses) as year end approaches in order to avoid forfeiting benefits. Modifying the "use it or lose it" rule to allow a limited carryforward will encourage saving for unexpected medical expenses and reduce the incentive to accelerate expenses or incur unnecessary costs, while preserving the character of a cafeteria plan health FSA as an arrangement that provides current health insurance coverage.

Proposal

An employer's cafeteria plan health FSA could permit up to $500 in amounts available for an employee's medical expenses but not used during the plan year to be carried forward to the employee's account for the next plan year of the health FSA. The proposal would be effective for plan years beginning after December 31, 2001.

PROVIDE ADDITIONAL CHOICE WITH REGARD TO UNUSED BENEFITS IN A HEALTH FLEXIBLE SPENDING ARRANGEMENT

Current Law

A flexible spending arrangement ("FSA") is a reimbursement account or other arrangement under which an employee is reimbursed for qualified benefits. An FSA for medical care (or other qualified benefits) may be part of a salary reduction cafeteria plan. Under such a plan, an employee reduces current compensation and the employer agrees to provide the employee with qualified benefits. If the arrangement meets the cafeteria plan requirements of section 125, the compensation that was available is not included in the employee's gross income or wages for employment tax purposes. Section 125 prohibits cafeteria plans from providing deferred compensation. Proposed regulations under section 125 include rules that prevent FSAs from being used to provide deferred compensation, and require that FSAs have risk-shifting and risk-distribution characteristics similar to traditional health insurance. These rules include a "use it or lose it" provision that prevents the carry forward to future years of amounts in a cafeteria plan that are not used for medical expenses incurred by the end of a year.

Reasons for Change

Participation in FSAs can help employees to save appropriately for unexpected medical expenses. Requiring employees to forfeit the FSA account balance that has not been used at the end of the year discourages the use of FSAs. A related proposal would allow cafeteria plans to permit employees to carry forward up to $500 in unused amounts within the FSA. Also allowing employers to give participants the option of receiving a distribution of up to $500 in unused amounts or the option of contributing this amount to the employer's retirement plan or to an Archer Medical Savings Account (MSA) will further encourage participation. These options provide additional flexibility for employees participating in FSAs who would not benefit from the carryforward, such as participants terminating employment with the employer.

Proposal

An employer's cafeteria plan could permit up to $500 in amounts available but not used for medical expenses during the plan year to be distributed to the employee or contributed to a 401(k) plan, 403(b) plan, governmental 457(b) plan, or MSA. Amounts distributed would be subject to income tax withholding and employment taxes. Amounts the participant chooses to contribute to a 401(k) or other plan or MSA would be subject to the normal rules (e.g., contribution limits, discrimination tests, withdrawal restrictions, employment taxes) applicable to elective contributions to the receiving plan or MSA.

The proposal would be effective for plan years beginning after December 31, 2001.

PERMANENTLY EXTEND AND REFORM ARCHER MSA'S

Current Law

An MSA is a trust or custodial account used to accumulate funds on a tax-preferred basis to pay for medical expenses. An individual is eligible to establish an MSA only if the employee (or the employee's spouse) is covered by a high deductible health plan (and no other health plan) and is either self-employed or employed by a small employer maintaining the high deductible health plan. Generally, if more than 750,000 individuals establish an MSA before 2002, no additional MSAs may be established.

A high deductible health plan is defined as a health plan with an annual deductible in the range of $1,550 to $2,350 in the case of individual coverage and in the range of $3,100 to $4,650 in all other cases. A high deductible health plan must also have an out-of-pocket limit that is no higher than $3,100 in the case of individual coverage and $5,700 in all other cases.

Individual contributions to an MSA that do not exceed specified limits are deductible in determining AGI and employer contributions to an MSA are excludable up to those same limits. An individual who receives an employer contribution for a year is not allowed to make a deductible contribution for the same year. In addition, contributions to an MSA are not permitted under a cafeteria plan. The annual limit on MSA contributions is 65 percent of the annual deductible in the case of individual coverage and 75 percent of the annual deductible all other cases.

Earnings on an MSA are not includible in income. Distributions from an MSA that are used to pay medical expenses are generally excludable for income. If a distribution is not for purposes of paying medical expenses, the distribution is includible in income and subject to a 15-percent additional tax. Amounts distributed after an account holder reaches age 65, dies or becomes disabled are not subject to this 15-percent additional tax.

Reasons for Change

MSAs provide an additional option for individuals, including those currently without health insurance, to purchase coverage, and give them more control over spending on medical expenses. This control provides an incentive for individuals to become more cost conscious purchasers of medical services, potentially reducing the growth of health care costs. Eliminating restrictions on the availability of MSAs and easing some of the restrictions on MSA plan features will simplify the rules and make the use of these accounts attractive to more individuals.

Proposal

MSAs would be made permanent and liberalized. The 750,000 cap on the number of MSAs and the restriction related to employer size would be removed. All employees and individuals covered by a high deductible health plan, other than a health plan for which the individual is eligible to claim a refundable health care credit, would be eligible for MSAs. The definition of high deductible health plan would be modified to permit an annual deductible as low as $1,000 for individual coverage and $2,000 in all other cases.

MSA contributions would be allowed up to 100 percent of the maximum deductible and could be made by the employee, the individual or both up to the applicable limit for the individual for that particular year. Contributions to MSAs could be made through a cafeteria plan.

The proposal would be effective for taxable years beginning after December 31, 2001.

PROVIDE AN ADDITIONAL PERSONAL EXEMPTION TO HOME CARETAKERS OF FAMILY MEMBERS

Current Law

Taxpayers are allowed to claim exemptions for themselves, their spouses and their dependents. To qualify as a dependent, an individual must (1) be a specified relative or member of the taxpayer's household for a full year,[3] (2) receive over half of his or her support from the taxpayer,[4] (3) not have gross income in excess of the exemption amount,[5] (4) be a citizen or resident of the United States or resident of Canada or Mexico, and (5) not be required to file a joint tax return with his or her spouse.

In 2001, the amount of the exemption is $2,900. Personal exemptions are phased-out by two percentage points for each $2,500 ($1,250 if married filing separately) or fraction thereof by which adjusted gross income exceeds certain thresholds ($132,950 for single filers, $199,450 for joint filers, $166,200 for heads of households, and $99,725 for married couples filing separate returns). Both the amount of the exemption and the income thresholds at which the exemption begins to phase out are indexed for inflation.

Reasons for Change

A parent's long illness or disability can impose significant burdens on their adult children who choose to care for them at home. Similar burdens are incurred by taxpayers who are the primary caregivers for their ill or disabled spouses or grandparents. Taxpayers who provide long-term care in their own home for close family members incur significant costs, and therefore do not have the same ability to pay as other taxpayers. Providing an additional exemption adjusts for differences in ability to pay between caregivers and other taxpayers and recognizes the formal and informal costs of providing long-term care.

Proposal

Taxpayers would be eligible to claim an additional personal exemption for certain qualified family members residing with the taxpayer in the household the taxpayer maintains. A taxpayer would be treated as maintaining the household for the year only if over half the cost of maintaining the household for the year is furnished by the taxpayer. Qualified family members would include any individual with long-term care needs who (1) is the spouse of the taxpayer or an ancestor of the taxpayer or the spouse of such an ancestor and (2) is a member of the taxpayer's household for the entire year. An individual would be considered to have long-term care needs if he or she were certified by a licensed physician (prior to the filing of a return claiming the exemption) as being unable for at least 180 consecutive days to perform at least two activities of daily living (ADLs) without substantial assistance from another individual, due to a

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[3] Specified relatives include the taxpayer's sons, daughters, grandchildren, siblings, parents, aunts, uncles, nieces and nephews.

