General Explanations of the Administration's Fiscal Year 2003 Revenue Proposals

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GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2003 REVENUE PROPOSALS

Introduction

This report summarizes the revenue proposals in the Administration's Fiscal Year 2003 Budget. These proposals are part of a program designed to strengthen the American economy, create jobs, and foster economic growth. The proposals affect a wide range of areas including encouraging saving, strengthening education, investing in health care, increasing housing opportunities, protecting the environment, and encouraging charitable giving. To maintain their favorable effects and provide greater certainty for economic and financial planning, the proposals extend several tax provisions that expired in 2001 and permanently extend the tax cuts enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 as well as the Research and Experimentation tax credit.

Along with the proposals detailed in this report, the Administration is pursuing two additional important tax policy initiatives. First, to reinvigorate economic growth and assist workers affected by the recent economic downturn, the Administration will continue working with Congress in a bipartisan manner to enact an economic security package to prevent further job losses and help displaced workers get back to work quickly as well as a worker assistance package to provide additional temporary, quick, and effective help for those who have lost their jobs.

Second, the Administration is undertaking a project to achieve significant simplification of the tax code. The Treasury's Office of Tax Policy is preparing staff white papers that will develop and analyze a number of options for simplification of tax provisions affecting families and individuals, businesses and investment, retirement and savings, tax-exempt organizations, and excise taxes. These white papers will provide the basis for discussions with the Congress, tax practitioners, and taxpayers which will, in turn, lead to development of tax simplification legislation.

ADMINISTRATION PROPOSALS

TAX INCENTIVES

Provide Incentives for Charitable Giving

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 necessary 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 contributions to qualified charitable organizations in addition to claiming the standard deduction, effective for tax years beginning after December 31, 2001. The deduction would be phased-in between 2002 and 2012 as follows: (1) Taxpayers (other than married taxpayers filing joint returns) would be allowed a maximum deduction of $100 in 2002 through 2004, $300 in 2005 through 2011, and $500 in 2012 and subsequent years. (2) Married taxpayers filing a joint return would be allowed a maximum deduction of $200 in 2002 through 2004, $600 in 2005 through 2011, and $1,000 in 2012 and subsequent years. Deductible contributions would be subject to existing rules governing itemized charitable contributions, such as the substantiation requirements and the percentage-of-AGI limitations. The non-itemizer deduction would not be a preference item for alternative minimum tax purposes, and would not affect the calculation of AGI.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-570	-1,429	-1,437	-2,288	-3,567	-3,591	-12,312	-32,636

PERMIT TAX-FREE WITHDRAWALS FROM INDIVIDUAL RETIREMENT ACCOUNTS (IRAS) 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 ($137,300 for most filers in 2002).

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 59½ from a traditional or Roth IRA directly to a qualified charitable organization. The exclusion would not apply to indirect gifts through a split interest entity such as a charitable remainder trust or pooled income fund, or through the purchase of a charitable gift annuity. 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.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-93	-192	-205	-219	-230	-238	-1,084	-2,632

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 five percent of net income. Contributions in excess of the limit can be carried forward for up to five years.

Reasons for Change

The combined efforts of the government, the non-profit sector and the private sector are necessary to help people in need and to deal with community problems. The charitable donations of corporations are an important source of support for charitable and other non-profit organizations that deal with important community problems and needs. Increasing the limit on the charitable deduction would provide an incentive for corporations to increase their support for charitable organizations.

Proposal

The limit on deductions for charitable contributions by corporations 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.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-24	-169	-121	-127	-139	-156	-712	-1,730

EXPAND AND INCREASE THE ENHANCED CHARITABLE DEDUCTION FOR CONTRIBUTIONS OF FOOD INVENTORY

Current Law

A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) the taxpayer's basis in the contributed property, plus one-half of the gain that would have been realized had the property been sold or (2) two times basis. To be eligible for the enhanced deduction, the inventory must be contributed to a charitable organization (other than a private nonoperating foundation), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with these requirements. To claim the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

Reasons for Change

The lack of incentives for businesses other than C corporations (including many farmers and small businesses) to donate food inventory to charity is hindering efforts by charities to combat hunger. Increasing the amount of the enhanced deduction for contributions of food inventory, making it available to any taxpayer engaged in a trade or business, and clarifying the method of determining fair market value in the case of surplus food will increase donations of food inventory.

Proposal

Any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value, or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 15 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items are sold by the taxpayer at the time of the contribution or, if not so sold at such time, in the recent past.

These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2001.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-10	-49	-54	-59	-66	-72	-300	-789

REFORM EXCISE TAX BASED ON INVESTMENT INCOME OF PRIVATE FOUNDATIONS

Current Law

Private foundations that are exempt from Federal income tax generally are subject to a two-percent excise tax on their net investment income. The excise tax rate is reduced to one percent in any year in which the foundation's distributions for charitable purposes exceed the average level of the foundation's charitable distributions over the five preceding taxable years (with certain adjustments). Private foundations that are not exempt from Federal income tax, including certain charitable trusts, must pay an excise tax equal to the excess (if any) of the sum of the excise tax on net investment income and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. Under current law, private nonoperating foundations generally are required to make annual distributions for charitable purposes equal to at least five percent of the fair market value of the foundation's noncharitable use assets (with certain adjustments). The amount that a foundation is required to distribute annually for charitable purposes is reduced by the amount of the excise tax paid by the foundation.

Reasons for Change

The current "two-tier" structure of the excise tax on private foundation net investment income may discourage foundations from significantly increasing their distributions for charitable purposes in any particular year. Under the current formula, any increase in the foundation's percentage payout in a given year (by increasing the average percentage payout) makes it more difficult for the foundation to qualify for the reduced one percent excise tax rate in subsequent years. Eliminating the "two-tier" structure of this excise tax would ensure that private foundations do not suffer adverse excise tax consequences if they increase their grantmaking in a particular year to respond to charitable needs. Such a change would also simplify tax planning and the calculation of the excise tax for private foundations. In addition, lowering the excise tax rate for all foundations would make additional funds available for charitable purposes.

Proposal

This proposal would replace the two rates of tax on private foundations that are exempt from Federal income tax with a single tax rate of one percent. The tax on private foundations not exempt from Federal income tax would be equal to the excess (if any) of the sum of the one-percent excise tax on net investment income and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The special reduced excise tax rate available to tax-exempt private foundations that maintain their historic level of charitable distributions would be repealed.

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

Revenue Estimate

2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-122	-177	-181	-189	-198	-205	-950	-2,101

MODIFY TAX ON UNRELATED BUSINESS TAXABLE INCOME OF CHARITABLE REMAINDER TRUSTS

Current law

A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a noncharity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust.

Distributions from a charitable remainder trust, which are included in the income of the beneficiary for the year that the annuity or unitrust amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred; (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred; (3) other income to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred; and (4) corpus (trust principal).

Charitable remainder trusts are exempt from Federal income tax. However, charitable remainder trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus.

Reasons for Change

Under current law, a charitable remainder trust that has any unrelated business taxable income loses its tax-exempt status for the year. The Administration believes that imposing a tax equal to 100 percent of any unrelated business taxable income received by a charitable remainder trust is a more appropriate remedy than loss of tax exemption for the year.

Proposal

The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of a charitable remainder trust, in lieu of removing the trust's Federal income tax exemption for any year in which unrelated business taxable income is received. The amount of the tax would be treated as paid from corpus. Therefore, the unrelated business taxable income would be considered income of the trust for purposes of determining the character of the distribution made to the beneficiary.

The proposal would be effective for taxable years beginning after December 31, 2001, regardless of when the trust was created.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-1	-3	-3	-4	-4	-4	-18	-48

MODIFY BASIS ADJUSTMENT TO STOCK OF S CORPORATIONS CONTRIBUTING APPRECIATED PROPERTY

Current Law

If an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining income tax liability. A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder. In many cases, a shareholder's basis in S corporation stock reflects the basis of the contributed property, whereas the charitable contribution deduction reflects the value of the contributed property. As a result, current law effectively prevents some S corporation shareholders from obtaining the full benefit of the charitable contribution deduction.

Reasons for Change

The proposal modifies the rules for adjusting the basis of S corporation stock to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property by an S corporation.

