FEDERAL RECEIPTS AND COLLECTIONS

3. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Federal Government's sovereign or governmental powers. The difference between receipts and outlays determines the surplus or deficit.

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following chapter.

Growth in receipts.—Total receipts in 2001 are estimated to be $2,019.0 billion, an increase of $62.8 billion or 3.2 percent relative to 2000. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. Receipts are projected to grow at an average annual rate of 3.8 percent between 2001 and 2005, rising to $2,340.9 billion.

As a share of GDP, receipts are projected to decline from 20.4 percent in 2000 to 19.4 percent in 2005.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1999 actual	Estimate					
		2000	2001	2002	2003	2004	2005
Individual income taxes	879.5	951.6	972.4	995.2	1,025.6	1,066.1	1,116.8
Corporation income taxes	184.7	192.4	194.8	195.4	195.7	200.0	205.9
Social insurance and retirement receipts	611.8	650.0	682.1	712.2	741.7	771.3	815.3
(On-budget)	(167.4)	(173.3)	(182.2)	(189.9)	(197.4)	(204.7)	(216.7)
(Off-budget)	(444.5)	(476.8)	(499.9)	(522.2)	(544.2)	(566.7)	(598.6)
Excise taxes	70.4	68.4	76.7	79.8	80.8	81.8	83.4
Estate and gift taxes	27.8	30.5	32.3	34.9	36.3	38.7	37.0
Customs duties	18.3	20.9	20.9	22.6	24.3	25.7	27.9
Miscellaneous receipts	34.9	42.5	39.9	41.2	43.2	52.6	54.5
Total receipts	**1,827.5**	**1,956.3**	**2,019.0**	**2,081.2**	**2,147.5**	**2,236.1**	**2,340.9**
(On-budget)	*(1,383.0)*	*(1,479.5)*	*(1,519.1)*	*(1,559.0)*	*(1,603.2)*	*(1,669.4)*	*(1,742.3)*
(Off-budget)	*(444.5)*	*(476.8)*	*(499.9)*	*(522.2)*	*(544.2)*	*(566.7)*	*(598.6)*

Table 3–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2001	2002	2003	2004	2005
Social security (OASDI) taxable earnings base increases:.					
$76,200 to $80,100 on Jan. 1, 2001	1.8	4.8	5.2	5.7	6.3
$80,100 to $83,700 on Jan. 1, 2002	....	1.6	4.3	4.7	5.2
$83,700 to $87,300 on Jan. 1, 2003	....	....	1.6	4.3	4.7
$87,300 to $90,600 on Jan. 1, 2004	....	....	....	1.5	4.0
$90,600 to $93,900 on Jan. 1, 2005	....	....	....	....	1.5

ENACTED LEGISLATION

Several laws were enacted in 1999 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

To Extend the Tax Benefits Available With Respect to Services Performed in a Combat Zone to Services Performed in the Federal Republic of Yugoslavia (Serbia/Montenegro) and Certain Other Areas, and for Other Purposes.—This Act, which was signed by President Clinton on April 19, 1999, provides the same tax relief to military personnel participating in Operation Allied Force as that provided as a consequence of the Executive Order that designates the Kosovo area of operations as a combat zone. In addition, this Act extends the tax filing and payment deadlines provided as a consequence of the Executive Order to military personnel outside the United States who are deployed outside their duty station as part of Operation Allied Force.

Under the Executive Order, which was issued by President Clinton on April 13, 1999, the Kosovo area of operations, including the above airspace, encompasses The Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea above the 39th parallel. The tax benefits provided military personnel serving in those areas include extension of deadlines for filing and paying taxes; exemption of military pay earned while serving in the combat zone (subject to a dollar limit for commissioned officers) from withholding and income tax; and, exemption of toll telephone calls originating in the combat zone from the telephone excise tax.

Miscellaneous Trade and Technical Corrections Act of 1999—This Act makes miscellaneous technical and clerical corrections to U.S. trade laws, corrects obsolete references, and authorizes the temporary suspension or refund of tariffs on over 120 categories of imported items. These items include 13 inch televisions, chemicals (some of which are used to develop cancer and AIDS-fighting drugs), textile printing machines, weaving machines, manufacturing equipment, certain rocket engines, and a number of pigments and dyes. The Act also extends tariff credits for wages paid in the production of watches in the Virgin Islands to the production of fine jewelry. The receipt losses associated with the tariff refunds and suspensions are offset by a provision that clarifies the tax treatment of certain corporate restructuring transactions, which is described below.

Restrict basis creation through section 357(c).—A transferor generally is required to recognize gain on a transfer of property in certain tax-free exchanges to the extent that the sum of the liabilities assumed, plus those to which the transferred property is subject, exceeds the transferor's basis in the property. This gain recognition to the transferor generally increases the basis of the transferred property in the hands of the transferee. However, if a recourse liability is secured by multiple assets, prior law was unclear as to whether a transfer of one asset, where the transferor remains liable, is a transfer of property "subject to" the liability. Similar issues exist with respect to nonrecourse liabilities. Under this provision, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability generally is eliminated. Except as provided in regulations, a recourse liability is treated as assumed to the extent that the transferee has agreed and is expected to satisfy the liability (whether or not the transferor has been relieved of the liability). Except as provided in regulations, a nonrecourse liability is treated as assumed by the transferee of any asset subject to the liability. However, the amount of nonrecourse liability treated as assumed is reduced by the amount of the liability that an owner of other assets not transferred to the transferee and also subject to the liability has agreed with the transferee to satisfy, and is expected to satisfy, up to the fair market value of such other assets. The transferor's recognition of gain as a result of assumption of liability shall not increase the transferee's basis in the transferred asset to an amount in excess of its fair market value. Moreover, if no person is subject to U.S. tax on gain recognized as the result of the assumption of a nonrecourse liability, then the transferee's basis in the transferred assets is increased only to the extent such basis would be increased if the transferee had assumed only a ratable portion of the liability, based on the relative fair market value of all assets subject to such nonrecourse liability. The Treasury Department has authority to prescribe regulations necessary to carry out the purposes of the provision, and to apply the treatment set forth in this provision where appropriate elsewhere in the Internal Revenue Code. This provision applies to transfers made after October 18, 1998.

Consolidated Appropriations Act for FY 2000.—This Act, which was signed by President Clinton on November 30, 1999, makes progress on several important fronts: it puts education first, makes America a safer place, strengthens our effort to preserve natural areas and protect our environment, and strengthens America's leadership role in the world. Although most of the provisions in this Act affect Federal spending programs, a transfer from the surplus funds of the Federal Reserve System to the Treasury of $3.752 billion in FY 2000 affects governmental receipts.

Ticket to Work and Work Incentives Improvement Act of 1999.—This Act, which was signed by President Clinton on December 17, 1999, ensures that individuals with disabilities have a greater opportunity to participate in the workforce and in the American Dream and extends important tax provisions. Despite these accomplishments, the President is disappointed that this Act includes a provision for a special allowance adjustment for student loans, that it delays the implementation of a proposed Department of Health and Human Services final rule on the distribution of human organs for transplantation, and that the revenue losses are not fully offset. The major provisions of this Act affecting governmental receipts are described below.

Expired and Expiring Provisions

Extend minimum tax relief for individuals.—Certain nonrefundable personal tax credits (dependent care credit, credit for the elderly and disabled, adoption credit, child tax credit, credit for interest on certain home mortgages, HOPE Scholarship and Lifetime Learning credit, and the D.C. homebuyer's credit) are provided under current law. Generally, these credits are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax. An additional child tax credit is provided under current law to families with three or more qualifying children. This credit, which may be offset against social security payroll tax liability (provided that liability exceeds the amount of the earned income credit), is reduced by the amount of the individual's minimum tax liability (that is, the amount by which the individual's tentative minimum tax exceeds the individual's regular tax liability). For taxable year 1998, prior law allowed nonrefundable personal tax credits to offset regular income tax liability in full (as opposed to only the amount by which the regular tax liability exceeded the tentative minimum tax). In addition, for taxable year 1998, the additional child credit provided to families with three or more qualifying children was not reduced by the amount of the individual's minimum tax liability. This Act extends the provision that allows the nonrefundable personal tax credits to offset regular income tax liability in full to taxable years beginning in 1999. For taxable years beginning in 2000 and 2001 the nonrefundable personal credits may offset both the regular tax and the minimum tax. In addition, for taxable years beginning in 1999, 2000, and 2001, the additional child credit provided to families with three or more qualifying children will not be reduced by the amount of the individual's minimum tax liability.

Extend and modify research and experimentation tax credit.—The 20-percent tax credit for certain research and experimentation expenditures is extended to apply to qualifying expenditures paid or incurred during the period July 1, 1999 through June 30, 2004. In addition, effective for taxable years beginning after June 30, 1999, the credit rate applicable under the alternative incremental research credit is increased by one percentage point per step, and the definition of qualified research is expanded to include research undertaken in Puerto Rico and possessions of the United States. Under this Act, credits attributable to the period beginning on July 1, 1999 and ending on September 30, 2000 may not be taken into account in determining any amount required to be paid for any purpose under the Internal Revenue Code prior to October 1, 2000. On or after October 1, 2000, such credits may be taken into account through the filing of an amended return, an application for expedited refund, an adjustment of estimated taxes, or other means that are allowed by the Internal Revenue Code. Similarly, research credits that are attributable to the period beginning on October 1, 2000 and ending on September 30, 2001 may not be taken into account in determining any amount required to be paid for any purpose under the Internal Revenue Code prior to October 1, 2001.

Extend exceptions provided under subpart F for certain active financing income.—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 such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes "foreign personal holding company income" and insurance income. The U.S. 10-percent shareholders of a CFC also are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (income derived from services performed for a related person outside the country in which the CFC is organized). For taxable years beginning in 1998 and 1999, certain income derived in the active conduct of a banking, financing, insurance, or similar business is excepted from the Subpart F rules regarding the taxation of foreign personal holding company income and foreign base company services income. This Act extends the exception for two years, with very minor modifications, to apply to taxable years beginning in 2000 and 2001.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. For taxable years beginning after December 31, 1997 and before January 1, 2000, domestic oil and gas production from "marginal" properties is exempt from the 100-percent of net income limitation. This Act extends the exemption to apply to taxable years beginning after December 1, 1999 and before January 1, 2002.

Extend the work opportunity tax credit.—The work opportunity tax credit provides an incentive for employers to hire individuals from certain targeted groups. The credit equals a percentage of qualified wages paid during the first year of the individual's employment with the employer. The credit percentage is 25 percent for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. This Act extends the credit to apply to individuals who begin work on or after July 1, 1999 and before January 1, 2002.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit enables employers to claim a tax credit on the first $20,000 of eligible wages paid to certain long-term family assistance 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. Under this Act the credit is extended to apply to individuals who begin work on or after July 1, 1999 and before January 1, 2002.

Extend exclusion for employer-provided educational assistance.—Certain amounts paid by an employer for educational assistance provided to an employee are excluded from the employee's gross income for income and payroll tax purposes. The exclusion is limited to $5,250 of educational assistance with respect to an individual during a calendar year and applies whether or not the education is job-related. The exclusion, which is limited to undergraduate courses, is extended to apply to courses beginning after May 31, 2000 and before January 1, 2002.

Extend and modify wind and biomass tax credit and expand eligible biomass sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind or "closed-loop" biomass. Under prior law, the credit applies to electricity produced by a facility placed in service before July 1, 1999, and is allowable for production during the 10-year period after a facility is originally placed in service. This Act extends the credit to apply to facilities placed in service after June 30, 1999 and before January 1, 2002. Electricity produced at a wind facility placed in service during this period does not qualify for the credit, however, if it is sold pursuant to a pre-1987 contract that has not been modified to limit the purchaser's obligation to acquire electricity at above-market prices. The Act also expands the credit to apply to poultry waste facilities placed in service after December 31, 1999 and before January 1, 2002.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. This program, which had expired after June 30, 1999, is extended through September 30, 2001. Refunds of any duty paid between June 30, 1999 and December 17, 1999 are provided upon request of the importer.

Extend authority to issue Qualified Zone Academy Bonds.—The Taxpayer Relief Act of 1997 (TRA97) included a provision that allows State and local governments to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds must be used for teacher training, purchases of equipment, curricular development, and rehabilitation and repairs at certain public school facilities. Under TRA97, a nationwide total of $400 million of qualified zone academy bonds was authorized to be issued in each of calendar years 1998 and 1999. Effective December 17, 1999, an additional $400 million of qualified zone academy bonds is authorized to be issued in each of calendar years 2000 and 2001. In addition, unused authority arising in 1998 and 1999 may be carried forward for up to three years and unused authority arising in 2000 and 2001 may be carried forward for up to two years.

Extend tax credit for first-time D.C. homebuyers.—The tax credit (up to $5,000) provided for the first-time purchase of a principal residence in the District of Columbia, which was scheduled to expire after December 31, 2000, is extended to apply to residences purchased on or before December 31, 2001.

Extend expensing of brownfields remediation costs.—Taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The ability to deduct such expenditures is extended for one year, to apply to expenditures paid or incurred before January 1, 2002.

Time-Sensitive Provisions

Prohibit disclosure of advanced pricing agreements (APAs) and APA background files.—Returns and return information, as defined by the Internal Revenue Service (IRS), are confidential and cannot be disclosed unless authorized by the Internal Revenue Code. In contrast, written determinations issued by the IRS generally are available for public inspection. The APA program is an alternative dispute resolution program conducted by the IRS, which resolves international transfer pricing issues prior to the filing of the corporate tax return. To resolve such issues, the taxpayer submits detailed and confidential financial information, business plans and projections to the IRS for consideration. This Act confirms that APAs and related background information are confidential return information and not written determinations available for public inspection. Effective December 17, 1999, APAs or related background files are prohibited from being released to the public, regardless of whether the APA was executed before or after that date. The Treasury Department also is required to produce an annual report that contains general and statistical information about the APA program, and general descriptions of the APAs concluded during the year.

Provide authority to postpone certain tax-related deadlines by reason of year 2000 (Y2K) failures.—The Secretary of the Treasury is permitted to postpone, on a taxpayer-by-taxpayer basis, certain tax-related deadlines for a period of up to 90 days, if he determines that the taxpayer has been affected by an actual Y2K related failure. In order to be eligible for relief, the taxpayer must have made a good faith, reasonable effort to avoid any Y2K related failures.

Expand list of taxable vaccines.—Under prior law an excise tax of $.75 per dose is levied on the following vaccines: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, rotavirus gastroenteritis, and varicella (chickenpox). This Act adds any conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines, effective for vaccines sold by a manufacturer or importer after December 17, 1999.

Delay requirement that registered motor fuels terminals offer dyed fuel as a condition of registration.—With limited exceptions, excise taxes are imposed on all highway motor fuels when they are removed from a registered terminal facility, unless the fuel is indelibly dyed and is destined for a nontaxable use. Terminal facilities are not permitted to receive and store nontaxed motor fuels unless they are registered with the IRS. Prior law requires that effective July 1, 2000, in order to be registered, a terminal must offer for sale both dyed and undyed fuel (the "dyed-fuel mandate"). Under this Act the effective date of the dyed-fuel mandate is postponed until January 1, 2002.

Provide that Federal production payments to farmers are taxable in the year received. —A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless such amount properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. Under production flexibility contracts entered into between certain eligible owners and producers and the Secretary of Agriculture, as provided in the Federal Agriculture Improvement and Reform Act of 1996 (FAIR Act), annual payments are made at specific times during the Federal government's fiscal year. One-half of each annual payment is to be made on either December 15 or January 15 of the fiscal year, at the option of the recipient; the remaining one-half is to be paid no later than September 30 of the fiscal year. The option to receive the payment on December 15 potentially results in the constructive receipt (and thus potential inclusion in income) of one-half of the annual payment at that time, even if the option to receive the amount on January 15 is elected. For fiscal year 1999, as provided under The Emergency Farm Financial Relief Act of 1998, all payments are to be paid at such time or times during the fiscal year as the recipient may specify. This option to receive all of the 1999 payment in calendar year 1998 potentially results in constructive receipt (and thus potential inclusion in income) in that year, whether or not the amounts are actually received. The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, provided that effective for production flexibility contract payments made in taxable years ending after December 31, 1995, the time a production flexibility contract payment is to be included in income is to be determined without regard to the options granted for payment. Effective December 17, 1999, this Act provides that any unexercised option to accelerate the receipt of any payment under a production flexibility contract that is payable under the FAIR Act is to be disregarded in determining the taxable year in which such payment is properly included in gross income. Options to accelerate payments that are enacted in the future are covered by this rule, providing the payment to which they relate is mandated by the Fair Act as in effect on the date of enactment of this Act.

Revenue Offset Provisions

Modify estimated tax requirements of individuals.—An individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax. An individual generally does not have an underpayment of estimated tax if timely estimated tax payments are made at least equal to: (1) 100 percent of the tax shown on the return of the individual for the preceding tax year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year. For any individual with an adjusted gross income (AGI) of more than $150,000 as shown on the return for the preceding taxable year, the 100 percent of last year's liability safe harbor generally is modified to be a 110 percent of last year's liability safe harbor. However, under prior law, the 110 percent of last year's liability safe harbor for individuals with AGI of more than $150,000 was modified for taxable years beginning in 1999 through 2002, as follows: for taxable years beginning in 1999 the safe harbor is 105 percent; for taxable years beginning in 2000 and 2001 the safe harbor is 106 percent, and for taxable years beginning in 2002, the safe harbor is 112 percent. Under this Act the estimated tax safe harbor for individuals with AGI of more than $150,000 is modified as follows: for taxable years beginning in 2000 the safe harbor is 108.6 percent and for taxable years beginning in 2001 the safe harbor is 110.0 percent.

Clarify the tax treatment of income and losses on derivatives.—Capital gain treatment applies to gain on the sale or exchange of a capital asset. Gain or loss on other assets (stock in trade or other types of inventory, property used in a trade or business that is real property or subject to depreciation, accounts or notes receivable acquired in the ordinary course of a trade or business, certain copyrights, and U.S. government publications) generally is considered ordinary. This Act adds three categories to the list of assets the gain or loss on which is considered ordinary for Federal income tax purposes: commodities derivatives held by commodities derivatives dealers, hedging transactions, and supplies of a type regularly consumed by the taxpayer in the ordinary course of a taxpayer's trade or business. In defining a hedging transaction, the Act replaces the "risk reduction" standard with a "risk management" standard with respect to ordinary property held or certain liabilities incurred, and provides that the definition of a hedging transaction includes a transaction entered into primarily to mange such other risks as the Secretary of the Treasury may prescribe in regulations. These changes are effective for any instrument held, acquired or entered into; any transaction entered into; and any supplies held or acquired on or after December 17, 1999.

Expand reporting of cancellation of indebtedness income.—Gross income generally includes income from the discharge of indebtedness. If a bank, thrift institution, or credit union discharges $600 or more of any indebtedness of a debtor, the institution must report such discharge to the debtor and the IRS. This Act extends these reporting requirements to additional entities involved in the trade or business of lending (such as finance companies and credit card companies, whether or not they are affiliated with a financial institution), effective for discharges of indebtedness occurring after December 31, 1999.

Limit conversion of character of income from constructive ownership transactions with respect to partnership interests.—A pass-thru entity, such as a partnership, generally is not subject to Federal income tax. Instead, each owner includes his/her share of a pass-thru entity's income, gain, deduction or credit in his/her own taxable income. The character of the income generally is determined at the entity level and flows through to the owners. A taxpayer can enter into a derivatives transaction that is designed to give the taxpayer the economic equivalent of an ownership interest in a partnership but that is not itself a current ownership interest in the partnership. These so-called "constructive ownership" transactions purportedly allow taxpayers to defer income and to convert ordinary income and short-term capital gain into long-term capital gain. This Act treats long-term capital gain recognized from a constructive ownership transaction as ordinary income to the extent the long-term capital gain recognized from the transaction exceeds the long-term capital gain that could have been recognized had the taxpayer invested in the partnership interest directly. In addition, an interest charge is imposed on the amount of gain that is treated as ordinary income. These changes are effective with respect to transactions entered into on or after July 12, 1999. Generally any contract, option or any other arrangement that is entered into or exercised on or after that date, which extends or otherwise modifies the terms of a transaction entered into prior to such date, will be treated as a transaction entered into on or after July 12, 1999.

Extend and modify qualified transfers of excess pension assets used for retiree health benefits.—A pension plan may provide medical benefits to retired employees through a section 401(h) account that is a part of the pension plan. Qualified transfers of excess assets of a defined benefit pension plan (other than a multiemployer plan) to a section 401(h) account are permitted, subject to amount and frequency limitations, use requirements, deduction limitations, and vesting and minimum benefit requirements. This Act extends the ability of employers to transfer excess defined benefit pension plan assets to 401(h) accounts through December 31, 2005. In addition, effective with respect to qualified transfers made after December 17, 1999, the minimum benefit requirement is replaced with a minimum cost requirement.

Modify installment method for accrual basis taxpayers.—Generally, an accrual method requires a taxpayer to recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. The installment method of accounting provides an exception to these general recognition principles by allowing a taxpayer to defer recognition of income from the disposition of certain property until payment is received. To the extent that an installment obligation is pledged as security for any indebtedness, the net proceeds of the secured indebtedness are treated as a payment on such obligation, thereby triggering the recognition of income. This Act generally prohibits the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting. The present-law exceptions regarding the availability of the installment method for use by cash method taxpayers, for dispositions of property used or produced in the trade or business of farming, and for dispositions of timeshares or residential lots are not affected by this change. This Act also modifies the pledge rule to provide that entering into any arrangement that gives the taxpayer the right to satisfy an obligation with an installment note will be treated in the same manner as the direct pledge of the installment note. These changes are effective with respect to sales or other dispositions entered into on or after December 17, 1999.

Deny charitable contribution deduction for transfers associated with split-dollar insurance arrangements.—A taxpayer who itemizes deductions generally is allowed to deduct charitable contributions paid during the taxable year. The amount of the deduction allowable for a taxable year with respect to any charitable contribution depends on the type of property contributed, the type of organization to which the property is contributed, and the income of the taxpayer. In general, to be deductible as a charitable contribution, a payment to charity must be a gift made without receipt of adequate consideration and with donative intent. Under a charitable split-dollar insurance arrangement, a taxpayer typically transfers funds to a charity with the understanding that the charity will use the funds to pay premiums on a cash value life insurance policy that benefits both the charity and members of the transferor's family, either directly or indirectly through a family trust or partnership. This Act eliminates such abuses of the charitable contributions deduction by denying a charitable contribution deduction for any transfer to a charity in connection with a charitable split-dollar insurance transaction. Specifically, the denial of the deduction applies if, in connection with the transfer, the charity directly or indirectly pays, or has previously paid, any premium on any "personal benefit contract" with respect to the transferor, or there is an understanding or expectation that any person will directly or indirectly pay any premium on any "personal benefit contract" with respect to the transferor. A personal benefit contract with respect to the transferor is any life insurance, annuity, or endowment contract for whom the direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family or any other person (other than a charitable organization) designated by the transferor. The Act also imposes an excise tax on any participating charity equal to the amount of any premiums paid by the charity on such a "personal benefit contract" in connection with a charitable split-dollar insurance transaction. The deduction is denied for any transfers after February 8, 1999 and the excise tax applies to premiums paid after December 17, 1999.

Require basis adjustments when a partnership distributes certain stock to a corporate partner.—Under prior law, generally no gain or loss was recognized on the receipt by a corporation of property distributed in complete liquidation of a subsidiary corporation in which it owned 80-percent of the stock. The basis of property received by the distributee in such a liquidation was the same as it was in the hands of the subsidiary. This Act provides for a reduction in basis of the assets of a corporation if stock in that corporation is distributed by the partnership to a corporate partner that, as a result of the distribution and related transactions, owns 80 percent or more of the stock of such corporation. The amount of the reduction generally equals the amount of the excess of the partnership's adjusted basis in the stock of the distributed corporation immediately before the distribution, over the corporate partner's basis in that stock immediately after the distribution, subject to certain limitations. The corporate partner must recognize long-term capital gain to the extent the amount of the basis reduction exceeds the basis of the property of the distributed corporation. This change generally is effective for distributions made after July 14, 1999, except that in the case of a corporation that is a partner in a partnership on July 14, 1999, the provision is effective for distributions by that partnership to the corporation after December 17, 1999 (or, for a corporation that so elects, distributions after June 30, 2001).