[4] For purposes of determining whether a taxpayer provides over half of an individual's support, public assistance payments are taken into account as support payments made by a governmental authority.

[5] This test does not apply if the dependent is the taxpayer's child (son, daughter, stepson, or stepdaughter or foster child) and is under the age of 19 at the close of the calendar year (24 if a full-time student).

loss of functional capacity.[6] As under section 7702B(c)(2)(B), ADLs would be eating, toileting, transferring, bathing, dressing, and continence. Substantial assistance would include both hands-on assistance (that is, the physical assistance of another person without which the individual would be unable to perform the ADL) and stand-by assistance (that is, the presence of another person within arm's reach of the individual that is necessary to prevent, by physical intervention, injury to the individual when performing the ADL).

As an alternative to the two-ADL test described above, an individual would be considered to have long-term care needs if he or she were certified by a licensed physician as, for at least 180 consecutive days, (1) requiring substantial supervision to be protected from threats to health and safety due to severe cognitive impairment and (2) being unable to perform at least one ADL or, to the extent provided in regulations prescribed by the Secretary of the Treasury (in consultation with the Secretary of Health and Human Services) being unable to engage in age appropriate activities.

The taxpayer would be required to provide a correct taxpayer identification number for the individual with long-term care needs, as well as a correct physician identification number (e.g., the Unique Physician Identification Number that is currently required for Medicare billing) for the certifying physician. Failure to provide correct taxpayer and physician identification numbers would be subject to mathematical error procedures (enabling the Internal Revenue Service to summarily assess additional tax without issuing a notice of deficiency). Further, the taxpayer could be required to provide other proof of the existence of long-term care needs in such form and manner, and at such times, as the Secretary requires.

The proposal would be effective for taxable years beginning after December 31, 2001.

[6] A portion of the period certified by the physician must occur within the taxable year for which the exemption is claimed. After the initial certification, individuals must be re-certified by their physician within three years or such other period as the Secretary prescribes.

PROVIDE TAX RELIEF FOR AWARDS UNDER CERTAIN HEALTH EDUCATION PROGRAMS

Current Law

Section 117 provides tax-free treatment for certain scholarship and fellowship grants used to pay qualified tuition and related expenses, but not to the extent that any grant represents compensation for services. The National Health Service Corps (NHSC) Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program provide certain education awards to participants on condition that the participants provide certain services. These education awards generally involve the payment of higher education expenses (under the NHSC program, the awards also may be used for the repayment or cancellation of existing or future student loans). Because the recipients are required to perform services in exchange for the education awards, the awards used to pay higher education expenses are taxable income to the recipient.

Reasons for Change

Imposing a tax liability on education awards under these Federal programs undercuts the objective of providing an incentive for health professionals to serve in medically underserved geographic areas, in the case of the NHSC Scholarship Program, or the Armed Forces, in the case of the Armed Forces Health Professions Program.

Proposal

Amounts received by an individual under the National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program would be "qualified scholarships" excludable from income, without regard to any service obligation by the recipient.

The proposal would be effective for education awards received after December 31, 2001.

Assist Americans with Disabilities

EXCLUDE FROM INCOME THE VALUE OF EMPLOYER-PROVIDED COMPUTERS, SOFTWARE, AND PERIPHERALS

Current Law

The value of computers, software and other office equipment provided by an employer to an employee for use at the employee's home is generally excludable from income to the extent that the employee uses the equipment to perform work for the employer, and includible in income to the extent that the employee uses the equipment for personal purposes or to carry on a trade or business other than working as an employee of the employer.

Taxpayers with disabilities may claim an itemized deduction for impairment-related work expenses. The deduction is not subject to the two-percent of adjusted gross income (AGI) floor applicable to miscellaneous itemized deductions.

An individual with a disability is defined as any individual who has a physical or mental disability (including, but not limited, to blindness or deafness), which for such individual constitutes or results in a functional limitation to employment, or who has any physical or mental impairment (including, but not limited to, a sight or hearing impairment), which substantially limits one or more major life activities.

Impairment-related work expenses are defined as expenses for attendant care services at the individual's place of employment and other expenses in connection with such place of employment which are necessary for the individual to be able to work. Impairment-related work expenses must be ordinary and necessary. Depreciable capital items are not included under the definition of impairment-related work expenses. Depreciation attributable to these items, however, may be deductible, subject to certain limitations (such as, for example, the two-percent AGI floor).

Reasons for Change

Disabled individuals may incur additional costs in order to work and earn taxable income. For example, they may require special equipment in order to work, particularly to enable them to telecommute. However, employees cannot exclude the entire value of such equipment provided by an employer if they use the equipment for personal use as well as work. This restriction can impose significant recordkeeping requirements on employers and workers. Removing this restriction would lower the costs of telecommuting by disabled individuals.

Proposal

An individual with a disability would be allowed to exclude from income the value of any computers, software or other office equipment provided by such individual's employer which are

necessary for the individual to perform work for the employer at home.[7] In order to qualify for the exclusion, the employee would be required to make substantial use of the equipment to perform work for the employer. The exclusion would apply to all use of such equipment, including use by the employee for personal purposes or to carry on a trade or business other than working as an employee of the employer.

The proposal would adopt the current-law definition of individuals with disabilities. Employees would be required to provide their employer with a certification from a licensed physician showing that they meet the criteria to be considered an individual with a disability in such form and manner, and at such times, as the Secretary requires.

The proposal would be effective for taxable years beginning after December 31, 2001.

[7] If the employer provided the employee with use of equipment after the end of the equipment's depreciable life, the value of such use to the employee would be deemed to be zero.

PERMANENTLY EXTEND AND INCREASE THE ADOPTION TAX CREDIT

Current Law

Families who adopt children are provided a nonrefundable tax credit of 100 percent of the first $5,000 per adoption ($6,000 for adoptions of children with special needs) of qualified expenses paid in the adoption process. Tax credits in excess of tax liability may be carried forward for up to five years. The tax credit does not apply to adoptions by stepparents.

Qualified expenses for an adoption may be incurred in a single year or in more than one year, but the maximum qualifying amounts for the credit are cumulative for an adoption. Qualified expenses do not include any expenses which are paid or reimbursed under any other government or non-government program.

The credit is phased out ratably for taxpayers with incomes between $75,000 and $115,000.

The tax credit generally sunsets after 2001, but is permanent with respect to adoptions of children with special needs.

Reasons for Change

In 1998, the latest year for which data are available, the tax provisions for adoption provided financial assistance to about 50,400 adoptions. Without legislation, such assistance would terminate after 2001 for over 90 percent of such adoptions. Continuing to provide tax benefits for adoptions would reduce the financial burden for taxpayers undertaking adoptions, would permit some adoptions that would not otherwise be undertaken, and, in conjunction with Federal expenditure programs, would help promote the movement of children from foster care into permanent homes.

Proposal

The adoption tax credit for the adoptions of children without special needs would be made permanent and the limit on qualified expenses would be increased to $7,500 per adoption. The limit for adoptions of children with special needs would be increased to $8,500 per adoption for expenses paid or incurred after December 21, 2001.

Help Farmers and Fishermen Manage Economic Downturns

ESTABLISH FARM, FISH, AND RANCH RISK MANAGEMENT (FFARRM) SAVINGS ACCOUNTS

Current Law

There is no provision in present law allowing the elective deferral of farm or fishing income. However, farmers can elect to average their farming income over a three-year period, and farmers may carry back net operating losses over the five previous years. In addition, taxes can be deferred on certain forms of income, including disaster payments, crop insurance, and proceeds from emergency livestock sales. Farmers are also permitted to use the cash receipts and disbursement and the installment methods of accounting.