Proposal

The proposal allows an S corporation shareholder to increase the basis of the S corporation stock by an amount equal to the excess of the charitable contribution deduction that flows through to the shareholder over the shareholder's pro rata share of the adjusted basis of the contributed property.

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

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-8	-11	-13	-17	-21	-25	-87	-282

ALLOW EXPEDITED CONSIDERATION OF APPLICATIONS FOR EXEMPT STATUS

Current Law

Most charitable organizations are required to apply for recognition of exemption under section 501(c)(3) by filing Form 1023, Application for Recognition of Exemption, with the Internal Revenue Service. Organizations that are not required to file Form 1023 include churches (and their integrated auxiliaries), conventions and associations of churches, and any organization (other than a private foundation) having gross receipts normally not more than $5,000. If an organization files Form 1023 within 15 months following the end of the month in which it is organized, recognition of exempt status, if granted, will normally relate back to the date of organization. Upon request, the IRS will automatically extend this 15-month period for an additional 12 months. Otherwise, exemption will normally be recognized as of the date the organization's application was received by the IRS. In appropriate circumstances, upon written request, the IRS will expedite review of applications for recognition of exempt status. For example, the IRS will generally approve requests for expedited review of applications filed by organizations formed to provide disaster relief to victims of natural disasters or other emergencies.

Reasons for Change

The Administration wishes to facilitate the formation of charitable organizations that intend to work with Federal, State and local governments to provide vital social services to the neediest members of our society.

Proposal

The Administration proposes to allow expedited consideration of applications for exempt status by organizations formed for the primary purpose of providing social services to the poor and the needy. To be eligible, the organization must have applied for a grant under a Federal, State, or local program that provides funding for social service programs on or before the day that the organization applies to the Secretary of the Treasury for determination of its exempt status. Organizations that demonstrate that, under the terms of the grant program, section 501(c)(3) status is required before the organization is eligible to apply for a grant would also qualify for expedited consideration. Each organization would be required to include with its application for exempt status a copy of its completed grant application.

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

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
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Strengthen and Reform Education

PROVIDE REFUNDABLE TAX CREDIT FOR CERTAIN COSTS OF ATTENDING A DIFFERENT SCHOOL FOR PUPILS ASSIGNED TO FAILING PUBLIC SCHOOLS

Current Law

The No Child Left Behind Act of 2001 amended the Elementary and Secondary Education Act of 1965 to provide that federal grant funds may be used by local educational agencies (LEAs) to provide supplemental educational services, such as tutoring and summer school, to children enrolled in a public school "identified for school improvement" for two consecutive years. These services may be provided by private entities. A school is identified for improvement after failing to make "adequate yearly progress" for two consecutive years under State-established standards. In addition, if a school is identified for improvement, LEAs must (unless prohibited by State law) provide public school choice. This means that LEAs must give students assigned to a school identified for improvement an option to transfer to another public school within the jurisdiction of the LEA, which may include a public charter school. The LEA is obligated to provide transportation to students who request such a transfer. A student who transfers is permitted to remain at that school through its highest grade, but the LEA is not obligated to provide transportation if the student's original school has improved to the point of making adequate yearly progress. Federal funds generally may not be used to pay the costs of attending a private school.

Reasons for Change

Parents of a child enrolled in a public school failing to make adequate yearly progress may conclude that transferring their child to another public school or enrolling their child in a private school is in the child's best interests. A refundable tax credit for a portion of the costs of attending a different school would reduce the financial barriers to improving such a child's educational opportunities.

Proposal

A refundable credit of 50 percent of the first $5,000 of qualifying elementary and secondary education expenses would be allowed for certain expenses incurred with respect to the enrollment or attendance in a different, qualifying school of a taxpayer's qualifying child who is a qualifying student. A qualifying child for this purpose would be one having the same principal place of abode as the taxpayer for more than one-half of the taxable year and is the taxpayer's son, daughter, stepson or stepdaughter, a sibling or stepsibling (or descendent of such individual) who the taxpayer cares for as the taxpayer's own child. An eligible foster child within the meaning used for purposes of the earned income tax credit would also qualify. Credits would be allowed for more than one qualifying child. The credit would apply against both regular and alternative minimum tax liabilities.

A qualifying student generally would be one who, under the school attendance rules and boundaries used by the LEA, attended at the close of the prior school year a public elementary or secondary school ("the local school") identified as failing to make adequate yearly progress. The identification of a school as failing to make adequate yearly progress would be made on a State-by-State basis under the terms of the No Child Left Behind Act (the Act) as of the opening day of a school year. In addition, a student who is newly assigned to a school that failed to make adequate yearly progress during the prior school year would qualify. For example, such a student attending school for the first time would qualify. Similarly, a student would qualify who, at the end of the prior school year, attended a public elementary school that made adequate progress, and was assigned as an entering student to a junior high school that had not made adequate yearly progress. A student who attended a qualifying school in one year generally would continue to qualify for additional years, even if the local school made adequate yearly progress in a subsequent year. Such a child would not qualify if he or she had a new local school (not identified as failing to make adequate yearly progress) as a result of passing into a higher grade. For example, a 6^{th} grader who qualified because his local elementary school was designated as failing to make adequate yearly progress when he was a 5^{th} grader would not qualify during the 7^{th} grade if his local school for the 7^{th} grade was a junior high school not so designated with respect to the prior year. If the local elementary school ran through the 8^{th} grade, this student would qualify during the 6^{th}, 7^{th} and 8^{th} grade even if the local school made adequate yearly progress when the student was in the 6^{th} and 7^{th} grades. A qualifying student at the beginning of a school year would continue to qualify for the remainder of that school year if the student moved out of the local school's attendance area but continued to attend the same qualifying school. Qualifying students would be only those in grades K – 12.

A qualifying school would be any public school (other than the local school), including a public charter school, making adequate yearly progress in the prior year or a private elementary or secondary school located in the United States. The definition of a school would be determined under State law.

Qualifying expenses would be tuition and required fees, transportation expenses, and certain other expenses incurred by the taxpayer in connection with the attendance of a qualifying student at a qualifying school. Tuition or required fees paid to a public school within the jurisdiction of the LEA in which the failing school is located would not qualify. This limitation is consistent with the LEAs obligation to provide free public education to students within its jurisdiction. Expenses that would be a qualified elementary and secondary education expense for purposes of Coverdell education savings accounts generally would also qualify. If the taxpayer's car were used to provide transportation, the expenses would be limited by the cost-per-mile allowed in connection with the use of a car for charitable activities. The additional qualifying expenses include expenditures for academic tutoring, special needs services in the case of a special needs student, books, supplies, and computer technology and equipment, as well as expenditures for room and board, uniforms, and supplementary items and services (including extended day care programs) which are required or provided by the school. In the case of a qualified school that is a home school, as defined under state law, qualifying expenses for the taxpayer would include expenditures for academic tutoring, special needs services in the case of a special needs student, books, supplies, and computer technology and equipment. No qualifying expenses for which a credit is claimed could also be treated as qualifying distributions from Coverdell educational savings accounts. Rules regarding the timing of qualifying payments would follow those used in connection with the Hope and lifetime learning credits.

Taxpayers claiming the credit would be required to provide the name and taxpayer identification number of the qualifying student and the name and address of the local school that the student would normally have attended. Further, taxpayers would be required to keep records of qualifying expenses.

LEAs would be asked to include an explanation of the availability of this tax credit as part of the dissemination of the annual reviews per section 1116(a)(C) of the Act.

The provision would be effective with respect to expenses incurred beginning with the 2002-2003 school year and through the 2006-2007 school year.

Revenue Estimate[1]

2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	-165	-443	-691	-980	-1,244	-3,523	-4,201

[1] The estimate includes both receipt and outlay effects. The outlay effect for the proposal is $156 million, $420 million, $656 million, $930 million, and $1,184 million in fiscal years 2003-2007, respectively. The outlay effect is $3,346 million and $3,991 million for the fiscal year 2003-2007 and 2003-2012 periods, respectively.

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 expenses incurred in taxable years beginning after December 31, 2003.

