TECHNICAL EXPLANATION OF H.R. 8, THE "JOB PROTECTION AND RECESSION PREVENTION ACT OF 2012" SCHEDULED FOR CONSIDERATION BY THE HOUSE OF REPRESENTATIVES

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of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of H.R. 8, the "Job Protection and Recession Prevention Act of 2012," scheduled for consideration by the House of Representatives.

[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of H.R. 8, the "Job Protection and Recession Prevention Act of 2012" Scheduled for Consideration by the House of Representatives* (JCX-63-12), July 24, 2012. This document can also be found on our website at www.jct.gov.

I. EXTENSION OF 2001 AND 2003 TAX RELIEF[2]
(sec. 2 of the bill)

A. Individual Income Tax Rate Reductions

Present Law

In general

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases.

Prior to the The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")[3] the rate brackets were 15, 28, 31, 36, and 39.6 percent. The 2001 Act created a new 10-percent regular income tax bracket for a portion of taxable income that was previously taxed at 15 percent. The 2001 Act also reduced the tax rates in excess of 15 percent to 25, 28, 33, and 35 percent, respectively.

Tax rate schedules

Separate rate schedules apply based on an individual's filing status. For 2012, the regular individual income tax rate schedules are as follows:

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[2] The Economic Growth and Tax Relief Act of 2001(Pub. L. No. 107-16) provided a sunset provision that made the provisions of that Act inapplicable to taxable years beginning after December 31, 2010, and in the case of estate, gift, and generation-skipping transfer taxes, to estates of decedents dying, gifts made, or generation-skipping transfers made after that date. Subsequent legislation repealed the sunset provision for certain provisions of that Act. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312) extended the sunset date for two years (through 2012).

The Jobs and Growth Tax Relief Act of 2003 (Pub. L. 108-27) provided a sunset provision that made the provisions of that Act relating to the reduction in taxes on dividends and capital gains inapplicable to taxable years beginning after December 31, 2008. The Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. 109-222) extended the sunset for two years (through 2010) and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312) extended the sunset date for two additional years (through 2012).

The bill extends the date of the sunset provisions of both Acts for one additional year (through 2013). This portion of the document describes the provisions extended by the bill for one additional year.

[3] Pub. L. No. 107-16. References to the EGTRRA are to that Act as amended by subsequent legislation.

Table 1.–Federal Individual Income Tax Rates for 2012

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $8,700	10% of the taxable income
Over $8,700 but not over $35,350	$870 plus 15% of the excess over $8,700
Over $35,350 but not over $85,650	$4,867.50 plus 25% of the excess over $35,350
Over $85,650 but not over $178,650	$17,442.50 plus 28% of the excess over $85,650
Over $178,650 but not over $388,350	$43,482.50 plus 33% of the excess over $178,650
Over $388,350	$112,683.50 plus 35% of the excess over $388,350
Heads of Households	
Not over $12,400	10% of the taxable income
Over $12,400 but not over $47,350	$1,240 plus 15% of the excess over $12,400
Over $47,350 but not over $122,300	$6,482.50 plus 25% of the excess over $47,350
Over $122,300 but not over $198,050	$25,220 plus 28% of the excess over $122,300
Over $198,050 but not over $388,350	$46,430 plus 33% of the excess over $198,050
Over $388,350	$109,229 plus 35% of the excess over $388,350
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $17,400	10% of the taxable income
Over $17,400 but not over $70,700	$1,740 plus 15% of the excess over $17,400
Over $70,700 but not over $142,700	$9,735 plus 25% of the excess over $70,700
Over $142,700 but not over $217,450	$27,735 plus 28% of the excess over $142,700
Over $217,450 but not over $388,350	$48,665 plus 33% of the excess over $217,450
Over $388,350	$105,062 plus 35% of the excess over $388,350
Married Individuals Filing Separate Returns	
Not over $8,700	10% of the taxable income
Over $8,700 but not over $35,350	$870 plus 15% of the excess over $8,700
Over $35,350 but not over $71,350	$4,867.50 plus 25% of the excess over $35,350
Over $71,350 but not over $108,725	$13,867.50 plus 28% of the excess over $71,350
Over $108,725 but not over $194,175	$24,332.50 plus 33% of the excess over $108,725
Over $194,175	$52,531 plus 35% of the excess over $109,175

The following table is the staff of the Joint Committee on Taxation's estimates of the individual rate structure in 2013 (after the expiration of the EGTRRA sunset).

Table 2.–Federal Individual Income Tax Rates for 2013

If taxable income is:	**Then income tax equals:**
Single Individuals	
Not over $36,100	15% of the taxable income
Over $36,100 but not over $87,550	$5,422 plus 28% of the excess over $36,100
Over $87,550 but not over $182,600	$19,814 plus 31% of the excess over $87,550
Over $182,600 but not over $397,000	$49,280 plus 36% of the excess over $182,600
Over $397,000	$126,464 plus 39.6% of the excess over $397,000
Heads of Households	
Not over $48,400	15% of the taxable income
Over $48,400 but not over $125,000	$7,260 plus 28% of the excess over $48,400
Over $125,000 but not over $202,450	$28,708 plus 31% of the excess over $125,000
Over $202,450 but not over $397,000	$52,718 plus 36% of the excess over $202,450
Over $397,000	$122,756 plus 39.6% of the excess over $397,000
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $60,350	15% of the taxable income
Over $60,350 but not over $145,900	$9,052 plus 28% of the excess over $60,350
Over $145,900 but not over $222,300	$33,006 plus 31% of the excess over $145,900
Over $222,300 but not over $397,000	$56,690 plus 36% of the excess over $222,300
Over $397,000	$119,582 plus 39.6% of the excess over $397,000
Married Individuals Filing Separate Returns	
Not over $30,175	15% of the taxable income
Over $30,175 but not over $72,950	$4,526 plus 28% of the excess over $30,175
Over $72,950 but not over $111,150	$16,503 plus 31% of the excess over $72,950
Over $111,150 but not over $198,500	$28,345 plus 36% of the excess over $111,150
Over $198,500	$59,791 plus 39.6% of the excess over $198,500

Explanation of Provision

The bill extends the EGTRRA individual income tax rates for one year (through 2013). The rate structure is indexed for inflation. The following table is the staff of the Joint Committee on Taxation's estimates of the individual rate structure in 2013 under the bill.