Reasons for Change

The income of an individual engaged in farming, commercial fishing, or ranching can fluctuate significantly from year to year depending on the weather, agricultural markets, and other factors beyond the individual's control. The income averaging and net operating loss rules of current law provide tax relief in good years, but there are no provisions encouraging farmers, fishermen, and ranchers to put aside part of their income in good years to provide a cushion when harvests fail or prices fall.

Proposal

Individuals engaged in an eligible business would be allowed to establish Farm, Fish, and Ranch Risk Management (FFARRM) accounts. Eligible businesses for this purpose would be farming, ranching, or commercial fishing businesses that are not passive activities of the taxpayer.

All FFARRM accounts would be domestic trusts for the exclusive benefit of the farmer, fisherman, or rancher who establishes the trust. The trust would be required to satisfy certain other requirements, including a requirement that the governing instrument of the trust limit trust assets to cash and certain interest-bearing obligations. A FFARRM account would be treated as a grantor trust and income earned in the account would be taxed currently to the individual who established the account.

In each year, a taxpayer would be permitted to make contributions to a FFARRM account equal to 20 percent of taxable income from eligible businesses. The taxable income from eligible businesses would be determined without regard to amounts deducted or included in gross income under the FFARRM account rules but otherwise in the manner prescribed for purposes of the income averaging rules. Only cash contributions would be permitted, and the amount of the contribution during a taxable year would be allowed as a deduction for that year. For this purpose, contributions made on or before the due date (without regard to extensions) of the taxpayer's return for a taxable year would be treated as having been made on the last day of the year. A six-percent excise tax would be imposed on excess contributions.

The deduction for FFARRM account contributions would be taken into account in determining adjusted gross income and would reduce income attributable to the eligible business for all income tax purposes other than determining the maximum permitted FFARRM account contribution for the taxable year. Contributions to a FFARRM account would not reduce earnings from self employment.

Distributions from a FFARRM account, except to the extent attributable to income earned in the account or nondeductible contributions, would be included in gross income (but not self-employment income) of the individual who established the account. Any amount that has not been distributed by the close of the fifth year following the year of deposit would be deemed to be distributed in the fifth year. The deemed distribution would be included in gross income of the account owner and would be subject to a 10-percent excise tax. For purposes of these rules, distributions during a year would be treated as made first from account earnings that have not been previously distributed and then from deposits in the order made beginning with the earliest. In addition, distributions made on or before the due date (without regard to extensions) of the taxpayer's return for a taxable year would be treated as having been made on the last day of the year.

Other deemed distribution rules would apply if the account owner ceases to engage in an eligible business or dies. If the account owner does not engage in an eligible business during two consecutive taxable years, the balance of the FFARRM account would deemed to be distributed to the owner on the last day of the two-year period. In addition, if the individual who established the FFARRM account dies and the individual's surviving spouse is not designated as the beneficiary, the account would cease to be a FFARRM account on the date of the owner's death and the balance of the account would be deemed to be distributed to the owner on the date of death. A surviving spouse designated as the beneficiary of a FFARRM account would, on the other hand, "step into the shoes" of the deceased owner with respect to the account. The deemed distributions under these rules would be included in gross income of the owner but would not be subject to an additional excise tax.

The proposal would be effective for taxable years beginning after December 31, 2001.

Increase Housing Opportunities

PROVIDE TAX CREDIT FOR DEVELOPERS OF AFFORDABLE SINGLE-FAMILY HOUSING

Current Law

No tax credits are available to developers of new or rehabilitated, affordable single-family housing. Current law does provide tax credits to owners of qualified low-income rental units through the low-income housing tax credit (LIHTC). The LIHTC may be claimed over a 10-year period for a portion of the cost of rental housing occupied by tenants having incomes below specified levels. The credit percentage for newly constructed or substantially rehabilitated housing that is not federally subsidized is adjusted monthly by the Internal Revenue Service so that generally the 10 annual credit amounts have a present value of 70 percent of qualifying costs. The credit percentage for substantially rehabilitated housing that is federally subsidized and for existing buildings is calculated to have a present value of 30 percent of qualified expenditures. In general, the aggregate first-year credit authority allocated to each State is $1.50 per capita in 2001 and $1.75 per capita in 2002. Per capita amounts are indexed for inflation beginning in 2003. Tax credits are allocated to particular projects by State or local housing agencies pursuant to publicly announced plans for allocation. Authority to allocate credits may be carried forward by agencies to the following calendar year. Unused credit allocations may be returned to an agency for reallocation. Credit allocations may revert to the agency if less than 10 percent of the taxpayer's reasonably expected qualifying basis is expended within 6 months of receiving the allocation. Authority not used in a timely manner reverts to a national pool for distribution to States requesting additional authority. Agencies may award less than the maximum credits generally applicable. Generally, a qualifying building must be placed in service in the year the credit is allocated unless at least 10 percent of the taxpayer's reasonably expected basis in the property is expended in the year of allocation or within 6 months of the allocation date. Rules are provided for the allocation of costs to individual units in multi-unit projects and to property that is part of a project but used for purposes other than rental housing. The tax credit period begins with the taxable year in which qualified buildings are placed in service (or, in certain circumstances, the succeeding taxable year). Credits are recaptured if the required number of units is not rented to qualifying tenants for a period of 15 years.

Current law allows tax-exempt bonds (mortgage revenue bonds) to be issued by State and local governments to finance mortgages at interest rates that are below-market for homebuyers who meet certain income and purchase price limits. In general, eligible individuals must be first-time homebuyers and have incomes of 115 percent (100 percent for families with less than 3 members) or less of the greater of area or statewide median gross income (applicable median family income). The subsidy is recaptured under certain conditions if the home is sold within 9 years of the date of purchase.

Reasons for Change

The quality of life in distressed neighborhoods can be improved by increasing home ownership. Existing buildings in these neighborhoods often need extensive renovation before they can provide decent owner-occupied housing. Renovation may not occur because the costs involved exceed the prices at which the housing units could be sold. Similarly, the costs of new

construction may exceed their market value. Properties will sit vacant and neighborhoods will remain blighted unless the gap between development costs and market prices can be filled.

Proposal

The proposal would create a single-family housing tax credit (SFHTC). First-year credit authority of $1.75 per resident would be made available annually to States (including U.S. possessions) beginning in calendar year 2002. The per capita amount would be indexed for inflation beginning in 2003. Pursuant to a plan of allocation, State or local housing credit agencies would award first-year credits to housing units comprising a project for the development of single-family housing in census tracts with median incomes of 80 percent or less of area median income, based initially upon 2000 census data. Rules similar to the current law rules for the LIHTC would apply regarding carry forward and return of unused credits and a national pool for unused credits. Credits allocated to a project would revert to the agency unless expenditures equal to 10 percent or more of reasonably expected qualifying costs were made within 6 months of receipt of the allocation. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits with respect to a unit, as of the beginning of the credit period (described below), could not exceed 50 percent of the qualifying costs of the unit. For these purposes, present value would be determined based on the mid-term Applicable Federal Rate in effect for the date the agency allocated credits to the project. Rules similar to the current law rules for the LIHTC would apply to determine eligible costs of individual units. The Treasury Department would have the authority to promulgate necessary reporting requirements.

The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the date of sale to a qualified buyer (or, if later, the date a certificate of occupancy was issued) would be eligible to claim SFHTCs over a 5-year period beginning on that date. No credits with respect to a housing unit would be available unless the unit was sold within a 1-year period beginning on the date a certificate of occupancy is issued with respect to that unit.