Revenue Estimate

2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
			($'s in millions)				
---	---	-16	-163	-191	-207	-577	-1,718

Invest in Health Care

REFUNDABLE TAX CREDIT FOR THE PURCHASE OF HEALTH INSURANCE

Current Law

Under present law, 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 medical care, qualified long-term care services, and premiums for qualified long-term care insurance (subject to a dollar limit).

Employer-provided health insurance and reimbursements for medical care are generally excluded from gross income for income tax purposes 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 pre-tax basis.

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

In addition, self-employed individuals and individuals employed by small employers maintaining a high-deductible health plan are allowed to accumulate funds in a medical savings account (MSA) 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).

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

Almost 40 million Americans are reported to go without health insurance coverage for an entire year. These uninsured individuals require an incentive to assist them in purchasing health insurance. The incentive must provide assistance to low-income individuals and families with little or no income tax liability. At the same time, the incentive should not discourage individuals from entering the labor force or from earning additional income. The incentive also needs to be made available in advance and with certainty, so that uninsured individuals receive financial assistance at the same time they purchase health insurance. A health tax credit made available in advance for individuals who are not covered by public or employer-provided health plans will provide these incentives. In addition, allowing the credit to be applied to health insurance purchased through private and state purchasing groups and at state option to certain state insurance programs will enhance the tax credit’s purchasing power and improve coverage options.

Proposal

The proposal would create a refundable income tax credit for the cost of health insurance purchased by individuals under age 65. The credit would provide a subsidy of up to 90 percent of the health insurance premium, up to a maximum credit of $1,000 per adult and $500 per child for up to two children. The maximum subsidy percentage of 90 percent would apply for low-income taxpayers and would be phased down at higher incomes. Individuals participating in public or employer-provided health plans would generally not be eligible for the tax credit. In addition, individuals would not be allowed to claim the credit and make a contribution to an MSA for the same taxable year.

Individuals with no dependents who file a single return and have modified AGI up to $15,000 would be eligible for the maximum subsidy rate of 90 percent and a maximum tax credit of $1,000. The subsidy percentage for these individuals would be phased down ratably from 90 percent to 50 percent between $15,000 and $20,000 of modified AGI, and then phased out completely at $30,000 of modified AGI.

All other filers with modified AGI up to $25,000 would be eligible for the maximum subsidy rate of 90 percent, and the maximum credit of $1,000 per adult and $500 per child for up to two children. The subsidy percentage would be phased out ratably between $25,000 and $40,000 of modified AGI in the case of a policy covering only one adult, and between $25,000 and $60,000 of modified AGI in the case of a policy or policies covering more than one adult. The maximum credit for these other filers would vary by income and the number of adults and children covered by a policy. For example, the maximum tax credit would equal $3,000 for families with modified AGI up to $25,000 who obtain a policy covering two adults and two or more children.

The maximum allowable premium for credit purposes would be $1,111 for an adult and $556 for a child at all income levels. These dollar amounts would be indexed by the Consumer Price Index based on all-urban consumers.

Examples of the maximum credit:

(1) Individuals with No Dependents Filing a Single Return

Modified AGI	$15,000	$20,000	$30,000
Maximum Credit	$1,000	$556	$0

(2) Other Filers Obtaining a Policy Covering Only One Adult

Modified AGI	$25,000	$30,000	$40,000
Maximum Credit	$1,000	$667	$0

(3) Other Filers Obtaining a Policy Covering Two Adults

Modified AGI	$25,000	$40,000	$60,000
Maximum Credit	$2,000	$1,143	$0

(4) Other Filers Obtaining a Policy Covering Two Adults and One Child

Modified AGI	$25,000	$40,000	$60,000
Maximum Credit	$2,500	$1,429	$0

(5) Other Filers Obtaining a Policy Covering Two Adults and Two or More Children

Modified AGI	$25,000	$40,000	$60,000
Maximum Credit	$3,000	$1,714	$0

Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, the tax credit would be available in advance at the time the insurance is purchased. Individuals would reduce their premium payment by the amount of the credit and the health insurer would be reimbursed by the Department of the Treasury for the amount of the advance credit. Eligibility for the advance credit would be based on the individual's prior year tax return.

Eligible health insurance plans would be required to meet minimum coverage standards, including coverage for high medical expenses. In addition to the non-group insurance market, qualifying health insurance could also be purchased through private purchasing groups, state-sponsored insurance purchasing pools and state high-risk pools. At state option, effective after December 31, 2003, the tax credit would be allowed for certain individuals not otherwise eligible for public health insurance programs to buy into privately contracted state sponsored purchasing groups (such as Medicaid or SCHIP purchasing pools for private insurance or state government employee programs for states in which Medicaid or SCHIP does not contract with private plans.) States could, under limited circumstances, provide an additional contribution to individuals who purchased private insurance through such purchasing groups. The maximum state contribution would be $2,000 per adult for up to two adults for individuals with incomes up to 133 percent of poverty. The maximum state contribution would phase down ratably reaching $500 per adult at 200 percent of poverty. Individuals with income above 200 percent of poverty would not be eligible for a state contribution. States would not be allowed to provide any other explicit or implicit cross subsidies.

The health insurance tax credit would be effective for taxable years beginning after December 31, 2002, and would be available in advance beginning July, 2003.

Revenue Estimate[2]

[2] The estimate includes both receipt and outlay effects. The outlay effect for the proposal is $667 million, $5,158 million, $6,292 million, $6,560 million, and $6,441 million in fiscal years 2003-2007, respectively. The outlay effect is $25,145 million and $59,873 million for the fiscal year 2003-2007 and 2003-2012 periods, respectively.

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	-912	-6,874	-9,103	-9,334	-9,392	-35,615	-88,989

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 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, 2004, but would be phased in so that 25 percent of the premium would be deductible for 2004, 35 percent for 2005, 65 percent for 2006, and 100 percent for 2007 and thereafter.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-335	-605	-1,222	-2,158	-4,320	-20,331

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, 2003.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-441	-723	-782	-830	-2,776	-7,819

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, 2003.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-23	-39	-45	-52	-159	-566

PERMANENTLY EXTEND AND REFORM ARCHER MEDICAL SAVINGS ACCOUNTS (MSAS)

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. MSAs may not be established after December 31, 2002.

A high deductible health plan is defined as a health plan with an annual deductible in the range of $1,650 to $2,500 in the case of individual coverage and in the range of $3,300 to $4,950 in all other cases. Generally, no coverage of medical services is permitted under an MSA plan before the deductible is met. A high deductible health plan must also have an out-of-pocket limit that is no higher than $3,300 in the case of individual coverage and $6,050 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. Making MSAs permanent would make the MSA market a more viable option. Eliminating restrictions on the availability of MSAs and easing some of the restrictions on MSA plan features will simplify the rules, make MSA qualified health insurance more like policies available in the health insurance market today, 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. Such plans would also be permitted to provide, without counting against the deductible, up to $100 of coverage for allowable preventive services per covered individual each year.

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, 2002.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	-28	-299	-468	-530	-607	-1,932	-5,975

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 2002, the amount of the exemption is $3,000. 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 ($137,300 for single filers, $206,000 for joint filers, $171,650 for heads of households, and $103,000 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, 2003.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-318	-362	-345	-348	-1,373	-3,578

[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.

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, 2003.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-2	-6	-6	-6	-20	-52

[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.

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 be 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, 2003.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-133	-350	-244	-171	-898	-1,233

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 $1.75 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 2003. The per capita amount would be indexed for inflation beginning in 2004. 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 by the initial homebuyer within the first 5 years following the 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 2003.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	-7	-76	-302	-715	-1,252	-2,352	-15,257

Encourage Saving

ESTABLISH INDIVIDUAL DEVELOPMENT ACCOUNTS (IDAS)

Current Law

Other than section 25B, enacted last spring, no current tax provision is specifically targeted to encourage low-income families to save and develop a pool of capital to be used for purposes such 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 annual appropriation of $25 million. Under the program, which the Department of Health and Human Services administers, an IDA can be opened by certain individuals who meet a net worth test and are eligible for the Earned Income Tax Credit or for Temporary Assistance for Needy Families (the successor to AFDC). Individuals' contributions receive no tax preference but are matched by contributions from a program run by a state 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 withdrawals must be paid directly to a mortgage provider, university, or business capitalization account at a financial institution. Match rates chosen by the state or nonprofit must be between 50 and 400 percent.