Table 3.–Federal Individual Income Tax Rates for 2013 Under the Bill[4]

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $8,900	10% of the taxable income
Over $8,900 but not over $36,150	$890 plus 15% of the excess over $8,900
Over $36,150 but not over $87,550	$4,978 plus 25% of the excess over $36,150
Over $87,550 but not over $182,600	$17,828 plus 28% of the excess over $87,550
Over $182,600 but not over $397,000	$ 44,442 plus 33% of the excess over $182,600
Over $397,000	$115,194 plus 35% of the excess over $397,000
Heads of Households	
Not over $12,700	10% of the taxable income
Over $12,700 but not over $48,400	$1,270 plus 15% of the excess over $12,700
Over $48,400 but not over $125,000	$6,625 plus 25% of the excess over $48,400
Over $125,000 but not over $202,450	$25,775 plus 28% of the excess over $125,000
Over $202,450 but not over $397,000	$47,461 plus 33% of the excess over $202,450
Over $397,000	$111,663 plus 35% of the excess over $397,000
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $17,800	10% of the taxable income
Over $17,800 but not over $72,300	$1,780 plus 15% of the excess over $17,800
Over $72,300 but not over $145,900	$9,955 plus 25% of the excess over $72,300
Over $145,900 but not over $222,300	$28,355 plus 28% of the excess over $145,900
Over $222,300 but not over $397,000	$49,747 plus 33% of the excess over $222,300
Over $397,000	$107,398 plus 35% of the excess over $397,000

[4] A comparison of Table 3, below, with Table 2, above, illustrates the tax rate changes. Note that Table 3 also incorporates the provision to retain the marriage penalty relief with respect to the size of the 15 percent rate bracket, as discussed below.

Married Individuals Filing Separate Returns	
Not over $8,900	10% of the taxable income
Over $8,900 but not over $36,150	$890 plus 15% of the excess over $8,900
Over $36,150 but not over $72,950	$4,977 plus 25% of the excess over $36,150
Over $72,950 but not over $111,150	$14,177 plus 28% of the excess over $72,950
Over $111,150 but not over $198,500	$24,873 plus 33% of the excess over $111,150
Over $198,500	$53,699 plus 35% of the excess over $198,500

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

B. Termination of the Overall Limitation on Itemized Deductions and the Phase-out of Personal Exemptions

Present Law

Overall limitation on itemized deductions ("Pease" limitation)

An individual may elect to claim his or her itemized deductions for a taxable year in lieu of the standard deduction. Itemized deductions generally are those deductions which are not allowed in computing adjusted gross income ("AGI"). Itemized deductions include unreimbursed medical expenses, investment interest, casualty and theft losses, wagering losses, charitable contributions, qualified residence interest, State and local income taxes (or in lieu of income, sales taxes), property taxes, unreimbursed employee business expenses, and certain other miscellaneous expenses.

Prior to EGTRRA, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) was limited for upper-income taxpayers ("Pease" limitation). In computing this reduction of total itemized deductions, all limitations applicable to such deductions (such as the separate floors) were first applied and, then, the otherwise allowable total amount of itemized deductions was reduced by three percent of the amount by which the taxpayer's AGI exceeded a threshold amount, which was indexed annually for inflation. The otherwise allowable itemized deductions could not be reduced by more than 80 percent. EGTRRA phased-out and terminated the Pease limitation.

Pursuant to the general EGTRRA sunset, the Pease limitation becomes fully effective again in 2013. Adjusting for inflation, the Joint Committee staff estimates the AGI threshold is $177,550 for 2013.

Personal exemption phase-out for certain taxpayers ("PEP")

Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2012, the amount deductible for each personal exemption is $3,800. This amount is indexed annually for inflation.

Prior to EGTRRA, the deduction for personal exemptions was reduced or eliminated for taxpayers with incomes over certain thresholds, which were indexed annually for inflation. Specifically, the total amount of exemptions that a taxpayer could claim was reduced by two percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeded the applicable threshold. The phase-out rate was two percent for each $1,250 for married taxpayers filing separate returns. Thus, a taxpayer's available personal exemptions were phased-out over a $122,500 range (which was not indexed for inflation), beginning at the applicable threshold. EGTRRA phased-out and terminated PEP.

Pursuant to the general EGTRRA sunset, the personal exemption phase-out becomes fully effective again in 2013. According to Joint Committee Staff estimates the PEP thresholds for 2013 would be: (1) $177,550 for single individuals; (2) $266,300 for married couples filing joint returns; and (3) $221,950 for heads of households.

Explanation of Provision

Overall limitation on itemized deductions ("Pease" limitation)

Under the bill the overall limitation on itemized deductions does not apply for one additional year (through 2013).

Personal exemption phase-out for certain taxpayers ("PEP")

Under the bill the personal exemption phase-out does not apply for one additional year (through 2013).

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

C. Increase the Child Tax Credit

Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000 through 2012 and $500 thereafter.[5] A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.[6]

The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.[7]

The credit is allowable against the regular tax and, for taxable years beginning before January 1, 2013, is allowed against the alternative minimum tax ("AMT"). For taxable years beginning after December 31, 2012, the credit is not allowed against the AMT. To the extent the child credit exceeds the taxpayer's income tax liability, the taxpayer is eligible for a refundable credit[8] (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula).[9] The threshold dollar amount enacted by EGTRRA was $10,000 indexed for inflation. The American Recovery and Reinvestment Act of 2009 ("ARRA") reduced the threshold dollar amount to $3,000 (unindexed) for 2009 and 2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the $3,000 threshold for both 2011 and 2012. After 2012, the ability to determine the refundable child credit based on earned income in excess of the threshold dollar amount expires.

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income tax credit ("EITC"). After 2012, due to the expiration of the earned income formula, this is the only manner of obtaining a refundable child credit.

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[5] Sec. 24(a).

[6] Sec. 24(c).

[7] Sec. 24(b).

[8] The refundable credit may not exceed the maximum credit per child of $1,000 through 2012 and $500 thereafter.

[9] Sec. 24(d).