Eligible homebuyers would have incomes at 80 percent (70 percent for families with less than 3 members) or less of applicable median family income. They would not have to be first-time homebuyers. Rules similar to the mortgage revenue bond provisions would apply to determine applicable median family income. As in the case of mortgage revenue bonds, homebuyers would be subject to recapture provisions in certain circumstances. In particular, recapture rules would apply if the homebuyer (or a subsequent buyer) sold the property to a nonqualified buyer within 3 years of the date of initial sale of the unit. The recapture tax would equal the lesser of (1) 80 percent of the gain upon resale and (2) a recapture amount. The recapture amount would equal the value of the credits allocated to the housing unit being resold, reduced by 1/36th of that value for each month between the initial sale and the sale to a nonqualified buyer. No recapture provision would apply to taxpayers eligible to claim SFHTCs. If a housing unit for which any credit is claimed were converted to rental property within the first 5 years following the initial purchase, no deductions for depreciation or property taxes could be claimed with respect to that unit during that time period.

The proposal would be effective beginning with first-year credit allocations for calendar year 2002.

Encourage Saving

ESTABLISH INDIVIDUAL DEVELOPMENT ACCOUNTS (IDA'S)

Current Law

There is no tax provision under current law specifically targeted to low-income families to encourage them to save and develop a pool of capital to be used for such purposes as a first-time home purchase, higher education expenses or small business capitalization.

IDAs were first authorized under the Personal Work and Responsibility Act of 1996. The Assets for Independence Act of 1998 established a five-year IDA demonstration program, with an appropriation of $25 million per year. Under the program, certain individuals eligible for Temporary Assistance for Needy Families (TANF, the successor to AFDC), or eligible for the Earned Income Tax Credit (EITC) and who meet a net worth test, could open an IDA. Individuals' contributions receive no tax preference, but are matched by contributions from a state program or a participating nonprofit organization. The matching contributions and their earnings are not taxable to the individual. Withdrawals can be made for higher education, first home purchase, or small business capitalization. Matching amounts are typically held separately and, upon withdrawal, must be paid directly to a mortgage provider, university, or business capitalization account at a financial institution. Match rates are chosen by the state or nonprofit and must be between 50 and 400 percent. The IDA program is administered by the Department of Health and Human Services.

Reasons for Change

One third of all Americans have no assets available for investment, and another twenty percent have only negligible assets. The household savings rate of the United States lags far behind other industrial nations, constraining national economic growth and preventing many Americans from entering the economic mainstream by buying a house, obtaining an adequate education, or starting a business.

Absent some inducement, financial institutions may not encourage the establishment of IDAs because the administrative cost associated with the establishment and maintenance of small accounts is large as a fraction of the account balance. In addition, financial education is an essential component of a policy to assist lower-income persons in building assets. By helping financial institutions and their non-profit partners to defray the costs associated with both account administration and providing financial education, the credit will both stimulate savings and encourage a sensible approach to lifetime financial planning.

Proposal

The Administration's proposal would create a tax credit, subject to the provisions of the General Business Credit, to defray the cost to financial institutions of establishing IDAs, contributing matching funds to these accounts and providing financial education to account holders. The range of financial institutions eligible to participate includes all those institutions eligible under current law to serve as the custodian of IRAs. The goals and broad outline of this program are

similar to those of the IDA demonstration program; however, certain specific design features are intended to facilitate administration through the tax system.

Individuals between the ages of 18 and 60, who are not students and meet certain income requirements, would be eligible to establish and contribute to an IDA. For single filers, the income limit would be $15,000 in AGI, while the corresponding thresholds for head-of-household and joint filers would be $22,500 and $30,000 in AGI respectively. In all cases, eligibility would be determined by the previous year's AGI.

The credit provided to a financial institution sponsoring an IDA program would consist of three components: First, a $70 per account credit could be claimed to offset in part the cost to the financial institution of establishing the account and providing basic financial literacy training. A second credit component, consisting of $30 per account per year, would offset the ongoing costs to the financial institution of maintaining and administering the account. Finally, the financial institution would be eligible to claim a 90-percent credit for up to $300 contributed to each account annually, for a maximum credit of $270. Sponsoring financial institutions, in order to be eligible for the credit, would be required to match account holder contributions on a dollar-for-dollar basis and provide earnings on such amounts. Matching contributions and earnings thereon would be tracked separately by the financial institution.

Individuals could withdraw their contributions and matching funds, along with earnings thereon, for qualified purposes including certain higher education expenses, first-time home purchase, and business start-up expenses. The financial institution at which the IDA is held would be required to disburse the funds directly to another financial institution (in cases of home purchase or business start-up) or to an institution of higher education. Non-qualified distributions would result in the forfeiture of matching funds and earnings thereon. Matching funds and earnings thereon would be available, without penalty, to the account holder for any purpose after he or she attains the age of 62.

Contributions to IDAs by individuals would not be deductible and the earnings on such contributions would be taxable to the account holder. Matching contributions and earnings on such contributions would not be taxable to the account holder at any time.

The proposal would provide explicit regulatory authority to Treasury to adopt rules that will permit financial institutions sponsoring IDA programs to verify the eligibility of individuals seeking to open accounts and ensure that such individuals do not already possess accounts at other institutions. Furthermore, the authority would extend to rules governing the recapture of credits claimed by financial institutions with respect to non-eligible individuals and individuals who, by virtue of making a non-qualified withdrawal of their contributions, forfeit matching funds and earnings thereon.

The credit would be provided with respect to IDAs established between 2003 and 2007. The annual maintenance credit as well as the credit for matching funds advanced by financial institutions would be available for years between 2003 and 2009.

Protect the Environment

PERMANENTLY EXTEND EXPENSING OF BROWNFIELDS REMEDIATION COSTS

Current Law

Taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement of hazardous substances at a qualified contaminated site (so-called "brownfields").

Hazardous substances are defined generally for purposes of the brownfields provision by reference to sections 101(14) and 102 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA). A qualified contaminated site generally is any property that (1) is held for use in a trade or business, for the production of income, or as inventory; (2) contains (or potentially contains) a hazardous substance; and (3) is certified by the appropriate state environmental agency as to the presence (or potential presence) of a hazardous substance. However, sites that are identified on the national priorities list under CERCLA do not qualify as qualified contaminated sites.

The Community Renewal Tax Relief Act of 2000 extended the brownfields provision to expenditures paid or incurred before January 1, 2004. In addition, the bill eliminated the targeted area requirement included in the original provision, which generally restricted eligible sites to areas with low median income as well as those within the boundaries of designated empowerment zones and enterprise communities.

Reasons for Change

The Administration believes that encouraging environmental remediation is an important national goal. The brownfields provision encourages the cleanup of contaminated brownfields, thereby enabling them to be brought back into productive use in the economy and mitigating potential harms to public health. Extending the special treatment accorded to brownfields on a permanent basis would remove doubt among taxpayers as to the future deductibility of remediation expenditures and would promote the goal of encouraging environmental remediation.

Proposal

The expensing of brownfield remediation expenditures would be made permanent by eliminating the restriction that qualified expenditures must be paid or incurred on or before December 31, 2003.

EXCLUDE 50 PERCENT OF GAINS FROM THE SALE OF PROPERTY FOR CONSERVATION PURPOSES

Current Law

A taxpayer who sells property must generally recognize, and pay taxes on, the full amount of any gain realized, even if the property is an interest in environmentally sensitive land or water and the sale is to an entity that will protect the land or water from development. By contrast, to encourage donations for conservation purposes, tax law provides a charitable contribution deduction not only for gifts to charity of a taxpayer's entire interest in property but also for conservation-oriented donations of partial interests, such as remainder interests and conservation easements. A charitable contribution deduction may also be available in certain cases where the property is sold to a charity for less than its fair market value (that is, a "bargain sale"). In some cases, if a qualified conservation easement has been donated, land burdened by that easement may receive a reduced valuation for estate tax purposes.