Reasons for Change

One third of all Americans have no assets available for investment, and another fifth have only negligible assets. The United States household savings rate lags far behind other industrial nations, constraining national economic growth and keeping 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 relative to 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 matching participants' contributions, administering the accounts, 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 of establishing and running IDA programs, contributing matching funds to the appropriate accounts, and providing financial education to account holders. Program sponsors could be qualified financial institutions, qualified nonprofits, or qualified Indian tribes, but the accounts would have to be held by an institution 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 dependents or students and meet certain income requirements would be eligible to establish and contribute to an IDA. For single filers, the income limit would be $20,000 in modified AGI. The corresponding thresholds for head-of-household and joint filers would be $30,000 and $40,000 respectively. (Married individuals filing separately could not participate.) Modified AGI is AGI as ordinarily computed, plus certain exempt items. In all cases eligibility would be determined by the individual's circumstances for the previous taxable year. Sponsors would match contributions from eligible account holders on a dollar-for-dollar basis up to $500 per year. The main account (including earnings) and an account containing the matching amounts (including earnings) would be tracked separately by the sponsor.

Qualifying financial institutions (and other persons as provided in regulations) could claim a tax credit for an IDA program. The credit would have two components: First, a $50-per-account credit could be claimed each year to offset the ongoing costs of maintaining and administering each account and providing financial education to participants. Except for the first year that an account is open, the credit would be available only for accounts with a balance at year's end of more than $100. In addition, there is a credit for the dollar-for-dollar matching amounts.

Participants could generally withdraw their contributions and matching funds (including earnings) for qualified purposes, which include certain higher education expenses, first-time home purchase expenditures, and small business capitalization. The financial institution at which the IDA is held would generally 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 could not be made from the account containing the matching funds (including earnings). Non-qualified withdrawals from the account containing the participant's contributions would result in the forfeiture of some or all of the amounts in the matching-fund account. Matching funds and earnings would generally be available, without penalty, to the account holder for any purpose after he or she attains the age of 61.

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

The proposal includes explicit regulatory authority for Treasury to adopt rules to permit IDA program sponsors to verify the eligibility of individuals seeking to open accounts and to ensure that these individuals have not previously opened such an IDA. The authority would also extend to rules governing the recapture of credits claimed with respect to non-eligible individuals and with respect to matching amounts and earnings that are forfeited.

The credit would apply with respect to the first 900,000 IDA accounts opened before January 1, 2008, and with respect to matching funds for participant contributions that are made after December 31, 2002, and before January 1, 2010. The credit could generally be claimed for taxable years ending after December 31, 2002, and beginning before January 1, 2010.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	-124	-267	-319	-300	-255	-1,265	-1,722

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”). This provision applies only to expenditures paid or incurred before January 1, 2004.

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.

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.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-193	-306	-299	-289	-1,087	-2,390

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 may want their land to be protected for conservation purposes but cannot afford simply to donate either the land or an easement on the land, especially if the land is the landowner's primary salable asset. By adding an incentive for sales to qualified conservation groups, the current proposal complements the existing provisions that encourage charitable donations. This proposal would encourage the sale of appreciated, environmentally sensitive land and land rights to qualified conservation groups, thus achieving conservation goals through voluntary sales of property, rather than imposing government regulation on land use. The proposal would achieve this goal by strengthening the ability of conservation groups to compete with other potential buyers of appreciated, environmentally sensitive land.

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 taxpayer or a member of the taxpayer's family must have owned the property sold for the three years immediately preceding the date of the sale.

The provision would be effective for sales taking place on or after January 1, 2004.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	-2	-44	-90	-94	-98	-328	-918

Increase Energy Production and and Promote Energy Conservation

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.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-92	-227	-303	-212	-143	-146	-1,031	-1,779

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.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-3	-6	-7	-8	-17	-24	-62	-72

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.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-89	-156	-168	-178	-188	-199	-889	-2,042

PROVIDE TAX CREDIT FOR PURCHASE OF CERTAIN HYBRID AND FUEL CELL VEHICLES

Current Law

No generally available income tax credit for purchases of hybrid vehicles is available currently. A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000. A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current, the original use of which commences with the taxpayer, and that is acquired for use by the taxpayer and not for resale. The full amount of the credit is available for purchases prior to 2002. The credit begins to phase down in 2002 and does not apply to vehicles placed in service after 2004.

Certain costs of qualified clean-fuel property, including clean-fuel vehicles, may be deducted when such property is placed in service. Qualified electric vehicles do not qualify for the clean-fuel vehicle deduction. The deduction begins to phase down in 2002 and does not apply to property placed in service after 2004.

Reasons for Change

The transportation sector now accounts for 67 percent of U.S. oil consumption. Cars, sport utility vehicles, light trucks, and minivans alone account for 40 percent of U.S. oil consumption, about 20 to 40 percent of all urban smog-forming emissions, and 20 percent of greenhouse gas emissions. Almost all of these vehicles use a single gasoline-fueled engine.

Hybrid vehicles, which have more than one source of power on board the vehicle, and electric vehicles have the potential to reduce petroleum consumption, air pollution, and greenhouse gas emissions. The proposed credits will encourage the purchase of highly fuel- efficient vehicles that incorporate advanced automotive technologies and will help to move hybrid and fuel cell vehicles from the laboratory to the highway. These vehicles can significantly reduce oil consumption, emissions of air pollutants, and emissions of carbon dioxide, the most prevalent greenhouse gas.

Proposal

The proposal would provide temporary tax credits for certain hybrid and fuel cell vehicles:

(1) Credit for qualified hybrid vehicles. A credit, of up to $4,000, would be available for purchases of qualified hybrid vehicles after December 31, 2001, and before January 1, 2008. The credit would be:

(a) $250 if the rechargeable energy storage system provides at least 5 percent but less than 10 percent of the maximum available power;
(b) $500 if the rechargeable energy storage system provides at least 10 percent and less than 20 percent of the maximum available power;

(c) $750 if the rechargeable energy storage system provides at least 20 percent and less than 30 percent of the maximum available power; and

(d) $1,000 if the rechargeable energy storage system provides 30 percent or more of the maximum available power.

If the vehicle's fuel economy exceeds the 2000 model year city fuel economy, the amount of credit shown in (a) through (d) above would be increased by the following amounts:

(i) $500 if the vehicle achieves at least 125 percent but less than 150 percent of the 2000 model year city fuel economy:

(ii) $1,000 if the vehicle achieves at least 150 percent but less than 175 percent of the 2000 model year city fuel economy;

(iii) $1,500 if the vehicle achieves at least 175 percent but less than 200 percent of the 2000 model year city fuel economy;

(iv) $2,000 if the vehicle achieves at least 200 percent but less than 225 percent of the 2000 model year city fuel economy;

(v) $2,500 if the vehicle achieves at least 225 percent but less than 250 percent of the 2000 model year city fuel economy; and

(vi) $3,000 if the vehicle achieves at least 250 percent of the 2000 model year city fuel economy.