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. At the taxpayer's election, combat pay may be treated as earned income for these purposes. Unlike the EITC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EITC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Any credit or refund allowed or made to an individual under this provision (including to any resident of a U.S. possession) is not taken into account as income and shall not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

Explanation of Provision

The bill extends the $1,000 child tax credit and allows the child tax credit against the individual's regular income tax and AMT for one year (through 2013). The bill also extends the repeal of a prior-law provision that reduced the refundable child credit by the amount of the AMT for one year (through 2013). The bill does not extend the changes made by ARRA to the earned income formula for determining the refundable child credit. Under the bill, the staff of the Joint Committee on Taxation estimates that in 2013, the earned income threshold for computing the refundable child credit will be $13,350.[10] Finally, the bill extends the rule that the refundable portion of the child tax credit does not constitute income and shall not be treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds for one year (through 2013).

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

[10] This amount is $10,000 indexed for inflation.

D. Marriage Penalty Relief and Earned Income Tax Credit Simplification

Present Law

Marriage penalty

A married couple generally is treated as one tax unit that must pay tax on the couple's total taxable income. Although married couples may elect to file separate returns, the rate schedules and other provisions are structured so that filing separate returns usually results in a higher tax than filing a joint return. Other rate schedules apply to single persons and to single heads of households.

A "marriage penalty" exists when the combined tax liability of a married couple filing a joint return is greater than the sum of the tax liabilities of each individual computed as if they were not married. A "marriage bonus" exists when the combined tax liability of a married couple filing a joint return is less than the sum of the tax liabilities of each individual computed as if they were not married.

Basic standard deduction

EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. The basic standard deduction for a married taxpayer filing separately continued to equal one-half of the basic standard deduction for a married couple filing jointly; thus, the basic standard deduction for unmarried individuals filing a single return and for married couples filing separately are the same.

Fifteen percent rate bracket

EGTRRA increased the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return.

Earned income tax credit

The earned income tax credit ("EITC") is a refundable tax credit available to certain lower-income individuals. Generally, the amount of an individual's allowable earned income credit is dependent on the individual's earned income, adjusted gross income, and the number of qualifying children.

Explanation of Provision

Basic standard deduction

The bill increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return for one year (2013).

15 percent rate bracket

The bill increases the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the 15-percent regular income tax rate bracket for an unmarried individual filing a single return for one year (2013).

Earned income tax credit

The bill extends certain EITC provisions adopted by EGTRRA for one year (2013).

These include: (1) a simplified definition of earned income; (2) a simplified relationship test; (3) a simplified tie-breaking rule; (4) additional math error authority for the Internal Revenue Service; (5) a repeal of the prior-law provision that reduced an individual's EITC by the amount of his alternative minimum tax liability; and (6) a $3,000 increase in the beginning and ending points of the credit phase-out for married taxpayers.[11]

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

[11] The amount is indexed for inflation annually. The ARRA provision that increases the beginning and endpoints of the phaseout by an additional $2,000 is not extended under the bill.

E. Provide Education Incentives

Present Law

Income and wage exclusion for awards under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program

Gross income does not include amounts received as a qualified scholarship by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution.[12] This exclusion does not extend to scholarship amounts covering regular living expenses, such as room and board. In addition to the exclusion for qualified scholarships, the Code provides an exclusion from gross income for qualified tuition reductions for certain education provided to employees (and their spouses and dependents) of certain educational organizations. Amounts excludable from gross income as amounts received as a qualified scholarship are also excludable from wages for payroll tax purposes.[13]

The exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction. An exception to this rule applies in the case of the National Health Service Corps Scholarship Program (the "NHSC Scholarship Program") and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the "Armed Forces Scholarship Program").

The NHSC Scholarship Program and the Armed Forces Scholarship Program provide education awards to participants on the condition that the participants provide certain services. In the case of the NHSC Scholarship Program, the recipient of the scholarship is obligated to provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health care professionals. In the case of the Armed Forces Scholarship Program, the recipient of the scholarship is obligated to serve a certain number of years in the military at an armed forces medical facility.

Under the sunset provisions of the EGTRRA, the exclusion from gross income and wages for the NHSC Scholarship Program and the Armed Forces Scholarship Program will no longer apply for taxable years beginning after December 31, 2012.

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[12] Sec. 117.

[13] Sec. 3121(a)(20).

Income and wage exclusion for employer-provided educational assistance

If certain requirements are satisfied, up to $5,250 annually of educational assistance provided by an employer to an employee is excludable from gross income for income tax purposes and from wages for employment tax purposes.[14] Under EGTRRA, this exclusion applies to both graduate and undergraduate courses. For the exclusion to apply, certain requirements must be satisfied. The educational assistance must be provided pursuant to a separate written plan of the employer. The employer's educational assistance program must not discriminate in favor of highly compensated employees. In addition, no more than five percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program can be provided for the class of individuals consisting of more than five-percent owners of the employer and the spouses or dependents of such more than five-percent owners.

For purposes of the exclusion, educational assistance means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees, and similar payments, books, supplies, and equipment. Educational assistance also includes the provision by the employer of courses of instruction for the employee (including books, supplies, and equipment). Educational assistance does not include (1) tools or supplies that may be retained by the employee after completion of a course, (2) meals, lodging, or transportation, or (3) any education involving sports, games, or hobbies. The exclusion for employer-provided educational assistance applies only with respect to education provided to the employee (e.g., it does not apply to education provided to the spouse or a child of the employee).

In the absence of the specific exclusion for employer-provided educational assistance, employer-provided educational assistance is excludable from gross income and wages only if the education expenses qualify as a working condition fringe benefit.[15] In general, education qualifies as a working condition fringe benefit if the employee could have deducted the education expenses under section 162 if the employee paid for the education. In general, education expenses are deductible by an individual under section 162 if the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, applicable law, or regulations imposed as a condition of continued employment. However, education expenses are generally not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In determining the amount deductible for purposes of a working condition fringe benefit, the two-percent floor on miscellaneous itemized deductions is disregarded.

The specific exclusion for employer-provided educational assistance was originally enacted on a temporary basis, and, before EGTRRA, was subject to an expiration date of December 31, 2001. EGTRRA deleted the exclusion's explicit expiration date and extended the

[14] Secs. 127, 3121(a)(18).