Modify rules relating to real estate investment trusts (REITs).—REITs generally are restricted to owning passive investments in real estate and certain securities. Under prior law, no single corporation could account for more than five percent of the total value of a REIT's assets, and a REIT could not own more than 10-percent of the outstanding voting securities of any issuer. Through the use of non-voting preferred stock and multiple subsidiaries, up to 25 percent of the value of a REIT's assets could consist of subsidiaries that conduct otherwise impermissible activities. Under this Act, the 10-percent vote test is changed to a 10-percent "vote or value" test, meaning that a REIT cannot own more than 10 percent of the outstanding voting securities or more than 10 percent of the total value of securities of a single issuer. In addition, taxable REIT subsidiaries owned by a REIT cannot represent more than 20 percent of the value of a REIT's assets. For purposes of the 10-percent value test, securities are generally defined to exclude safe harbor debt owned by a REIT. In addition, an exception to the limitation on ownership of securities of a single issuer applies in the case of a "taxable REIT subsidiary" that meets certain requirements. The Act also provides rules for the operation of hotels and health care facilities; defines "independent contractor" for certain purposes; modifies REIT distribution requirements to conform to the rules for regulated investment companies (RICs); modifies earnings and profits rules for RICs and REITs; and replaces the prior law adjusted basis comparison with a fair market comparison, in determining whether certain rents from personal property exceed a 15-percent limit. These provisions generally are effective for taxable years beginning after December 31, 2000, with transition for certain REIT holdings and leases in effect on July 12, 1999.

Modify estimated tax rules for closely held REITs.—If a person has a direct interest or a partnership interest in income-producing assets that produce income throughout the year, that person's estimated tax payments generally must reflect the quarterly amounts expected from the asset. However, a dividend distribution of earnings from a REIT is considered for estimated tax purposes when the dividend is paid. To take advantage of this deferral of estimated taxes, some corporations have established closely held REITS that may make a single distribution for the year, timed such that it need not be taken into account under the estimated tax rules as early as would be the case if the assets were directly held by the controlling entity. Effective for estimated tax payments due on or after November 15, 1999, with respect to a closely held REIT, this Act provides that any person owning at least 10 percent of the vote or value of the REIT is required to accelerate the recognition of year-end dividends attributable to the closely held REIT.

Other Provisions

Simplify foster child definition under the earned income tax credit (EITC).—This Act clarifies the definition of foster child for purposes of claiming the EITC. Effective for taxable years beginning after December 31, 1999, the foster child must be the taxpayer's sibling (or a descendant of the taxpayer's sibling), or be placed in the taxpayer's home by an agency of a State or one of its political subdivisions or a tax-exempt child placement agency licensed by a State.

Allow members of the clergy to revoke exemption from Social Security and Medicare coverage.—Under current law, ministers of a church who are opposed to participating in the Social Security and Medicare programs on religious principles may reject coverage by filing with the IRS before the tax filing date for their second year of work in the ministry. This Act provides an opportunity for members of the clergy to revoke their exemptions from Social Security and Medicare coverage during a 2-year period beginning January 1, 2000.

ADMINISTRATION PROPOSALS

The President's plan targets tax relief to provide assistance in obtaining higher education for working families, to relieve poverty and revitalize lower-income communities, and to make health care more affordable. The President's plan also provides relief from the marriage penalty and provides child-care assistance, promotes retirement savings, provides relief from the alternative minimum tax and other simplifications of the tax laws, encourages philanthropy, and offers assistance in bridging the digital divide. The President's plan also contains measures that will curtail the proliferation of corporate tax shelters, restrict the use of overseas tax havens, and close other loopholes and tax subsidies.

PROVIDE TAX RELIEF

Expand Educational Opportunities

Provide College Opportunity tax cut—Under current law, individuals may claim a Lifetime Learning credit equal to 20 percent of qualified tuition and related expenses up to $5,000 (increasing to $10,000 in 2003) incurred during the year for post-secondary education for the taxpayer, the taxpayer's spouse, or one or more dependents. The credit phases out for taxpayers filing joint returns with modified AGI from $80,000 to $100,000, and $40,000 to $50,000 for single taxpayers. The phase-out ranges will be adjusted for inflation occurring after 2000. To further assist taxpayers in obtaining post-secondary education throughout their lifetimes, the Administration proposes that the Lifetime Learning credit rate be increased to 28 percent. In addition, the phase-out range for the credit would be increased to $100,000 to $120,000 of modified AGI for joint returns and $50,000 to $60,000 of modified AGI for single taxpayers. To guarantee that all eligible taxpayers receive the full value of this education assistance, taxpayers may elect to deduct qualified tuition and related expenses instead of claiming the credit.

Provide incentives for public school construction and modernization.—The Administration proposes to institute a new program of Federal tax assistance for public elementary and secondary school construction or rehabilitation. Under the proposal, State and local governments (including U.S. possessions) would be able to issue up to $22 billion of "qualified school modernization bonds," $11 billion in each of 2001 and 2002. In addition, $200 million of qualified school modernization bonds in each of 2001 and 2002 would be allocated for the construction and renovation of Bureau of Indian Affairs funded schools. Holders of these bonds would receive annual Federal income tax credits, set according to market interest rates by the Treasury Department, in lieu of interest. Issuers would be responsible for repayment of principal. These qualified school modernization bonds would be similar to qualified zone academy bonds (QZABs), created by TRA97 and extended by the Ticket to Work and Work Incentives Improvement Act of 1999. QZABs allow bonds to be issued for certain public schools with the interest on the bonds effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of these bonds can be used for teacher training, purchases of equipment, curricular development, and rehabilitation and repair of the school facilities. The Administration proposes to authorize the issuance of additional QZABs of $1.0 billion in 2001 and $1.4 billion in 2002, and to allow the proceeds of these bonds also to be used for school construction.

Expand exclusion for employer-provided educational assistance to include graduate education.—Certain amounts paid by an employer for educational assistance provided to an employee currently are excluded from the employee's gross income for income and payroll tax purposes. The exclusion is limited to $5,250 of educational assistance with respect to an individual during a calendar year and applies whether or not the education is job-related. The exclusion currently is limited to undergraduate courses beginning before January 1, 2002. The exclusion previously applied to graduate courses that began before July 1, 1996. The Administration proposes to reinstate the exclusion for graduate education for courses beginning on or after July 1, 2000 and before January 1, 2002.

Eliminate 60-month limit on student loan interest deduction.—Current law provides an income tax deduction for certain interest paid on a qualified education loan during the first 60 months that interest payments are required, effective for interest due and paid after December 31, 1997. The maximum deduction available is $2,500 for years after 2000 (for years 1998, 1999 and 2000, the limits are $1,000, $1,500 and $2,000, respectively) and the deduction is phased out for taxpayers with AGI between $40,000 and $55,000 (between $60,000 and $75,000 for joint filers). The 60-month limitation under current law adds significant complexity and administrative burdens for taxpayers, lenders, loan servicing agencies, and the IRS. Thus, to simplify the calculation of deductible interest payments, reduce administrative burdens, and provide longer-term relief to low- and middle-income taxpayers with large educational debt, the Administration proposes to eliminate the 60-month limitation. This proposal would be effective for interest due and paid on qualified education loans after December 31, 2000.

Eliminate tax when forgiving student loans subject to income contingent repayment.—Students who borrow money to pay for postsecondary education through the Federal government's Direct Loan program may elect income contingent repayment of the loan. If they elect this option, their loan repayments are adjusted in accordance with their income. If after the borrower makes repayments for a twenty-five year period any loan balance remains, it is forgiven. The Administration proposes to eliminate any Federal income tax the borrower may otherwise owe as a result of the forgiveness of the loan balance. The proposal would be effective for loan cancellations after December 31, 2000.

Provide tax relief for participants in certain Federal education programs.—Present law provides tax-free treatment for certain scholarship and fellowship grants used to pay qualified tuition and related expenses, but not to the extent that any grant represents compensation for services. In addition, tax-free treatment is provided for certain discharges of student loans on condition that the individual works for a certain period of time in certain professions for any of a broad class of employers. To extend tax-free treatment to education awards under certain Federal programs, the Administration proposes to amend current law to provide that any amounts received by an individual under the National Health Service Corps (NHSC) Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program are "qualified scholarships" excludable from income, without regard to the recipient's future service obligation. In addition, the proposal would provide an exclusion from income for any repayment or cancellation of a student loan under the NHSC Scholarship Program, the Americorps Education Award Program, or the Armed Forces Health Professions Loan Repayment Program. The exclusion would apply only to the extent that the student incurred qualified tuition and related expenses for which no education credit was claimed during academic periods when the student loans were incurred. The proposal would be effective for awards received after December 31, 2000.

Provide Poverty Relief and Revitalize Communities

Increase and simplify the Earned Income Tax Credit (EITC).—Low- and moderate-income workers may be eligible for the EITC. For every dollar a low-income worker earns up to a limit, between 7 and 40 cents are provided as a tax credit. The applicable credit rate depends on the presence and number of children in the worker's family. Above $13,030 ($5,930 if the taxpayer does not reside with children), the size of the tax credit is gradually phased out. Although the EITC lifts millions out of poverty each year, poverty among children living in larger families remains at unacceptably high levels. Because the credit initially increases as income rises, the EITC rewards marriage for very low-income workers. But the EITC also causes marriage penalties among two-earner couples whose income falls in or above the credit's phase-out range. Further, while the EITC has been shown, on net, to increase work effort, phasing out the credit results in high marginal tax rates for recipients in the phase-out range. To address these problems, the Administration proposes that the credit rate be increased from 40 percent to 45 percent for families with three or more children. If both spouses work and earn at least $725, the credit would begin to phase out at $14,480 ($7,380 if the couple does not reside with children). For taxpayers with two or more children, the phase-out rate would be reduced from 21.06 percent to 19.06 percent.

Under current law, nontaxable earned income, such as 401(k) contributions, is included in earned income for purposes of calculating the EITC. To encourage retirement savings, simplify the calculation of earned income, and improve compliance, the Administration is proposing that these nontaxable forms of income would no longer count toward eligibility for the EITC. The proposal would be effective for taxable years beginning after December 31, 1999.

A proposed technical correction would clarify that taxpayers are eligible to receive the small credit for workers without qualifying children, if they cannot claim the credit for workers with children because their child does not have a social security number. The proposed change will also clarify that taxpayers may not receive any credit (even the small credit for workers without qualifying children), if their child is not taken into account because another taxpayer who may claim the child has higher modified AGI.

Increase and index low-income housing tax credit per-capita cap.—Low-income housing tax credits provide an incentive to build and make available affordable rental housing units to households with low incomes. The amount of the first-year credits that can be awarded in each State is currently limited to $1.25 per capita. That limit has not been changed since it was established in 1986. The Administration proposes to increase the annual State limitation to $1.75 per capita effective for calendar year 2001 and to index that amount for inflation, beginning with calendar year 2002. The proposed increases in this cap will permit additional new and rehabilitated low-income housing to be provided while still encouraging State housing agencies to award the credits to projects that best meet specific needs.

Provide New Markets Tax Credit.—Businesses located in low-income urban and rural communities often lack access to sufficient equity capital. To help attract new capital to these businesses, taxpayers would be allowed a credit against Federal income taxes for certain investments made to acquire stock or other equity interests in a community development investment entity selected by the Treasury Department to receive a credit allocation. Selected community development investment entities would be required to use the investment proceeds to provide capital to businesses located in low-income communities. During the period 2001-2005, the Treasury Department would authorize selected community development investment entities to issue $15 billion of new stock or equity interests with respect to which credits could be claimed. The credit would be allowed for each year during the five-year period after the stock or equity interest is acquired from the selected community development investment entity, and the credit amount that could be claimed for each of the five years would equal six percent of the amount paid to acquire the stock or equity interest from the community development investment entity. The credit would be subject to current-law general business credit rules, and would be available for qualified investments made after December 31, 2000.

Expand Empowerment Zone (EZ) tax incentives and authorize additional EZs.—The Omnibus Budget Reconciliation Act of 1993 (OBRA93) authorized a Federal demonstration project in which nine EZs and 95 empowerment communities were designated in a competitive application process. Among other benefits, businesses located in the nine original EZs are eligible for four Federal tax incentives: an employment wage credit; an additional $20,000 per year of section 179 expensing; a new category of tax-exempt private activity bonds; and "brownfields" expensing for certain environmental remediation expenses. The Taxpayer Relief Act of 1997 (TRA97) authorized the designation of two additional EZs, which generally are eligible for the same tax incentives that are available within the EZs authorized by OBRA93. In addition, TRA97 authorized the designation of another 20 EZs (so-called "Round II EZs") that are eligible for the same tax incentives (other than the employment wage credit) available in the 11 other EZs. To date, the EZ program has promoted significant economic development, but these communities still do not fully share in the nation's general prosperity. Therefore, the Administration proposes that the EZ program be extended and strengthened by making the employment wage credit available in all existing 31 EZs through 2009. Furthermore, the Administration proposes that, beginning in 2001, an additional $35,000 (rather than $20,000) per year of section 179 expensing be allowed in all EZs, and that enhanced tax-exempt financing benefits for private business activities be available in all EZs. (As described below, the Administration's budget proposes a permanent extension of the "brownfields" expensing for EZs and other targeted areas.) Finally, the Administration proposes that an additional 10 EZs be designated as of January 1, 2002. Businesses located within these 10 new EZs will be eligible for the full range of tax incentives available in the other EZs.

Provide Better America Bonds to improve the environment.—Under current law, State and local governments may issue tax-exempt bonds to finance purely public environmental projects. Certain other environmental projects may also be financed with tax-exempt bonds, but are subject to an overall cap on private-purpose tax-exempt bonds. The subsidy provided with tax-exempt bonds may not provide a deep enough subsidy to induce State and local governments to undertake beneficial environmental infrastructure projects. The Administration proposes to allow State and local governments (including U.S. possessions and Indian tribal governments) to issue tax credit bonds (similar to existing Qualified Zone Academy Bonds) to finance projects to protect open spaces or otherwise to improve the environment. Significant public benefits would be provided by creating more livable urban and rural environments; creating forest preserves near urban areas; protecting water quality; rehabilitating land that has been degraded by toxic or other wastes or destruction of its ground cover; improving parks; and reestablishing wetlands. A total of $2.15 billion of bond authority would be authorized for each of the five years beginning in 2001. The Environmental Protection Agency, in consultation with other agencies, would allocate the bond authority based on competitive applications. The bonds would have a maximum maturity of 15 years and the bond issuer effectively would receive an interest-free loan for the term of the bonds. During that interval, bond holders would receive Federal income tax credits in lieu of interest.

Permanently extend the expensing of brownfields remediation costs.—Under TRA97, taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital accounts as deductible in the year paid or incurred. The provision does not apply to expenditures paid or incurred after December 31, 2001. The Administration proposes that the provision be made permanent.

Expand tax incentives for specialized small business investment companies (SSBICs).—Current law provides certain tax incentives for investment in SSBICs. The Administration proposes to enhance the tax incentives for SSBICs. First, the existing provision allowing a tax-free rollover of the proceeds of a sale of publicly-traded securities into an investment in a SSBIC would be modified to extend the rollover period to 180 days, to allow investment in the preferred stock of a SSBIC, to eliminate the annual caps on the SSBIC rollover gain exclusion, and to increase the lifetime caps to $750,000 per individual and $2,000,000 per corporation. Second, the proposal would allow a SSBIC to convert from a corporation to a partnership within 180 days of enactment without giving rise to tax at either the corporate or shareholder level, but the partnership would remain subject to an entity-level tax upon ceasing activity as a SSBIC or at any time that it disposes of assets that it holds at the time of conversion on the amount of "built-in" gains inherent in such assets at the time of conversion. Third, the proposal would make it easier for a SSBIC to meet the qualifying income, distribution of income, and diversification of assets tests to qualify as a tax-favored regulated investment company. Finally, in the case of a direct or indirect sale of SSBIC stock that qualifies for treatment under section 1202, the proposal would raise the exclusion of gain from 50 percent to 60 percent. The tax-free rollover and section 1202 provisions would be effective for sales occurring after the date of enactment. The regulated investment company provisions would be effective for taxable years beginning on or after the date of enactment.

Bridge the Digital Divide

Encourage sponsorship of qualified zone academies and technology centers.—Under current law, State and local governments can issue qualified zone academy bonds to fund improvements in certain "qualified zone academies" which provide elementary or secondary education. To encourage corporations to become sponsors of such academies and technology centers, a tax credit would be provided equal to 50 percent of the amount of corporate sponsorship payments made to a qualified zone academy, or a public library or community technology center, located in (or adjacent to) a designated empowerment zone or enterprise community. The credit would be available for corporate cash contributions, but only if a credit allocation has been made with respect to the contribution by the local governmental agency with responsibility for implementing the strategic plan of the empowerment zone or enterprise community. Up to $8 million of credits could be allocated with respect to each of the existing 31 empowerment zones (and each of the 10 additional empowerment zones proposed to be designated under the Administration's budget); and up to $2 million of credits could be allocated with respect to each of the designated enterprise communities. The credit would be subject to the current-law general business credit rules, and would be effective for sponsorship payments made after December 31, 2000.

Extend and expand enhanced deduction for corporate donations of computers.—The current-law enhanced deduction for contributions of computer technology and equipment for elementary or secondary school purposes is scheduled to expire for taxable years beginning after December 31, 2000. The Administration proposes extending this provision through June 30, 2004. In addition, to promote access of all persons to computer technology and training, the enhanced deduction would be expanded to apply to contributions of computer equipment to a public library or community technology center located in a designated empowerment zone or enterprise community, or in a census tract with a poverty rate of 20 percent or more.

Provide tax credit for workplace literacy, basic education, and basic computer skills training.—Under current law, employers may deduct the costs of providing workplace literacy, basic education, and basic computer skill programs to employees, but no tax credits are allowed for any employer-provided education. As a result, employers lack sufficient incentive to provide basic education programs, the benefits of which are more difficult for employers to capture through increased productivity than the benefits of job-specific education. The Administration proposes to allow employers who provide certain workplace literacy, English literacy, basic education, or basic computer training for their eligible employees to claim a credit against Federal income taxes equal to 20 percent of the employer's qualified expenses, up to a maximum credit of $1,050 per participating employee. Qualified education would be limited to basic instruction at or below the level of a high school degree, English literacy instruction, or basic computer skills. Eligible employees in basic education or computer training generally would not have received a high school degree or its equivalent. Instruction would be provided either by the employer, with curriculum approved by the State Adult Education Authority, or by local education agencies or other providers certified by the Department of Education. The credit would be available for taxable years beginning after December 31, 2000.

Make Health Care More Affordable

Assist taxpayers with long-term care needs.—Current law provides a tax deduction for certain long-term care expenses. However, the deduction does not assist with all long-term care expenses, especially the costs of informal family caregiving. The Administration proposes to provide a new long-term care tax credit of $3,000. The credit could be claimed by a taxpayer for himself or herself or for a spouse or dependent with long-term care needs. To qualify for the credit, an individual with long-term care needs must be certified by a licensed physician as being unable for at least six months to perform at least three activities of daily living without substantial assistance from another individual due to loss of functional capacity. An individual may also qualify if he or she requires substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and has difficulty with one or more activities of daily living or certain other age-appropriate activities. For purposes of the proposed credit, the current-law dependency tests would be liberalized, raising the gross income limit and allowing taxpayers to use a residency test rather than a support test. The credit would be phased out in combination with the child credit and the disabled worker credit for taxpayers with AGI in excess of the following thresholds: $110,000 for married taxpayers filing a joint return, $75,000 for a single taxpayer or head of household, and $55,000 for married taxpayers filing a separate return. The credit would be phased in at $1,000 in 2001, $1,500 in 2002, $2,000 in 2003, $2,500 in 2004, and $3,000 in 2005 and subsequent years.

Encourage COBRA continuation coverage.—Current law provides a tax preference for employer-provided group health plans, but not for individually purchased health insurance coverage except to the extent that medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. The Administration proposes to make health insurance more affordable for workers in transition and for retiring workers by providing a nonrefundable tax credit for the purchase of COBRA coverage. Individuals would receive a 25-percent tax credit for their own contributions towards COBRA coverage. The proposal would be effective for taxable years beginning after December 31, 2001.

Provide tax credit for Medicare buy-in program.—The Administration proposes to make health insurance more affordable for older workers, retirees and displaced workers by providing a 25-percent nonrefundable tax credit for individuals purchasing health insurance through a newly created Medicare buy-in program. Under a separate proposal, all individuals at least sixty-two years of age and under sixty-five years of age, and workers displaced from their jobs who are at least fifty-five years of age and under sixty-two years of age, would be eligible to buy into Medicare. Taxpayers would be eligible for a credit of 25 percent of premiums paid under the Medicare buy-in program prior to age sixty-five. The proposal would be effective for taxable years beginning after December 31, 2001.

Provide tax relief for workers with disabilities.—Under current law, disabled taxpayers may claim an itemized deduction for impairment-related work expenses. The Administration proposes to allow disabled workers to claim a $1,000 credit. This credit would help compensate people with disabilities for both formal and informal costs associated with work (e.g., personal assistance to get ready for work or special transportation). In order to be considered a worker with disabilities, a taxpayer must submit a licensed physician's certification that the taxpayer has been unable for at least 12 months to perform at least one activity of daily living without substantial assistance from another individual. A severely disabled worker could potentially qualify for both the proposed long-term care and disabled worker tax credits. The credit would be phased out in combination with the child credit and the proposed long-term care credit for taxpayers with AGI in excess of the following thresholds: $110,000 for married taxpayers filing a joint return, $75,000 for a single taxpayer or head of household, and $55,000 for married taxpayers filing a separate return. The proposal would be effective for taxable years beginning after December 31, 2000.

Provide tax relief to encourage small business health plans.—Small businesses generally face higher costs in establishing and operating health plans than do larger employers. Health benefit purchasing coalitions provide an opportunity for small businesses to offer a greater choice of health plans to their workers and to purchase health insurance at a reduced cost. The formation of these coalitions, however, has been hindered by limited access to capital. The Administration proposes to establish a temporary, special tax rule in order to facilitate the formation of health benefit purchasing coalitions. The special rule would facilitate private foundation grants and loans to fund initial operating expenses of qualified coalitions by treating such grants and loans as being made for exclusively charitable purposes. The special foundation rule would apply to grants and loans made prior to January 1, 2009 for initial operating expenses incurred prior to January 1, 2011. In addition, in order to encourage the use of qualified coalitions by small businesses, the Administration proposes a temporary tax credit for small employers that currently do not provide health insurance to their workforces. The credit would equal 20 percent of small employer contributions to employee health plans purchased through a qualified coalition. The credit would be available to employers with at least two, but not more than 50 employees, counting only employees with annual compensation of at least $10,000 in the prior calendar year. The maximum per policy credit amount would be $400 per year for individual coverage and $1,000 per year for family coverage. The credit would be allowed with respect to employer contributions made during the first 24 months that the employer purchases health insurance through a qualified coalition, and would be subject to the overall limitations of the general business credit. The proposed credit would be effective for taxable years beginning after December 31, 2000 for health plans established before January 1, 2009.

Encourage development of vaccines for targeted diseases.—The proposed tax credit would encourage development of new vaccines for diseases that occur primarily in developing countries by providing a market for successful vaccines. The proposal would provide a credit against Federal income taxes for sales of a qualifying vaccine to a qualifying organization. The credit would equal 100 percent of the amount paid by the qualifying organization. A qualifying organization would be a nonprofit organization that purchases and distributes vaccines for developing countries. A qualifying vaccine would be a vaccine for targeted diseases that receives FDA approval as a new drug after the date of enactment. The targeted diseases would include malaria, tuberculosis, HIV/AIDS, and certain other infectious diseases. The credit would be available only if a credit allocation has been made with respect to the sale of a qualifying vaccine to a qualifying organization by the U.S. Agency for International Development (AID). For the period 2002 - 2010, AID would be allowed to designate up to $1 billion of sales as eligible for the credit ($100 million per year for 2002 through 2006 and $125 million per year for 2007 through 2010). Unallocated amounts for any year would be carried over and available for allocation in the ten following years.