(2) <u>Credit for qualified fuel cell vehicles</u>. A credit of up to $8,000 would be available for the purchase of new qualified fuel cell vehicles after December 31, 2001, and before January 1, 2008. The credit would be $4,000, but, if the vehicle's fuel economy exceeds the 2000 model year city fuel economy, the credit would increase by the following amounts:

I. $1,000 if the vehicle achieves at least 150 percent but less than 175 percent of the 2000 model year city fuel economy;

II. $1,500 if the vehicle achieves at least 175 percent but less than 200 percent of the 2000 model year city fuel economy;

III. $2,000 if the vehicle achieves at least 200 percent but less than 225 percent of the 2000 model year city fuel economy;

IV. $2,500 if the vehicle achieves at least 225 percent but less than 250 percent of the 2000 model year city fuel economy;

V. $3,000 if the vehicle achieves at least 250 percent but less than 275 percent of the 2000 model year city fuel economy;

VI. $3,500 if the vehicle achieves at least 275 percent but less than 300 percent of the 2000 model year city fuel economy; and

VII. $4,000 if the vehicle achieves at least 300 percent of the 2000 model year city fuel economy.

The 2000 model year city fuel economy would be the following:

If the vehicle inertia weight class is:	The 2000 model year city fuel economy is: For a passenger automobile:	For a light truck:
1,500 or 1,750 lbs	43.7 mpg	37.6 mpg
2,000 lbs	38.3 mpg	33.7 mpg
2,250 lbs	34.1 mpg	30.6 mpg
2,500 lbs	30.7 mpg	28.0 mpg
2,750 lbs	27.9 mpg	25.9 mpg
3,000 lbs	25.6 mpg	24.1 mpg
3,500 lbs	22.0 mpg	21.3 mpg
4,000 lbs	19.3 mpg	19.0 mpg
4,500 lbs	17.2 mpg	17.3 mpg
5,000 lbs	15.5 mpg	15.8 mpg
5,500 lbs	14.1 mpg	14.6 mpg
6,000 lbs	12.9 mpg	13.6 mpg
6,500 lbs	11.9 mpg	12.8 mpg
7,000 or 8,500 lbs	11.1 mpg	12.0 mpg

The "vehicle inertia weight class" is defined in regulations prescribed by the Environmental Protection Agency for purposes of title II of the Clean Air Act.

A qualifying hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy which include both: (1) an internal combustion engine or heat engine using combustible fuel, and (2) a rechargeable energy storage system. A qualifying fuel cell vehicle is a motor vehicle that is propelled by power derived from one or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel which is stored on board the vehicle and may or may not require reformation prior to use. A qualifying vehicle must meet all applicable regulatory requirements.

Maximum available power means the maximum value available from the battery or other energy storage device, during a standard power test, divided by the sum of the battery or other energy storage device and the SAE net power of the heat engine.

These credits would be available for all qualifying light vehicles including cars, minivans, sport utility vehicles, and light trucks. Taxpayers would be able to claim only one of the credits per vehicle and taxpayers who claim either credit would not be able to claim the qualified electric vehicle credit or the deduction for clean-fuel vehicle property for the same vehicle. Business taxpayers claiming either credit would be subject to the limitations on the general business credit and would be required to reduce the basis of the vehicle by the amount of the credit.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-21	-80	-181	-349	-530	-763	-1,903	-3,027

PROVIDE TAX CREDIT FOR ENERGY PRODUCED FROM LANDFILL GAS

Current Law

Taxpayers that produce gas from biomass (including landfill methane) are eligible for a tax credit ("the section 29 credit") equal to $3 per barrel-of-oil equivalent. For this purpose, a barrel-of-oil equivalent is the amount of gas that has a Btu (British thermal unit) content of 5.8 million. To qualify for the credit, the gas must be produced domestically from a facility placed in service by the taxpayer before July 1, 1998, pursuant to a written binding contract in effect before January 1, 1997. In addition, the gas must be sold to an unrelated person before January 1, 2008.

The amount of the section 29 credit generally is adjusted by an inflation adjustment factor for the calendar year in which the sale occurs. The inflation adjustment factor for the 2000 calendar year was 2.0454, and the inflation-adjusted amount of the credit for that year was $6.14 per barrel or barrel equivalent. The credit begins to phase out if the annual average unregulated wellhead price per barrel of domestic crude oil exceeds $23.50 multiplied by the inflation adjustment factor. For 2000, the inflation adjusted threshold for onset of the phaseout was $48.07 ($23.50 x 2.0454) and the average wellhead price for that year was $26.73.

The amount of the section 29 credit allowable with respect to a project is reduced by any unrecaptured business energy tax credit or enhanced oil recovery credit claimed with respect to such project.

The section 29 credit may not be used to offset alternative minimum tax liability. Any unused section 29 credit generally may not be carried back or forward to another taxable year; however, a taxpayer receives a credit for prior year minimum tax liability to the extent that a section 29 credit is disallowed as a result of the operation of the alternative minimum tax. The credit is limited to what would have been the regular tax liability but for the alternative minimum tax.

Reasons for Change

The tax credit helps make fuel produced from landfill methane competitive with other fuels. Extending the credit would continue the important contribution of this renewable energy source to the Nation's long-term energy supply.

Proposal

The credit would be allowed for fuel produced from landfill methane if the fuel is produced from a facility (or portion of a facility) placed in service after December 31, 2001, and before January 1, 2011, and is sold (or used to produce electricity that is sold) before January 1, 2011. The credit for fuel produced at landfills subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines would be limited to two-thirds of the otherwise applicable amount beginning on January 1, 2008, if any portion of the facility for producing fuel at the landfill was placed in service before July 1, 1998, and beginning on January 1, 2002, in all other cases. The proposal would clarify, for purposes of determining the extent to which a facility is placed in service after December 31, 2001, that the facility includes the wells, pipes, and related components used to collect landfill methane and that only production attributable to wells, pipes, and related components placed in service after December 31, 2001, is treated as produced from the portion of the facility placed in service after that date.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-12	-34	-59	-86	-120	-140	-439	-1,130

PROVIDE TAX CREDIT FOR COMBINED HEAT AND POWER PROPERTY

Current Law

Combined heat and power (CHP) systems are used to produce electricity (and/or mechanical power) and usable thermal energy from a single primary energy source. No income tax credit is currently provided for investments in CHP property.

Depreciation allowances for CHP property vary by asset use and capacity. Assets used to produce electricity with a capacity of 500 kilowatts or less are classified with other manufacturing assets, and generally have cost recovery periods of five to ten years. Other assets employed in the production of electricity have either a 15-year or 20-year recovery period. For assets that are structural components of buildings, however, the recovery period is either 39 years (if nonresidential real property) or 27.5 years (if residential rental property).

Reasons for Change

Combined heat and power systems utilize thermal energy that is otherwise wasted when producing electricity by more conventional methods. CHP systems achieve a greater level of overall energy efficiency, and thereby lessen the consumption of primary fossil fuels. They can lower total energy costs and reduce carbon emissions. An investment tax credit for CHP assets is expected to encourage increased energy efficiency by accelerating planned investment and inducing additional investment in CHP systems. The increased demand for such equipment should, in turn, reduce CHP production costs and spur additional technological innovations in improved CHP systems.

Proposal

The proposal would establish a 10-percent investment credit for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). CHP property would be defined as property comprising a system that uses the same energy source for the simultaneous or sequential generation of (1) electricity or mechanical shaft power (or both) and (2) steam or other forms of useful thermal energy (including heating and cooling applications). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency of the system would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. For this purpose, total energy efficiency would be calculated as the sum of the useful electrical, thermal, and mechanical power produced by the system at normal operating rates, measured on a Btu basis, divided by the lower heating value of the primary fuel source for the system supplied. The eligibility of qualified CHP property would be verified under regulations prescribed by the Secretary of the Treasury.

Qualified CHP assets that are assigned cost recovery periods of less than 15 years would be eligible for the credit, but only if the taxpayer elected to treat such property as having a 22-year class life. Thus, for such property, regular tax depreciation allowances would be calculated using a 15-year recovery period and the 150 percent declining balance method.

The credit would be treated as an energy credit under the investment credit component of the section 38 general business credit, and would be subject to the rules and limitations governing that credit. Taxpayers using the credit for CHP equipment would not be entitled to any other tax credit for the same equipment.

The credit would apply to investments in CHP equipment placed in service after December 31, 2001, but before January 1, 2007.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-97	-208	-235	-238	-296	-139	-1,116	-1,091

PROVIDE EXCISE TAX EXEMPTION (CREDIT) FOR ETHANOL

Current Law

Current law provides an income tax credit and an excise tax exemption for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol is 53 cents per gallon, but small ethanol producers (i.e., those producing less than 30 million gallons of ethanol per year) qualify for a credit of 63 cents per gallon on the first 15 million gallons of ethanol produced in a year. A credit of 60 cents per gallon is allowed for renewable source methanol.

As an alternative to the income tax credit, gasohol blenders may claim a gasoline tax exemption of 53 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol that is blended into qualifying gasohol.

The income tax credit expires on December 31, 2007, and the excise tax exemption expires on September 30, 2007. In addition, the ethanol credit and exemption are each reduced by 1 cent per gallon in 2003 and by an additional 1 cent per gallon in 2005. Neither the credit nor the exemption applies during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon. Under current law, the motor fuel tax dedicated to the Highway Trust Fund will be limited to 4.3 cents per gallon beginning on October 1, 2005.