[15] Sec. 132(d).

exclusion to graduate courses. However, those changes are subject to EGTRRA's sunset provision so that the exclusion will not be available for taxable years beginning after December 31, 2012. Thus, at that time, educational assistance will be excludable from gross income only if it qualifies as a working condition fringe benefit (i.e., the expenses would have been deductible as business expenses if paid by the employee). As previously discussed, to meet such requirement, the expenses must be related to the employee's current job.[16]

Deduction for student loan interest

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit.[17] Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending an eligible educational institution on at least a half-time basis. Eligible educational institutions are (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. Additionally, to qualify as an eligible educational institution, an institution must be eligible to participate in Department of Education student aid programs.

The maximum allowable deduction per year is $2,500. For 2012, the deduction is phased out ratably for single taxpayers with AGI between $60,000 and $75,000 and between $125,000 and $155,000 for married taxpayers filing a joint return. The income phaseout ranges are indexed for inflation and rounded to the next lowest multiple of $5,000.

Effective for taxable years beginning after December 31, 2012, the changes made by EGTRRA to the student loan provisions no longer apply. The EGTRRA changes scheduled to expire are: (1) increases that were made in the AGI phaseout ranges for the deduction and (2) rules that extended deductibility of interest beyond the first 60 months that interest payments are required. With the expiration of the EGTRRA changes, the phaseout ranges will revert to a base level of $40,000 to $55,000 ($60,000 to $75,000 in the case of a married couple filing jointly), but with an adjustment for inflation occurring since 2002. Thus, the staff of the Joint Committee on Taxation estimates that the phaseout ranges will be $50,000 to $65,000 ($75,000 to $90,000 in the case of a married couple filing jointly) for 2013.

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[16] Treas. Reg. sec. 1.162-5.

[17] Sec. 221.

Coverdell education savings accounts

A Coverdell education savings account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary.[18] Annual contributions to Coverdell education savings accounts may not exceed $2,000 per designated beneficiary and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return); the AGI of the contributor, and not that of the beneficiary, controls whether a contribution is permitted by the taxpayer.

Earnings on contributions to a Coverdell education savings account generally are subject to tax when withdrawn.[19] However, distributions from a Coverdell education savings account are excludable from the gross income of the distributee (i.e., the student) to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. The earnings portion of a Coverdell education savings account distribution not used to pay qualified education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.[20]

Tax-free (including free of additional 10-percent tax) transfers or rollovers of account balances from one Coverdell education savings account benefiting one beneficiary to another Coverdell education savings account benefiting another beneficiary (as well as redesignations of the named beneficiary) are permitted, provided that the new beneficiary is a member of the family of the prior beneficiary and is under age 30 (except in the case of a special needs beneficiary). In general, any balance remaining in a Coverdell education savings account is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if the beneficiary dies before attaining age 30, within 30 days of the date that the beneficiary dies).

Qualified education expenses include "qualified higher education expenses" and "qualified elementary and secondary education expenses."

The term "qualified higher education expenses" includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis.[21] Moreover, qualified higher education expenses include certain room and board expenses for any period

[18] Sec. 530.

[19] In addition, Coverdell education savings accounts are subject to the unrelated business income tax imposed by section 511.

[20] This 10-percent additional tax does not apply if a distribution from an education savings account is made on account of the death or disability of the designated beneficiary, or if made on account of a scholarship received by the designated beneficiary.

[21] Qualified higher education expenses are defined in the same manner as for qualified tuition programs.

during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified tuition program for the benefit of the beneficiary of the Coverdell education savings account.[22]

The term "qualified elementary and secondary education expenses," means expenses for: (1) tuition, fees, academic tutoring, special needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as determined under State law; (2) room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary; and (3) the purchase of any computer technology or equipment (as defined in section 170(e)(6)(F)(i)) or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary education expense unless the software is predominantly educational in nature.

Qualified education expenses generally include only out-of-pocket expenses. Such qualified education expenses do not include expenses covered by employer-provided educational assistance or scholarships for the benefit of the beneficiary that are excludable from gross income. Thus, total qualified education expenses are reduced by scholarship or fellowship grants excludable from gross income, as well as any other tax-free educational benefits, such as employer-provided educational assistance, that are excludable from gross income.

Effective for taxable years beginning after December 31, 2012, the changes made by EGTRRA to Coverdell education savings accounts no longer apply. The EGTRRA changes scheduled to expire are: (1) the increase in the contribution limit to $2,000 from $500; (2) the increase in the phaseout range for married taxpayers filing jointly to $190,000-$220,000 from $150,000-$160,000; (3) the expansion of qualified expenses to include elementary and secondary education expenses; (4) special age rules for special needs beneficiaries; (5) clarification that corporations and other entities are permitted to make contributions, regardless of the income of the corporation or entity during the year of the contribution; (6) certain rules regarding when contributions are deemed made and extending the time during which excess contributions may be returned without additional tax; (7) certain rules regarding coordination with the Hope and Lifetime Learning credits; and (8) certain rules regarding coordination with qualified tuition programs.

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[22] Sec. 530(b)(2)(B).

Amount of governmental bonds that may be issued by governments qualifying for the "small governmental unit" arbitrage rebate exception

To prevent State and local governments from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than needed for the purpose of the borrowing, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds.[23] The Code also provides certain exceptions to the arbitrage restrictions. Under one such exception, small issuers of governmental bonds issued for local governmental activities are not subject to the rebate requirement.[24] To qualify for this exception the governmental bonds must be issued by a governmental unit with general taxing powers that reasonably expects to issue no more than $5 million of tax-exempt governmental bonds in a calendar year.[25] Prior to EGTRRA, the $5 million limit was increased to $10 million if at least $5 million of the bonds are used to finance public schools. EGTRRA provided the additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirements is increased from $5 million to $10 million.[26] Thus, these governmental units may issue up to $15 million of governmental bonds in a calendar year provided that at least $10 million of the bonds are used to finance public school construction expenditures. This increase is subject to the EGTRRA sunset.