Strengthen Families and Improve Work Incentives

Provide marriage penalty relief and increase standard deduction.—Under current law, the standard deduction for single filers is estimated to be $4,500 in 2001. For married couples who file joint individual returns, the standard deduction will be $7,550, which is less than the combined amount for two single individuals. To reduce marriage penalties, the Administration proposes to increase the standard deduction for two-earner couples to double the amount of the standard deduction for single filers. The increase would be phased in evenly over five years. When fully phased in, the increase (at 2001 levels) would be $1,450. In addition, beginning in 2005, the Administration proposes to increase the standard deduction by $250 for single filers, $350 for heads of household, and $500 for joint filers.

Increase, expand, and simplify child and dependent care tax credit.—Under current law, taxpayers may receive a nonrefundable tax credit for a percentage of certain child care expenses they pay in order to work. The credit rate is phased down from 30 percent of expenses (for taxpayers with AGI of $10,000 or less) to 20 percent (for taxpayers with AGI above $28,000). The Administration believes that the maximum credit rate is too low. Moreover, because it is nonrefundable, many families who have significant child care costs and relatively low incomes are not eligible for the maximum credit. To alleviate the burden of child care costs for these families, the Administration proposes to make the credit refundable. Under the proposal, the maximum credit rate would be increased from 30 percent to 40 percent in 2003, and to 50 percent in 2005 and subsequent years. The credit would become refundable in 2003. Eligibility for the maximum credit rate would be extended to taxpayers with AGI of $30,000 or less. The credit rate would be reduced by one percentage point for every $1,000 of AGI above $30,000 but would not be less than 20 percent.

Under current law, no additional tax assistance under the child and dependent care tax credit is provided to families with infants, who require intense and sustained care. Furthermore, parents who themselves care for their infants, instead of incurring out-of-pocket child care expenses, receive no benefit under the child and dependent care tax credit. In order to provide assistance to these families, the Administration proposes to supplement the credit with an additional, nonrefundable credit for all taxpayers with children under the age of one, whether or not they incur out-of-pocket child care expenses. The amount of additional credit would be the applicable credit rate multiplied by $500 for a child under the age of one ($1,000 for two or more children under the age of one).

The Administration also proposes to simplify eligibility for the credit by eliminating a complicated household maintenance test. Certain credit parameters would be indexed. The proposal would be effective for taxable years beginning after December 31, 2000.

Provide tax incentives for employer-provided child-care facilities.—The Administration proposes to provide taxpayers a credit equal to 25 percent of expenses incurred to build or acquire a child care facility for employee use, or to provide child care services to children of employees directly or through a third party. Taxpayers also would be entitled to a credit equal to 10 percent of expenses incurred to provide employees with child care resource and referral services. A taxpayer's credit could not exceed $150,000 in a single year. Any deduction the taxpayer would otherwise be entitled to take for the expenses would be reduced by the amount of the credit. Similarly, the taxpayer's basis in a facility would be reduced to the extent that a credit is claimed for expenses of constructing or acquiring the facility. The credit would be effective for taxable years beginning after December 31, 2000.

Promote Expanded Retirement Savings, Security, and Portability

The Administration proposes further expansions of retirement savings incentives, including initiatives that would expand retirement plan coverage and other workplace-based savings opportunities, particularly for moderate- and lower-income workers not currently covered by employer-sponsored plans. Many of the new provisions are focused on employees of small businesses, a group that currently has low pension coverage. Other proposals enhance the fairness of plans by improving existing retirement plans for employers of all sizes, increase retirement security for women, promote portability, expand workers' and spouses' rights to know about their retirement benefits, and simplify pension rules. These provisions generally are effective for taxable years beginning after 2000.

Encourage Retirement Savings

The Administration proposes two major initiatives designed to encourage retirement savings for moderate- and lower-income workers.

Establish Retirement Savings Accounts.—Current law tax incentives to save through Individual Retirement Accounts (IRAs) and pensions provide little impetus to saving by moderate- and lower-income workers. The Administration's proposal would create Retirement Savings Accounts, in which participants' voluntary contributions are matched by employers or financial institutions. The match will be provided in the form of a tax credit. Participation by financial institutions and taxpayers would be voluntary. Financial institutions could also claim a $10 tax credit to defray the administrative costs of establishing each new account.

Under the proposal, eligible taxpayers would qualify for a match. Participants would make voluntary contributions to an account at a participating financial institution or employer-sponsored qualified retirement plan. Workers would receive a basic match of as much as 100 percent for up to $1,000 in contributions ($500 from 2002 to 2004). They would also qualify for a supplemental match of up to $100 for the first $100 contributed to the account.

The basic match phases down to 20 percent for taxpayers with AGI in the following ranges: between $25,000 and $50,000 ($20,000 and $40,000 from 2002 to 2004) for married taxpayers filing a joint return, $18,750 to $37,500 ($15,000 to $30,000 from 2002 to 2004) for taxpayers filing a head-of-household return, and $12,500 to $25,000 ($10,000 to $20,000 from 2002 to 2004) for single taxpayers. The supplemental match phases out over the same income ranges. The 20 percent basic match is available for taxpayers with AGI up to $80,000 ($40,000 from 2002 to 2004) on joint returns, $60,000 ($30,000 from 2002 to 2004) on head-of-household returns and $40,000 ($20,000 from 2002 to 2004) on single returns.

Taxpayers with at least $5,000 in earnings (which could be joint earnings for married taxpayers filing a joint return) and aged 25 to 60 would be eligible for the match. Withdrawals for certain special purposes would be permitted after five years; withdrawals for other purposes would not be permitted until retirement. The tax treatment would be similar to that afforded deductible IRAs or contributions to employer pensions: contributions would be excludable from income, earnings would not be taxed, but withdrawals would be included in taxable income.

The credits would be effective for tax years beginning after December 31, 2001.

Provide small business tax credit for automatic contributions for non-highly compensated employees.—Small employers could claim a nonrefundable tax credit equal to 50 percent of qualifying contributions made on behalf of non-highly compensated employees. Qualifying contributions are nonelective contributions to defined contribution plans of at least one percent of pay and nonelective or matching contributions of up to an additional two percent of pay (for a total of three percent of pay). Alternatively, qualifying contributions could be benefits accrued under a non-integrated defined benefit plan if equivalent to a three-percent nonelective contribution (in accordance with regulations that could provide simplified methods for defined benefit plans to qualify for the credit). Contributions must be vested at least as fast as either a three-year cliff or five-year graded schedule, must be subject to withdrawal restrictions, and must be allocated in proportion to pay. Credits claimed for subsequently forfeited contributions would be subject to recapture at a rate of 35 percent. An employer could claim the credit for three years. The credit would be effective for tax years beginning after December 31, 2001 and ending on or before December 31, 2009.

Expand Pension Coverage for Employees of Small Business

The Administration proposes a number of other incentives to encourage the adoption of retirement plans by small employers, generally those that have 100 or fewer employees with $5,000 or more of compensation in the preceding year.

Provide tax credit for plan start up and administrative expenses.—The Administration proposes a three-year tax credit for the administrative and retirement education expenses of any small business that sets up a new qualified defined benefit or defined contribution plan (including a 401(k) plan), savings incentive match plan for employees (SIMPLE), simplified employee pension (SEP), or payroll deduction IRA arrangement. The credit would cover 50 percent of the first $2,000 in administrative and retirement education expenses for the plan or arrangement for the first year of the plan and 50 percent of the first $1,000 of such expenses for each of the second and third years. The tax credit would help promote new plan sponsorship by targeting a tax benefit to employers adopting new plans or payroll deduction IRA arrangements, providing a marketing tool to financial institutions and advisors promoting new plan adoption, and increasing awareness of retirement savings options. The credit would be available for plans established after 1998 and before 2010.

Provide for payroll deduction IRAs.—Employers could offer employees the opportunity to make IRA contributions on a pre-tax basis through payroll deduction. Providing employees an exclusion from income (in lieu of a deduction) is designed to increase saving among workers in businesses that do not offer a retirement plan. Signing up for payroll deduction is easy for an employee. In addition, saving is facilitated because it becomes automatic as salary reduction contributions continue each paycheck after an employee’s initial election. Peer group participation may also encourage employees to save more. Finally, the favorable tax treatment of salary reductions would encourage participation.

Provide for the SMART plan.—In addition to tax credits for qualified retirement plans, the Administration is proposing a new small business defined benefit type plan (the “SMART” plan) for calendar years beginning after 2000. The SMART plan combines certain key features of defined benefit plans and defined contribution plans: guaranteed minimum retirement benefits, an option for payments over the course of an employee’s retirement years, and Pension Benefit Guaranty Corporation insurance, together with individual account balances that can benefit from favorable investment returns and have enhanced portability.

Enhance the 401(k) SIMPLE plan.—The Administration proposes expanding the small business 401(k) SIMPLE plan and making it significantly more flexible without sacrificing fairness in the allocation of contributions to moderate- and lower-wage employees. The proposal would make three major changes to the existing 401(k) SIMPLE plan nonelective contribution alternative. First, non-highly compensated employees would be permitted to contribute up to $10,500 a year. Second, the employer’s options under a 401(k) SIMPLE plan would be expanded: instead of being required to make a two-percent nonelective employer contribution (with a $6,000 employee contribution limit), employers could opt to make a one-percent, two-percent, three-percent or higher nonelective employer contribution (subject to the requirement that all eligible employees receive the same rate of nonelective contribution). The one-percent 401(k) SIMPLE plan would allow highly compensated employees to contribute up to $3,000 to the plan if the employer made a non-integrated, fully vested, withdrawal-restricted one-percent automatic contribution on behalf of all employees. The proposal would not change the current-law two-percent 401(k) SIMPLE plan, with its $6,000 contribution limit, except to restrict application of the $6,000 limit to highly compensated employees, allowing others to contribute up to $10,500. In addition, as is the case under current law with the 401(k) nonelective safe harbor, an employer could make a three-percent (or greater) nonelective contribution, permitting all employees, including highly compensated ones, to contribute up to $10,500. Third, employers would have the flexibility to wait until as late as December 1 of the year for which the contribution is made to assess their financial situation for the year and decide on the level of their nonelective contribution.

Eliminate IRS user fees for small business plan determination letters.—The Administration proposes the elimination of user fees for requests made after the date of enactment for an initial determination letter from the IRS for a qualified retirement plan maintained by a small business. To obtain the relief, the request must be made during the first five plan years.

Permit certain S corporation shareholders and partners to borrow from plans.—S corporation shareholders and partners owning less than 20 percent of the business would be able to borrow from the employer's qualified retirement plan in which they participate under the same rules that apply to all qualified plan participants for loans first made or refinanced after 2000.

Enhance Fairness in Pension Plans

The Administration proposes modifications to the vesting rules, the contribution and deduction limits, and the 401(k) safe harbor plan rules to enhance the fairness of pensions to moderate- and lower-income workers.

Accelerate vesting for qualified plans.—The Administration proposes accelerating the current-law five-year (or seven-year graded) allowable vesting schedule for qualified retirement plans. Given the mobile nature of today's workforce, particularly of working women, there is a significant risk that many participants will leave employment before fully vesting in their retirement benefits. Under the proposal, plans would be required to provide that an employee would be fully vested after completing three years of service or would vest in annual 20 percent increments beginning after one year of service. In addition, time off under the Family and Medical Leave Act (FMLA) of up to 12 weeks of unpaid leave to care for a new child, to care for a family member who has a serious health condition, or because the worker has a serious health condition would be included in service for determining retirement plan vesting and eligibility to participate in the plan.

Modify contribution and annual addition limitations.—The deduction limits for profit sharing plans and the percentage-of-pay limitations of defined contribution plans would be liberalized to ensure that non-highly compensated employees' benefits are not inappropriately limited. The general 15-percent deduction limit for stock bonus and profit sharing plans would be increased by the amount of elective contributions on behalf of non-highly compensated employees participating in the plan that exceed, in the aggregate, 15 percent of compensation otherwise paid or accrued on behalf of such non-highly compensated employees. For purposes of determining the employer's deduction under the combined plan limit that applies when an employer has both a pension plan and a stock bonus or profit sharing plan in which the same employee participates, elective contributions on behalf of non-highly compensated employees would be disregarded. In addition, the 15-percent-of-compensation deduction limit would be further liberalized by treating certain salary reduction amounts as compensation in determining the deduction limits. The proposal also would increase the maximum allowable annual addition for defined contribution plans from 25 percent to 35 percent of compensation.

Expand coverage of non-highly compensated employees under 401(k) safe harbor plans.—The Administration would modify the section 401(k) matching formula safe harbor by requiring that, in addition to the matching contribution, either (1) the employer make a contribution of one percent of compensation for each eligible non-highly compensated employee, regardless of whether the employee makes elective contributions, or (2) the plan provide for current and newly hired employees to be automatically enrolled in the 401(k) plan at a three-percent contribution rate (where employees can elect other rates, including zero contribution). The proposal would also permit nonelective contributions to replace matching contributions in the 401(k) matching formula safe harbor.

Simplify the definition of highly compensated employee.—The Administration proposes to simplify the definition of highly compensated employee by eliminating the top-paid group election. Under the simplified definition, an employee would be treated as highly compensated if the employee (1) was a five-percent owner at any time during the year or the preceding year, or (2) had compensation in excess of $80,000 (as adjusted) for the preceding year.

Clarify the division of Section 457 assets upon divorce.—To make consistent the treatment of retirement benefits upon divorce, the Administration proposes to extend to section 457(b) plans the qualified domestic relations order (QDRO) regime that applies to distributions from a qualified plan made to a spouse, former spouse or alternate payee. Accordingly, the proposal would not tax the employee on distributions from a section 457(b) plan made to an alternate payee pursuant to a QDRO and also clarifies that a section 457(b) plan will not be treated as violating the restrictions on distributions when it honors the terms of a QDRO.

Offer joint and 75-percent survivor annuity option.—Current law requires certain pension plans to offer to pay pension benefits as a joint and survivor annuity; frequently, the benefit for the surviving spouse is reduced to 50 percent of the monthly benefit paid when both spouses were alive. Under the proposal, plans that are subject to the joint and survivor annuity rules would be required to offer an option that pays a survivor benefit equal to at least 75 percent of the benefit the couple received while both were alive. This option would be especially helpful to women because they tend to live longer than men and because many aged widows have incomes below the poverty level.

Promote Retirement Savings Portability

The Administration proposes significant changes to promote the portability and encourage the preservation of retirement savings.

Encourage pension asset preservation by default rollover to IRA.—The direct rollover rules would be modified to encourage preservation of retirement assets by making a direct rollover the default option for eligible rollover distributions from a qualified retirement plan, section 403(b) annuity or governmental section 457(b) plan. The new rule would apply where a participant is entitled to an eligible rollover distribution from a qualified retirement plan, 403(b) annuity or governmental section 457(b) plan, the distribution is greater than $1,000, and the distribution is subject to nonconsensual cashout under the plan (i.e, does not exceed $5,000 or is made after normal retirement age). In these circumstances, the distribution would be required to be directly rolled over to an eligible retirement plan (including an IRA), unless the participant affirmatively elects to receive the distribution in cash. For convenience, the rollover IRA could be designated when the employee becomes a participant in the plan; alternatively, it could be designated at termination of employment. If the participant fails to designate a rollover plan or IRA and does not affirmatively elect to receive the distribution in cash, then involuntary cashout amounts could be transferred to an IRA designated by the payor (for the benefit of the participant) or, at the election of the plan sponsor, retained in the plan.

Expand permitted rollovers of employer-provided retirement savings.—Under current law, rollovers are not allowed between qualified retirement plans, section 403(b) tax-sheltered annuities and governmental section 457(b) plans. The Administration proposes that an eligible rollover distribution from a qualified retirement plan, a section 403(b) tax-sheltered annuity, or a governmental section 457(b) plan could be rolled over to a traditional IRA, a qualified retirement plan, a section 403(b) annuity, or a governmental section 457(b) plan. Amounts distributed from a governmental section 457(b) plan would be subject to the early withdrawal tax to the extent the distribution consists of amounts attributable to rollovers from another type of plan. A governmental section 457(b) plan would be required to separately account for such amounts. To facilitate the preservation of the retirement savings of participants in governmental section 457(b) plans and to rationalize the treatment of different types of broad-based retirement plans, the Administration also proposes to extend the direct rollover and withholding rules to governmental section 457(b) plans. These plans, like qualified plans, would be required to provide written notification to participants regarding eligible rollover distributions (but would not be required to accept rollovers). Finally, the proposal would allow eligible rollover distributions to be rolled over from a qualified trust sponsored by a previous employer to a Federal employee's Thrift Savings Plan (TSP) account.

Permit consolidation of retirement savings.—The Administration's proposal would allow individuals to consolidate their IRA funds and their workplace retirement savings in a single fund. Individuals who have IRAs with deductible IRA contributions would be permitted to transfer funds from their IRAs to their qualified defined contribution retirement plan, 403(b) tax-sheltered annuity or governmental section 457(b) plan, provided that the retirement plan trustee could qualify as an IRA trustee. In addition, the proposal would allow individuals to roll over after-tax IRA or employer plan contributions to their new employer's defined contribution plan or to an IRA if the plan or IRA provider agrees to track and report the after-tax portion of the rollover for the individual. Finally, surviving spouses would be permitted to roll over distributions to a qualified plan, 403(b) annuity or governmental section 457(b) plan.

Allow purchase of service credits in governmental defined benefit plans.—Employees of State and local governments, particularly teachers, often move between states and school districts in the course of their careers. Under State law, they often can purchase service credits in their State defined benefit pension plans for time spent in another state or district and earn a pension reflecting a full career of employment in the state in which they conclude their career. Under current law, these employees cannot make a tax-free transfer of the money they have saved in their 403(b) plan or governmental 457(b) plan to purchase these credits and often lack other resources to use for this purpose. Under the proposal, State and local government employees would be able to use funds from these retirement savings plans to purchase service credits through a direct transfer without first having to take a taxable distribution of these amounts.

Allow immediate participation in Federal Thrift Savings Plan (TSP).—Under the Administration's proposal, all waiting periods for Federal employees' participation in TSP (including matching and nonelective contributions) would be eliminated for new hires and rehires.

Improve Pension Security

The Administration proposes a number of changes to improve pension security in defined benefit plans.

Modify pension plan deduction rules.—For defined benefit plans, the change in the full funding limitation based on current liability would be phased in more quickly, so that this limitation would be 170 percent of current liability for years beginning after December 31, 2003. In addition, the ten-percent excise tax on nondeductible contributions would not apply to the extent a contribution is nondeductible solely as a result of the current liability full funding limit. The special deduction rule for terminating plans would be modified so that, at plan termination, all contributions needed to satisfy the plan's liabilities would be immediately deductible. In the case of a plan with fewer than 100 participants, liabilities attributable to recent benefit increases for highly compensated employees would be disregarded for this purpose.

Simplify full funding limitation for multiemployer plans.—The limit on deductible contributions based on a specified percentage of current liability would be eliminated for multiemployer defined benefit plans. Therefore, the annual deduction for contributions to such a plan would be limited to the amount by which the plan's accrued liability exceeds the value of the plan's assets.

Modify defined benefit limit rules for multiemployer plans.—Defined benefit limits applicable to multiemployer defined benefit plans would be modified to eliminate the 100-percent-of-compensation limit (but not the $135,000 limit) for such plans. In addition, the special early retirement provisions for determining the defined benefit limit that currently apply to defined benefit plans sponsored by governments, tax-exempt organizations and merchant marine would be expanded to include multiemployer plans. Finally, the rule requiring aggregation of benefits provided from a single employer for purposes of the defined benefit limit would be modified so as not to require aggregation of a multiemployer defined benefit plan and a single employer defined benefit plan for purposes of the 100-percent-of-compensation limit.

Increase Disclosure and Right to Know

The Administration proposes to improve disclosure to workers and their spouses.

Improve disclosure for plan amendments that significantly reduce future benefit accruals.—The Administration's proposal would strengthen the existing disclosure requirements that apply when a pension plan is amended to significantly reduce the rate of future benefit accrual. The proposal would require that the notice summarize the important terms of the amendment, including identification of the effective date of the amendment, a statement that the amendment is expected to significantly reduce the rate of future benefit accrual, a general description of how the amendment significantly reduces the rate of future benefit accrual, and a description of the class or classes of participants to whom the amendment applies. Participants must receive the notice at least 45 days before the effective date of the plan amendment. If the plan has at least 100 active participants, the plan administrator would also be required to provide affected participants an enhanced advance notice of the amendment that describes, and illustrates using specific examples, the impact of the amendment on representative affected participants; to make available the formulas and factors used in those examples in order to permit similar calculations to be made; and to make available a follow-up individualized benefit statement estimating the participant's projected retirement benefits. Regulations could exempt certain amendments, such as amendments that do not make a fundamental change in a plan's formula.

Pension "right-to-know" proposals.—The Administration's proposal would enhance workers' and spouses' rights to know about their pension benefits by, among other things, requiring that the same explanation of a pension plan's survivor benefits that is provided to a participant be provided to the participant's spouse.

Provide AMT Relief for Families and Simplify the Tax Laws

Provide adjustments for personal exemptions and the standard deduction in the individual alternative minimum tax (AMT).—The Administration is concerned that the AMT imposes financial and compliance burdens upon taxpayers that have few preference items and were not the originally intended targets. In particular, the Administration is concerned that the individual AMT may act to erode the benefits of dependent personal exemptions and standard deductions that are intended to provide relief for middle-income taxpayers—especially those with larger families. For example, under current law, a couple with five children and $70,000 of income that claims the standard deduction would be subject to the AMT in 2000. In response, the Administration proposes to phase out the tax preference status of dependent exemptions under the AMT; that is, when fully phased in, claiming children as personal exemptions on a tax return would not cause a taxpayer to be subject to the AMT. For tax years 2000 through 2007, only the first two dependent exemptions would be AMT preference items; in 2008 and 2009, only the first exemption would be a preference; in 2010 and thereafter, dependent exemptions would no longer be treated as an AMT preference. The Administration also proposes to allow taxpayers who claim the standard deduction for regular income tax purposes to claim the same standard deduction for AMT purposes for tax years 2000 and 2001. That provision would complement the provision enacted in 1999 that allows the use of personal credits against the AMT through 2001.

Simplify and increase standard deduction for dependent filers.—Currently, the standard deduction for tax filers who can be claimed as dependents by another taxpayer is the smaller of the standard deduction for single taxpayers ($4,400 for tax year 2000) or the special standard deduction for dependent filers. The special standard deduction is the larger of (1) $700 (for tax year 2000) or (2) the individual's earned income plus $250 (for tax year 2000). The current provision requires dependents to file a tax return if they have at least $250 of interest and dividends from their savings and their earnings plus income from savings is at least $700. To simplify the standard deduction and increase it for dependent filers, the Administration proposes that, beginning in 2000, the standard deduction for dependent filers would be the individual's earned income plus $700 (indexed after 2000), but not more than the regular standard deduction. This proposal would reduce the number of dependent filers required to file a tax return by 400,000 and simplify filing for other dependents with earned income.

Replace support test with residency test (limited to children).—Under current law, taxpayers must provide over half the support of individuals claimed as dependents on their tax return. Under the proposal, taxpayers would be allowed to claim their children as dependents by meeting a residency test instead of a support test. If the child is 18 or younger (23 or younger if a full-time student) and is the taxpayer's son, daughter, stepchild, or grandchild, then the support test may be waived if the taxpayer lives with the child for over half the year. A twelve-month test would apply to foster children. If more than one taxpayer could claim the child as a dependent under the proposed rule, the taxpayer with the highest AGI would be entitled to the dependency exemption. The proposal would be effective for taxable years beginning after December 31, 2000.