Reasons for Change

The tax credit and excise tax exemption help make ethanol and renewable source methanol competitive with other fuels. Extending the credit and exemption would continue the important contribution of these renewable energy sources to the Nation's long-term energy supply.

Proposal

The income tax credit and the excise tax exemption would be extended through December 31, 2010. The current law rule providing that neither the credit nor the exemption applies during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon would be retained. As under current law, the credit and the exemption would each be reduced by 1 cent per gallon in 2003 and by an additional 1 cent per gallon in 2005.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
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IMPROVE TAX ADMINISTRATION

Modify the IRS Restructuring and Reform Act of 1998 (RRA1998)

MAKE SECTION 1203 OF THE IRS RESTRUCTURING AND REFORM ACT OF 1998 MORE EFFECTIVE AND FAIR

Current Law

Section 1203 of the IRS Restructuring and Reform Act of 1998 (RRA1998) requires the Commissioner of Internal Revenue to terminate an employee for certain specifically enumerated violations committed by the employee in connection with the performance of the employee's official duties. The Commissioner has non-delegable authority to determine whether mitigating factors support a personnel action other than termination for a covered violation.

Reasons for Change

The Administration's proposal would enhance the IRS' effectiveness by more carefully tailoring the types of conduct by IRS employees that are subject to sanctions, by reinforcing the seriousness with which covered violations will be handled, by providing clear guidance to IRS employees regarding covered conduct and associated penalties, and by allowing the imposition of penalties that are commensurate with specific violations.

Current law requires the termination of an IRS employee for the failure to timely file tax returns, except where such failure is due to reasonable cause and not due to willful neglect. An IRS employee who fails to timely file a refund return (i.e., for a year for which the employee is entitled to a refund) is subject to termination even though a taxpayer who files a refund return late is not subject to any penalty. Late-filed refund return cases have constituted a significant percentage of the section 1203 cases to date, and these cases do not represent the type of serious conduct for which the penalties imposed by the statute should apply. In addition, a number of section 1203 cases have involved allegations of wrongful conduct by IRS employees against other IRS employees. The Treasury Inspector General for Tax Administration has recommended that these types of cases be removed from the list of violations covered by section 1203 of RRA1998. Such allegations can be addressed by existing administrative and statutory procedures. The Administration's proposal would eliminate late refund returns and employee vs. employer acts from the list of covered violations. The proposal also would strenthen taxpayer protections by enhancing the Commissioner's ability to punish the unauthorized access of taxpayer return information.

Current law requires termination for any covered violation unless the Commissioner personally determines that mitigating factors justify some other personnel action. The proposal would require the Commissioner to establish guidelines outlining specific penalties, up to and including termination, for specific types of covered violations. These guidelines will provide notice to IRS employees of the punishment that would result from specific violations. This change would improve IRS employee morale and enhance the fundamental fairness of the statute.

Proposal

The Administration's proposal would modify section 1203 of RRA1998 by (i) removing the late-filing of refund returns from the list of violations; (ii) removing employee vs. employee acts (i.e., for violation of an employee's, rather than a taxpayer's, Constitutional or civil rights) from the list of violations; and (iii) adding the unauthorized inspection of returns or return information to the list of violations. In addition, the proposal would require the Commissioner to establish guidelines outlining specific penalties, up to and including termination, for specific types of wrongful conduct covered by section 1203 of RRA 1998. The Commissioner would retain the non-delegable authority to determine whether mitigating factors support a personnel action other than that specified in the guidelines for a covered violation.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

CURB THE USE OF FRIVOLOUS SUBMISSIONS AND FILINGS MADE TO IMPEDE OR DELAY TAX ADMINISTRATION

Current Law

The IRS may assert a penalty of $500 on an individual who files a return that either does not contain sufficient information that would allow the IRS to determine whether the tax shown on the return is correct or contains information indicating that the tax shown is substantially incorrect, if the return was filed based on a position that is frivolous or, based on information on the return, was intended to delay or impede tax administration.

Reasons for Change

The IRS has been faced with a significant number of taxfilers who are filing returns based on frivolous arguments or who are seeking to hinder tax administration by filing returns that are patently incorrect. In addition, taxpayers are using existing procedures for Collection Due Process hearings, offers in compromise, installment agreements, and taxpayer assistance orders to impede or delay tax administration by raising frivolous arguments. The IRS must address such frivolous arguments through mandated procedures, which results in delay and additional administrative burden and expense. Allowing the IRS to assert more substantial penalties for frivolous submissions, and to dismiss frivolous requests without the need to follow otherwise mandated procedures, would deter egregious taxpayer behavior and enable the IRS to utilize its resources more efficiently.

Proposal

The Administration's proposal would increase the penalty for frivolous tax returns from $500 to $5,000. In addition, the proposal would permit the IRS to dismiss requests for Collection Due Process hearings, installment agreements, offers in compromise, and taxpayer assistance orders if they are based on frivolous arguments or are intended to delay or impede tax administration. Individuals submitting such requests are subject to a $5,000 penalty for repeat behavior or failure to withdraw the request after being given the opportunity to do so. The IRS would be permitted to maintain administrative records of frivolous submissions by taxpayers. The IRS, however, would be required to remove the designation of a taxpayer if, after a reasonable period of time, no further frivolous submissions are made by the taxpayer. Finally, the proposal would require the IRS to publish, at least annually, a listing of positions, arguments, requests, and proposals deemed frivolous for purposes of the statute.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

AUTHORIZE PARTIAL-LIABILITY INSTALLMENT AGREEMENTS

Current Law

The IRS may enter into an agreement with a taxpayer to pay a tax liability in installments. The IRS, however, may enter into an installment agreement only if the agreement provides for the full payment of the liability.

Reasons for Change

The Administration's proposal will provide the IRS with an additional option for collecting tax from taxpayers who currently are unable to pay the full amount owed. Currently, the only available option in these situations is an offer in compromise, or OIC, which may not be available in many situations. For example, an OIC may not be practical when a taxpayer has limited assets, such as a modest amount of equity in a home or business, but the taxpayer cannot make payments equal to the amount of the taxpayer's equity in the house or business. At the same time, the equity may not be sufficient to justify the costs of enforced collection, and seizure of the asset may leave the taxpayer without any means of making future payments.

The IRS' current procedures require rejection of an installment agreement for less than the full amount of the liability and placement of the case in currently-not-collectible status. For taxpayers who do not qualify for the OIC program but who desire to make some payment towards their tax liability, this result undermines respect for the tax system. A partial-liability installment agreement will allow taxpayers to make payments towards their liability while at the same time leaving open the possibility of the collection of a larger amount, including the entire liability, if the taxpayer's circumstances change.

Proposal

The Administration's proposal would allow the IRS to enter into installment agreements for amounts less than the full liability owed by taxpayers.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	60	49	50	52	54	265	559

ALLOW FOR THE TERMINATION OF INSTALLMENT AGREEMENTS FOR FAILURE TO FILE RETURNS AND FOR FAILURE TO MAKE TAX DEPOSITS

Current Law

The IRS may terminate an agreement with a taxpayer to pay a tax liability in installments only for specific statutory grounds. These statutory grounds do not include a taxpayer's failure to file required returns or a taxpayer's failure to make required tax deposits.

Reasons for Change

The IRS' administrative procedures require that installment agreements contain a provision requiring taxpayers to meet all return filing and deposit obligations during the term of the agreement. This provision is intended to insure that the privilege of paying a tax liability in installments is extended only to those taxpayers willing to commit to future compliance. The installment agreement statute, however, does not allow the IRS to terminate an agreement even if a taxpayer fails to file required returns or fails to make required federal tax deposits, and the taxpayer may incur significant additional unpaid tax liability before the agreement can be terminated.