Issuance of tax-exempt private activity bonds for public school facilities

Interest on bonds that nominally are issued by State or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue act. These bonds are called "private activity bonds."[27] The term "private person" includes the Federal government and all other individuals and entities other than State or local governments.

Only specified private activity bonds are tax-exempt. EGTRRA added a new type of private activity bond that is subject to the EGTRRA sunset. This category is bonds for

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[23] The exclusion from gross income for interest on State and local bonds does not apply to any arbitrage bond (sec. 103(a), (b)(2)). A bond is an arbitrage bond if it is part of an issue that violates the restrictions against investing in higher-yielding investments under section 148(a) or that fails to satisfy the requirement to rebate arbitrage earnings under section 148(f).

[24] Ninety-five percent or more of the net proceeds of a governmental bond issue are to be used for local governmental activities of the issuer. Sec. 148(f)(4)(D).

[25] Under Treasury regulations, an issuer may apply a fact-based rather than an expectations-based test. Treas. Reg. sec. 1.148-8(c)(1).

[26] Sec. 148(f)(4)(D)(vii).

[27] The Code provides that the exclusion from gross income does not apply to interest on private activity bonds that are not qualified bonds within the meaning of section 141. See secs. 103(b)(1), 141.

elementary and secondary public school facilities that are owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency.[28] The term school facility includes school buildings and functionally related and subordinate land (including stadiums or other athletic facilities primarily used for school events) and depreciable personal property used in the school facility. The school facilities for which these bonds are issued must be operated by a public educational agency as part of a system of public schools.

A public-private partnership agreement is defined as an arrangement pursuant to which the for-profit corporate party constructs, rehabilitates, refurbishes, or equips a school facility for a public school agency (typically pursuant to a lease arrangement). The agreement must provide that, at the end of the contract term, ownership of the bond-financed property is transferred to the public school agency party to the agreement for no additional consideration.

Issuance of these bonds is subject to a separate annual per-State private activity bond volume limit equal to $10 per resident ($5 million, if greater) in lieu of the present-law State private activity bond volume limits. As with the present-law State private activity bond volume limits, States can decide how to allocate the bond authority to State and local government agencies. Bond authority that is unused in the year in which it arises may be carried forward for up to three years for public school projects under rules similar to the carryforward rules of the present-law private activity bond volume limits.

Explanation of Provision

The bill extends for one year the EGTRRA sunset as it applies to the NHSC Scholarship Program and the Armed Forces Scholarship Program, the section 127 exclusion from income and wages for employer-provided educational assistance, the student loan interest deduction, and Coverdell education savings accounts. The bill also extends the EGTRRA sunset as it applies to the expansion of the small government unit exception to arbitrage rebate and allowing issuance of tax-exempt private activity bonds for public school facilities. Thus, all of these tax benefits for education continue to be available through 2013.

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

[28] Sec. 142(a)(13), (k).

F. Other Incentives for Families and Children (Includes Extension of the Adoption Tax Credit, Employer-Provided Adoption Assistance, Employer-Provided Child Care Tax Credit, and Dependent Care Tax Credit)

Present Law

Adoption credit and exclusion from income for employer-provided adoption assistance

Present law for 2012 provides: (1) a maximum adoption credit of $12,650 per eligible child (both special needs and non-special needs adoptions); and (2) a maximum exclusion for employer-provided adoption assistance of $12,650 per eligible child (both special needs and non-special needs adoptions).[29] For 2012, the credit is not refundable. These dollar amounts are adjusted annually for inflation. These benefits are phased-out over a $40,000 range for taxpayers with modified adjusted gross income ("modified AGI") in excess of certain dollar levels. For 2012, the phase-out range is between $189,710 and $229,710. The phaseout threshold is adjusted for inflation annually, but the phaseout range remains a $40,000 range. Under present law, for purposes of the credit and exclusion, a special needs adoption finalized during the taxable year is deemed to include $12,650 of eligible expenses associated with that adoption, regardless of whether expenses rose to that level. Present law allows taxpayers to claim the adoption credit against their alternative minimum tax liability.

For taxable years beginning after December 31, 2012, the amount of the adoption credit is reduced to $6,000, and only applies in the case of special needs adoptions. The employer-provided adoption assistance exclusion terminates. The phase-out range is reduced to lower income levels (i.e., between $75,000 and $115,000). The maximum credit, exclusion, and phase-out range are not indexed for inflation. The provision providing for special rules regarding the expenses relating to special needs adoptions do not apply, and the credit may not offset alternative minimum tax liability.

Employer-provided child care tax credit

Taxpayers receive a tax credit equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. The

[29] Secs. 36C and 137. EGTRRA increased the maximum credit and exclusion to $10,000 (indexed for inflation after 2002) for both non-special needs and special needs adoptions, increased the phase-out starting point to $150,000 (indexed for inflation after 2002). Section 10909 of the Patient Protection and Affordable Care Act, Pub. L. No. 111-148: (1) extended the EGTRRA expansion of the adoption credit and exclusion for employer-provided adoption assistance for one year (for 2011); (2) increased by $1,000 (to $13,170, indexed for inflation) the maximum adoption credit and exclusion from income for employer-provided adoption assistance for two years (2010 and 2011); and (3) made the credit refundable for two years (2010 and 2011). The 2010 Act extended for one year (2012) the EGTRRA expansion of the adoption credit and the exclusion from income for employer-provided adoption assistance. The changes to the adoption credit and exclusion from employer-provided adoption assistance for 2010 and 2011 (relating to the $1,000 increase in the maximum credit and exclusion and the refundability of the credit), enacted as part of the Patient Protection and Affordable Care Act, were not extended by the 2010 Act provision or otherwise to date.

maximum total credit that may be claimed by a taxpayer cannot exceed $150,000 per taxable year.

Qualified child care expenses include costs paid or incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of the taxpayer's qualified child care facility; (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care (unless it is the principal residence of the taxpayer), and the facility must meet all applicable State and local laws and regulations, including any licensing laws. A facility is not treated as a qualified child care facility with respect to a taxpayer unless: (1) it has open enrollment to the employees of the taxpayer; (2) use of the facility (or eligibility to use such facility) does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q)); and (3) at least 30 percent of the children enrolled in the center are dependents of the taxpayer's employees, if the facility is the principal trade or business of the taxpayer. Qualified child care resource and referral expenses are amounts paid or incurred under a contract to provide child care resource and referral services to the employees of the taxpayer. Qualified child care services and qualified child care resource and referral expenditures must be provided (or be eligible for use) in a way that does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q) of the Code.