Index maximum exclusion for capital gains on sale of principal residence.—Under current law, taxpayers can generally exclude up to $250,000 ($500,000 for married taxpayers filing joint returns) of gain on the sale of a principal residence. To be eligible for the full exclusion, the taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years preceding the sale. A taxpayer may claim the deduction only once in any two-year period. Under the proposal, the maximum exclusion amounts would be indexed for inflation effective January 1, 2001. The proposal will prevent inflation from subjecting more taxpayers to tax when they sell their homes, and will prevent more taxpayers from having to maintain complex records regarding the cost of their homes.

Provide tax credit to encourage electronic filing of individual income tax returns.—Under current law, tax return preparation costs of individuals, including any costs of electronic filing, may be deducted only by taxpayers who itemize deductions and then only to the extent that such costs, in combination with most other miscellaneous itemized deductions, exceed two percent of AGI. The proposal would provide a temporary, refundable tax credit for the electronic filing of individual income tax returns. The credit would be for tax years 2001 through 2006 and would be $10 for each electronically filed return, and $5 for each TeleFile return (which are filed by entering information through the keypads of telephones). The credit would encourage taxpayers to try electronic return or Telefile submission, which reduces taxpayer errors and the need for subsequent contacts between the taxpayer and the IRS and which permits taxpayers to receive their tax refunds faster. The credit would help the IRS achieve the goal set in the 1998 IRS Restructuring and Reform Act of having 80 percent of 2006 returns filed electronically. No later than tax year 2002, the IRS would be required to offer one or more options to the public, through contract arrangements with the private sector, for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer.

Clarify the tax treatment of disabled workers in a sheltered workshop.—The Administration's proposal would provide a limited exclusion from the definition of "employment" for certain services rendered by disabled individuals in a sheltered workshop program effective the date of enactment. The exclusion would be limited to service (1) performed for a period of no more than 18 months under a minimum wage exemption certificate issued by the Department of Labor and (2) provided in a sheltered workshop operated by a section 501(c)(3) organization or a State or local government. However, organizations could voluntarily agree to provide coverage, pursuant to an agreement with the Social Security Administration. Corresponding changes would be made to the Social Security Act.

Simplify, retarget and expand expensing for small business.—In place of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $20,000 of the cost of qualifying property (generally depreciable tangible property) placed in service in taxable year 2000. The deductible amount rises to $24,000 in 2001 and 2002, and to $25,000 in 2003 and subsequent taxable years. The Administration proposes to increase the amount of investment that can be expensed to $25,000 in taxable year 2001; thereafter, this amount would be increased for inflation in increments of $1,000. In addition, the Administration proposes certain modifications to better target the applicability of expensing, to allow the deduction to be claimed at the entity level for flow-through businesses, and to make certain computer software eligible for expensing.

Provide optional Self-employment Contributions Act (SECA) computations.—Self-employed individuals currently may elect to increase their self-employment income for purposes of obtaining social security coverage. Current law provides more liberal treatment for farmers as compared to other self-employed individuals. The Administration proposes to extend the favorable treatment currently accorded to farmers to other self-employed individuals. The proposal would be effective for taxable years beginning after December 31, 2000.

Clarify rules relating to certain disclaimers.—Under current law, if a person refuses to accept (disclaims) a gift or bequest prior to accepting the transfer (or any of its benefits), the transfer to the disclaiming person generally is ignored for Federal transfer tax purposes. Current law is unclear as to whether certain transfer-type disclaimers benefit from rules applicable to other disclaimers under the estate and gift tax. Current law is also silent as to the income tax consequences of a disclaimer. The Administration proposes to extend to transfer-type disclaimers the rule permitting disclaimer of an undivided interest in property as well as the rule permitting a spouse to disclaim an interest that will pass to a trust for the spouse's benefit. The proposal also clarifies that disclaimers are effective for income tax purposes. The proposal would apply to disclaimers made after the date of enactment.

Simplify the foreign tax credit limitation for dividends from 10/50 companies.—TRA97 modified the regime applicable to indirect foreign tax credits generated by dividends from so-called 10/50 companies. Specifically, the Act retained the prior law "separate basket" approach with respect to pre-2003 distributions by such companies, adopted a "single basket" approach with respect to post-2002 distributions by such companies of their pre-2003 earnings, and adopted a "look-through" approach with respect to post-2002 distributions by such companies of their post-2002 earnings. The application of the three approaches results in significant additional complexity. The proposal would simplify the application of the foreign tax credit limitation significantly by applying a look-through approach immediately to dividends paid by 10/50 companies, regardless of the year in which the earnings and profits out of which the dividends are paid were accumulated (including pre-2003 years). The proposal would be effective for taxable years beginning after December 31, 1999.

Provide interest treatment for dividends paid by certain regulated investment companies to foreign persons.—Under current law, foreign investors in U.S. bond and money-market mutual funds are effectively subject to withholding tax on interest income and short term capital gains derived through such funds. Foreign investors that hold U.S. debt obligations directly generally are not subject to U.S. taxation on such interest income and gains. This proposal would eliminate the discrepancy between these two classes of foreign investors by eliminating the U.S. withholding tax on distributions from U.S. mutual funds that hold substantially all of their assets in cash or U.S. debt securities (or foreign debt securities that are not subject to withholding tax under foreign law). The proposal is designed to enhance the ability of U.S. mutual funds to attract foreign investors and to eliminate complications now associated with the structuring of vehicles for foreign investment in U.S. debt securities. The proposal would be effective for mutual fund taxable years beginning after the date of enactment.

Expand declaratory judgment remedy for non-charitable organizations seeking determinations of tax-exempt status. —Under current law, organizations seeking tax-exempt status as charities are allowed to seek a declaratory judgment as to their tax status if their application is denied or delayed by the IRS. A noncharity (an organization not described in section 501(c)(3)) that applies to the IRS for recognition of its tax-exempt status faces potential tax liability if its application ultimately is denied by the IRS. This creates uncertainty for the noncharity, particularly when the IRS determination is delayed for a significant period of time. To reduce this uncertainty, the declaratory judgment procedure available to charities under current-law section 7428 would be expanded, so that if the application of any organization seeking tax-exempt status under section 501(c) is pending with the IRS for more than 270 days, and the organization has exhausted all administrative remedies available within the IRS, then the organization could seek a declaratory judgment as to its tax-exempt status from the United States Tax Court. The proposal would be effective for applications for recognition of tax-exempt status filed after December 31, 2000.

Simplify the active trade or business requirement for tax-free spin-offs.—In order to satisfy the active trade or business requirement for tax-free spin-offs, split-offs, and split-ups, the distributing corporation and the controlled corporation both must be engaged in the active conduct of a trade or business. If a corporation is not itself active, it may satisfy the active trade or business test indirectly, but only if substantially all of its assets consist of stock and securities of a controlled corporation that is engaged in an active trade or business. Because the substantially all standard is much higher than that required if the corporation is active itself, a taxpayer often must engage in pre-distribution restructurings that it otherwise would not have undertaken. There is no clear policy reason that the standards for meeting the active trade or business requirement should differ depending upon whether a corporation is considered to be active on a direct or indirect basis. Therefore, the Administration proposes to simplify the requirement by removing the substantially all test and generally allowing an affiliated group to satisfy the active trade or business requirement as long as the affiliated group, taken as a whole, is considered active. This proposal would be effective for transactions after the date of enactment.

Modify translation of foreign withholding taxes by accrual basis taxpayers.—Under current law, taxpayers who take foreign income taxes into account when accrued generally are required to translate such taxes into dollars by using the average exchange rate for the taxable year to which such taxes relate. This rule was intended to be a simplification measure that would reduce the need for accrual basis taxpayers to redetermine the amount of foreign tax credits claimed with respect to foreign taxes accrued prior to the date of payment. This rule may not clearly reflect income, however, in the case of foreign withholding taxes paid by an accrual basis taxpayer, because such taxes are never accrued prior to the date the tax is paid (regardless of the taxpayer's method of accounting). Moreover, certain taxpayers that receive income subject to withholding taxes (such as regulated investment companies with a taxable year that differs from the calendar year) may find it impossible to comply with current law. The proposal would provide that foreign withholding taxes are to be translated at the spot rate on the date of payment, regardless of the method of accounting of the taxpayer. The proposal would be effective for taxable years beginning after the date of enactment.

Eliminate duplicate penalties for failure to file annual reports.—Employer penalties for failure to file an annual report would be simplified by eliminating the Internal Revenue Code penalties for a plan to which ERISA applies. Certain other ERISA reporting penalties would be modified or eliminated.

Clarify foreign tax credit rules to provide the circumstances under which a domestic corporation that owns a foreign corporation through a partnership will be eligible for the deemed-paid credit.—A domestic corporation that is a U.S. shareholder of a controlled foreign corporation (CFC) can claim deemed-paid foreign tax credits with respect to foreign taxes paid by the CFC on the subpart F income that the U.S. shareholder currently includes in income to the same extent that it would be so allowed if the subpart F inclusion were treated as an actual dividend distribution. To be eligible for the deemed-paid credit on an actual dividend distribution, a domestic corporation must own 10% or more of the voting stock of the foreign corporation from which it receives the dividend. Under current law, it is not clear how to apply the deemed-paid foreign tax credit rules when a foreign corporation is owned through a partnership. The proposal would provide that the deemed-paid credit is available to a domestic corporation that, through a partnership, owns 10% or more of the voting stock of a foreign corporation from which it receives its proportionate share of dividend income. This rule would apply to both foreign and U.S. partnerships. For purposes of this provision, a foreign partnership would be treated as a tier under the rule that allows the deemed-paid credit only with respect to taxes paid by foreign corporations that are not below the sixth tier.

Encourage Philanthropy

Allow deduction for charitable contributions by non-itemizing taxpayers.—To provide an incentive for taxpayers who use the standard deduction to make large charitable contributions, the Administration proposes a deduction for substantial charitable contributions made by taxpayers who do not itemize their deductions. Under current law, individual taxpayers who itemize their deductions generally may claim a deduction (subject to certain percentage limitations) for contributions made to qualified charitable organizations. However, individual taxpayers who elect the standard deduction (so-called "non-itemizers") may not claim a deduction for charitable contributions, although the standard deduction theoretically includes an allowance for moderate amounts of charitable giving. The proposal would allow taxpayers who are non-itemizers to deduct 50 percent of their charitable contributions in excess of $1,000 ($2,000 for married taxpayers filing jointly) for taxable years beginning after December 31, 2000 and before January 1, 2006. For taxable years beginning after December 31, 2005, non-itemizers would be allowed to deduct 50 percent of their charitable contributions in excess of $500 ($1,000 for married taxpayers filing jointly).

Simplify and reduce the excise tax on foundation investment income.—Under current law, private foundations generally are subject to a two-percent excise tax on their net investment income. In some cases, the excise tax rate is reduced to one percent, provided that current-year grantmaking by the foundation is determined under a complex formula to not fall below the average level of the foundation's grantmaking in the five preceding taxable years (with certain adjustments). This complex formula creates a perverse incentive for foundations not to significantly increase their grantmaking for charitable purposes in any particular year, because if a foundation does so, it becomes more difficult for the foundation to qualify for the reduced one-percent excise tax rate in subsequent years. Accordingly, the Administration proposes that the excise tax on private foundation investment income be simplified by reducing the general two-percent excise tax rate to a 1.25-percent excise tax rate that would apply in all cases. The complex formula for determining whether a foundation is maintaining its historic level of charitable grantmaking, and the special excise tax rate available to only some foundations, would be repealed. Thus, private foundations would not suffer adverse excise tax consequences if they respond to charitable needs by significantly increasing their grantmaking in a particular year. The proposal would be effective for taxable years beginning after December 31, 2000.

Increase limit on charitable donations of appreciated property.—Under current law, charitable contributions made by individuals who do not claim the standard deduction are deductible for income tax purposes, up to certain limits depending on the type of property donated and whether the donee organization qualifies as a public charity or private foundation. Contributions made by an individual to a public charity generally are deductible in an amount not exceeding 50 percent of the individual's AGI for the current year (with any remaining amount carried over for up to five taxable years). In the case of contributions made by an individual to a private foundation, a 30-percent AGI limitation generally applies. However, in the case of donated stock and other non-cash contributions, a 30-percent AGI limitation applies to gifts to public charities, and a 20-percent AGI limitation applies to gifts to private foundations. These special contribution limits for non-cash gifts create unnecessary complexity and could discourage gifts of valuable or unique property to charitable organizations. Therefore, the Administration proposes that the special contribution limits for non-cash gifts be repealed, effective for contributions made after December 31, 2000.

Clarify public charity status of donor advised funds.—In recent years, there has been an explosive growth in so-called "donor advised funds" maintained by charitable corporations. These funds generally permit a donor to claim a current charitable contribution deduction for amounts contributed to a charity and to provide ongoing advice regarding the investment or distribution of such amounts, which are maintained by the charity in a separate fund or account. In the absence of clear guidelines, donor advised funds potentially may be used to provide donors with the benefits normally associated with private foundations (such as control over grantmaking), without the regulatory safeguards that apply to private foundations. Therefore, the Administration proposes that current-law rules be clarified so that a charitable corporation which, as its primary activity, operates donor advised funds may qualify as a publicly supported organization only if: (1) there is no material restriction or condition that prevents the corporation from freely and effectively employing the contributed assets in furtherance of its exempt purposes; (2) distributions from donor advised funds are made only to public charities (or private operating foundations); and (3) the corporation distributes annually for charitable purposes an amount equal to at least five percent of the fair market value of the corporation's aggregate investment assets. The proposal also would clarify that, for purposes of the section 4958 excise tax on certain excess benefit transactions, a person who provides advice with respect to a particular donor advised fund maintained by a public charity is treated as having substantial influence with respect to that particular fund.

Promote Energy Efficiency and Improve the Environment

Buildings

Provide tax credit for energy-efficient building equipment.—No income tax credit is provided currently for investment in energy-efficient building equipment. The Administration proposes to provide a new tax credit for the purchase of certain highly efficient building equipment technologies, including fuel cells, electric heat pump water heaters, and natural gas heat pumps. The credit would equal 20 percent of the amount of qualified investment, subject to caps of $500 per kilowatt for fuel cells, $500 per unit for electric heat pump water heaters, and $1,000 per unit for natural gas heat pumps. The credit would be available for the four-year period beginning January 1, 2001 and ending December 31, 2004.

Provide tax credit for new energy-efficient homes.—No income tax credit is provided currently for investment in energy-efficient homes. The Administration proposes to provide a tax credit to taxpayers who purchase, as a principal residence, certain newly constructed homes that are highly energy efficient. The credit would equal $1,000 or $2,000 depending upon the home's energy efficiency. The $1,000 credit would be available for homes purchased between January 1, 2001 and December 31, 2003 that reduce energy usage by at least 30 percent relative to the standard under the 1998 International Energy Conservation Code (IECC). The $2,000 credit would be available for homes purchased between January 1, 2001 and December 31, 2005 that reduce energy usage by at least 50 percent relative to the IECC standard.

Transportation

Extend electric vehicle tax credit and provide tax credit for hybrid vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2002. The credit begins to phase down in 2002 and is not available after 2004. The Administration proposes to extend the present $4,000 credit through 2006 and to allow the full amount of the credit to be available for qualified electric vehicles through 2006. The Administration also proposes to provide a tax credit of up to $3,000 for purchases of a qualified hybrid vehicle after December 31, 2002 and before January 1, 2007. A qualified hybrid vehicle is a road vehicle that can draw propulsion energy from both of the following on-board sources of stored energy: a consumable fuel and a rechargeable battery. The amount of the credit would depend upon the vehicle's design performance. The credit would be available for all qualifying light vehicles including cars, minivans, sport utility vehicles, and light trucks.

Industry

Provide 15-year depreciable life for distributed power property.—Distributed power technologies can be more energy efficient and generate fewer greenhouse gases than conventional generation methods. To promote the use of these technologies, the Administration proposes to simplify and rationalize the current system for assigning cost recovery periods to certain depreciable property by assigning a single 15-year recovery period to qualifying distributed power property. Distributed power property would include depreciable assets used by a taxpayer to produce electricity for use in a nonresidential or residential building that is used in the taxpayer's trade or business. Such property also would include depreciable assets used to generate electricity for primary use in an industrial manufacturer's process or plant activity, provided such assets had a rated total capacity in excess of 500 kilowatts. Qualifying property could be used to produce thermal energy or mechanical power for use in a heating or cooling application. However, at least 40 percent of the total useful energy produced in a commercial or residential setting must consist of electrical power. When used in an industrial setting, at least 40 percent of produced energy must be used in the taxpayer's manufacturing process or plant activity. In addition, a taxpayer would be required to have a reasonable expectation that no more than 50 percent of the produced electricity would be sold to, or used by, unrelated persons. The proposal would apply to assets placed in service after the date of enactment.

Clean Energy Sources

Extend and modify the tax credit for producing electricity from certain sources.—Current law provides taxpayers a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind or "closed-loop" biomass. The electricity must be sold to an unrelated third party and the credit applies to the first 10 years of production. The current credit applies only to facilities placed in service before January 1, 2002, after which it expires. The Administration proposes to extend the current credit for wind and closed-loop biomass for two and one-half years, to facilities placed in service before July 1, 2004, and to expand eligible biomass to include certain biomass from forest-related resources, agricultural sources and other sources for facilities placed in service after December 31, 2000 and before January 1, 2006. Biomass facilities that were placed in service before July 1, 1999 would be eligible for a credit of 1.0 cent per kilowatt hour for electricity produced from the newly eligible sources from January 1, 2001 through December 31, 2003. A 0.5-cent-per-kilowatt-hour tax credit would also be allowed for cofiring biomass in coal plants from January 1, 2001 through December 31, 2005. In addition, electricity produced from methane from certain facilities would be eligible for the following credits: (1) 1.5 cent per kilowatt hour for methane produced from landfills not subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines (NSPS/EG), or (2) 1.0 cent per kilowatt hour for methane produced from landfills subject to NSPS/EG. The credit would apply to facilities placed in service after December 31, 2000 and before January 1, 2006.

Provide tax credit for solar energy systems.—Current law provides a 10-percent business energy investment tax credit for qualifying equipment that uses solar energy to generate electricity, to heat or cool, to provide hot water for use in a structure, or to provide solar process heat. The Administration proposes a new tax credit for purchasers of roof-top photovoltaic systems and solar water heating systems located on or adjacent to the building for uses other than heating swimming pools. The proposed credit would be equal to 15 percent of qualified investment up to a maximum of $1,000 for solar water heating systems and $2,000 for rooftop photovoltaic systems. The credit would apply only to equipment placed in service after December 31, 2000 and before January 1, 2006 for solar water heating systems, and after December 31, 2000 and before January 1, 2008 for rooftop photovoltaic systems. (Taxpayers would choose between the proposed tax credit and the current-law tax credit for each investment.)

Electricity Restructuring

Revise tax-exempt bond rules for electric power facilities.—To encourage restructuring the nation's electric power industry so that consumers benefit from competition, rules relating to the use of tax-exempt bonds to finance electric power facilities would be modified. To encourage public power systems to implement retail competition, outstanding bonds issued to finance transmission facilities would continue their tax-exempt status if private use resulted from allowing nondiscriminatory open access to those facilities. Outstanding bonds issued to finance generation or distribution facilities would continue their tax-exempt status if the issuer implements retail competition. To support fair competition within the restructured industry, interest on newly issued bonds to finance electric generation or transmission facilities would not be exempt. Distribution facilities could continue to be financed with tax-exempt bonds. These changes would be effective upon enactment.

Modify taxation of contributions to nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal the limitation for taxable years beginning after December 31, 2000. As under current law, deductible contributions would not be permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's decommissioning costs.

Modify International Trade Provisions

Extend and modify Puerto Rico economic-activity tax credit.—The Puerto Rico and possessions tax credit was repealed in 1996. However, both the income-based credit and the economic-activity-based credit remain available for certain business operations conducted in taxable years beginning before January 1, 2006, subject to base-period caps. To provide a more efficient tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity-based credit that was begun in 1993, the proposal would modify the phase-out of the economic-activity-based credit for Puerto Rico by (1) opening it to newly established business operations during the phase-out period, effective for taxable years beginning after December 31, 1999, and (2) extending the phase-out period through taxable years beginning before January 1, 2009.

Extend the Generalized System of Preferences (GSP) and modify other trade provisions.—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. The Administration proposes to extend the program, which expires after September 30, 2001, through June 30, 2004. The Administration also is proposing to: (1) enhance trade benefits, through December 31, 2010, for subsaharan African countries undertaking strong economic reforms; (2) grant, through September 30, 2004, duty-free treatment to certain imports from the Southeast Europe countries and territories of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Romania, Slovenia, Kosovo and Montenegro; and (3) provide, through December 31, 2004, expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria. These proposals will help Caribbean Basin countries prepare for a future free trade agreement with the United States and respond to the effects of Hurricanes George and Mitch, and will help the countries of Southeast Europe rebuild and reintegrate their economies and work toward achieving lasting political stability in the region.

Levy tariff on certain textiles and apparel products produced in the Commonwealth of the Northern Mariana Islands (CNMI).—The Administration is proposing a tariff on textile and apparel products that are produced in the CNMI without certain percentages of workers who are U.S. citizens, nationals or permanent residents or citizens of the Pacific island nations freely associated with the U.S.

Miscellaneous Provisions

Make first $2,000 of severance pay exempt from income tax.—Under current law, payments received by a terminated employee are taxable as compensation. The Administration proposes to allow an individual to exclude up to $2,000 of severance pay from income when certain conditions are met. First, the severance must result from a reduction in force by the employer. Second, the individual must not obtain a job within six months of separation with compensation at least equal to 95 percent of his or her prior compensation. Third, the total severance payments received by the employee must not exceed $75,000. The exclusion would be effective for severance pay received in taxable years beginning after December 31, 2000 and before January 1, 2004.

Exempt Holocaust reparations from Federal income tax.—The Internal Revenue Code defines gross income as "gross income from whatever source derived," except for certain items specifically exempt or excluded by statute. Although the United States - Federal Republic of Germany Income Tax Convention and a series of rulings issued by the IRS provide that certain Holocaust-related reparations are exempt from Federal income tax, there is no explicit statutory exception from gross income for amounts received by Holocaust victims or their heirs. In recent years, several countries and companies within those countries have acknowledged that they have not made adequate compensation or restitution to victims or their heirs for the deprivations inflicted upon them during the Nazi Holocaust, and have agreed to establish funds or to make direct payments of cash or property to such individuals. To provide clarity and relief for Holocaust victims and their families, the Administration proposes a statutory exemption from gross income for any amount received by an individual or heir of an individual from Holocaust-related funds and settlements, including in compensation for or recovery of property confiscated in connection with the Holocaust. The proposal would be effective for amounts received on or after January 1, 2000. No inference is intended as to the tax treatment of amounts received prior to that date.

ELIMINATE UNWARRANTED BENEFITS AND ADOPT OTHER REVENUE MEASURES

The President's plan closes tax shelters and other loopholes, curtails unwarranted corporate tax subsidies, improves tax compliance and adopts other revenue measures.

Limit Benefits of Corporate Tax Shelter Transactions

The Administration continues to be concerned about the use and proliferation of corporate tax shelters and their effect upon both the corporate tax base and the integrity of the tax system as a whole. The primary goals of corporate tax shelters are to manufacture tax benefits that can be used to offset unrelated income of the taxpayer or to create tax-favored or tax-exempt economic income.

The growing use of corporate tax shelters was further described by the Treasury Department in its White Paper entitled, The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals, issued in July 1999. The paper concludes that corporate tax shelters are best addressed by increasing disclosure of corporate tax shelter activities, increasing and strengthening the substantial understatement penalty, codifying the judicially-created economic substance doctrine, and providing consequences to all parties to the transaction

(e.g., promoters, advisors, and tax-indifferent, accommodating parties.)

The Administration proposes several general remedies to curb the growth of corporate tax shelters that focus on these four themes. In addition, the Administration proposes to modify the treatment of certain specific transactions that provide sheltering potential. No inference is intended as to the treatment of any of these transactions under current law.