Reasons for Change

Some landowners would take steps to preserve their land preserved in its undeveloped state or protect special features of the land from development but may not be able to afford to simply donate the land for conservation purposes, especially if the land is their primary salable asset. For these taxpayers, the tax incentive for charitable contributions is ineffective in encouraging preservation of the land. Land preservation would be encouraged, however, by reducing capital gains taxes on sales of land or conservation easements to conservation charities or to governments for conservation purposes. This would be a non-regulatory approach to conservation and protection of the environment.

Proposal

When land (or an interest in land or water) is voluntarily sold for conservation purposes (as defined below), only 50 percent of any capital gain would be included in the seller's income. The exclusion would be computed without regard to improvements. To be eligible for the partial exclusion, the sale must be to a qualified conservation organization. A qualified conservation organization is either a governmental unit or a charity that is a qualified organization under section 170(h)(3) and that is organized and operated primarily for conservation purposes. Conservation purposes means the preservation of land areas for outdoor recreation by, or the education of, the general public; the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; or the preservation of open space where the preservation is for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy.

The buyer must provide a written statement representing that it is a qualified conservation organization and that it intends to hold the property exclusively for conservation purposes and not to transfer it for valuable consideration other than to a qualified conservation organization in a transaction that would qualify for this 50 percent exclusion if the buyer/transferor were taxable. The partial exclusion would not be available for sales pursuant to a condemnation order but would apply to any gain recognized in a sale that is made in response to the threat or imminence

of such an order. If the property sold is less than the taxpayer's entire interest in the property, it must satisfy requirements like those applicable to qualified conservation contributions under section 170(h). In addition, the property sold must have been owned by the taxpayer or a member of the taxpayer's family for the three years immediately preceding the date of the sale.

The provision would be effective for sales taking place on or after the date of first committee action.

Energy Policy Proposals

EXTEND AND MODIFY THE TAX CREDIT FOR PRODUCING ELECTRICITY FROM CERTAIN SOURCES

Current Law

Current law provides taxpayers a 1.5-cent-per-kilowatt-hour tax credit for electricity produced from wind, "closed-loop" biomass (organic material from a plant that is planted exclusively for purposes of being used at a qualified facility to produce electricity), and poultry waste. The credit amount is indexed for inflation after 1992 and is 1.7 cents per kilowatt hour in 2001. The electricity must be sold to an unrelated third party and the credit is limited to the first 10 years of production. In addition, the credit is reduced if the facility producing the electricity is financed by governmental grants or subsidized energy financing, tax-exempt bonds, or other tax credits (governmental financing). The percentage reduction in the credit is the same as the governmental financing percentage of the total capital cost of the facility. The credit applies only to facilities that are owned by the taxpayer claiming the credit and that are placed in service before January 1, 2002.

Reasons for Change

The tax credit helps make electricity produced from wind and biomass competitive with other forms of electricity. These renewable energy sources will be an important part of the Nation's long-term energy supply. Expanding eligible biomass sources would increase the production of electricity from biomass.

Proposal

The credit for electricity produced from wind and biomass (but not poultry waste) would be extended for three years to facilities placed in service before January 1, 2005. In addition, eligible biomass sources would be expanded to include (i) closed-loop biomass and (ii) any solid, nonhazardous, cellulosic waste material that is segregated from other waste materials and is derived from: (a) any of the following forest-related resources: mill residues, pre-commercial thinnings, slash and brush, but not including old growth timber or wood waste incidental to pulp and paper production; (b) waste pallets, crates, and dunnage, and landscape or right-of-way tree trimmings, but not including unsegregated municipal solid waste (garbage) and post-consumer waste paper; or (c) agricultural sources, including orchard tree crops, vineyard, grain, legumes, sugar, and other crop byproducts or residues. In addition, the rules relating to governmental financing would be modified. There would be no percentage reduction in the credit for governmental financing attributable to tax-exempt bonds. Instead, such financing would reduce the credit only to the extent necessary to offset the value of the tax exemption.

Special rules would apply to facilities placed in service before January 1, 2002. Electricity produced at such facilities from newly eligible sources would be eligible for the credit only from January 1, 2002, through December 31, 2004. The credit for such electricity would be computed at a rate equal to 60 percent of the generally applicable rate.

Electricity produced from newly eligible biomass co-fired in coal plants would be eligible for the credit only from January 1, 2002, through December 31, 2004. The credit for such electricity would be computed at a rate equal to 30 percent of the generally applicable rate.

In the case of a wind or biomass facility operated by a lessee, the proposal would permit the lessee, rather than the owner, to claim the credit. This rule would apply to production under leases entered into after the date on which the proposal is enacted.

PROVIDE TAX CREDIT FOR RESIDENTIAL SOLAR ENERGY SYSTEMS

Current Law

A 10-percent investment tax credit is provided to businesses for qualifying equipment that uses solar energy to generate electricity, to heat or cool or provide hot water for use in a structure, or to provide solar process heat. No credit is available for nonbusiness purchases of solar energy equipment.

Reasons for Change

A tax credit for solar energy equipment used to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) will reduce the cost of these investments and encourage individuals to adopt these systems. Solar energy will be an important part of the Nation's long-term energy supply. Increasing the demand for these systems should also increase private-sector research to reduce costs further and increase efficiency.

Proposal

Individuals that purchase photovoltaic equipment or solar water heating equipment for use in a dwelling unit that the individual uses as a residence would be allowed a nonrefundable personal credit equal to 15 percent of the cost of the equipment and its installation. Equipment would qualify for the credit only if it is used exclusively for purposes other than heating swimming pools. The Secretary of the Treasury would be authorized to prescribe regulations providing for recapture of the credit if the equipment is used in a manner inconsistent with this requirement. An individual would be allowed a cumulative maximum credit of $2,000 per residence for photovoltaic equipment and $2,000 per residence for solar water heating equipment. The credit would apply only to solar water heating equipment placed in service after December 31, 2001, and before January 1, 2006, and to photovoltaic systems placed in service after December 31, 2001, and before January 1, 2008.

MODIFY TREATMENT OF NUCLEAR DECOMMISSIONING FUNDS

Current Law

Although accrual basis taxpayers generally may not deduct an item until economic performance occurs, a taxpayer responsible for nuclear power plant decommissioning may elect to deduct contributions made to a qualified nuclear decommissioning fund.

A qualified nuclear decommissioning fund is a segregated fund that is established by the taxpayer, restricted to certain types of investments, and used exclusively for the payment of decommissioning costs, taxes on fund income, and management costs. Contributions to the fund are deductible in the year made to the extent they were collected as part of the cost of service to ratepayers. Withdrawals from the fund to pay for decommissioning expenses are included in income at the time of withdrawal, but the taxpayer also is entitled to a deduction for decommissioning expenses as economic performance for those costs occurs. A 20-percent tax rate applies to the taxable income of the fund.

Nuclear decommissioning costs are otherwise deductible (without regard to section 280B) expenses to be incurred in connection with the entombment, decontamination, dismantlement, removal, and disposal of a nuclear plant that has permanently ceased the production of electricity.

Accumulations in a qualified fund are limited to the amount necessary to pay post-1983 nuclear decommissioning costs (determined as if decommissioning costs accrued ratably over the estimated useful life of the plant). To prevent accumulations of funds in excess of those required to pay post-1983 decommissioning costs and to ensure that contributions to the fund are not deducted more rapidly than level funding, taxpayers are required to obtain a ruling from the IRS to establish the maximum annual contribution that may be made to the fund. Taxpayers are required to obtain subsequent rulings setting new ruling amounts in certain instances.