Any amounts for which the taxpayer may otherwise claim a tax deduction are reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility is reduced by the amount of the credits.

Credits taken for the expenses of acquiring, constructing, rehabilitating, or expanding a qualified facility are subject to recapture for the first ten years after the qualified child care facility is placed in service. The amount of recapture is reduced as a percentage of the applicable credit over the 10-year recapture period. Recapture takes effect if the taxpayer either ceases operation of the qualified child care facility or transfers its interest in the qualified child care facility without securing an agreement to assume recapture liability for the transferee. The recapture tax is not treated as a tax for purposes of determining the amount of other credits or determining the amount of the alternative minimum tax. Other rules apply.

This tax credit expires for taxable years beginning after December 31, 2012.

Dependent care tax credit

The maximum dependent care tax credit is $1,050 (35 percent of up to $3,000 of eligible expenses) if there is one qualifying individual, and $2,100 (35 percent of up to $6,000 of eligible expenses) if there are two or more qualifying individuals.[30] The 35-percent credit rate is reduced, but not below 20 percent, by one percentage point for each $2,000 (or fraction thereof)

[30] Sec. 21.

of adjusted gross income above ("AGI") $15,000. Therefore, the credit percentage is reduced to 20 percent for taxpayers with AGI over $43,000. Generally, eligible expenses include expenses for household services and expenses for the care of a qualifying individual but only if such expenses are incurred to enable the taxpayer to be gainfully employed.

The level of this credit is reduced for taxable years beginning after December 31, 2012, under EGTRRA.

Explanation of Provision

Adoption credit and exclusion from income for employer-provided adoption assistance

The bill extends the EGTRRA expansion of these two for one year (2013). Therefore, for 2013, the maximum benefit is $12,170 (indexed for inflation after 2010). The adoption credit and exclusion are phased out ratably for taxpayers with modified adjusted gross income between $193,930 and $233,930 (indexed for inflation) for 2013.[31] The 2012 rules relating to expenses for special needs adoptions are retained, and taxpayers remain able to offset their alternative minimum tax liability with the credit.

Employer-provided child care tax credit

The bill extends this tax benefit for one year (through 2013).

Expansion of dependent care tax credit

The bill extends the EGTRRA expansion of the dependent care tax credit for one year (through 2013).

Effective Date

The provisions apply to taxable years beginning after December 31, 2012.

[31] The changes to the adoption credit and exclusion from employer-provided adoption assistance for 2010 and 2011 (relating to the $1,000 increase in the maximum credit and exclusion and the refundability of the credit) enacted as part of the Patient Protection and Affordable Care Act, are not extended by the provision.

G. Alaska Native Settlement Trusts

Present Law

The Alaska Native Claims Settlement Act ("ANCSA")[32] established Alaska Native Corporations to hold property for Alaska Natives. Alaska Natives are generally the only permitted common shareholders of those corporations under section 7(h) of ANCSA,which provides restrictions regarding the transfer of Settlement Common Stock, unless an Alaska Native Corporation specifically allows other shareholders under specified procedures.

ANCSA permits an Alaska Native Corporation to transfer money or other property to an Alaska Native Settlement Trust ("Settlement Trust") for the benefit of beneficiaries who constitute all or a class of the shareholders of the Alaska Native Corporation, to promote the health, education and welfare of beneficiaries and to preserve the heritage and culture of Alaska Natives.[33]

Alaska Native Corporations and Settlement Trusts, as well as their shareholders and beneficiaries, are generally subject to tax under the same rules and in the same manner as other taxpayers that are corporations, trusts, shareholders, or beneficiaries.

Special tax rules enacted in EGTRRA allow an election to use a more favorable tax regime for transfers of property by an Alaska Native Corporation to a Settlement Trust and for income taxation of the Settlement Trust.[34] There is also simplified reporting to beneficiaries.[35]

Under the special tax rules, a Settlement Trust may make an irrevocable election to pay tax on taxable income at the lowest rate specified for individuals (rather than the highest rate that is generally applicable to trusts) and to pay tax on capital gains at a rate consistent with being subject to such lowest rate of tax. As described further below, beneficiaries may generally thereafter exclude from gross income distributions from a trust that has made this election. Also, contributions from an Alaska Native Corporation to an electing Settlement Trust generally will not result in the recognition of gross income by beneficiaries on account of the contribution. An electing Settlement Trust remains subject to generally applicable requirements for classification and taxation as a trust.

A Settlement Trust distribution is excludable from the gross income of beneficiaries to the extent of the taxable income of the Settlement Trust for the taxable year and all prior taxable years for which an election was in effect, decreased by income tax paid by the Trust, plus tax-

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[32] 43 U.S.C. 1601 *et. seq.*

[33] With certain exceptions, once an Alaska Native Corporation has made a conveyance to a Settlement Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgment, except with respect to the lawful debts and obligations of the Settlement Trust.

[34] Sec. 646.

[35] Sec. 6039H.

exempt interest from State and local bonds for the same period. Amounts distributed in excess of the amount excludable is taxed to the beneficiaries as if distributed by the sponsoring Alaska Native Corporation in the year of distribution by the Trust, which means that the beneficiaries must include in gross income as dividends the amount of the distribution, up to the current and accumulated earnings and profits of the Alaska Native Corporation. Amounts distributed in excess of the current and accumulated earnings and profits are not included in gross income by the beneficiaries.

A special loss disallowance rule reduces (but not below zero) any loss that would otherwise be recognized upon disposition of stock of a sponsoring Alaska Native Corporation by a proportion, determined on a per share basis, of all contributions to all electing Settlement Trusts by the sponsoring Alaska Native Corporation. This rule prevents a stockholder from being able to take advantage of a decrease in value of an Alaska Native Corporation that is caused by a transfer of assets from the Alaska Native Corporation to a Settlement Trust.

The fiduciary of an electing Settlement Trust is obligated to provide certain information relating to distributions from the trust in lieu of reporting requirements under Section 6034A.