Increase disclosure of certain transactions.—Greater disclosure of corporate tax shelter transactions will discourage some corporations from engaging in such activity and would aid the IRS in identifying questionable transactions and enforcing current law. The Administration proposes to require disclosure of certain reportable transactions. Disclosure would be required if a transaction possesses certain objective characteristics common to corporate tax shelter transactions. Disclosure would be made on a short form or statement that provides the essence of the transaction, is filed with the IRS National Office and with the tax return by the due date of the return, and is signed by a corporate officer with the appropriate knowledge of the transaction. Significant monetary and procedural remedies would be imposed upon failure to provide the required disclosure. The proposal would be effective for transactions entered into after the date of first committee action.

Modify substantial understatement penalty for corporate tax shelters.—The current 20-percent substantial understatement penalty imposed on corporate tax shelter items can be avoided if the corporate taxpayer had reasonable cause for the tax treatment of the item and acted in good faith. In order to change the cost-benefit analysis of entering a corporate tax shelter, the Administration proposes to increase the substantial understatement penalty on corporate tax shelter items to 40 percent. In order to encourage disclosure, the penalty will be reduced to 20 percent if the corporate taxpayer provides the requisite disclosure of the transaction. The 20-percent penalty for disclosed transactions could be avoided by a showing that the taxpayer reasonably believed that it had a strong chance of sustaining its tax position and acted in good faith. The proposal would be effective for transactions entered into after the date of first committee action.

Codify the economic substance doctrine.—The "economic substance" doctrine is a longstanding, judicially-created standard providing that in order for a transaction to be respected for tax purposes, it must be imbued with economic substance. The economic substance doctrine requires an analysis and balancing of the claimed tax benefits from a transaction with the pre-tax profit of the transaction. The Administration proposes codifying the economic substance standard. Under the proposal, a transaction will not be respected for tax purposes if the present value of the expected economic profit from the transaction is insignificant compared to the present value of the expected tax benefits. Similar rules would apply to financing transactions. The proposal would apply to transactions entered into on or after the date of first committee action.

Tax income from corporate tax shelters involving tax-indifferent parties.—The Federal income tax system has many participants who are indifferent to tax consequences (e.g., foreign persons, tax-exempt organizations, and Native American tribal organizations). Many corporate tax shelters rely on tax-indifferent participants who absorb taxable income generated by the shelters so that corresponding losses or deductions can be allocated to taxable participants. The proposal would provide that any income received by a tax-indifferent person with respect to a corporate tax shelter would be taxable to the extent the person is trading on its special tax status. The proposal would be effective for transactions entered into on or after the date of first committee action.

Impose a penalty excise tax on certain fees received by promoters and advisors..—Users of corporate tax shelters often pay large fees to promoters and advisors with respect to the shelter transactions. The proposal would impose a 25-percent penalty excise tax on fees received in connection with the promotion of corporate tax shelters and the rendering of certain tax advice related to corporate tax shelters. The proposal would be effective for payments made on or after the date of first committee action.

Require accrual of income on forward sale of corporate stock.—There is little substantive difference between a corporate issuer's current sale of its stock for deferred payment and an issuer's forward sale of the same stock. In both cases, a portion of the deferred payment compensates the issuer for the time-value of money during the term of the contract. Under current law, the issuer must recognize the time-value element of the deferred payment as interest if the transaction is a current sale for deferred payment but not if the transaction is a forward contract. Under the proposal, the issuer would be required to recognize the time-value element of the forward contract as well. The proposal would be effective for forward contracts entered into after the date of first committee action.

Modify treatment of ESOP as S corporation shareholder.—Pursuant to provisions enacted in 1996 and 1997, an employee stock ownership plan (ESOP) may be a shareholder of an S corporation and the ESOP's share of the income of the S corporation is not subject to tax until distributed to the plan beneficiaries. The Administration proposes to require ESOPs that are not broad based to pay tax on S corporation income (including capital gains on the sale of stock) as the income is earned and to allow the ESOP a deduction for distributions of such income to plan beneficiaries. The deduction would apply only to the extent distributions exceed all prior undistributed amounts that were previously not subject to unrelated business income tax. The proposal would be effective for taxable years beginning on or after the date of first committee action. In addition, the proposal would be effective for acquisitions of S corporation stock by an ESOP after such date and for S corporation elections made on or after such date.

Limit dividend treatment for payments on certain self-amortizing stock.—Under current law, distributions of property by a corporation to its shareholders are treated as dividends to the extent of the current or accumulated earnings and profits of the corporation. The Treasury Department previously became aware of certain abusive transactions involving so-called "fast-pay" stock. Under a typical fast-pay arrangement, a corporation that is subject to tax only at the shareholder level (a conduit entity) issues preferred stock to one class of investors and common stock to a second class of investors. The preferred stock is economically self-amortizing because the distributions made with respect to the stock (although treated entirely as dividends under current law) represent in part a return of the investors' investment and in part a return on their investment. While The Treasury Department has issued regulations that recharacterize a fast-pay arrangement involving certain domestic conduit entities, legislation limiting the dividend characterization on self-amortizing stock (including self-amortizing stock issued by foreign conduit entities) may be a more comprehensive solution. The proposal would provide that, in the case of a distribution with respect to self-amortizing stock issued by a conduit entity (including a foreign conduit entity), the amount treated as a dividend shall not exceed the amount of the distribution that would have been characterized as interest had the self-amortizing stock been a debt instrument. The proposal would be effective for distributions with respect to self-amortizing stock made after the date of enactment.

Prevent serial liquidation of U.S. subsidiaries of foreign corporations.—When a domestic corporation distributes a dividend to a foreign corporation, it is subject to U.S. withholding tax. In contrast, if a domestic corporation distributes earnings in a subsidiary liquidation under section 332, the foreign shareholder generally is not subject to any withholding tax. Relying on section 332, some foreign corporations have used holding companies to avoid the withholding tax. They establish U.S. holding companies to receive tax-free dividends from operating subsidiaries, and then liquidate the holding companies, thereby avoiding the withholding tax. Subsequently, they re-establish the holding companies to receive future dividends. The proposal would impose withholding tax on any distribution made to a foreign corporation in complete liquidation of a U.S. holding company if the holding company was in existence for less than 5 years. The proposal would also achieve a similar result with respect to serial terminations of U.S. branches. The proposal would be effective for liquidations and terminations occurring on or after the date of enactment.

Prevent capital gains avoidance through basis shift transactions involving foreign shareholders.—A distribution in redemption of stock generally is treated as a dividend if it does not result in a meaningful reduction in the shareholder's proportionate interest in the distributing corporation, measured with reference to certain constructive ownership rules, including option attribution. If an amount received in redemption of stock is treated as a distribution of a dividend, the basis of the remaining stock generally is increased to reflect the basis of the redeemed stock. The basis of the remaining stock is not increased, however, to the extent that the basis of the redeemed stock was reduced or eliminated pursuant to the extraordinary dividend rules. In certain circumstances, these rules require a corporate shareholder to reduce the basis of stock with respect to which a dividend is received by the nontaxed portion of the dividend, which generally equals the amount of the dividend that is offset by the dividends received deduction. To prevent taxpayers from attempting to offset capital gains by generating artificial capital losses through basis shift transactions involving foreign shareholders, the Administration proposes to treat the portion of a dividend that is not subject to current U.S. tax as a nontaxed portion. Similar rules would apply in the event that the foreign shareholder is not a corporation. The proposal would be effective for distributions on or after the date of first committee action.

Prevent mismatching of deductions and income inclusions in transactions with related foreign persons.—Current law provides that if any debt instrument having original issue discount (OID) is held by a related foreign person, any portion of such OID shall not be allowable as a deduction to the issuer until paid. Section 267 and the regulations thereunder apply similar rules to other expenses and interest owed to related foreign persons. These general rules are modified, however, so that a deduction is allowed when the OID is includible in the income of a foreign personal holding company (FPHC), controlled foreign Department corporation (CFC), or passive foreign investment company (PFIC). The Treasury Department has learned of certain structured transactions (involving both U.S. payors and U.S.-owned foreign payors) designed to allow taxpayers inappropriately to take advantage of the current rules by accruing deductions to related FPHCs, CFCs or PFICs, without the U.S. owners of such related entities taking into account for U.S. tax purposes an amount of income appropriate to the accrual. This results in an improper mismatch of deductions and income. The proposal would provide that deductions for amounts accrued but unpaid to related foreign CFCs, PFICs or FPHCs would be allowable only to the extent the amounts accrued by the payor are, for U.S. tax purposes, reflected in the income of the direct or indirect U.S. owners of the related foreign person. The proposal would contain an exception for certain short term transactions entered into in the ordinary course of business. The Secretary of Treasury would be granted regulatory authority to provide exceptions from these rules. The proposal would be effective for amounts accrued on or after the date of first committee action.

Prevent duplication or acceleration of loss through assumption of certain liabilities.—Generally, if as part of a transaction in which one or more persons contribute property in exchange for the stock of a corporation that they control immediately thereafter, the corporation also assumes a liability of a transferor, the transferor's basis in the stock of the controlled corporation is reduced by the amount of the liability assumed. To facilitate the incorporation of certain businesses that have liabilities that have not yet given rise to a deduction, special rules apply to provide that the assumption of such liabilities does not reduce the transferor's basis in the stock of the controlled corporation. Relying on these special rules and other authority, some taxpayers have attempted to accelerate or duplicate deductions for certain losses by separating liabilities from the associated business or assets, contributing them to a corporation, and selling stock in that corporation at a purported loss. The Administration proposes that if the basis of stock received by a transferor as part of a tax-free exchange with a controlled corporation exceeds its fair market value, then the basis of the stock received would be reduced (but not below the fair market value) by the amount of a fixed or contingent liability that is assumed by the controlled corporation and that did not otherwise reduce the transferor's basis in the corporation's stock. Except as provided by the Secretary of Treasury , the proposal would not apply where the trade or business or substantially all the assets associated with the liability are also transferred to the controlled corporation. Regulations would be issued to prevent the acceleration or duplication of losses through the assumption of liabilities in transactions involving partnerships, and may also be issued to modify the rules of this proposal as applied to S corporations. The proposal and the regulations addressing transactions involving partnerships would be effective for assumptions of liability on or after October 19, 1999. Regulations addressing transactions involving S corporations would be effective on or after October 19, 1999, or such later date as may be prescribed by such rules.

Amend 80/20 company rules.—Interest or dividends paid by a so-called "80/20 company" generally are partially or fully exempt from U.S. withholding tax. A U.S. corporation is treated as an 80/20 company if at least 80 percent of the gross income of the corporation for the three-year period preceding the year of the payment is foreign source income attributable to the active conduct of a foreign trade or business (or the foreign business of a subsidiary). Certain foreign multinationals improperly seek to exploit the rules applicable to 80/20 companies in order to avoid U.S. withholding tax liability on earnings of U.S. subsidiaries that are distributed abroad. The proposal would prevent taxpayers from avoiding withholding tax through manipulations of these rules. The proposal would limit the amount of interest and dividends exempt from withholding to the amount of foreign active business income received by the U.S. corporation during the 3-year testing period. The proposal would apply to interest or dividends paid or accrued more than 30 days after the date of enactment.

Modify corporate-owned life insurance (COLI) rules.—In general, interest on indebtedness with respect to life insurance, endowment or annuity contracts is not deductible unless the insurance contract insures the life of a "key person" of a business. In addition, interest deductions of a business generally are reduced under a proration rule if the business owns or is a direct or indirect beneficiary with respect to certain insurance contracts. The COLI proration rules generally do not apply if the contract covers an individual who is a 20-percent owner of the business or is an officer, director, or employee of such business. These exceptions still permit leveraged businesses to fund significant amounts of deductible interest and other expenses with tax-exempt or tax-deferred inside buildup on contracts insuring employees, officers, directors, and shareholders. The Administration proposes to repeal the exception under the COLI proration rules for contracts insuring employees, officers or directors (other than certain contracts insuring 20-percent owners) of the business. The proposal also would conform the key person exception for disallowed interest deductions attributable to indebtedness with respect to life insurance contracts to the modified 20-percent owner exception in the COLI proration rules. The proposal would be effective for taxable years beginning after date of enactment.

Require lessors of tax-exempt-use property to include service contract options in lease term.—Under current law, a lessor of tax-exempt-use property is allowed depreciation deductions computed on a straight-line basis over a period of not less than 125 percent of the term of the lease. The existing depreciation rules do not consider service contracts, which can be structured to resemble leases. In recent years, lessors have attempted to accelerate depreciation deductions by structuring transactions that have a relatively short lease followed by a service contract. The proposal would require lessors to include the term of service contracts in the lease term for purposes of determining the depreciation period. The proposal would be effective for leases entered into after the date of enactment.

Financial Products

Require banks to accrue interest on short-term obligations.—Under current law, a bank (regardless of its accounting method) must accrue as ordinary income interest, including original issue discount, on short-term obligations. Some court cases have held that banks that use the cash receipts and disbursements method of accounting do not have to accrue stated interest and original issue discount on short-term loans made in the ordinary course of the bank's business. The Administration believes it is inappropriate to treat these short-term loans differently than other short-term obligations held by the bank. The Administration's proposal would clarify that banks must accrue interest and original issue discount on all short-term obligations, including loans made in the ordinary course of the bank's business, regardless of the banks' overall accounting method. The proposal would be effective for obligations acquired (including originated) on or after the date of enactment. No inference is intended regarding the current-law treatment of these transactions.

Require current accrual of market discount by accrual method taxpayers.—Under current law, a taxpayer that holds a debt instrument with market discount is not required to include the discount in income as it accrues, even if the taxpayer uses an accrual method of accounting. Under the proposal, a taxpayer that uses an accrual method of accounting would be required to include market discount in income as it accrues. The proposal would also cap the amount of market discount on distressed debt instruments. The proposal would be effective for debt instruments acquired on or after the date of enactment.

Modify and clarify certain rules relating to debt-for-debt exchanges.—Under current law, an issuer can inappropriately accelerate interest deductions by refinancing a debt instrument in a debt-for-debt exchange at a time when the issuer's cost of borrowing has declined. The proposal would spread the issuer's net deduction for bond repurchase premium in a debt-for-debt exchange over the term of the new debt instrument using constant yield principles. In addition, the proposal would modify the measurement of the net income or deduction in debt-for-debt exchanges involving contingent payment debt instruments. Finally, the proposal would modify the measurement of taxable boot to the holder in debt-for-debt exchanges that are part of corporate reorganizations. The proposal would apply to debt-for-debt exchanges occurring on or after the date of enactment.

Modify and clarify the straddle rules.—A "straddle" is the holding of two or more offsetting positions with respect to actively-traded personal property. If a taxpayer enters into a straddle, the taxpayer must defer the recognition of loss from the "loss leg" of the straddle until the taxpayer recognizes the offsetting gain from the "gain leg" of the straddle. Further, the taxpayer must capitalize the net interest and carrying charges properly attributable to the straddle. The proposal would modify and clarify a number of provisions under the straddle rules. In particular, to match the timing of straddle losses with related gains, the proposal would provide that loss realized on one leg of a straddle would be capitalized into the other leg of the straddle. This capitalization would operate as an ordering rule eliminating the need for an identification rule when the legs are of different sizes. In addition, to ensure that the loss on a straddle leg is properly measured, the proposal would require taxpayers that physically settle certain derivatives contracts to determine the amount of the loss subject to deferral under the straddle rules immediately before the physical settlement. The proposal would also repeal the current-law exception from the straddle rules for certain offsetting positions in stock. Finally, the proposal would clarify that a debt instrument issued by a taxpayer may itself be a leg in a straddle and would clarify the situations in which interest and carrying charges are considered properly allocable to a straddle and, therefore, must be capitalized. The proposal would be effective for certain losses incurred and certain straddles entered into on or after the date of first committee action.

Provide generalized rules for all stripping transactions.—Under current law, it may be possible to separate the right to receive income from the ownership of underlying income-producing property (other than debt). In many cases, the tax treatment of income-stripping transactions does not clearly reflect the parties' economic income from the transactions. As a result, it is possible for taxpayers to structure income-stripping transactions that exploit deficiencies of current law. The proposal would eliminate these planning opportunities by treating income-stripping transactions as loans. Under this approach, the owner of the property would be required to account for income from the property in the period in which it was earned. The proposal would be effective for income-stripping transactions entered into after the date of first committee action.

Require ordinary treatment for certain dealers of commodities and equity options.—Under current law, certain dealers of commodities and equity options treat the income from their day-to-day trading or dealing activities as giving rise to capital gain. Dealers of other property typically treat the income from their day-to-day dealing activities as giving rise to ordinary income. The proposal would require commodities and equity-option dealers to treat the income from their day-to-day activities as giving rise to ordinary income, not capital gain. The proposal would be effective for tax years beginning after the date of enactment.

Prohibit tax deferral on contributions of appreciated property to swap funds.—A swap fund is an investment partnership that is designed to allow taxpayers holding large blocks of appreciated stock to diversify their stock investments without recognizing gain and paying tax. Typically, a fund is established into which wealthy individuals transfer their stock. In exchange for the transferred stock, these individuals receive an interest in the fund. Under current law, these individuals do not have to recognize gain if more than 20 percent of the fund's assets are comprised of nonmarketable securities. The proposal would prohibit the deferral of gain where the fund is a passive investment vehicle. The proposal would be effective for transfers occurring on or after the date of enactment.

Corporate Provisions

Conform control test for tax-free incorporations, distributions, and reorganizations.—For tax-free incorporations, tax-free distributions, and reorganizations, "control" is defined as the ownership of 80 percent of the voting stock and 80 percent of the number of shares of all other classes of stock of the corporation. This test is easily manipulated by allocating voting power among the shares of a corporation, allowing corporations to retain control of a corporation but sell a significant amount of the value of the corporation. In contrast, the necessary "ownership" for tax-free liquidations, qualified stock purchases, and affiliation is at least 80 percent of the total voting power of the corporation's stock and at least 80 percent of the total value of the corporation's stock. The Administration proposes to conform the control requirement for tax-free incorporations, distributions, and reorganizations with that used for determining affiliation. This proposal is effective for transactions on or after the date of enactment.

Treat receipt of tracking stock in certain distributions and exchanges as the receipt of property.—"Tracking stock" is an economic interest that is intended to relate to and track the economic performance of one or more separate assets of the issuer, and gives its holder a right to share in the earnings or value of less than all of the corporate issuer's earnings or assets. Tracking stock issued by a corporation represents an economic interest different than non-tracking stock of the issuer. Under the proposal, the receipt of tracking stock in a distribution made by a corporation with respect to its stock and tracking stock received in exchange for other stock in the issuing corporation would be treated as the receipt of property by the shareholders. Under this proposal, the Secretary of Treasury would have authority to treat tracking stock as nonstock (debt, a notional principal contract, etc.) or as stock of another entity as appropriate to prevent avoidance. No inference is intended regarding the tax treatment of tracking stock under current law. This proposal is effective for tracking stock issued on or after the date of enactment.

Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions.—No gain or loss will be recognized if one or more persons transfer property to a controlled corporation (or partnership) solely in exchange for stock in the corporation (or a partnership interest). Where there is a transfer of less than "all substantial rights" to use property, the Internal Revenue Service's position is that such transfer will not qualify as a tax-free exchange. However, the Claims Court rejected the Service's position in *E.I. Du Pont de Nemours and Co. v. U.S.*, holding that any transfer of something of value could be a "transfer" of "property." The inconsistency between the positions has resulted in whipsaw of the government. The Administration proposes to provide that a transfer of an interest in intangible property constituting less than all of the substantial rights of the transferor will not fail to qualify for tax-free treatment solely because the transferor does not transfer all rights, title and interest in an intangible asset, and the transferor must allocate the basis of the intangible between the retained rights and the transferred rights based upon respective fair market values. Consistent reporting by the transferor and the transferee would be required. This proposal is effective for transfers after the date of enactment.

Modify tax treatment of certain reorganizations involving portfolio stock.—If a target corporation owns stock in the acquiring corporation and wants to combine with the acquiring corporation in a downstream reorganization, the target corporation transfers its assets to the acquiring corporation and the shareholders of the target corporation receive stock of the acquiring corporation in exchange for their target corporation stock. Alternatively, if the acquiring corporation owns stock in the target corporation, the target corporation can merge upstream, transfer its assets upstream, or merge sideways into a subsidiary of the acquiring corporation with the other shareholders of target receiving acquiring corporation stock. Under current law, all of these reorganizations qualify for tax-free treatment. Under the proposal, where a target corporation holds less than 20 percent of the stock of an acquiring corporation and the target corporation combines with the acquiring corporation in a reorganization in which the acquiring corporation is the survivor, the target corporation must recognize gain, but not loss, as if it distributed the acquiring corporation stock that it held immediately prior to the reorganization. Alternatively, where an acquiring corporation owns less than 20 percent of a target corporation and the target corporation combines with the acquiring corporation or a subsidiary of the acquiring corporation, the acquiring corporation must recognize gain, but not loss, as if it had sold its target corporation stock immediately before the reorganization. Nonrecognition treatment would continue to apply to other assets transferred by the target corporation and to the target corporation shareholders. This proposal is effective for transactions on or after the date of enactment.

Modify definition of nonqualified preferred stock.—Subject to certain exceptions, in otherwise tax-free transactions, the receipt of nonqualified preferred stock is treated as money or other property and, thus, gain may be recognized. Under current law, nonqualified preferred stock is defined as stock which is "limited and preferred as to dividends and does not participate in corporate growth to any significant extent." Taxpayers may be taking positions that are inconsistent with the policy of the nonqualified preferred stock provisions (i.e., nonrecognition treatment is inappropriate where taxpayers receive relatively secure instruments in exchange for relatively risky instruments), by including illusory participation rights or including terms that taxpayers argue create an "unlimited" dividend. The proposal would clarify the definition of preferred stock to eliminate taxpayer arguments that stock issued is nominally participating or unlimited as to dividends. The proposal would apply to transactions that occur after the date of first committee action.

Modify estimated tax provision for deemed asset sales—Taxpayers can make an election to treat certain sales of stock as sales of assets. This election may be made up to 8 1/2 months after the stock sale. Taxpayers may be taking the position that they do not have to pay any estimated taxes until after the 8 1/2 month period has expired and rely on current law as providing that there will be no penalty for nonpayment. The proposal would clarify the estimated tax provisions to require that estimated taxes be paid based upon gain from either the stock sale or the deemed asset sale. The proposal would apply to transactions that occur after the date of first committee action.

Modify treatment of transfers to creditors in divisive reorganizations.—In order to separate businesses in a tax-free spin-off, a corporation (distributing) will not recognize gain or loss on the contribution of property to a controlled corporation solely in exchange for stock or securities of the controlled corporation. Under current law, if the distributing corporation also receives other property or money, it will not recognize gain as long as it distributes the property or money to its creditors in connection with the reorganization. The amount of property or money that may be distributed to creditors without gain to the distributing corporation is unlimited. Thus, taxpayers may avoid gain that otherwise would be recognized if liabilities are assumed by the controlled corporation that exceed the basis of assets contributed. The proposal would limit the amount of property or money that the distributing corporation can distribute to creditors without gain to the amount of basis of the assets contributed to the controlled corporation in the reorganization. In addition, the proposal would provide that acquisitive reorganizations would no longer be subject to gain recognition where liabilities are assumed in excess of the basis of assets transferred. The proposal would be effective for transactions on or after the date of enactment.

Passthroughs

Provide mandatory basis adjustments for partners that have a significant net built-in loss in partnership property.—Currently, a partner's share of basis in partnership property is adjusted in the case of a distribution of partnership property or a sale of a partnership interest only if the partnership has a special election in effect. The electivity of these provisions has created numerous opportunities for abuse by taxpayers. Accordingly, the Administration proposes that the basis adjustment rules would be made mandatory with respect to any partner (treating related persons as one person), whose share of net built-in loss in partnership property is equal to the greater of $250,000 or ten percent of the partner's total share of partnership assets (measured by reference to fair market value). In calculating the ten-percent threshold, property acquired by the partnership with a principal purpose of allowing a partner or partners to avoid the limitation would be disregarded. The proposal would be effective for distributions and transfers of partnership interest after the date of enactment.