A qualified fund may be transferred in connection with the sale, exchange, or other transfer of the nuclear power plant to which it relates. If the transferee is eligible to maintain a qualified fund and continues to maintain the fund after the transfer while satisfying certain other conditions, the regulations treat the transfer as a nontaxable transaction. No gain or loss is recognized on the transfer of the qualified decommissioning fund and the transferee takes the transferor's basis in the fund. The regulations also permit the IRS to treat a transfer that does not satisfy these conditions as a nontaxable transaction (with continued qualification of the fund) when that is necessary and appropriate to carry out the purposes of the statutory and regulatory provisions relating to qualified funds.

Regulators may also require utilities to set aside amounts for nuclear decommissioning in excess of the amount allowed as a deductible contribution. In addition, pursuant to regulatory requirements, taxpayers may have set aside amounts for nuclear decommissioning prior to the enactment of the qualified fund rules in 1984. The treatment of these pre-1984 amounts varies. Some taxpayers may have received no tax benefit while others may have deducted the amounts or excluded the amounts from gross income.

Reasons for Change

The Administration is concerned that appropriate incentives be provided to insure adequate funds are available for the decommissioning of nuclear power plants. The favorable tax treatment of contributions to nuclear decommissioning funds recognizes the national importance of the establishment of segregated reserve funds for paying nuclear decommissioning costs. Although the favorable tax treatment was adopted at a time when nuclear power plants were operated by regulated public utilities, deregulation will not reduce the need for such funds. Deregulation will, however, generally eliminate traditional cost of service determinations for ratemaking purposes. In many cases, a line charge or other fee will be imposed by a State or local government or a public utility commission to ensure that adequate funds will be available for decommissioning, but there is no assurance that this will be the case under all State deregulation plans.

State deregulation plans frequently require utilities to divest electricity generation assets, including nuclear power plants and related nuclear decommissioning funds. The transferor of a nuclear power plant also may be required to fund the full amount of the plant's decommissioning costs in connection with the transfer. The policy of limiting fund accumulations to the amount necessary to pay post-1983 nuclear decommissioning costs may discourage these transactions and increase the risk that decommissioning costs will not be adequately funded.

Deregulation has also made it increasingly common for nuclear decommissioning funds to be transferred in transactions that do not satisfy the generally applicable regulatory conditions for nontaxability. Uncertainty concerning the tax treatment of these transfers may be impeding the transition to deregulated electricity markets.

Proposal

The cost of service limitation would be eliminated. Thus, unregulated taxpayers would be allowed a deduction for amounts contributed to a qualified nuclear decommissioning fund.

The maximum contribution and deduction for a taxable year generally would be limited to the ruling amount obtained from the IRS, but taxpayers would be permitted to make contributions in excess of the ruling amount in two cases. First, taxpayers would be permitted to make transfers to a qualified fund of amounts held in certain nonqualified nuclear decommissioning funds to the extent such amounts do not exceed the present value of the amount required to pay the plant's pre-1984 decommissioning costs. Transfers would be permitted from a fund in which amounts are irrevocably set aside pursuant to the requirements of a State or Federal agency exclusively for the purpose of funding the decommissioning of the nuclear power plant. Second, if the present value of the amount required to pay the plant's pre-1984 decommissioning costs exceeds the amount held in such nonqualified funds, the taxpayer would be permitted to contribute an amount equal to the excess. Any portion of the amount transferred under these rules that exceeds the amount previously deducted (other than under the qualified fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant. If the qualified fund is subsequently transferred, deductions under this rule for periods subsequent to the transfer will be allowed to the transferee rather than the transferor unless the transferor is

tax exempt. Accumulations in the fund attributable to amounts contributed under these rules would not be taken into account in determining the ruling amount for the fund.

The treatment of transfers of qualified funds would be clarified. Any transfer of a qualified fund in connection with the transfer of the power plant with respect to which the fund was established would be nontaxable and no gain or loss will be recognized by the transferor or transferee as a result of the transfer.

The proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid.

The proposal would be effective for taxable years beginning after December 31, 2001.

ONE-YEAR EXTENSION OF PROVISIONS EXPIRING IN 2001

EXTEND THE WORK OPPORTUNITY TAX CREDIT

Current Law

Under current law, employers are generally entitled to a Work Opportunity Tax Credit (WOTC) for the first $6,000 of wages paid to several target groups of economically disadvantaged workers or workers with disabilities. The maximum WOTC credit is generally $2,400 per worker. For workers employed between 120 and 400 hours, the WOTC credit rate is 25 percent of qualified wages. For workers employed over 400 hours, the WOTC credit rate is 40 percent. Employers must reduce their deduction for wages paid by the amount of the credit claimed. The minimum employment period that employees must work before employers can claim the WOTC credit is 120 hours.

Current WOTC target groups include qualified: (1) recipients of Temporary Assistance to Needy Families (TANF), (2) veterans, (3) ex-felons, (4) high-risk youth, (5) participants in State-sponsored vocational rehabilitation programs, (6) summer youth, (7) food stamp recipients, and (8) Supplemental Security Income (SSI) recipients.

The credit is effective for workers hired before January 1, 2002.

Reasons for Change

The goal of the Work Opportunity Tax Credit is to provide employers with a tax incentive to hire and retain individuals who want to work but are likely to have difficulty entering and remaining in the work force. An extended wage credit would continue to serve as an inducement for employers to hire these individuals and provide them with on-the-job training that will improve their labor market skills.

Proposal

The Work Opportunity Tax Credit would be extended for one year, so that the credit would be effective for individuals who begin work before January 1, 2003.

EXTEND THE WELFARE-TO-WORK TAX CREDIT

Current Law

The Welfare-to-Work (WTW) Tax Credit enables employers to claim a tax credit for eligible wages paid to certain long-term welfare recipients. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. Thus, the maximum credit is $8,500 per qualified employee. Employers must reduce their deduction for eligible wages paid to qualified employees by the amount of WTW credits claimed. The minimum employment period that employees must work before employers can claim the WTW credit is 400 hours.

A qualified long-term welfare recipient is: (1) a member of a family that has received Temporary Assistance for Needy Families (TANF) for at least 18 consecutive months ending on the hiring date; (2) a member of a family that has received TANF for a total of 18 months after August 5, 1997, provided the hiring date is within two years of the date when the 18 month total is reached; or (3) a member of a family ineligible for TANF because of any Federal- or State-imposed time limit, if the family member is hired within two years of the date of benefit cessation.

Eligible wages are defined to include amounts paid by the employer for: (1) educational assistance excludable under a section 127 program; (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

The Welfare-to-Work Tax Credit is effective for individuals who begin work before January 1, 2002.

Reasons for Change

Extending the Welfare-to-Work Tax Credit would continue to encourage employers to hire, invest in training, and provide certain benefits and more permanent employment to long-term welfare recipients who need stable jobs to support their families.

Proposal

The Welfare-to-Work Tax Credit would be extended for one year, so that the credit would be effective for individuals who begin work before January 1, 2003.

EXTEND EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

Current Law

Section 127 provides that an employee's gross income and wages do not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts are paid or incurred pursuant to a qualified educational assistance program. This exclusion is limited to $5,250 of educational assistance with respect to an individual during a calendar year. The exclusion applies whether or not the education is job-related. In the absence of this exclusion, educational assistance is excludable from income only if it is related to the employee's current job.

The exclusion applies with respect to undergraduate courses beginning before January 1, 2002.

Reasons for Change

Well-educated workers are essential to an economy experiencing technological change and facing global competition. Extension of section 127 will expand educational opportunity, increase productivity, and encourage retraining of current and former employees to reflect the changing needs of the workplace. In addition, extending section 127 will simplify the rules for employers and workers by eliminating the need to distinguish between job-related training and other employer-provided educational assistance.