The earnings and profits of an Alaska Native Corporation are not reduced by the amount of its contributions to an electing Trust at the time of the contributions. However, the Alaska Native Corporation earnings and profits are reduced as and when distributions to the beneficiaries are thereafter made by the electing Trust that are taxed to the beneficiaries as dividends from the Alaska Native Corporation.

The election to pay tax at the lowest rate is not available in certain disqualifying cases: (a) where transfer restrictions have been modified either to allow a transfer of a beneficial interest that would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act if the interest were Settlement Common Stock, or (b) where transfer restrictions have been modified to allow a transfer of any Stock in an Alaska Native Corporation that would not be permitted by section 7(h) if it were Settlement Common Stock and the Alaska Native Corporation thereafter makes a transfer to the Trust. Where an election is already in effect at the time of such disqualifying situations, the special rules applicable to an electing trust cease to apply and rules generally applicable to trusts apply. In addition, the distributable net income of the trust is increased by undistributed current and accumulated earnings and profits of the trust, limited by the fair market value of trust assets at the date the trust becomes so disposable. The effect is to cause the trust to be taxed at regular trust rates on the amount of recomputed distributable net income not distributed to beneficiaries, and to cause the beneficiaries to be taxed on the amount of any distributions received consistent with the applicable tax rate bracket.[36]

Explanation of Provision

The bill extends the amendments to electing Settlement Trusts for one year (through 2013).

[36] These provisions enacted by EGTRRA are subject to the EGTRRA sunset.

Effective Date

The provision is effective for taxable years of electing Settlement Trusts, their beneficiaries, and sponsoring Alaska Native Corporations beginning after December 31, 2012.

H. Reduced Rates on Capital Gains and Dividends

Present Law

Capital gains

In general

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual generally is taxed at rates lower than rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to $3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Tax rates before 2013

Under present law, for taxable years beginning before January 1, 2013, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. Any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero rate. These rates apply for purposes of both the regular tax and the AMT.

Under present law, the "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the excess of the sum of the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) and the amount of gain equal to the additional amount of gain that would be excluded from gross income under section 1202 (relating to certain small business stock) if the percentage limitations of section 1202(a) did not apply, over the sum of the net short-term capital loss for the taxable year and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

An individual's unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

Tax rates after 2012

For taxable years beginning after December 31, 2012, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. Any adjusted net capital gain which otherwise would be taxed at the 15-percent rate is taxed at a 10-percent rate.

In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10-percent capital gain rate is taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which began after December 31, 2000, that would otherwise have been taxed at a 20-percent rate is taxed at an 18-percent rate.

The tax rates on 28-percent gain and unrecaptured section 1250 gain are the same as for taxable years beginning before 2013.

For taxable years beginning after December 31, 2012, a tax is imposed on net investment income (which includes net gain included in gross income from the disposition of property other than certain property held in a trade or business) in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount.[37] The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

[37] The tax is subject to the individual estimated tax provisions. The tax is not deductible in computing any tax imposed by subtitle A of the Internal Revenue Code (relating to income taxes).

Dividends

In general

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits.

Tax rates before 2013

An individual's qualified dividend income is taxed at the same rates that apply to net capital gain. This treatment applies for purposes of both the regular tax and the alternative minimum tax. Thus, for taxable years beginning before 2013, an individual's qualified dividend income is taxed at rates of zero and 15 percent. The zero-percent rate applies to qualified dividend income which otherwise would be taxed at a 10- or 15-percent rate if the special rates did not apply.

Qualified dividend income generally includes dividends received from domestic corporations and qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

Special rules apply in determining a taxpayer's foreign tax credit limitation under section 904 in the case of qualified dividend income. For these purposes, rules similar to the rules of section 904(b)(2)(B) concerning adjustments to the foreign tax credit limitation to reflect any capital gain rate differential will apply to any qualified dividend income.

If a taxpayer receives an extraordinary dividend (within the meaning of section 1059(c)) eligible for the reduced rates with respect to any share of stock, any loss on the sale of the stock is treated as a long-term capital loss to the extent of the dividend.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the RIC is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (1) the qualified dividend income of the RIC for the taxable year and (2) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of dividends qualifying for reduced rates that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (1) the qualified dividend income of the REIT for the taxable year, (2) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (3) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

The reduced rates do not apply to dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities.[38]

Tax rates after 2012

For taxable years beginning after 2012, all dividends received by an individual are taxed at ordinary income tax rates.

For taxable years beginning after December 31, 2012, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes dividends, or the excess of modified adjusted gross income over the threshold amount.[39] The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

Explanation of Provision

Under the bill, the regular and minimum tax rates for qualified dividend income and capital gain in effect for 2012 are extended for one additional year (through 2013).

[38] In addition, for taxable years beginning before 2013, amounts treated as ordinary income on the disposition of certain preferred stock (sec. 306) are treated as dividends for purposes of applying the reduced rates; the tax rate for the accumulated earnings tax (sec. 531) and the personal holding company tax (sec. 541) is reduced to 15 percent; and the collapsible corporation rules (sec. 341) are repealed.

[39] The tax is subject to the individual estimated tax provisions. The tax is not deductible in computing any tax imposed by subtitle A of the Internal Revenue Code (relating to income taxes).

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

I. Estate, Gift, and Generation-Skipping Transfer Taxes

Present Law

In general

In general, a gift tax is imposed on certain lifetime transfers and an estate tax is imposed on certain transfers at death. A generation skipping transfer tax generally is imposed on certain transfers, made either directly or in trust or using a similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation younger than that of the transferor). Transfers subject to the generation skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

A unified credit is available with respect to taxable transfers by gift and at death.[40] The unified credit offsets tax computed at the lowest estate and gift tax rates on a specified amount of transfers, referred to as the applicable exclusion amount. As amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Extension Act"),[41] the estate tax applicable exclusion amount is $5 million and is indexed for inflation for decedents dying in calendar years after 2011. The gift tax is unified with the estate tax, with an applicable exclusion amount of $5 million (indexed for inflation after 2011). For 2012, the inflation-indexed estate and gift tax applicable exclusion amount is $5.12 million. The generation skipping transfer tax exclusion is equal to the applicable exclusion amount for estate tax purposes (e.g., $5.12 million for 2012). The top estate and gift tax rate is 35 percent.