Proposal

The Administration's proposal would permit the IRS to terminate an installment agreement if a taxpayer fails to timely file tax returns or if a taxpayer fails to timely make required federal tax deposits.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
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CONSOLIDATE JUDICIAL REVIEW OF COLLECTION DUE PROCESS CASES IN THE UNITED STATES TAX COURT

Current Law

The Collection Due Process (CDP) statutes entitle taxpayers to notice and a right to a CDP hearing with the IRS Office of Appeals after the filing of a notice of Federal tax lien and prior to an intended levy. The taxpayer may request judicial review of a determination by the IRS Office of Appeals. The CDP statutes currently provide that venue for the review of an Appeals determination in a CDP case depends on which court (i.e., Tax Court or district court) would have jurisdiction over the underlying tax. Under this rule, the Tax Court reviews CDP cases involving deficiency-type taxes, generally income and estate taxes. The district court reviews cases involving nondeficiency-type taxes, generally employment and excise taxes.

Reasons for Change

The current statute, which divides responsibility for judicial review between the Tax Court and district courts was intended to give jurisdiction to the court that would have the most expertise over the underlying tax. In practice, however, taxpayer challenges in CDP cases have focused primarily on collection issues rather than liability issues. In particular, relatively few district court cases have involved challenges to the underlying tax liability.

The division of jurisdiction between the Tax Court and the district courts has needlessly complicated the CDP process by making it more confusing and expensive for taxpayers. A taxpayer who mistakenly files a request for review with the wrong court must incur the expense of refiling the case. In certain circumstances, a taxpayer may be required to seek judicial review in both the Tax Court and a district court. In addition, there are indications that some taxpayers are using the venue provisions to delay collection activity by deliberately filing the case with the wrong court.

Most cases seeking judicial review of Appeals determinations in CDP cases already are handled by the Tax Court. This proposal not only will simplify and streamline the CDP process for taxpayers but will also enable the Government and taxpayers to benefit from the Tax Court's expertise in CDP issues.

Proposal

This Administration's proposal would provide that the United States Tax Court shall be the exclusive venue for suits to obtain judicial review of any determination issued by Appeals after a CDP hearing.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

ELIMINATE THE MONETARY THRESHOLD FOR COUNSEL REVIEW OF OFFERS IN COMPROMISE

Current Law

Whenever a compromise is reached between the IRS and a taxpayer under section 7122, a record of the compromise must be placed on file along with an opinion from the IRS Chief Counsel. The opinion of Chief Counsel is not required when the total liability, including penalties and interest, is less than $50,000. All compromises, regardless of amount, are subject to continuous quality review by the Secretary.

Reasons for Change

The Administration's proposal would allow the IRS to more efficiently direct resources for offer-in-compromise (or OIC) cases while retaining existing quality review procedures. Many OIC cases do not present any significant legal issues, and the required legal review for cases meeting the statutory threshold can delay the acceptance process under current administrative procedures. The proposal would require the establishment of criteria for determining when review by Chief Counsel is appropriate. By retaining the requirement of continuous quality review by the Secretary, this proposal will insure that the overall quality of case dispositions does not decline.

Proposal

The Administration's proposal would eliminate the requirement that the opinion of Chief Counsel be placed on file for any accepted offer in compromise involving unpaid tax, penalty, and interest equal to or exceeding $50,000. This proposal would require the Secretary to establish standards for determining when an opinion of Counsel must be obtained.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

Initiate IRS Cost Saving Measures

PERMIT CERTIFICATES OF MAILING AS AN ALTERNATIVE TO CERTIFIED OR REGISTERED MAIL

Current Law

Several different Internal Revenue Code provisions require that certain notices and correspondence be sent to taxpayers by certified or registered mail. Certified mail and registered mail are first class mail that also provide proof of mailing with a delivery record maintained by the U.S. Postal Service.

Reasons for Change

The Administration's proposal will provide the IRS with a lower-cost option for mailing by allowing the use of a certificate of mailing, which is first class mail that provides evidence that the mail was presented to the Postal Service for mailing. Since the IRS often is required to mail a notice or correspondence to a taxpayer's last known address without the requirement of actual receipt by the taxpayer, the certificate of mailing provides the required proof that the IRS has actually mailed the notice or correspondence.

Proposal

The Administration's proposal would permit the IRS to use certificates of mailing as an alternative to certified mail and registered mail for most notices and correspondence now requiring certified or registered mail.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

ELIMINATE THE RETURN-RECEIPT REQUIREMENT FOR PRE-LEVY CDP NOTICES

Current Law

The IRS is required to provide taxpayers with notice of the right to request a collection due process (or CDP) hearing with the IRS Office of Appeals prior to levy. The IRS must provide the required notice by either delivering the notice in person, leaving the notice at the taxpayer's residence or usual place of business, or sending the notice by certified or registered mail, return receipt requested. With respect to service by mailing, the IRS is required only to send the notice to the taxpayer's last known address.

Reasons for Change

The elimination of the return-receipt requirement for notices of a right to a pre-levy CDP hearing will reduce costs without affecting the IRS' ability to determine whether a notice was delivered to the taxpayer. The U.S. Postal Service retains delivery information for certified and registered mail. In addition, certified or registered mail that is undeliverable or refused for delivery is returned to the IRS, and the IRS' administrative practice is to post this information to the taxpayer's account.

Proposal

This proposal would eliminate the return-receipt requirement for notices of a right to a pre-levy CDP hearing. Such notices would still be required to be sent by certified or registered mail.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

MODIFY THE DUAL-NOTICE REQUIREMENT FOR JOINT FILERS RESIDING AT THE SAME ADDRESS

Current Law

Section 3201(d) of the IRS Restructuring and Reform Act of 1998 (RRA1998) requires that the IRS, whenever practicable, send separate notices to each individual taxpayer filing a joint return.

Reasons for Change

Section 3201(d) of RRA1998 was intended to insure that all joint filers have an opportunity to participate in any proceeding that affects the joint return, tax liability, or collection of their balance-due accounts. Spouses living at the same address, however, generally do not need the added safeguard of separate notices. Joint filers, in fact, may consider the receipt of dual notices at the same address confusing, redundant, and fiscally irresponsible.

Proposal

The Administration's proposal would eliminate the requirement that separate notices be sent to joint filers who reside at the same address. This proposal would not supercede other provisions that specifically require separate notices.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

TREAT FALSE RETURNS AS NULLITIES NOT SUBJECT TO DEFICIENCY PROCEDURES

Current Law

Deficiency procedures must be used to disallow certain claimed credits, including the earned income (EITC), regulated investment company (RIC) and real estate investment trust (REIT) credits, that often are the basis for fraudulent claims for refund. In addition, existing rules do not permit the assessment of tax against a person who forges the signature of another person in order to obtain a refund of tax in another person's name.

Reasons for Change

The IRS has been faced with the increasing use of fraudulent credit claims to obtain refunds based on frivolous arguments such as slavery reparations. In cases where a taxpayer is claiming a credit that has no factual basis (e.g., when the IRS determines from the payor that no payments have been made that would support the credit), the IRS must still follow deficiency procedures to disallow the credit. Permitting the IRS to make assessments, without deficiency procedures, in these cases would reduce administrative burden and allow the IRS to more effectively target resources.

Proposal

The Administration's proposal would permit the assessment, without deficiency procedures, of fraudulent claims for EITC, gasoline or special fuels, RIC, and REIT credits without deficiency procedures. The proposal also would permit the assessment of tax, without deficiency procedures, against a person who forges a signature in order to obtain a refund of tax in another person's name.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

ALLOW THE FINANCIAL MANAGEMENT SERVICE TO RETAIN TRANSACTION FEES FROM LEVIED AMOUNTS

Current Law

The IRS may continuously levy 15 percent of a delinquent taxpayer's federal payments under the Federal Payment Levy Program (FPLP). The FPLP is administered by the Financial Management Service (FMS) of the Department of the Treasury. By statute, FMS must charge the IRS the costs incurred by FMS in developing and operating the FPLP.[8]

Reasons for Change

The IRS pays the FPLP fees to FMS out of the IRS' own appropriations. The FPLP fees have increased since the inception of the program due to increased FMS costs and increased use of the FPLP program. The proposal would alter internal government accounting to effectively eliminate accounting costs.

Proposal

The Administration's proposal would allow FMS to retain directly a portion of the levied funds as payment for FMS's fees. A delinquent taxpayer, however, would receive full credit for the amount levied upon – i.e., the amount credited to a taxpayer's account would not be reduced by FMS's fee.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
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[8]For the current fiscal year, the IRS expects that the FPLP fees charged by FMS will be between $2 to $3 million.