Proposal

The current law exclusion would be extended through December 31, 2002.

EXTEND MINIMUM TAX RELIEF FOR INDIVIDUALS

Current Law

Taxpayers are subject to an alternative minimum tax (AMT) if their tentative minimum tax is greater than their regular tax liability. Taxable income for AMT purposes is calculated differently than for regular tax purposes. Under the AMT, certain income items are included that are not included for regular tax purposes. Also, certain deductions, including state and local tax deductions, miscellaneous itemized deductions, and the standard deduction, are not permitted. In addition, for AMT purposes, taxpayers may not deduct the personal exemptions they are allowed under the regular income tax. The AMT does has an exclusion amount, which differs by filing status but not by the number of persons in the tax-filing unit.

Under a temporary provision that expires after 2001, non-refundable personal tax credits can be used to reduce both regular tax liability (regardless of the AMT) and AMT liability. Beginning in 2002, taxpayers are allowed to use these credits only to the extent their regular tax liability exceeds their tentative minimum tax.

Reasons for Change

The original individual minimum tax was enacted to ensure that taxpayers with substantial amounts of economic income did not avoid significant tax liability by using exclusions, deductions, and credits. The Administration believes that allowing middle-income families to use non-refundable personal tax credits in full would not undermine the policy of the AMT and would promote the important social policies underlying the credits.

Moreover, the Administration believes that allowing these credits to be used in full would result in significant simplification. Substantially fewer taxpayers would need to perform complex and tedious computations to determine whether their personal credits were affected by the AMT.

Proposal

The temporary provision allowing non-refundable personal tax credits other than the child tax credit to reduce both regular tax liability (regardless of the AMT) and AMT liability would be extended for one year. A separate proposal, included with the proposal to increase the child tax credit, would permanently allow the child tax credit to reduce both regular tax liability (regardless of the AMT) and AMT liability and would provide that refundable credits would no longer be reduced by AMT liability.

EXTEND EXCEPTIONS PROVIDED UNDER SUBPART F FOR CERTAIN ACTIVE FINANCING INCOME

Current Law

Under the subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to current U.S. tax on certain income earned by the CFC, whether or not the income is distributed to the shareholders. The income subject to current U.S. tax under the subpart F rules includes, among other things, foreign personal holding company income and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial services company, such as dividends, interest, royalties, rents and annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. A temporary exception from subpart F for certain income that is derived in the active conduct of a banking, financing, insurance or similar business applies only for taxable years beginning on or before December 31, 2001.

Reasons for Change

The subpart F rules are designed to subject to current U.S. tax the income earned by CFCs that is either passive or easily moveable. However, without the exception, the rules will subject certain active financing income to current U.S. tax when the income is neither passive nor easily moveable.

Proposal

The proposal would extend the exclusion of certain active financing income from the subpart F rules to taxable years beginning in 2002.

EXTEND SUSPENSION OF NET INCOME LIMITATION ON PERCENTAGE DEPLETION FROM MARGINAL OIL AND GAS WELLS

Current Law

Taxpayers are allowed a deduction for depletion of oil and gas wells. Independent oil and gas producers and royalty owners may determine part or all of this deduction using the percentage depletion method. (Percentage depletion is also allowed with respect to certain fixed-price gas contracts and natural gas from geopressured brine.) For any taxable year, the amount deducted under the percentage depletion method with respect to an oil or gas property generally may not exceed 100 percent of the net income from the property. For domestic production from marginal wells, however, the 100-percent-of-net-income limitation has been suspended for taxable years beginning after December 31, 1997, and before January 1, 2002.

Reasons for Change

A further extension of the tax incentive and relief provision relating to marginal wells that is scheduled to expire in calendar year 2000 would avoid production disruptions and allow the Administration and Congress to evaluate the need for additional extensions or other modifications of the provision.

Proposal

The suspension of the 100-percent-of-net-income limitation for marginal wells would be extended for one year. Thus, the limitation would not apply for taxable years beginning in 2002.

EXTEND AUTHORITY TO ISSUE QUALIFIED ZONE ACADEMY BONDS

Current Law

Under current law, State and local governments can issue qualified zone academy bonds (QZABs) to fund the improvement of certain eligible public schools. An eligible holder of a QZAB receives annual Federal income tax credits. These annual credits compensate the holder for lending money and, therefore, are treated like taxable interest payments for Federal tax purposes. Eligible holders are banks, insurance companies, and corporations actively engaged in the business of lending money. The credit rate for a QZAB is set on its day of sale by reference to credit rates established by the Department of the Treasury. The maximum term of a QZAB issued during any month is determined by reference to the adjusted applicable Federal rate (AFR) published by the Internal Revenue Service for the month in which the bond is issued. The higher the AFR, the shorter the maximum term (rounded to whole years) so as to keep the extent of the Federal subsidy approximately equal to half the face amount of the bond.

Current law establishes authority to issue $400 million of QZABs for each year from 1998 through 2001. The annual cap is allocated among the States in proportion to their respective populations of individuals with incomes below the poverty line. Unused authority to issue QZABs may be carried forward for two years (three years for authority arising in 1998 and 1999) after the year for which the authority was established.

A number of requirements must be met for a bond to be treated as a QZAB. First, the bond must be issued pursuant to an allocation of bond authority from the issuer's State educational agency. Second, at least 95 percent of the bond proceeds must be used for an eligible purpose at a qualified zone academy. Eligible purposes include rehabilitating school facilities, acquiring equipment, developing course materials, or training teachers. A qualified zone academy is a public school (or an academic program within a public school) that is designed in cooperation with business and is either (1) located in an empowerment zone or enterprise community, or (2) attended by students at least 35 percent of whom are estimated to be eligible for free or reduced-cost lunches under the National School Lunch Act. Third, private entities must have promised to contribute to the qualified zone academy certain property or services with a present value equal to at least 10 percent of the bond proceeds.

Reasons for Change

Aging school buildings and new educational technologies create a need to renovate older school buildings and to develop new curricula. Many school systems have insufficient fiscal capacity to finance needed renovation and programs. The QZAB provision encourages the development of innovative school programs through public/private partnerships.

Proposal

An additional $400 million of authority to issue QZABs would be provided for 2002.