A deduction is allowed for certain death taxes paid to any State or the District of Columbia.

The 2010 Extension Act extended certain special temporary rules originally enacted as part of EGTRRA relating to: (1) allocation of generation skipping transfer tax exemption; (2) estate tax conservation easements; and (3) installment payments of estate taxes.[42]

Portability of unused exclusion between spouses

Under a temporary provision enacted as part of the 2010 Extension Act, any applicable exclusion amount that remains unused as of the death of a spouse who dies after December 31,

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[40] Sec. 2010.

[41] Pub. L. No. 111-312, December 17, 2010. The 2010 Extension Act generally extends and modifies the estate and gift tax provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), Pub. L. No. 107-16, June 7, 2001.

[42] See Subtitles F, G and H of Title V of EGTRRA.

2010 (the deceased spousal unused exclusion amount), generally is available for use by the surviving spouse, as an addition to such surviving spouse's applicable exclusion amount.[43]

Sunset of EGTRRA and 2010 Extension Act estate and gift tax provisions

The estate, gift, and generation skipping transfer tax provisions of EGTRRA, as extended and modified by the 2010 Extension Act, apply for decedents dying, generation skipping transfers made, and gifts made before 2013. For transfers after December 31, 2012, the law scheduled to be in effect prior to the enactment of EGTRRA will apply. In general, this includes: (1) an estate and gift tax applicable exclusion amount of $1 million; (2) a top estate and gift tax rate of 55 percent; (3) no portability of unused exclusion between spouses; (4) a credit (rather than a deduction) for certain death taxes paid to any State or the District of Columbia; and (5) expiration of the special rules enacted under EGTRRA relating to allocation of generation skipping transfer tax exemption, estate tax conservation easements, and installment payments of estate taxes.

Explanation of Provision

The bill extends for one year (through 2013) the estate and gift tax provisions of EGTRRA, as extended and modified by the 2010 Extension Act.

Effective Date

The provision is effective for decedents dying, generation skipping transfers made, and gifts made after December 31, 2012.

[43] Sec. 2010(c). The provision does not allow a surviving spouse to use the unused generation skipping transfer tax exemption of a predeceased spouse.

II. EXTENSION OF INCREASED EXPENSING FOR SMALL BUSINESS DEPRECIABLE ASSETS (sec. 3 of the bill)

Present Law

A taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation.[44] For taxable years beginning in 2012, the maximum amount a taxpayer may expense is $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000.[45] The $125,000 and $500,000 amounts are indexed for inflation occurring since 2006.[46] The indexed amounts for 2012 are $139,000 and $560,000. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2013 is treated as qualifying property.

For taxable years beginning in 2013 and thereafter, a taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year, subject to limitation. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property (not including off-the-shelf computer software) that is purchased for use in the active conduct of a trade or business.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[47]

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[44] Additional section 179 incentives have been provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)). In addition, section 179(e) provides for an enhanced section 179 deduction for qualified disaster assistance property.

[45] Sec. 179(b)(2).

[46] Sec. 179(b)(6).

[47] Sec. 179(c)(1). An election or specification under section 179 with respect to any property may be revoked by the taxpayer without consent of the Commissioner for taxable years beginning before 2013. Any election or specification made for taxable years beginning after 2012 may not be revoked except with the consent of the Commissioner.

Explanation of Provision

The bill provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2013, is $100,000 of the cost of qualifying property placed in service for the taxable year. The $100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $400,000. The $100,000 and $400,000 amounts are indexed for inflation occurring since 2002. The indexed amounts for 2013 are $127,000 and $510,000.

In addition, the bill extends the treatment of off-the-shelf computer software as qualifying property, as well as the provision permitting a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner, for one year (through 2013).

Effective Date

The provision is effective for taxable years beginning after December 31, 2012.

III. EXTENSION OF THE ALTERNATIVE MINIMUM TAX RELIEF FOR INDIVIDUALS (sec. 4 of the bill)

Present Law

Present law imposes an alternative minimum tax ("AMT") on individuals. The AMT is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The exemption amounts are: (1) $74,450 for taxable years beginning in 2011 and $45,000 in taxable years beginning thereafter in the case of married individuals filing a joint return and surviving spouses; (2) $48,450 for taxable years beginning in 2011 and $33,750 in taxable years beginning thereafter in the case of other unmarried individuals; (3) $37,225 for taxable years beginning in 2011 $22,500 in taxable years thereafter in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits. These credit include the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child credit, the credit for interest on certain home mortgages, the Hope Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, the credit for certain plug-in electric vehicles, the credit for alternative motor vehicles, the credit for new qualified plug-in electric drive motor vehicles, and the D.C. first-time homebuyer credit.

For taxable years beginning before 2012, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

For taxable years beginning after 2011, the nonrefundable personal credits (other than the adoption credit, the child credit, the Hope Scholarship credit (for taxable years beginning after 2012), the credit for savers, the credit for residential energy efficient property, the credit for certain plug-in electric vehicles, the credit for alternative motor vehicles, and the credit for new qualified plug-in electric drive motor vehicles) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, the child credit, the Hope Scholarship credit (for taxable years beginning before 2013), the credit for savers, the credit for residential energy efficient property, the credit for certain plug-in electric vehicles, the credit for alternative motor vehicles, and the credit for new qualified plug-in electric drive motor vehicles are allowed to the full extent of the individual's regular tax and alternative minimum tax.[48]

Explanation of Provisions

The bill allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits for 2012 and 2013.

The bill provides that the individual AMT exemption amount for taxable years beginning in 2012 is (1) $78,750, in the case of married individuals filing a joint return and surviving spouses; (2) $50,600 in the case of other unmarried individuals; and (3) $39,375 in the case of married individuals filing separate returns.

The bill provides that the individual AMT exemption amount for taxable years beginning in 2013 is (1) $79,850, in the case of married individuals filing a joint return and surviving spouses; (2) $51,150 in the case of other unmarried individuals; and (3) $39,925 in the case of married individuals filing separate returns.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

[48] The rule applicable to the child credit and the adoption credit is subject to the EGTRRA sunset.