Modify treatment of closely held REITs.—When originally enacted, the real estate investment trust (REIT) legislation was intended to provide a tax-favored vehicle through which small investors could invest in a professionally managed real estate portfolio. REITs are intended to be widely held entities, and certain requirements of the REIT rules are designed to ensure this result. Among other requirements, in order for an entity to qualify for REIT status, the beneficial ownership of the entity must be held by 100 or more persons. In addition, a REIT cannot be closely held, which generally means that no more than 50 percent of the value of the REIT's stock can be owned by five or fewer individuals during the last half of the taxable year. Certain attribution rules apply in making this determination. The Administration is aware of a number of tax avoidance transactions involving the use of closely held REITs. In order to meet the 100 or more shareholder requirement, the REIT generally issues common stock, which is held by one shareholder, and a separate class of non-voting preferred stock with a relatively nominal value, which is held by 99 "friendly" shareholders. The closely held limitation does not disqualify the REITs that are utilizing this ownership structure because the majority shareholders of these REITs are not individuals. The Administration proposes to impose as an additional requirement for REIT qualification that no person can own stock of a REIT possessing 50 percent or more of the total combined voting power of all classes of voting stock or 50 percent or more of the total value of all shares of all classes of stock. For purposes of determining a person's stock ownership, rules similar to current-law rules would apply and stapled entities would be treated as one person. The proposal would be effective for entities electing REIT status for taxable years beginning on or after the date of first committee action.

Apply regulated investment company (RIC) excise tax to undistributed profits of REITs.—As a result of legislation passed in 1999, a REIT, like a RIC, is only required to distribute 90 percent of its REIT taxable income in order to maintain REIT status. A RIC is subject to a four-percent excise tax on the excess of the required distribution for a calendar year over the distributed amount for such calendar year.

The required distribution is equal to the sum of 98 percent of the RIC's ordinary income for the calendar year and 98 percent of the RIC's capital gain net income for the one-year period ending on October 31 of such calendar year. REITs are subject to a similar rule, except that the required distribution is equal to the sum of 85 percent of the REIT's ordinary income for the calendar year and 95 percent of the REIT's capital gain net income for such calendar year. In order to conform the treatment of REITs and RICs, the Administration proposes to modify the definition of required distribution for REITs, requiring a distribution of 98 percent of ordinary and capital gain income in order to avoid the four-percent excise tax. The proposal would be effective for calendar years beginning after December 31, 2000.

Allow RICs a dividends paid deduction for redemptions only in cases where the redemption represents a contraction in the RIC.—Under current law, a RIC is allowed a dividends paid deduction for dividends paid to shareholders. If a RIC redeems a shareholder's stock, the RIC can generally treat a portion of the redemption payment as a dividend for purpose of computing the dividends paid deduction. In situations where the redemption represents a contraction in the size of the RIC, this treatment ensures that the remaining shareholders of the RIC are taxed on no more than their pro rata share of the RIC's income. In situations where the redemption is accompanied by near simultaneous investments in the RIC by other investors, the RIC is in essentially the same position it would be in had the redeeming shareholder sold its shares in the RIC directly to the new investors. In this case, it is inappropriate to give the RIC a dividends paid deduction for the redemption. The proposal, therefore, allows a RIC to claim a dividends paid deduction with respect to a redemption only if the redemption represents a net contraction in the size of the RIC. The proposal would be effective for taxable years beginning after the date of enactment.

Require Real Estate Mortgage Investment Conduits (REMICs) to be secondarily liable for the tax liability of REMIC residual interest holders.—A REMIC is a statutory pass-through vehicle designed to facilitate the securitization of mortgages. A REMIC holds mortgages and issues one or more classes of debt instruments, called REMIC regular interests, that are entitled to the cash flows from the underlying mortgages. A REMIC also issues a REMIC residual interest. The holder of the REMIC residual interest must include in income the taxable income of the REMIC. In many cases, when it is issued the REMIC residual interest has a negative value because the reasonably anticipated net tax liability associated with holding the residual is greater than the value of the cash flows on the residual. Many holders of REMIC residual interests do not pay their tax liabilities when due. To ensure that the tax on REMIC residuals is paid when due, the proposal would require a REMIC to be secondarily liable for the tax liability of its residual interest. Under the proposal, if the tax on the residual was not paid when due, the REMIC would be required to pay the tax. Similar rules would apply with respect to Financial Asset Securitization Investment Trusts (FASITs). The proposal would be effective for REMICs and FASITs created after the date of enactment.

Tax Accounting

Deny change in method treatment to tax-free formations.—Generally, a taxpayer that desires to change its method of accounting must obtain the consent of the IRS Commissioner. In addition, in certain reorganization transactions a corporation acquiring assets generally is required to use the method of accounting used for those assets by the distributor or transferor corporation. Under current law, this carryover rule does not apply to tax-free contributions to a corporation or to a partnership. Consequently, taxpayers who transfer assets to a subsidiary or a partnership in such transactions may avail themselves of a new method of accounting without obtaining the consent of the IRS Commissioner. The Administration proposes to expand the transactions to which the carryover of method of accounting rules and the regulations thereunder apply to include tax-free contributions to corporations or partnerships, effective for transfers on or after the date of enactment.

Deny deduction for punitive damages.—The current deductibility of most punitive damage payments undermines the role of such damages in discouraging and penalizing certain undesirable actions or activities. The Administration proposes to disallow any deduction for punitive damages paid or incurred by the taxpayer, whether upon a judgment or in settlement of a claim. Where the liability for punitive damages is covered by insurance, such damages paid or incurred by the insurer would be included in the gross income of the insured person. The insurer would be required to report such payments to the insured person and to the IRS. The proposal would apply to damages paid or incurred on or after the date of enactment.

Repeal lower-of-cost-or-market inventory accounting method.—Taxpayers required to maintain inventories are permitted to use a variety of methods to determine the cost of their ending inventories, including the last-in, first-out (LIFO) method, the first-in, first-out (FIFO) method, and the retail method. Taxpayers not using a LIFO method may determine the carrying values of their inventories by applying the lower-of-cost-or-market (LCM) method or by writing down the cost of goods that are unsalable at normal prices or unusable in the normal way because of damage, imperfection or other similar causes (subnormal goods method). The allowance of write-downs under the LCM and subnormal goods methods is essentially a one-way mark-to-market method that understates taxable income. The Administration proposes to repeal the

LCM and subnormal goods methods effective for taxable years beginning after the date of enactment.

Disallow interest on debt allocable to tax-exempt obligations.—No income tax deduction is allowed for interest on debt used directly or indirectly to acquire or hold investments that produce tax-exempt income. The determination of whether debt is used to acquire or hold tax-exempt investments differs depending on the holder of the instrument. For banks and a limited class of other financial institutions, debt generally is treated as financing all of the taxpayer's assets proportionately. Securities dealers are not included in the definition of "financial institution," and under a special rule are subject to a disallowance of a much smaller portion of their interest deduction. For other financial intermediaries, such as finance companies, that are also not included in the narrow definition of "financial institutions," deductions are disallowed only when indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt investments. These taxpayers are therefore able to reduce their tax liabilities inappropriately through the double Federal tax benefits of interest expense deductions and tax-exempt interest income, notwithstanding that they operate similarly to banks. Effective for taxable years beginning after the date of enactment, with respect to obligations acquired on or after the date of first committee action, the Administration proposes that all financial intermediaries, other than insurance companies (which are subject to a separate regime), be treated the same as banks are treated under current law with regard to deductions for interest on debt used directly or indirectly to acquire or hold tax-exempt obligations.

Require capitalization of mutual fund commissions.—An expenditure that results in significant future benefits generally must be capitalized in order to match the expenditure with the revenues of the taxable period to which it is properly attributable. Under current securities law, a distributor of mutual fund shares may be compensated by the fund over a period of years or by the investors on redemption with respect to "Class B" shares it distributes. However, the distributor typically will pay an up-front commission to a broker to sell Class B shares to an investor. In order to more accurately match the income and expenses of mutual fund distributors, the Administration proposes that commissions paid to a broker by a distributor would be capitalized and recovered over six years (the period investors would have to hold shares without incurring a fee on redemption). The proposal would be effective for commissions paid or incurred in taxable years ending after the date of enactment. No inference is intended with respect to the treatment of distributor's commissions under current law.

Cost Recovery

Provide consistent amortization periods for intangibles.—Under current law, start-up and organizational expenditures are amortized at the election of the taxpayer over a period of not less than five years. Current law requires certain acquired intangible assets (goodwill, trademarks, franchises, patents, etc.) to be amortized over 15 years. The Administration believes that, to encourage the formation of new businesses, a fixed amount of start-up and organizational expenditures should be currently deductible. Thus, the proposal would allow a taxpayer to elect to deduct up to $5,000 each of start-up or organizational expenditures. However, for each taxpayer, the $5,000 amount is reduced (but not below zero) by the amount by which the cumulative cost of start-up or organizational expenditures exceeds $50,000. Start-up and organizational expenditures not currently deductible would be amortized over a 15-year period consistent with the amortization period for acquired intangible assets. The proposal generally would be effective for start-up and organizational expenditures incurred in taxable years beginning on or after the date of enactment.

Clarify recovery period of utility grading costs.—A taxpayer is allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property that is used in a trade or business or held for the production of income. For most tangible property placed in service after 1986, the amount of the depreciation deduction is determined under the modified accelerated cost recovery system (MACRS) using a statutorily prescribed depreciation method, recovery period, and placed in service convention. The recovery period may be determined by reference to the statutory recovery period or to the list of class lives provided by the Treasury Department. Electric and gas utility clearing and grading costs incurred to extend distribution lines and pipelines have not been assigned a class life. By default, such assets have a seven-year recovery period under MACRS. The Administration believes that applying the default rule to electric and gas utility clearing and grading costs is inappropriate. For example, the electric utility transmission and distribution lines and the gas utility trunk pipelines benefitted by the clearing and grading costs have MACRS recovery periods of 20 years and 15 years, respectively. The proposal would assign depreciable electric and gas utility clearing and grading costs incurred to locate transmission and distribution lines and pipelines to the class life assigned to the benefitted assets, giving these costs a recovery period of 20 years and 15 years, respectively. The proposal would be effective for electric and gas utility clearing and grading costs incurred on or after the date of enactment.

Apply rules generally applicable to acquisitions of intangible assets to acquisitions of professional sports franchises.—In general, the purchase price allocated to most intangible assets (including franchise rights) acquired in connection with the acquisition of a trade or business must be capitalized and amortized over a 15-year period. These rules were enacted in 1993 to minimize disputes regarding the proper treatment of acquired intangible assets. Special rules apply to intangible assets acquired in connection with a professional sports franchise. The 15-year amortization rules do not apply and special allocation rules apply to the purchase price. In order to provide consistent treatment among different trades or businesses and to minimize disputes regarding intangible assets acquired in connection with a professional sports franchise, the Administration proposes to repeal the special rules applicable to professional sports franchise acquisitions and apply the rules generally applicable to most intangible assets. The proposal would be effective for acquisitions after the date of enactment.

Insurance

Require recapture of policyholder surplus accounts.—Between 1959 and 1984, stock life insurance companies deferred tax on a portion of their profits. These untaxed profits were added to a policyholders surplus account (PSA). In 1984, Congress precluded life insurance companies from continuing to defer tax on future profits through PSAs. However, companies were permitted to continue to defer tax on their existing PSAs, and to pay tax on the previously untaxed profits in the PSAs only in certain circumstances. There is no remaining justification for allowing these companies to continue to defer tax on profits they earned between 1959 and 1984. Most pre-1984 policies have terminated, because pre-1984 policyholders have surrendered their pre-1984 contracts for cash, ceased paying premiums on those contracts, or died. The Administration proposes that companies generally would be required to include in their gross income over five years their PSA balances as of the beginning of the first taxable year starting after the date of enactment.

Modify rules for capitalizing policy acquisition costs of life insurance companies.—Under current law, insurance companies capitalize varying percentages of their net premiums for certain types of insurance contracts, and generally amortize these amounts over 10 years (5 years for small companies). These capitalized amounts are intended to serve as proxies for each company's commissions and other policy acquisition expenses. However, data reported by insurance companies to State insurance regulators each year indicate that the insurance industry is capitalizing substantially less than its actual policy acquisition costs, which results in a mismatch of income and deductions. The Administration proposes that insurance companies be required to capitalize modified percentages of their net premiums for certain lines of business. This change would be treated as a change in the insurance company's method of accounting. The modified percentages would more accurately reflect the ratio of actual policy acquisition expenses to premiums and the typical useful lives of the contracts. To ensure that companies never are required to capitalize more under this proxy approach than they would capitalize under normal tax accounting rules, companies that have low policy acquisition costs generally would be permitted to capitalize their actual policy acquisition costs.

Increase the proration percentage for property casualty (P&C) insurance companies.—In computing their underwriting income, P&C insurance companies deduct reserves for losses and loss expenses incurred. These loss reserves are funded in part with the company's investment income. In 1986, Congress reduced the reserve deductions of P&C insurance companies by 15 percent of the tax-exempt interest or the deductible portion of certain dividends received. In 1997, Congress expanded the 15-percent proration rule to apply to the inside buildup on certain insurance contracts. The existing 15-percent proration rule still enables P&C insurance companies to fund a substantial portion of their deductible reserves with tax-exempt or tax-deferred income. Other financial intermediaries, such as life insurance companies, banks and brokerage firms, are subject to more stringent proration rules that substantially reduce or eliminate their ability to use tax-exempt or tax-deferred investments to fund currently deductible reserves or to deduct interest expense. Effective for taxable years beginning after the date of enactment, with respect to investments acquired on or after the date of first committee action, the Administration proposes to increase the proration percentage to 25 percent.

Modify rules that apply to sales of life insurance contracts.—The sale of a life insurance contract insuring a person who is neither terminally nor chronically ill results in taxable income to the seller equal to the difference between the sales price and the seller's basis in the contract. Buyers generally are not required to report information to the IRS on these transactions. The buyer, who receives the death benefit when the insured dies, generally is liable for tax on his profit from the transaction under the "transfer for value" rules. However, the life insurance company generally is not required to report the death benefit payment. Moreover, the rule that the buyer's profits are taxable can be circumvented. The proposal would modify the transfer for value rules so they could no longer be circumvented. The proposal also would modify the reporting rules to require the buyer of a life insurance contract with a large death benefit to report information on the sale to the IRS, to the issuer of the life insurance contract, and to the seller of the life insurance contract. In addition, the proposal would modify the reporting rules to require that payment of death benefits under such previously-sold contracts be reported to the IRS and to the payee. The proposal would be effective for sales of life insurance contracts and payments of death benefits after the date of enactment.

Modify rules that apply to tax-exempt property casualty insurance companies.—Under current law, an insurance company with up to $350,000 of premium income is tax-exempt, regardless of the amount of investment income it has. Another provision allows certain small insurance companies to elect to be taxed only on their net investment income. Premiums of companies in the same controlled group are combined for purposes of determining whether an entity is eligible for tax exemption. An excise tax is imposed on premiums paid to foreign companies with respect to policies insuring U.S. risks. Current law allows foreign insurance companies to elect to be taxed as domestic companies if they meet certain requirements. These rules have been used by U.S. persons to shift assets into tax-free or tax-preferred affiliated insurance companies, which often are located in tax havens and issue "insurance" that is generated directly or indirectly by the U.S. person. The proposal would modify current law, beginning the first taxable year after date of enactment, so that all items of gross income of all affiliated companies would be aggregated in determining whether an insurance company qualifies for tax-exempt status. Also, tax-exempt status would not be available to foreign insurance companies beginning the first taxable year after the date of enactment. Conforming amendments would be made to the current-law election to be taxed on investment income. The proposal also would modify current law so that the election to be taxed as a U.S. corporation would not be available to a foreign company formed after the date of first Committee action, and would not be available beginning in the second year after the date of enactment for any other foreign company that would otherwise qualify for a tax exemption under current law.

Exempt Organizations

Subject investment income of trade associations to tax.—Trade associations described in section 501(c)(6) are generally exempt from Federal income tax, but are subject to tax on their unrelated business income. To eliminate the current-law bias in favor of trade association members' making and deducting advance payments to fund future collective activities of the trade association, the proposal would subject trade associations to unrelated business income tax on their net investment income in excess of $10,000 for any taxable year. As under current-law rules for certain other tax-exempt organizations, investment income would not be subject to tax under the proposal to the extent that it is set aside for a specified charitable purpose. In addition, any gain from the sale of property used directly in the performance of the trade association's exempt function would not be subject to tax under the proposal to the extent that the sale proceeds are used to purchase replacement exempt-function property. The proposal would be effective for taxable years beginning after December 31, 2000.

Impose penalty for failure to file an annual information return.—To encourage voluntary compliance and assist the IRS in its enforcement efforts, the proposal would impose a penalty on split-interest trusts (such as charitable remainder trusts, charitable lead trusts, and pooled income funds) that fail to file an annual information return on Form 5227. Form 5227 contains information regarding the trust's financial activities and whether the trust is subject to certain excise taxes. Under the proposal, any failure to file Form 5227 would be subject to a penalty of $20 per day (up to a maximum of $10,000 per return) or, in the case of any trust with income in excess of $250,000, $100 per day (up to a maximum of $50,000 per return). In addition, any trustee who knowingly fails to file Form 5227, unless such failure is not willful and is due to reasonable cause, would be jointly and severally liable for the amount of the penalty. The proposal would be effective for any return the due date for which is after the date of enactment.

Estate and Gift

Restore phaseout of unified credit for large estates.—Prior to TRA97, the benefit of both the estate tax graduated rate brackets below fifty-five percent and the unified credit were phased out by imposing a five-percent surtax on estates with a value above $10 million. When TRA97 increased the unified credit amount, the phase out of the unified credit was inadvertently omitted. The Administration proposes to restore the surtax in order to phase out the benefits of the unified credit as well as the graduated estate tax brackets. The proposal would be effective for decedents dying after the date of enactment.

Require consistent valuation for estate and income tax purposes.—The basis of property acquired from a decedent generally is its fair market value on the date of death. Property included in the gross estate of a decedent is valued also at its fair market value on the date of death. Recipients of lifetime gifts generally take a carryover basis in the property received. The Administration proposes to impose a duty of consistency on heirs receiving property from a decedent, requiring such heirs to use the value as reported on the estate tax return as the basis for the property for income tax purposes. Estates would be required to notify heirs (and the IRS) of such values. In addition, donors making lifetime gifts would be required to notify the recipients of such gifts (and the IRS) of the donor's basis in the property at the time of the gift, as well as any gift tax paid with respect to the gift. This proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

Require basis allocation for part sale, part gift transactions.—In a part gift, part sale transaction, the donee/purchaser takes a basis equal to the greater of the amount paid by the donee or the donor's adjusted basis at the time of the transfer. The donor/seller uses adjusted cost basis in computing the gain or loss on the sale portion of the transaction. The Administration proposes to rationalize basis allocation in a part gift, part sale transaction by requiring the basis of the property to be allocated ratably between the gift portion and the sale portion based on the fair market value of the property on the date of transfer and the consideration paid. This proposal would be effective for transactions entered into on or after the date of enactment.

Conform treatment of surviving spouses in community property States.—If joint property is owned by spouses in a non-community property state, a surviving spouse receives a stepped-up basis only in the half of the property owned by the deceased spouse. In contrast, when a spouse dies owning community property, the surviving spouse is entitled to a stepped-up basis not only in the half of the property owned by the deceased spouse, but also in the half of the property already owned by the surviving spouse prior to the decedent's death. The Administration proposes to eliminate the stepped-up basis in the part of the community property owned by the surviving spouse prior to the deceased spouse's death. The half of the community property owned by the deceased spouse would continue to be entitled to a stepped-up basis upon death. This treatment will be consistent with the treatment of joint property owned by spouses in a non-community property State. This proposal would be effective for decedents dying after the date of enactment.

Include qualified terminable interest property (QTIP) trust assets in surviving spouse's estate.—A marital deduction is allowed for qualified terminable interest property (QTIP) passing to a qualifying trust for a spouse either by gift or by bequest. The value of the recipient spouse's estate includes the value of any such property in which the decedent had a qualifying income interest for life and a deduction was allowed under the gift or estate tax. In some cases, taxpayers have attempted to whipsaw the government by claiming the deduction in the first estate and then arguing against inclusion in the second estate due to some technical flaw in the QTIP election. The Administration proposes that, if a deduction is allowed under the QTIP provisions, inclusion is required in the beneficiary spouse's estate. The proposal would be effective for decedents dying after the date of enactment.

Eliminate non-business valuation discounts.—Under current law, taxpayers are claiming large discounts on the valuation of gifts and bequests of interests in entities holding marketable assets. Because these discounts are inappropriate, the Administration proposes to eliminate valuation discounts except as they apply to active businesses. Interests in entities generally would be required to be valued for gift and estate tax purposes at a proportional share of the net asset value of the entity to the extent that the entity holds non-business assets. The proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

Eliminate gift tax exemption for personal residence trusts.—Current law excepts transfers of personal residences in trust from the special valuation rules applicable when a grantor retains an interest in a trust. The Administration proposes to repeal this personal residence trust exception. Thereafter, if a residence is to be used to fund a grantor retained interest trust, the trust would be required to pay out the required annuity or unitrust amount or else the grantor's retained interest would be valued at zero for gift tax purposes. This proposal would be effective for transfers in trust after the date of enactment.

Modify requirements for annual exclusion for gifts.—Currently, annual gifts of present interests of up to $10,000 (in 2000) per donor per donee are excepted from the gift tax. The decision in *Crummey v. Commissioner* held that a transfer in trust is a transfer of a present interest if the beneficiary has a right to withdraw the property from the trust for a limited period of time. Two recent cases expanded on the *Crummey* rule by holding that the annual exclusion is available, even where the person holding the withdrawal power is not a primary beneficiary of the trust. The Administration proposes to modify the annual exclusion rule as it applies to gifts and trusts so that a transfer to a trust would qualify only if: (1) during the life of the individual who is the beneficiary of the trust, no portion of the corpus or income of the trust may be distributed to or for the benefit of any person other than the beneficiary, and (2) the trust does not terminate before the beneficiary dies, the assets of the trust will be includible in the gross estate of the beneficiary. A withdrawal right would not be sufficient to create a present interest. This proposal would be effective for gifts completed after December 31, 2000. A grandfather rule would allow continued use of Crummey powers in existing irrevocable trusts, but only to the extent that the Crummey powers are held by primary noncontingent beneficiaries.

Pensions

Increase elective withholding rate for nonperiodic distributions from deferred compensation plans. —The Administration proposes increasing the current 10-percent elective withholding rate for nonperiodic distributions (such as certain lump sums) from pensions, IRAs and annuities to 15 percent, which more closely approximates the taxpayer's income tax liability for the distribution effective for distributions after 2001. The withholding would not apply to eligible rollover distributions.

Increase excise tax for excess IRA contributions.—Excess IRA contributions are currently subject to an annual 6-percent tax rate. With high investment returns, this annual 6-percent rate may be insufficient to discourage contributions in excess of the current limits for IRAs. The Administration proposes increasing from 6 percent to 10 percent the excise tax on excess contributions to IRAs for taxable years after the year the excess contribution is made. Thus, the 6-percent rate would continue to apply for the year of the excess contribution and the higher annual rate would only apply if the excess amounts are not withdrawn from the IRA. This increase would be effective for taxable years beginning after 2000.

Limit pre-funding of welfare benefits for 10 or more employer plans.—Current law generally limits the ability of employers to claim a deduction for amounts used to prefund welfare benefits. An exception is provided for certain arrangements where 10 or more employers participate because it is believed that such relationships involve risk-sharing similar to insurance which will effectively eliminate any incentive for participating employers to prefund benefits . However, as a practical matter, it has proven difficult to enforce the risk-sharing requirements in the context of certain arrangements. The Administration proposes limiting the 10 or more employer plan funding exception to medical, disability, and group-term life insurance benefits because these benefits do not present the same risk of prefunding abuse. Thus, effective for contributions paid after the date of first committee action, the existing deduction rules of the Internal Revenue Code would apply to prevent an employer who contributes to a 10 or more employer plan from claiming a current deduction for supplemental unemployment benefits, severance pay or life insurance (other than group-term life insurance) benefits to be paid in future years.

Subject signing bonuses to employment taxes.—Bonuses paid to individuals for signing a first contract of employment are ordinary income in the year received. The Administration proposes to clarify that these amounts are treated as wages for purposes of income tax withholding and FICA taxes effective after date of enactment. No inference is intended with respect to the application of prior law withholding rules to signing bonuses.