Revenue Estimates 1/
FY 2002 President's Budget
Preliminary

05-Apr-01	2001	2002	2003	2004	2005	2006	Fiscal Years 2007	2008	2009	2010	2011	2001-2006	2001-2011
							($'s in millions)						
Provision:													
President's Agenda for Tax Relief Presented To Congress On February 8th													
Create new 10-percent individual income tax bracket	--	-5,678	-13,847	-21,932	-29,849	-37,407	-39,734	-40,281	-40,602	-40,685	-40,603	-108,713	-310,618
Reduce individual income tax rates	--	-11,793	-21,047	-33,493	-42,306	-57,299	-63,741	-65,454	-67,020	-68,550	-69,963	-165,938	-500,666
Increase the child tax credit 2/	--	-1,238	-7,720	-11,908	-17,057	-21,923	-26,506	-27,422	-28,164	-28,875	-29,535	-59,846	-200,348
Reduce the marriage penalty	--	-1,435	-4,844	-7,773	-10,343	-12,675	-14,125	-14,645	-15,154	-15,657	-16,183	-37,070	-112,834
Provide charitable contribution deduction for nonitemizers	--	-482	-1,690	-2,963	-4,448	-6,065	-6,988	-7,087	-7,306	-7,500	-7,642	-15,648	-52,171
Permit tax-free withdrawals from IRAs for charitable contributions	--	-53	-181	-195	-210	-225	-241	-258	-277	-299	-322	-864	-2,261
Raise the cap on corporate charitable contributions	--	-85	-136	-136	-143	-149	-159	-169	-178	-202	-222	-649	-1,579
Increase and expand education savings accounts	--	-3	-25	-88	-204	-373	-593	-829	-1,037	-1,206	-1,287	-693	-5,645
Permanently extend the R&E tax credit	--	--	--	-1,055	-3,431	-5,415	-6,543	-7,388	-8,019	-8,567	-9,158	-9,901	-49,576
Phase out death tax	-152	-4,899	-10,405	-11,455	-13,517	-16,534	-21,757	-31,747	-40,291	-58,397	-62,346	-56,962	-271,500
Total President's Agenda for Tax Relief Presented To Congress February 8th	**-152**	**-25,666**	**-59,895**	**-90,998**	**-121,508**	**-158,065**	**-180,387**	**-195,280**	**-208,048**	**-229,938**	**-237,261**	**-456,284**	**-1,507,198**
Additional Tax Incentives													
Strengthen and Reform Education													
Allow teachers to deduct out-of-pocket classroom expenses	--	-21	-214	-249	-268	-286	-287	-289	-290	-292	-293	-1,038	-2,489
Allow tax-free distributions from Qualified State Tuition plans for certain higher education expenses and allow private colleges to offer prepaid tuition plans	--	-4	-20	-42	-66	-90	-114	-136	-160	-189	-214	-222	-1,035
Allow states to issue tax-exempt private activity bonds for school construction	--	-1	-4	-10	-15	-20	-26	-31	-36	-42	-47	-50	-232
Invest in Health Care													
Provide refundable tax credit for the purchase of health insurance 3/	--	-300	-3,427	-5,187	-7,705	-8,170	-8,991	-9,285	-9,420	-9,496	-9,552	-24,789	-71,533
Provide above-the-line deduction for long-term care insurance premiums	--	-273	-378	-404	-560	-1,097	-1,937	-2,362	-2,644	-2,944	-3,285	-2,712	-15,884
Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year	--	-200	-600	-700	-750	-800	-850	-900	-950	-1,000	-1,070	-3,050	-7,820
Provide additional choice with regard to unused benefits in a health flexible spending arrangement	--	-10	-30	-36	-41	-47	-54	-63	-73	-85	-101	-164	-540
Permanently extend and reform Archer MSAs	--	-100	-400	-425	-446	-469	-492	-517	-542	-570	-598	-1,840	-4,559
Provide an additional personal exemption to home caretakers of family members	--	-305	-432	-460	-502	-525	-533	-554	-568	-567	-559	-2,224	-5,005
Provide tax relief for awards under certain health education programs	--	0	-1	-2	-1	0	0	0	0	-1	-1	-4	-6

Provision:	05-Apr-01	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-2006	2001-2011
								Fiscal Years ($'s in millions)						
Assist Americans With Disabilities														
Exclude from income the value of employer-provided computers, software and peripherals		--	-2	-5	-5	-6	-6	-6	-6	-6	-6	-7	-24	-55
Strengthen Families														
Permanently extend and increase the adoption tax credit		--	-20	-197	-204	-212	-221	-230	-232	-234	-236	-238	-854	-2,024
Help Farmers and Fisherman Manage Economic Downturns														
Establish Farm, Fish and Ranch Risk Management (FFARRM) savings accounts		--	-79	-216	-154	-113	-86	-70	-60	-50	-43	-38	-648	-909
Increase Housing Opportunities														
Provide tax credit for developers of affordable single-family housing		--	-4	-45	-198	-516	-970	-1,487	-1,986	-2,365	-2,572	-2,643	-1,733	-12,786
Encourage Saving														
Establish Individual Development Accounts (IDAs)		--	--	-155	-270	-288	-305	-312	-151	-39	-15	-1	-1,018	-1,536
Promote Trade														
Expand and extend Andean trade preferences 4/		--	-190	-198	-205	-214	-55	0	0	0	0	0	-862	-862
Protect the Environment														
Permanently extend expensing of brownfields remediation costs		--	--	--	-235	-372	-363	-354	-343	-331	-321	-309	-970	-2,628
Exclude 50 percent of gains from the sale of property for conservation purposes		-18	-81	-89	-95	-104	-117	-136	-160	-195	-245	-314	-504	-1,554
Energy Policy Proposals														
Extend and modify the tax credit for producing electricity from certain sources		--	-116	-203	-222	-125	-58	-59	-57	-55	-56	-57	-724	-1,008
Provide tax credit for residential solar energy systems		--	-7	-15	-19	-25	-31	-20	-16	-7	0	0	-97	-140
Modify treatment of nuclear decommissioning funds		--	-54	-104	-124	-137	-151	-164	-179	-194	-210	-227	-570	-1,544
Total Additional Tax Incentives		**-18**	**-1767**	**-6733**	**-9246**	**-12466**	**-13867**	**-16122**	**-17327**	**-18159**	**-18890**	**-19554**	**-44097**	**-134149**

Provision:	05-Apr-01	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-2006	2001-2011
								Fiscal Years ($'s in millions)						
One-Year Extension of Provisions Expiring In 2001														
Extend the work opportunity tax credit		--	-60	-154	-118	-52	-31	-9	0	0	0	0	-415	-424
Extend the welfare-to-work tax credit		--	-12	-36	-36	-24	-17	-10	-2	0	0	0	-125	-137
Extend exclusion for employer-provided educational assistance		--	-247	-110	0	0	0	0	0	0	0	0	-357	-357
Extend minimum tax relief for individuals		--	-119	-477	0	0	0	0	0	0	0	0	-596	-596
Extend exceptions provided under subpart F for certain active financing income		--	-807	-556	0	0	0	0	0	0	0	0	-1,363	-1,363
Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells		--	-20	-13	0	0	0	0	0	0	0	0	-33	-33
Extend Generalized System of Preferences (GSP) 4/		--	-346	0	0	0	0	0	0	0	0	0	-346	-346
Extend authority to issue Qualified Zone Academy Bonds		--	-3	-9	-16	-18	-18	-18	-18	-18	-18	-18	-64	-154
Total One-Year Extension of Provisions Expiring In 2001		**0**	**-1614**	**-1355**	**-170**	**-94**	**-66**	**-37**	**-20**	**-18**	**-18**	**-18**	**-3299**	**-3410**
Total Effect on Receipts		**-170**	**-29,047**	**-67,983**	**-100,414**	**-134,068**	**-171,998**	**-196,546**	**-212,627**	**-226,225**	**-248,846**	**-256,833**	**-503,680**	**-1,644,757**

Department of the Treasury
Office of Tax Analysis

1/ Estimates for several provisions differ from estimates included in Table 3-3 of the Analytical Perspectives of the President's Budget, which presents only the effect on receipts of the Administration's legislative proposals. Estimates presented here for certain provisions identified below, include the effects on both receipts and outlays. Moreover, estimates were revised as proposals were finalized.

2/ The proposal to increase the child credit has both receipts and outlay effects. The outlay effect for the proposal is $215 million, $453 million, $710 million, $960 million, $1,210 million, $1,145 million, $1,066 million, $999 million and $933 million in fiscal years 2003 - 2011, respectively.

3/ The proposal to provide a refundable credit for the purchase of health insurance has both receipts and outlay effects. The outlay effect for the proposal is $300 million, $3,427 million, $5,187 million, $7,705 million, $8,170 million, $8,991 million, $9,285 million, $9,420 million $9,496 million and $9,552 million in fiscal years 2002 - 2011, respectively.

4/ These proposals are included in the FY 2002 Budget, but not described in these General Explanations. The estimates are net of income tax offsets.