EXTEND THE DUE DATE FOR ELECTRONICALLY FILED RETURNS

Current Law

Individual taxpayers must file their income tax returns, and pay any tax balance due, on or before April 15 following the close of the calendar year. (A taxpayer may request an extension of time to file a return, but no extension is available for the making of tax payments.) A variety of filing methods may be used by taxpayers, including electronic filing, mailing with the U.S. Postal Service, and delivery by certain private carriers. A taxpayer's failure to timely file a return or timely pay a tax liability is subject to penalties and/or interest.

Reasons for Change

Although the number of taxpayers filing returns electronically has increased each year, the rate of growth in the number of taxpayers filing electronically slowed in 2001. In addition, most taxpayers filing returns electronically are taxpayers who are claiming refunds, as opposed to taxpayers having balances due. The proposal would provide an incentive to file electronically, particularly for taxpayers who have a balance due and refund filers who file later in the filing season. By extending the due date for electronic returns, this proposal also would extend the due date for any tax balance due as that due date is keyed to the return due date. The extended due date for tax payments, however, would apply only if the payments are made by electronic funds transfer.

In the IRS Restructuring and Reform Act of 1998 (RRA1998), Congress established a goal of having at least 80 percent of all Federal tax and information returns filed electronically by 2007. This proposal will encourage additional taxpayers to file returns electronically. In addition, increased use of electronic filing and electronic payment will reduce processing costs for the federal government.

Proposal

The Administration's proposal would extend the return filing and payment date for the filing of individual income tax returns from April 15 to April 30, if the return is filed electronically. In order to qualify for this extended return due date, any balance due must be paid electronically by the extended return due date. The due date for returns filed on paper would remain April 15.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	---	---	---	---	---	---

REFORM UNEMPLOYMENT INSURANCE

REFORM UNEMPLOYMENT INSURANCE ADMINISTRATIVE FINANCING

Current Law

The administrative costs of the unemployment insurance system and a portion of certain extended benefit programs are funded through the Federal Unemployment Tax Act (FUTA). FUTA imposes a net federal payroll tax on employers of 0.8 percent of the first $7,000 paid annually by each employer to each employee, which includes a 0.2 percent surtax scheduled to expire at the end of 2007. (The statutory FUTA rate is 6.2 percent (including the 0.2 percent surtax), but employers who make timely and full payments of their state unemployment insurance taxes are entitled to a credit of 5.4 percent.) The extent to which FUTA balances are distributed to states to cover administrative expenses is determined by the federal appropriations process. The unemployment insurance taxes imposed by each state are held in a federal unemployment trust fund for that state and are used to pay unemployment benefits.

FUTA balances in excess of statutory ceilings are distributed to the states to pay either unemployment benefits or administrative costs of the system. (These are known as Reed Act distributions). A Reed Act distribution is projected for October 1, 2002.

Reasons for Change

The changes in this proposal are central to the Administration's forthcoming comprehensive proposal to reform the administrative financing of the unemployment insurance benefits system. Current rules limit the ability of states to use FUTA balances and to structure their programs to best suit each state's needs. Despite the level of FUTA balances, many states do not have the funds they need to administer their programs.

Proposal

Eliminate the 0.2 percent FUTA surtax in 2003 and make additional rate cuts to achieve a net FUTA tax rate of 0.2 percent in 2007. Transfer administrative funding to the states in 2005 and allow the states to use their benefit taxes to pay these costs. Federal administrative grants to states will continue, although at a significantly reduced level. During the transition to state financing, special Reed Act distributions will be made to the states, and additional federal funds for administrative expenses will be provided.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	-1,002	-1,451	-2,902	-2,982	-4,429	-12,766	-6,924

EXPIRING PROVISIONS

Extend Provisions that Expired in 2001 for Two Years

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 two years, so that the credit would be effective for individuals who begin work before January 1, 2004.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-43	-153	-200	-127	-60	-29	-569	-576

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 two years, so that the credit would be effective for individuals who begin work before January 1, 2004.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-9	-37	-57	-48	-32	-22	-196	-209

EXTEND MINIMUM TAX RELIEF FOR INDIVIDUALS

Current Law

An individual is subject to an alternative minimum tax (AMT) to the extent the individual's tentative minimum tax is greater than the regular tax liability. In computing the tentative minimum tax, taxable income 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. A specified exemption amount, which varies depending on filing status, is not subject to the AMT, but the regular tax personal exemptions for taxpayers and their dependents are not allowed in computing the AMT.

A temporary provision, which does not apply for taxable years after 2001, permitted an individual to reduce tax liability by the full amount of nonrefundable personal credits even if tax liability is reduced to an amount that is less than the individual's tentative minimum tax. In addition, for taxable years 2002 through 2010, an individual may similarly use the child credit, the adoption credit and the credit for qualified retirement savings contributions to reduce tax liability below the amount of the tentative minimum tax. Beginning in 2002, however, the other nonrefundable personal credits (e.g., the child and dependent care credit and the HOPE and Lifetime Learning credits) may not be used to reduce tax liability below the amount of the 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 is concerned that the individual AMT may impose financial and compliance burdens upon taxpayers who were not the originally intended targets of the AMT. The Administration believes that allowing full use of nonrefundable personal credits, all of which are limited in amount and which are generally limited to lower- and middle-income families, would not undermine the policy of the AMT and would promote the important social policies underlying the credits.

The Administration also believes that allowing nonrefundable personal credits to be used in full would avoid a significant increase in compliance burdens. Substantially fewer taxpayers would need to perform complex and tedious computations to determine whether the AMT limited the use of these credits.

Proposal

The proposal would allow an individual to reduce tax liability by the full amount of nonrefundable personal credits even if tax liability is reduced to an amount that is less than the individual's tentative minimum tax.

The proposal would be effective for taxable years beginning after December 31, 2001, and before January 1, 2004.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-122	-353	-256	---	---	---	-609	-609

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 U.S. tax currently 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 that began 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 exception of certain active financing income from the subpart F rules to taxable years beginning after December 31, 2001 and before January 1, 2004.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-864	-1,502	-630	---	---	---	-2,132	-2,132

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 2001 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 two years. Thus, the limitation would not apply for taxable years beginning after December 31, 2001 and before January 1, 2004.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-25	-44	-18	---	---	---	-62	-62

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

The authority to issue $400 million of QZABs per year would be extended for two years to 2002 and 2003.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
-4	-13	-25	-35	-37	-37	-147	-332

Permanently Extend Expiring Provisions

PERMANENTLY EXTEND PROVISIONS EXPIRING IN 2010

Current Law

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) created a new 10-percent individual income tax rate bracket, reduced marginal income tax rates for individuals, doubled the child credit and extended its refundability, provided additional incentives for education, eliminated the estate tax, increased IRA and pension incentives, reduced marriage penalties, and provided relief from the alternative minimum tax (AMT). These and a number of other provisions of EGTRRA sunset on December 31, 2010.

Reasons for Change

The tax relief and incentives to work, save, and invest provided by EGTRRA are essential to the long-run performance of the economy. All taxpayers should have the certainty of knowing that the provisions of EGTRRA will extend beyond 2010. Taxpayers make long-term plans far beyond 2010 when saving for their children's education, when undertaking new business ventures, when planning for retirement, and when planning future contributions to charity and bequests for their children. Taxpayers require the certainty that can be provided today by permanently extending the provisions of EGTRRA.

Proposal

The provisions of EGTRRA that sunset on December 31, 2010 would be permanently extended.

Revenue Estimate[9]

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
177	-555	-1,107	-1,500	-2,007	-2,204	-7,373	-352,968

[9] The estimate includes both receipt and outlay effects. There is no outlay effect in the fiscal year 2003-2007 period. The outlay effect for the proposal is $10,272 in the fiscal year 2003-2012 period.

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.

Revenue Estimate

Fiscal Years							
2002	2003	2004	2005	2006	2007	2003-2007	2003-2012
($'s in millions)							
---	---	-906	-2,949	-4,654	-5,623	-14,132	-51,051