Clarify employment tax treatment of choreworkers.—Choreworkers, individuals paid by State agencies to provide domestic services for disabled and elderly individuals, often provide services for more than one disabled or elderly individual. The Administration's proposal would clarify that State agencies, and not the disabled or elderly individual receiving the services, are responsible for withholding and employment taxes for choreworkers effective for wages paid after 2000. For this purpose, all wages paid by the State agency to a choreworker are treated as paid by a single employer.

Prohibit IRAs from investing in foreign sales corporations.—Foreign sales corporations (FSCs) are foreign corporations whose income is partially subject to US tax. IRAs were never intended to be able to invest in FSCs. The proposal would prohibit an IRA from investing in a FSC effective after the date of first committee action.

Compliance

Tighten the substantial understatement penalty for large corporations.—Currently taxpayers may be penalized for erroneous, but non-negligent, return positions if the amount of the understatement is "substantial" and the taxpayer did not disclose the position in a statement with the return. "Substantial" is defined as 10 percent of the taxpayer's total current tax liability, but this can be a very large amount. This has led some large corporations to take aggressive reporting positions where huge amounts of potential tax liability are at stake—in effect playing the audit lottery—without any downside risk of penalties if they are caught, because the potential tax still would not exceed 10 percent of the company's total tax liability. To discourage such aggressive tax planning, the Administration proposes that any deficiency greater than $10 million be considered "substantial" for purposes of the substantial understatement penalty, whether or not it exceeds 10 percent of the taxpayer's liability. The proposal, which would be effective for taxable years beginning after the date of enactment, would affect only taxpayers that have tax liabilities greater than or equal to $100 million.

Require withholding on certain gambling winnings.—Proceeds of most wagers with odds of less than 300 to 1 are exempt from withholding, as are all bingo and keno winnings. The Administration proposes to impose withholding on proceeds of bingo or keno in excess of $5,000 at a rate of 28 percent, regardless of the odds of the wager, effective for payments made after the start of the first calendar quarter that is at least 30 days after the date of enactment.

Require information reporting for private separate accounts.—Direct investments generally result in taxable income each year of dividends and interest, plus taxable gain or loss for changes in the value of the securities in the year that such securities are sold. In contrast, investments held through insurance contracts—called separate accounts—generally give rise to tax-free or tax-deferred income unless the policyholder has too much control over the contract's investments. Insurance companies sometimes create private separate accounts through which only one or a small group of policyholders may invest their funds. These policyholders generally exercise investor control, and thus are liable for income tax each year on the investment income earned. However, the IRS has no efficient way to identify which insurance contracts' funds are invested through private separate accounts. The Administration proposal would require insurance companies to report each insurance contract with funds invested through private separate accounts, and the policyholder taxpayer identification number and earnings for such contract. The proposal would be effective for taxable years beginning after the date of enactment.

Increase penalties for failure to file correct information returns.—Any person who fails to file required information returns in a timely manner or incorrectly reports such information is subject to penalties. For taxpayers filing large volumes of information returns or reporting significant payments, existing penalties ($15 per return, not to exceed $75,000 if corrected within 30 days; $30 per return, not to exceed $150,000 if corrected by August 1; and $50 per return, not to exceed $250,000 if not corrected at all) may not be sufficient to encourage timely and accurate reporting. The Administration proposes to increase the general penalty amount, subject to the overall dollar limitations, to the greater of $50 per return or five percent of the total amount required to be reported. The increased penalty would not apply if the aggregate amount actually reported by the taxpayer on all returns filed for that calendar year was at least 97 percent of the amount required to be reported. The increased penalty would be effective for returns the due date for which is more than 90 days after the date of enactment.

Miscellaneous

Modify deposit requirement for Federal Unemployment Act (FUTA).—Beginning in 2005, the Administration proposes to require an employer to pay Federal and State unemployment taxes monthly (instead of quarterly) in a given year, if the employer's FUTA tax liability in the immediately preceding year was $1,100 or more.

Reinstate Oil Spill Liability Trust Fund tax.—Before January 1, 1995, a five-cents-per-barrel excise tax was imposed on domestic crude oil and imported oil and petroleum products. The tax was dedicated to the Oil Spill Liability Trust Fund to finance the cleanup of oil spills and was not imposed for a calendar quarter if the unobligated balance in the Trust Fund exceeded $1 billion at the close of the preceding quarter. The Administration proposes to reinstate this tax for the period after September 30, 2001 and before October 1, 2010. The tax would be suspended for a given calendar quarter if the unobligated Trust Fund balance at the end of the preceding quarter exceeded $5 billion.

Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands.—Taxpayers are allowed to deduct a reasonable allowance for depletion relating to certain mineral deposits. The depletion deduction for any taxable year is calculated under either the cost depletion method or the percentage depletion method, whichever results in the greater allowance for depletion for the year. The percentage depletion method is viewed as an incentive for mineral production rather than as a normative rule for recovering the taxpayer's investment in the property. This incentive is excessive with respect to minerals mined on Federal and formerly Federal lands under the 1872 mining act, in light of the minimal costs of acquiring the mining rights ($5.00 or less per acre). The Administration proposes to repeal percentage depletion for non-fuel minerals mined on Federal lands where the mining rights were originally acquired under the 1872 law, and on private lands acquired under the 1872 law. The proposal would be effective for taxable years beginning after the date of enactment.

Impose excise tax on purchase of structured settlements.—Current law facilitates the use of structured personal injury settlements because recipients of annuities under these settlements are less likely than recipients of lump sum awards to consume their awards too quickly and require public assistance. Consistent with that policy, this favorable treatment is conditional upon a requirement that the periodic payments cannot be accelerated, deferred, increased or decreased by the injured person. Nonetheless, certain factoring companies are able to purchase a portion of the annuities from the recipients for heavily discounted lump sums. These purchases are inconsistent with the policy underlying favorable tax treatment of structured settlements. Accordingly, the Administration proposes to impose on any person who purchases (or otherwise acquires for consideration) a structured settlement payment stream, a 40-percent excise tax on the difference between the amount paid by the purchaser to the injured person and the undiscounted value of the purchased payment stream unless such purchase is pursuant to a court order finding that the extraordinary and unanticipated needs of the original intended recipient render such a transaction desirable. The proposal would apply to purchases occurring on or after the date of enactment. No inference is intended as to the contractual validity of the purchase or the effect of the purchase transaction on the tax treatment of any party other than the purchaser.

Require taxpayers to include rental income of residence in income without regard to the period of rental.—Under current law, rental income is generally includable in income and the deductibility of expenses attributable to the rental property is subject to certain limitations. An exception to this general treatment applies if a dwelling is used by the taxpayer as a residence and is rented for less than 15 days during the taxable year. The income from such a rental is not included in gross income and no expenses arising from the rental are deductible. The Administration proposes to repeal this 15-day exception. The proposal would apply to taxable years beginning after December 31, 2000.

Eliminate installment payment of heavy vehicle use tax.—An annual tax is imposed on the use of heavy (at least 55,000 pounds) highway vehicles. The tax year is July 1 through June 30 and the tax return is generally due on August 31 of the year to which it relates. A taxpayer may, however, elect to pay the tax in installments. The installment option generally permits payment of one quarter of the tax on each of the following dates: August 31, December 31, March 31, and

June 30. States are required to obtain evidence, before issuing tags for a vehicle, that the use tax return has been filed and any tax due with the return (generally only the first installment) has been paid. To foster compliance, the Administration proposes to eliminate the installment option for taxable years beginning after June 30, 2002. Thus, heavy vehicle owners would be required to pay the entire tax with their returns and would be unable to obtain State tags without providing proof of full payment.

Require recognition of gain on sale of principal residence if acquired in a tax-free exchange within five years of sale.—Gain of up to $250,000 ($500,000 in the case of a joint return) from the sale or exchange of property is excluded from income if, during the five-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more. No gain or loss is recognized if property held for use in a trade or business or for investment is exchanged solely for other like-kind property held for use in a trade or business or for investment. The current-law exclusion for principal residences, in combination with the tax-free like-kind exchange provision, allows planning opportunities for taxpayers who wish to liquidate real property held for use in a trade or business or for investment. Such planning opportunities are beyond the intended scope of the principal residence exclusion. The Administration proposes to require recognition of gain on the sale of property that has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more if the property was acquired in a tax-free like-kind exchange within five years of the sale. The proposal would be effective for sales after the date of enactment.

International

Identified Tax Havens

The Administration is concerned about the use of tax havens. Tax havens facilitate tax avoidance and evasion and many of them, through strict confidentiality rules, substandard regulatory regimes, and uncooperative information exchange practices, inhibit our law enforcement capabilities. The Administration proposes several remedies to reduce the attractiveness of, and increase access to information about activity in, certain tax havens identified by the Secretary of the Treasury ("Identified Tax Havens"). To identify tax havens that will be subject to these rules, the Secretary of the Treasury will use criteria including, but not limited to, whether a jurisdiction imposes no or nominal taxation, either generally or on specific classes of capital income, has strict confidentiality rules and practices, and has ineffective information exchange practices.

Require reporting of all payments to identified tax havens—The proposal would provide that all payments to entities, including corporations, partnerships and disregarded entities, branches, trusts, accounts or individuals resident or located in Identified Tax Havens must be reported on the taxpayer's annual return unless: (1) information regarding the payment would be available to the IRS upon request or otherwise, or (2) the payment is less than $10,000. Failure to report a covered payment would result in the imposition of a penalty equal to 20 percent of the amount of the payment. Special rules would apply to certain financial services businesses that would permit reporting certain payments on an aggregate basis. An anti-abuse rule would require aggregation of related payments for purposes of determining whether a payment is under $10,000. The proposal would be effective for payments made after the date of enactment.

Impose limitations on certain tax attributes and income flowing through Identified Tax Havens.—Current rules deny foreign tax credits for taxes paid to (1) countries whose governments the U.S. does not recognize, (2) countries with respect to which the U.S. has severed diplomatic relations, or (3) countries that the State Department cites as supporting international terrorism. In addition, the foreign tax credit limitation and other rules are applied separately to income attributable to such countries. The proposal would apply similar rules to Identified Tax Havens. In addition, the proposal would reduce by a factor (similar to the international boycott factor) a taxpayer's (1) otherwise allowable foreign tax credit or FSC benefit attributable to income from an Identified Tax Haven, and (2) the income, attributable to an Identified Tax Haven, that is otherwise eligible for deferral. This reduction of tax benefits would be based on a fraction the numerator of which is the sum of the taxpayer's income and gains from an Identified Tax Haven and the denominator of which is the taxpayer's total non-U.S. income and gains. The proposal would be effective for taxable years beginning after the date of enactment.

Mark-to-Market Proposals

Modify treatment of built-in losses and other attributes trafficking.—Under current law, a taxpayer that becomes subject to U.S. taxation may take the position that it determines its beginning bases in its assets under U.S. tax principles as if the taxpayer had historically been subject to U.S. tax. Other tax attributes are computed similarly. A taxpayer may thus "import" built-in losses or other favorable tax attributes incurred outside U.S. taxing jurisdiction to offset income or gain that would otherwise be subject to U.S. tax. To prevent this ability to import "built-in" losses or other favorable attributes, the proposal would eliminate tax attributes (including built-in items) and mark-to-market bases when an entity or an asset becomes relevant for U.S. tax purposes. The proposal would be effective for transactions in which assets or entities become relevant for U.S. tax purposes on or after the date of enactment.

Simplify taxation of property that no longer produces income effectively connected with a U.S. trade or business.—Under current law, a foreign person is subject to tax in the United States on net income that is effectively connected with a U.S. trade or business (“ECI”). If a foreign person transfers property from a U.S. trade or business to its foreign office, the United States retains the right to tax all of the gain realized from a subsequent disposition of the property if the disposition occurs within ten years of the time the property ceased to be used in the U.S. trade or business. The United States also retains, for ten years, the right to tax deferred income from an asset attributable to a U.S. trade or business. These rules are difficult to administer and may in some cases result in the United States taxing gain that economically accrued after the property was removed from U.S. taxing jurisdiction. The proposal would mark to market property (including rights to deferred income) at the time that the property ceases to be used in, or attributable to, a U.S. trade or business. The proposal would be effective for property that ceases to be used in, or attributable to, a U.S. trade or business after the date of enactment.

Prevent avoidance of tax on U.S.-accrued gains (expatriation).—Under current rules, persons renouncing U.S. citizenship for tax-avoidance purposes are subject to U.S. taxation for ten years after renunciation. Although these rules were modified in 1996, they are still easily avoided and impose significant administrative burdens on both taxpayers and the Government. The proposal would simplify and toughen the taxation of expatriates by repealing the current regime and imposing a one-time tax on accrued gains at the time of expatriation. Also, if an expatriate subsequently makes a gift or bequest to a U.S. person, the proposal would treat the gift as gross income to the U.S. recipient, taxable at the highest marginal rate applicable to gifts and bequests. In addition, the proposal would amend a 1996 law (the “Reed Amendment”), which requires the Attorney General to deny re-entry to a tax-motivated expatriate, to coordinate it with the tax proposal, and improve the enforceability of both the tax proposal and the Reed Amendment. The proposal would apply for individuals expatriating on or after the date of first committee action.

Other International Provisions

Expand ECI rules to include certain foreign source income.—Under current rules, only certain enumerated types of foreign source income of a nonresident (rents, royalties, interest, dividends and sales of inventory property) can be treated as effectively connected with a U.S. trade or business (“ECI”) and thus subject to net basis taxation. Economic equivalents of such enumerated types of foreign source income, such as interest equivalents (including letter of credit fees) and dividend equivalents, cannot constitute ECI under any circumstances. Moreover, some excluded foreign source income can in large part be attributable to business activities that take place in the United States. For example, a foreign satellite corporation with an office, satellite ground station or other fixed place of business in the United States may earn income with respect to the leasing of a satellite. Under current rules, such foreign source income would not be subject to U.S. tax as ECI even if it is attributable to the foreign corporation’s U.S. office. The proposal would expand the categories of foreign source income that could constitute ECI to include interest equivalents and dividend equivalents and to include other income that is attributable to an office or other fixed place of business in the U.S. The proposal would be effective for taxable years beginning after date of enactment.

Limit basis step-up for imported pensions.—Under current law, a nonresident alien individual who anticipates receiving a distribution from a foreign pension plan may, under certain circumstances, establish U.S. residency, receive the distribution, claim a high basis in the plan distribution, and pay little or no U.S. tax on the distribution. Moreover, as a result of certain existing U.S. tax treaties, the individual may pay no foreign tax on the distribution. The proposal would prevent individuals from utilizing internal law and U.S. tax treaties to produce double non-taxation on foreign pension plan distributions. The proposal would modify the Internal Revenue Code to give an individual basis in a foreign pension plan distribution only to the extent the individual previously has been subject to tax (either in the United States or the foreign jurisdiction) on the amounts being distributed. The proposal would be effective for distributions occurring on or after the date of enactment.

Replace sales-source rules.—If inventory is manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of the income from such sales is treated as earned in production activities and 50 percent in sales activities. The income from the production activities is sourced on the basis of the location of assets held or used to produce the income. The income from the sales activities (the remaining 50 percent) is sourced based on where title to the inventory transfers. If inventory is purchased in the United States and sold abroad, 100 percent of the sales income generally is deemed to be foreign source. These rules generally produce more foreign source income for United States tax purposes than is subject to foreign tax. This generally increases the U.S. exporters’ foreign tax credit limitation and allows U.S. exporters that operate in high-tax foreign countries to credit against their U.S. tax liability foreign income taxes levied in excess of the U.S. income tax rate. The proposal would require that the allocation between production and sales be based on actual economic activity. The proposal would be effective for taxable years beginning after the date of enactment.

Modify rules relating to foreign oil and gas extraction income.—To be eligible for the U.S. foreign tax credit, a foreign levy must be the substantial equivalent of an income tax in the U.S. sense, regardless of the label the foreign government attaches to it. Under regulations, a foreign levy is a tax if it is a compulsory payment under the authority of a foreign government to levy taxes and is not compensation for a specific economic benefit provided by the foreign country. Taxpayers that are subject to a foreign levy and that also receive (directly or indirectly) a specific economic benefit from the levying country are referred to as "dual capacity" taxpayers and may not claim a credit for that portion of the foreign levy paid as compensation for the specific economic benefit received. The Administration proposes to treat as taxes payments by a dual-capacity taxpayer to a foreign country that would otherwise qualify as income taxes or "in lieu of" taxes, only if there is a "generally applicable income tax" in that country. For this purpose, a generally applicable income tax is an income tax (or a series of income taxes) that applies to trade or business income from sources in that country, so long as the levy has substantial application both to non-dual-capacity taxpayers and to persons who are citizens or residents of that country. Where the foreign country does generally impose an income tax, as under present law, credits would be allowed up to the level of taxation that would be imposed under that general tax, so long as the tax satisfies the new statutory definition of a "generally applicable income tax." The proposal also would create a new foreign tax credit basket within section 904 for foreign oil and gas income. The proposal would be effective for taxable years beginning after the date of enactment. The proposal would yield to U.S. tax treaty obligations that allow a credit for taxes paid or accrued on certain oil or gas income.

Recapture overall foreign losses when controlled foreign corporation (CFC) stock is disposed.—Under the interest allocation rules of section 864(e), the value of stock in a CFC is added to the value of directly-owned foreign assets, and then compared to the value of domestic assets of a corporation (or a group of affiliated U.S. corporations) for purposes of determining how much of the corporation's interest deductions should be allocated against foreign income and how much against domestic income. If these deductions against foreign income result in (or increase) an overall foreign loss which is then applied against U.S. income, section 904(f) recapture rules require subsequent foreign income or gain to be recharacterized as domestic. Recapture can take place when a taxpayer disposes of directly-owned foreign assets, for example. However, there may be no recapture when a shareholder disposes of stock in a CFC. The proposal would correct that asymmetry by providing that property subject to the recapture rules upon disposition under section 904(f)(3) would include stock in a CFC. The proposal would be effective on or after the date of enactment.

Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office.—In the case of a sale of inventory property that is attributable to a nonresident's office or other fixed place of business within the United States, the sales income is generally U.S. source. The income is foreign source, however, if the inventory is sold for use, disposition, or consumption outside the United States and the nonresident's foreign office or other fixed place of business materially participates in the sale. The proposal would provide that the foreign source exception shall apply only if an income tax equal to at least 10 percent of the income from the sale is actually paid to a foreign country with respect to such income. The proposal thereby ensures that the United States does not cede its jurisdiction to tax such sales unless the income from the sale is actually taxed by a foreign country at some minimal level. The proposal would be effective for transactions occurring on or after the date of enactment.

OTHER PROVISIONS THAT AFFECT RECEIPTS

Reinstate environmental tax imposed on corporate taxable income and deposited in the Hazardous Substance Superfund Trust Fund.—Under prior law, a tax equal to 0.12 percent of alternative minimum taxable income (with certain modifications) in excess of $2 million was levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. The Administration proposes to reinstate this tax, which expired on December 31, 1995, for taxable years beginning after December 31, 1999 and before January 1, 2011.

Reinstate excise taxes deposited in the Hazardous Substance Superfund Trust Fund.—The excise taxes that were levied on petroleum, chemicals, and imported substances and deposited in the Hazardous Substance Superfund Trust Fund are proposed to be reinstated for the period after the date of enactment and before October 1, 2010. These taxes expired on December 31, 1995.

Convert a portion of the excise taxes deposited in the Airport and Airway Trust Fund to cost-based user fees assessed for Federal Aviation Administration (FAA) services.—The excise taxes that are levied on domestic air passenger tickets and flight segments, international departures and arrivals, and domestic air cargo are proposed to be reduced over time as more efficient, cost-based user fees for air traffic services are phased in beginning in fiscal year 2001. The Administration proposes to phase in implementation of the new fees over two years and raise sufficient revenue (excise taxes plus new fees) to support expected FAA operational and capital needs in the subsequent year.

Increase excise tax on tobacco products and levy a youth smoking assessment on tobacco manufacturers. —Under current law, the 34-cents-per-pack excise tax on cigarettes is scheduled to increase by 5-cents-per-pack effective January 1, 2002. The Administration proposes to accelerate the scheduled 5-cents-per-pack increase in the excise tax on cigarettes and to increase the tax by an additional 25-cents-per-pack effective October 1, 2000. Tax rates on other taxable tobacco products will increase proportionately. In addition, beginning after 2003, the Administration proposes to levy an assessment on tobacco manufacturers if the youth smoking rate is not reduced by 50 percent.

Recover State bank supervision and regulation expenses (receipt effect).—The Administration proposes to require the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to recover their respective costs for supervision and regulation of State-chartered banks and bank holding companies. The Federal Reserve currently funds the costs of such examinations from earnings; therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, will increase by the amount of the recoveries.

Maintain Federal Reserve surplus transfer to the Treasury.—In FY 2000, the Federal Reserve System transferred $3.752 billion from its capital account surplus funds to the Treasury. The Administration proposes in FY 2001 that the Federal Reserve System maintain the capital account surplus fund at the post-transfer level.

Restore premiums for the United Mine Workers of America Combined Benefit Fund.—The Administration proposes legislation to restore the previous calculation of premiums charged to coal companies that employed the retired miners that have been assigned to them. By reversing the court decision of *National Coal v. Chater*, this legislation will restore a premium calculation that supports medical cost containment.

Extend abandoned mine reclamation fees.—The abandoned mine reclamation fees, which are scheduled to expire on September 30, 2004, are proposed to be extended through September 30, 2014. These fees, which are levied on coal operators, generally are the lesser of 15 cents per ton for coal produced by underground mining and 35 cents per ton for coal produced by surface mining, or 10 percent of the value of the coal at the mine. Amounts collected will be used to continue abandoned coal mine reclamation. The coal mining states and Indian Tribes have identified over $4.2 billion in remaining restoration needs. Each year, states, Indian Tribes and Federal agencies identify additional needs.

Replace Harbor Maintenance Tax with the Harbor Services User Fee (receipt effect).—The Administration proposes to replace the ad valorem Harbor Maintenance Tax with a cost-based user fee, the Harbor Services User Fee. The user fee will finance construction and operation and maintenance of harbor activities performed by the Army Corps of Engineers, the costs of operating and maintaining the Saint Lawrence Seaway, and the costs of administering the fee. Through appropriation acts, the fee will raise an average of $980 million annually through FY 2005, which is less than would have been raised by the Harbor Maintenance Tax before the Supreme Court decision that the ad valorem tax on exports was unconstitutional.

Revise Army Corps of Engineers regulatory program fees.—The Army Corps of Engineers has not changed the fee structure of its regulatory program since 1977. The Administration proposes to pursue reasonable changes that would reduce the fees paid from many applicants and increase recovery from commercial applicants.

Roll back Federal employee retirement contributions.—The Administration proposes to roll back to pre-1999 levels the higher retirement contributions required of Federal employees by the Balanced Budget Act of 1997. The rollback is proposed to take effect in January 2001.

Provide government-wide buyout authority (receipt effect).—The Administration proposes to provide government-wide buyout authority, which will lower employee contributions to the civil service retirement fund.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	Estimate						
	2000	2001	2002	2003	2004	2005	2001–2005
Provide tax relief:							
Expand educational opportunities:							
Provide College Opportunity tax cut	....	–395	–2,009	–2,323	–3,103	–3,262	–11,092
Provide incentives for public school construction and modernization	....	–36	–174	–419	–739	–1,020	–2,388
Expand exclusion for employer-provided educational assistance to include graduate education	–66	–275	–90	....	....	....	–365
Eliminate 60-month limit on student loan interest deduction	....	–23	–80	–87	–89	–93	–372
Eliminate tax when forgiving student loans subject to income contingent repayment	....	....	....	....	....	....	....
Provide tax relief for participants in certain Federal education programs	....	–3	–7	–7	–7	–6	–30
Subtotal, expand educational opportunities	–66	–732	–2,360	–2,836	–3,938	–4,381	–14,247
Provide poverty relief and revitalize communities:							
Increase and simplify the Earned Income Tax Credit (EITC) [1]	....	–2,293	–1,936	–1,967	–1,992	–2,001	–10,189
Increase and index low-income housing tax credit per-capita cap	....	–6	–55	–168	–306	–448	–983
Provide New Markets Tax Credit	....	–30	–222	–515	–743	–940	–2,450
Extend Empowerment Zone (EZ) tax incentives and authorize additional EZs	....	–36	–167	–333	–452	–568	–1,556
Provide Better America Bonds to improve the environment	....	–8	–41	–112	–214	–315	–690
Permanently extend the expensing of brownfields remediation costs	....	....	–98	–152	–146	–140	–536
Expand tax incentives for specialized small business investment companies (SSBICs)	–*	–*	–*	–*	–*	–*	–*
Bridge the Digital Divide	....	–107	–272	–344	–289	–207	–1,219
Subtotal, provide poverty relief and revitalize communities	....	–2,480	–2,791	–3,591	–4,142	–4,619	–17,623
Make health care more affordable:							
Assist taxpayers with long-term care needs [2]	....	–109	–1,150	–1,681	–2,427	–3,028	–8,395
Encourage COBRA continuation coverage	....	....	–41	–858	–1,149	–1,286	–3,334
Provide tax credit for Medicare buy-in program	....	....	–5	–105	–140	–164	–414
Provide tax relief for workers with disabilities [2]	....	–18	–128	–143	–158	–165	–612
Provide tax relief to encourage small business health plans	....	–1	–9	–22	–35	–38	–105
Encourage development of vaccines for targeted diseases	....	....	....	....	....	....	....
Subtotal, make health care more affordable [2]	....	–128	–1,333	–2,809	–3,909	–4,681	–12,860
Strengthen families and improve work incentives:							
Provide marriage penalty relief and increase standard deduction	....	–248	–843	–1,536	–2,130	–4,637	–9,394
Increase, expand, and simplify child and dependent care tax credit [2]	....	–121	–589	–922	–1,288	–1,643	–4,563
Provide tax incentives for employer-provided child-care facilities	....	–42	–88	–121	–140	–148	–539
Subtotal, strengthen families and improve work incentives [2]	....	–411	–1,520	–2,579	–3,558	–6,428	–14,496
Promote expanded retirement savings, security, and portability:							
Establish Retirement Savings Accounts	....	....	–657	–2,185	–2,290	–4,034	–9,166
Provide small business tax credit for automatic contributions for non-highly compensated employees	....	....	–157	–648	–1,878	–3,074	–5,757
Provide tax credit for plan start up and administrative expenses; provide for payroll deduction IRAs	–1	–18	–35	–61	–92	–135	–341
Provide for the SMART plan	....	–44	–65	–66	–68	–70	–313
Enhance the 401(k) SIMPLE plan	....	–25	–61	–108	–161	–236	–591
Accelerate vesting for qualified plans	....	214	137	104	66	29	550
Other changes affecting retirement savings, security and portability	....	–53	–207	–288	–377	–450	–1,375
Subtotal, promote expanded retirement savings, security and portability	–1	74	–1,045	–3,252	–4,800	–7,970	–16,993
Provide AMT relief for families and simplify the tax laws:							
Provide adjustments for personal exemptions and the standard deduction in the individual alternative minimum tax (AMT)	–72	–377	–544	–996	–1,312	–1,650	–4,879
Simplify and increase standard deduction for dependent filers	–7	–42	–29	–33	–51	–37	–192
Replace support test with residency test (limited to children)	....	–66	–97	–102	–107	–112	–484
Provide tax credit to encourage electronic filing of individual income tax returns [2]	....	....	–192	–207	–208	–209	–816
Simplify, retarget and expand expensing for small business	....	–217	–206	–19	–86	–135	–663
Simplify the foreign tax credit limitation for dividends from 10/50 companies	–80	–168	–102	–46	10	27	–279
Other simplification	–1	–17	–23	–27	–30	–35	–132
Subtotal, provide AMT relief for families and simplify the tax laws [2]	–160	–887	–1,193	–1,430	–1,784	–2,151	–7,445
Encourage philanthropy:							
Allow deduction for charitable contributions by non-itemizing taxpayers	....	–516	–1,062	–733	–765	–817	–3,893
Simplify and reduce the excise tax on foundation investment income	....	–49	–70	–71	–73	–75	–338
Increase limit on charitable donations of appreciated property	....	–7	–47	–29	–20	–12	–115

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	Estimate						
	2000	2001	2002	2003	2004	2005	2001–2005
Clarify public charity status of donor advised funds	*	*	*	*	*	*	*
Subtotal, encourage philanthropy	....	–572	–1,179	–833	–858	–904	–4,346
Promote energy efficiency and improve the environment:							
Provide tax credit for energy-efficient building equipment	....	–18	–35	–49	–71	–28	–201
Provide tax credit for new energy-efficient homes	....	–82	–150	–194	–134	–73	–633
Extend electric vehicle tax credit and provide tax credit for hybrid vehicles	....	....	–4	–182	–700	–1,192	–2,078
Provide 15-year depreciable life for distributed power property	....	–1	–1	–2	–3	–3	–10
Extend and modify the tax credit for producing electricity from certain sources	....	–91	–173	–220	–231	–261	–976
Provide tax credit for solar energy systems	....	–9	–19	–25	–34	–45	–132
Subtotal, promote energy efficiency and improve the environment	....	–201	–382	–672	–1,173	–1,602	–4,030
Electricity restructuring	....	3	11	20	30	41	105
Modify international trade provisions:							
Extend and modify Puerto Rico economic-activity tax credit	....	–35	–67	–101	–134	–166	–503
Extend GSP and modify other trade provisions [3]	–10	–454	–858	–940	–884	–248	–3,384
Levy tariff on certain textiles/apparel produced in the CNMI [3]	....	....	169	169	169	169	676
Subtotal, modify international trade provisions [3]	–10	–489	–756	–872	–849	–245	–3,211
Miscellaneous provisions:							
Make first $2,000 of severance pay exempt from income tax	....	–43	–174	–180	–138	....	–535
Exempt Holocaust reparations from Federal income tax	–4	–17	–18	–19	–15	....	–69
Subtotal, miscellaneous provisions	–4	–60	–192	–199	–153	....	–604
Subtotal, provide tax relief [2 3]	**–241**	**–5,883**	**–12,740**	**–19,053**	**–25,134**	**–32,940**	**–95,750**
Refundable credits	....	**–23**	**–679**	**–736**	**–2,218**	**–2,343**	**–5,999**
Total gross tax relief including refundable credits [3]	**–241**	**–5,906**	**–13,419**	**–19,789**	**–27,352**	**–35,283**	**–101,749**
Eliminate unwarranted benefits and adopt other revenue measures:							
Limit benefits of corporate tax shelter transactions:							
Increase disclosure of certain transactions, modify substantial understatement penalty for corporate tax shelters, codify the economic substance doctrine, tax income from shelters involving tax-indifferent parties and impose a penalty excise tax on certain fees received by promotors and advisors	....	1,872	1,392	1,357	1,351	1,374	7,346
Require accrual of income on forward sale of corporate stock	1	5	10	15	21	26	77
Modify treatment of ESOP as S corporation shareholder	....	15	47	67	88	104	321
Limit dividend treatment for payments on certain self-amortizing stock	....	22	37	39	40	42	180
Prevent serial liquidation of U.S. subsidiaries of foreign corporations	12	20	19	19	19	18	95
Prevent capital gains avoidance through basis shift transactions involving foreign shareholders	71	328	121	65	45	26	585
Prevent mismatching of deductions and income in transactions with related foreign persons	....	62	108	112	117	122	521
Prevent duplication or acceleration of loss through assumption of certain liabilities	4	34	36	37	38	40	185
Amend 80/20 company rules	....	21	46	53	54	56	230
Modify corporate-owned life insurance (COLI) rules	....	176	340	417	489	548	1,970
Require lessors of tax-exempt-use property to include service contract options in lease term	....	6	11	17	24	30	88
Interaction	–42	–239	–175	–157	–157	–160	–888
Subtotal, limit benefits of corporate tax shelter transactions	46	2,322	1,992	2,041	2,129	2,226	10,710
Other proposals:							
Require banks to accrue interest on short-term obligations	6	63	21	4	5	5	98
Require current accrual of market discount by accrual method taxpayers	1	7	13	19	25	31	95
Modify and clarify certain rules relating to debt-for-debt exchanges	9	73	74	71	70	70	358
Modify and clarify the straddle rules	14	30	34	33	34	35	166
Provide generalized rules for all stripping transactions	7	18	22	21	19	18	98
Require ordinary treatment for certain dealers of commodities and equity options	16	29	31	31	31	31	153
Prohibit tax deferral on contributions of appreciated property to swap funds	....	2	5	8	10	11	36
Conform control test for tax-free incorporations, distributions, and reorganizations	13	34	41	39	38	39	191
Treat receipt of tracking stock in certain distributions and exchanges as the receipt of property	28	108	158	153	149	151	719
Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions	1	41	51	53	55	57	257
Modify tax treatment of certain reorganizations involving portfolio stock	17	49	66	71	77	83	346
Modify definition of nonqualified preferred stock	11	53	61	64	67	54	299

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

		Estimate					
	2000	2001	2002	2003	2004	2005	2001–2005
Modify estimated tax provision for deemed asset sales	....	314	90	–23	–15	–8	358
Modify treatment of transfers to creditors in divisive reorganizations	3	15	18	19	20	21	93
Provide mandatory basis adjustments for partners that have a significant net built-in loss in partnership property	–41	50	52	55	60	58	275
Modify treatment of closely held REITs	....	1	4	8	12	17	42
Apply RIC excise tax to undistributed profits of REITs	....	....	1	1	1	1	4
Allow RICs a dividends paid deduction for redemptions only in cases where the redemption represents a contraction in the RIC	....	99	489	457	429	405	1,879
Require REMICs to be secondarily liable for the tax liability of REMIC residual interest holders	....	5	17	29	42	55	148
Deny change in method treatment to tax-free formations	3	59	59	59	61	63	301
Deny deduction for punitive damages	16	92	130	137	144	151	654
Repeal lower-of-cost-or-market inventory accounting method	....	459	447	371	372	154	1,803
Disallow interest on debt allocable to tax-exempt obligations	4	11	18	24	30	35	118
Require capitalization of mutual fund commissions	....	23	111	98	83	64	379
Provide consistent amortization periods for intangibles	....	–216	–220	34	259	445	302
Clarify recovery period of utility grading costs	12	40	65	82	91	99	377
Apply rules generally applicable to acquisitions of tangible assets to acquisitions of professional sports franchises	2	43	73	113	141	139	509
Require recapture of policyholder surplus accounts	....	65	174	285	522	782	1,828
Modify rules for capitalizing policy acquisition costs of life insurance companies	....	536	1,820	2,191	2,413	1,328	8,288
Increase the proration percentage for P&C insurance companies	....	48	82	98	115	133	476
Modify rules that apply to sales of life insurance contracts	....	13	35	39	43	48	178
Modify rules that apply to tax-exempt property casualty insurance companies	....	12	22	23	24	25	106
Subject investment income of trade associations to tax	....	180	309	325	341	358	1,513
Impose penalty for failure to file an annual information return	....	....	24	23	22	21	90
Restore phaseout of unified credit for large estates	....	33	70	78	83	106	370
Require consistent valuation for estate and income tax purposes	1	5	10	14	18	21	68
Require basis allocation for part sale, part gift transactions	....	2	3	4	5	5	19
Conform treatment of surviving spouses in community property States	3	19	42	59	75	92	287
Include QTIP trust assets in surviving spouse's estate	....	....	2	2	2	2	8
Eliminate non-business valuation discounts	....	271	575	600	636	618	2,700
Eliminate gift tax exemption for personal residence trusts	....	–1	–1	....	5	14	17
Modify requirements for annual exclusion for gifts	....	....	20	20	22	20	82
Increase elective withholding rate for nonperiodic distributions from deferred compensation plans	....	....	47	3	3	3	56
Increase excise tax for excess IRA contributions	....	1	12	13	14	14	54
Limit pre-funding of welfare benefits for 10 or more employer plans	....	92	156	159	151	150	708
Subject signing bonuses to employment taxes	....	5	3	3	3	2	16
Clarify employment tax treatment of choreworkers	....	48	64	64	63	63	302
Prohibit IRAs from investing in foreign sales corporations	3	16	29	30	32	33	140
Tighten the substantial understatement penalty for large corporations	....	26	44	45	41	37	193
Require withholding on certain gambling winnings	....	20	1	1	1	1	24
Require information reporting for private separate accounts	....	5	10	14	18	21	68
Increase penalties for failure to file correct information returns	....	6	15	15	9	10	55
Modify deposit requirement for FUTA	....	....	....	....	....	1,583	1,583
Reinstate Oil Spill Liability Trust Fund tax [3]	....	....	253	261	264	266	1,044
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	....	94	96	97	99	101	487
Impose excise tax on purchase of structured settlements	6	7	5	2	....	–2	12
Require taxpayers to include rental income of residence in income without regard to the period of rental	....	4	11	12	12	13	52
Eliminate installment payment of heavy vehicle use tax [3]	....	....	378	27	30	32	467
Require recognition of gain on sale of principal residence if acquired in a tax-free exchange within five years of the sale	....	10	13	11	11	11	56
Limit benefits of transactions with ''Identified Tax Havens''	....	36	52	40	36	35	199
Modify treatment of built-in losses and other attributes trafficking	1	78	136	143	151	161	669
Simplify taxation of property that no longer produces income effectively connected with a U.S. trade or business	*	*	*	*	*	*	*
Prevent avoidance of tax on U.S.-accrued gains (expatriation)	3	28	58	107	155	212	560
Expand ECI rules to include certain foreign source income	....	22	38	39	41	42	182
Limit basis step-up for imported pensions	2	26	33	34	36	38	167
Replace sales-source rules	....	320	570	600	630	660	2,780
Modify rules relating to foreign oil and gas extraction income	....	5	69	112	118	124	428
Recapture overall foreign losses when CFC stock is disposed	1	1	*	*	*	*	1
Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office	1	7	10	11	11	11	50

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	Estimate						
	2000	2001	2002	2003	2004	2005	2001–2005
Subtotal, other proposals [3]	143	3,542	7,221	7,635	8,565	9,478	36,441
Subtotal, eliminate unwarranted benefits and adopt other revenue measures [3]	**189**	**5,864**	**9,213**	**9,676**	**10,694**	**11,704**	**47,151**
Net tax relief including refundable credits [3]	**–52**	**–42**	**–4,206**	**–10,113**	**–16,658**	**–23,579**	**–54,598**
Other provisions that affect receipts:							
Reinstate environmental tax on corporate taxable income [4]	....	725	432	438	434	437	2,466
Reinstate Superfund excise taxes [3]	152	707	762	772	785	797	3,823
Convert Airport and Airway Trust Fund taxes to a cost-based user fee system [3]	....	724	1,399	1,500	1,522	1,522	6,667
Increase excise tax on tobacco products and levy a youth smoking assessment on tobacco manufacturers [3]	446	4,084	3,738	3,532	10,140	9,700	31,194
Recover State bank supervision and regulation expenses (receipt effect) [3]	....	78	82	86	90	95	431
Maintain Federal Reserve surplus transfer to the Treasury	....	3,752	....	....	....	....	3,752
Restore premiums for United Mine Workers of America Combined Benefit Fund	....	11	10	10	9	9	49
Extend abandoned mine reclamation fees [3]	....	....	....	....	....	218	218
Replace Harbor Maintenance tax with the Harbor Services User Fee (receipt effect) [3]	....	–549	–602	–647	–681	–718	–3,197
Revise Army Corps of Engineers regulatory program fees [3]	....	5	5	5	5	5	25
Roll back Federal employee retirement contributions	....	–427	–619	–160	....	....	–1,206
Provide Government-wide buyout authority (receipt effect)	....	–9	–18	–9	....	....	–36
Total, other provisions [3 4]	**598**	**9,101**	**5,189**	**5,527**	**12,304**	**12,065**	**44,186**

* $500,000 or less

[1] The proposal to increase and simplify the Earned Income Tax Credit has both receipts and outlay effects. The receipts effect for the proposal is –$305 million, –$304 million, –$314 million, –$326 million and –$339 million for fiscal years 2001–2005, respectively. The outlay effect is $2,003 million, $1,936 million, $1,967 million, $1,992 million and $2,001 million for fiscal years 2001–2005, respectively.

[2] Amounts shown are the effect on receipts.

[3] Net of income offsets

[4] Net of deductibility for income tax purposes

Table 3–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1999 Actual	Estimate 2000	2001	2002	2003	2004	2005
Individual income taxes (federal funds):							
Existing law	879,480	951,945	978,249	1,005,714	1,040,248	1,086,039	1,143,081
Proposed Legislation (PAYGO)	....	–359	–5,634	–10,125	–14,215	–19,554	–25,821
Legislative proposal, discretionary offset	....	....	–205	–397	–424	–432	–432
Total individual income taxes	**879,480**	**951,586**	**972,410**	**995,192**	**1,025,609**	**1,066,053**	**1,116,828**
Corporation income taxes:							
Federal funds:							
Existing law	184,670	192,285	189,594	190,189	191,800	196,090	205,076
Proposed Legislation (PAYGO)	....	110	3,942	4,405	3,105	3,150	....
Legislative proposal, discretionary offset	....	....	119	102	110	119	131
Total Federal funds corporation income taxes	184,670	192,395	193,655	194,696	195,015	199,359	205,207
Trust funds:							
Hazardous substance superfund	10	....	....	....	....	....	....
Proposed Legislation (PAYGO)	....	....	1,115	664	674	668	673
Total corporation income taxes	**184,680**	**192,395**	**194,770**	**195,360**	**195,689**	**200,027**	**205,880**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old age and survivors insurance (Off-budget)	383,559	408,583	427,322	446,421	465,244	484,401	511,676
Disability insurance (Off-budget)	60,909	68,180	72,573	75,805	79,003	82,259	86,890
Hospital insurance	132,268	136,515	143,695	150,290	156,694	163,258	172,612
Railroad retirement:							
Social Security equivalent account	1,515	1,639	1,674	1,697	1,719	1,740	1,762
Rail pension and supplemental annuity	2,629	2,621	2,661	2,699	2,736	2,773	2,803
Total employment and general retirement	580,880	617,538	647,925	676,912	705,396	734,431	775,743
On-budget	136,412	140,775	148,030	154,686	161,149	167,771	177,177
Off-budget	444,468	476,763	499,895	522,226	544,247	566,660	598,566
Unemployment insurance:							
Deposits by States [1]	19,894	21,453	23,327	24,529	25,594	26,273	27,411
Proposed Legislation (PAYGO)	....	....	....	....	....	....	1,297
Federal unemployment receipts [1]	6,475	6,668	6,873	7,010	7,127	7,260	7,405
Proposed Legislation (PAYGO)	....	....	....	....	....	....	286
Railroad unemployment receipts [1]	111	67	54	97	123	124	102
Total unemployment insurance	26,480	28,188	30,254	31,636	32,844	33,657	36,501
Other retirement:							
Federal employees' retirement—employee share	4,400	4,221	4,269	4,194	3,547	3,197	3,028
Proposed Legislation (non-PAYGO)	....	....	–9	–18	–9	....	....
Proposed Legislation (PAYGO)	....	....	–427	–619	–160	....	....
Non-Federal employees retirement [2]	73	74	68	63	51	46	43
Total other retirement	4,473	4,295	3,901	3,620	3,429	3,243	3,071
Total social insurance and retirement receipts	**611,833**	**650,021**	**682,080**	**712,168**	**741,669**	**771,331**	**815,315**
On-budget	167,365	173,258	182,185	189,942	197,422	204,671	216,749
Off-budget	444,468	476,763	499,895	522,226	544,247	566,660	598,566
Excise taxes:							
Federal funds:							
Alcohol taxes	7,386	7,267	7,150	7,158	7,120	7,091	7,080
Proposed Legislation (PAYGO)	....	–32	32	....	....	....	....
Tobacco taxes	5,400	6,742	7,158	7,844	8,013	7,938	7,869
Proposed Legislation (PAYGO)	....	594	5,446	4,985	4,709	4,018	3,756
Transportation fuels tax	849	787	808	793	811	817	836
Telephone and teletype services	5,185	5,500	5,821	6,142	6,471	6,833	7,231
Ozone depleting chemicals and products	105	73	73	22	9	....	....
Other Federal fund excise taxes	368	2,174	2,200	2,114	1,997	1,987	2,030

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1999 Actual	Estimate 2000	2001	2002	2003	2004	2005
Proposed Legislation (PAYGO)	....	38	–74	–65	–69	–73	–77
Total Federal fund excise taxes	19,293	23,143	28,614	28,993	29,061	28,611	28,725
Trust funds:							
Highway	39,299	34,311	35,148	35,597	36,229	36,870	37,622
Proposed Legislation (PAYGO)	....	....	....	383	32	35	37
Airport and airway	10,391	9,222	9,645	10,173	10,630	11,333	12,115
Legislative proposal, discretionary offset	....	....	965	1,866	1,999	2,030	2,030
Aquatic resources	374	336	341	376	380	395	401
Black lung disability insurance	596	577	591	606	619	628	636
Inland waterway	104	104	107	109	111	114	116
Hazardous substance superfund	11	....	....	....	....	....	....
Proposed Legislation (PAYGO)	....	204	942	1,016	1,031	1,046	1,063
Oil spill liability	....	173	....	....	....	....	....
Proposed Legislation (PAYGO)	....	....	....	338	348	351	355
Vaccine injury compensation	130	131	134	137	139	141	110
Leaking underground storage tank	216	183	189	191	195	198	202
Total trust funds excise taxes	51,121	45,241	48,062	50,792	51,713	53,141	54,687
Total excise taxes	**70,414**	**68,384**	**76,676**	**79,785**	**80,774**	**81,752**	**83,412**
Estate and gift taxes:							
Federal funds	27,782	30,482	31,975	34,172	35,494	37,831	36,151
Proposed Legislation (PAYGO)	....	4	329	721	777	846	878
Total estate and gift taxes	**27,782**	**30,486**	**32,304**	**34,893**	**36,271**	**38,677**	**37,029**
Customs duties:							
Federal funds	17,727	20,149	21,405	23,430	25,262	26,554	27,921
Proposed Legislation (PAYGO)	....	–13	–569	–880	–990	–917	–71
Trust funds	609	739	797	870	932	978	1,030
Proposed Legislation (PAYGO)	....	....	–30	–30	–30	–30	–30
Legislative proposal, discretionary offset	....	....	–732	–803	–863	–908	–958
Total customs duties	**18,336**	**20,875**	**20,871**	**22,587**	**24,311**	**25,677**	**27,892**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	101	119	121	124	126	129	132
Proposed youth smoking assessment (PAYGO)	....	....	....	....	....	7,379	7,280
United Mine Workers of America combined benefit fund	148	142	138	132	127	122	118
Proposed Legislation (PAYGO)	....	....	11	10	10	9	9
Deposit of earnings, Federal Reserve System	25,917	32,452	25,664	30,196	31,296	32,489	33,662
Legislative proposal, discretionary offset	....	....	3,856	109	115	120	126
Defense cooperation	....	6	6	6	6	6	6
Fees for permits and regulatory and judicial services	6,572	7,509	7,965	8,726	9,549	10,378	10,972
Proposed Legislation (PAYGO)	....	....	–2	–7	–7	....	290
Legislative proposal, discretionary offset	....	....	7	7	7	7	7
Fines, penalties, and forfeitures	2,738	2,188	2,157	1,966	1,977	1,977	1,979
Gifts and contributions	186	281	188	156	150	148	149
Refunds and recoveries	–733	–192	–191	–190	–190	–190	–190
Total miscellaneous receipts	**34,929**	**42,505**	**39,920**	**41,235**	**43,166**	**52,574**	**54,540**
Total budget receipts	**1,827,454**	**1,956,252**	**2,019,031**	**2,081,220**	**2,147,489**	**2,236,091**	**2,340,896**
On-budget	1,382,986	1,479,489	1,519,136	1,558,994	1,603,242	1,669,431	1,742,330
Off-budget	444,468	476,763	499,895	522,226	544,247	566,660	598,566

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and administrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds.