FEDERAL RECEIPTS AND COLLECTIONS

16. 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 2005 are estimated to be $2,036.3 billion, an increase of $238.2 billion or 13.2 percent relative to 2004. Receipts are projected to grow at an average annual rate of 6.5 percent between 2005 and 2009, rising to $2,616.4 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation. These estimates reflect a downward adjustment for revenue uncertainty of $20 billion in 2004 and $15 billion in 2005. As this description suggests, these latter amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.

As a share of GDP, receipts are projected to increase from 15.7 percent in 2004 to 16.9 percent in 2005. The receipts share of GDP is projected to increase annually thereafter, rising to 17.8 percent in 2009.

Table 16–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	2003 actual	Estimate					
		2004	2005	2006	2007	2008	2009
Individual income taxes	793.7	765.4	873.8	956.5	1,049.3	1,133.4	1,209.9
Corporation income taxes	131.8	168.7	230.2	250.0	251.0	252.1	255.7
Social insurance and retirement receipts	713.0	732.4	793.9	834.0	878.7	918.8	960.2
(On-budget)	(189.1)	(198.4)	(218.8)	(230.9)	(242.4)	(251.2)	(261.2)
(Off-budget)	(523.8)	(534.0)	(575.1)	(603.1)	(636.3)	(667.6)	(698.9)
Excise taxes	67.5	70.8	73.2	75.8	77.9	80.0	82.2
Estate and gift taxes	22.0	23.9	21.4	23.9	21.5	22.2	23.6
Customs duties	19.9	22.6	22.1	24.4	26.2	27.6	30.0
Miscellaneous receipts	34.5	34.3	36.5	41.2	46.2	51.2	54.8
Adjustment for revenue uncertainty	....	–20.0	–15.0	....	....	....	....
Total receipts	**1,782.3**	**1,798.1**	**2,036.3**	**2,205.7**	**2,350.8**	**2,485.3**	**2,616.4**
(On-budget)	*(1,258.5)*	*(1,264.1)*	*(1,461.2)*	*(1,602.5)*	*(1,714.5)*	*(1,817.7)*	*(1,917.5)*
(Off-budget)	*(523.8)*	*(534.0)*	*(575.1)*	*(603.1)*	*(636.3)*	*(667.6)*	*(698.9)*

Table 16–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2005	2006	2007	2008	2009
Social security (OASDI) taxable earnings base increases:.					
$87,900 to $89,700 on Jan. 1, 2005	0.8	2.2	2.5	2.8	3.0
$89,700 to $93,000 on Jan. 1, 2006	....	1.6	4.3	4.7	5.2
$93,000 to $97,500 on Jan. 1, 2007	....	....	2.2	5.9	6.5
$97,500 to $101,400 on Jan. 1, 2008	....	....	....	1.9	5.1
$101,400 to $106,200 on Jan. 1, 2009	....	....	....	....	2.4

ENACTED LEGISLATION

Several laws were enacted in 2003 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT

In January 2003, President Bush proposed an economic growth package designed to reinvigorate the economic recovery, create jobs and enhance long-term economic growth. Congress acted quickly and on May 28, 2003 President Bush signed the Jobs and Growth Tax Relief Reconciliation Act (2003 jobs and growth tax cut), which included all the key features of his proposal. In addition to providing $20 billion in temporary fiscal assistance to the States, this Act accelerated many of the individual income tax reductions provided in the Economic Growth and Tax Relief Reconciliation Act of 2001 (2001 tax cut), increased temporarily the alternative minimum tax (AMT) exemption amount, reduced temporarily tax rates on dividends and capital gains, and increased temporarily incentives designed to speed up investment. The major provisions of the Act that affect receipts are described below. The year-by-year effect of these changes (as well as some of the changes provided in the 2001 tax cut) on various provisions of the tax code is shown in Chart 16–1.

Chart 16–1. MAJOR PROVISIONS OF THE TAX CODE UNDER THE 2001 AND 2003 TAX CUTS

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28, and 25 percent								Rates increased to 39.6, 36, 31, and 28 percent
10 Percent Bracket	Bracket upper income level increased to $7,000/$14,000 for single/joint filers and inflation-indexed		Bracket upper income level reduced to $6,000/ $12,000 for single/joint filers			Bracket upper income level increased to $7,000/ $14,000 for single/joint filers and inflation-indexed			Bracket eliminated, making lowest bracket 15 percent
15 Percent Bracket for Joint Filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers		Top of bracket for joint filers reduced to 180 percent of top of bracket for single filers	Top of bracket for joint filers increased to 187 percent of top of bracket for single filers	Top of bracket for joint filers increased to 193 percent of top of bracket for single filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers			Top of bracket for joint filers reduced to 167 percent of top of bracket for single filers
Standard Deduction for Joint Filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers		Standard deduction for joint filers reduced to 174 percent of standard deduction for single filers	Standard deduction for joint filers increased to 184 percent of standard deduction for single filers	Standard deduction for joint filers increased to 187 percent of standard deduction for single filers	Standard deduction for joint filers increased to 190 percent of standard deduction for single filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers		Standard deduction for joint filers reduced to 167 percent of standard deduction for single filers
Child Credit	Tax credit for each qualifying child under age 17 increased to $1,000		Tax credit for each qualifying child under age 17 reduced to $700				Tax credit for each qualifying child under age 17 increased to $800	Tax credit for each qualifying child under age 17 increased to $1,000	Tax credit for each qualifying child under age 17 reduced to $500
Estate Taxes	Top rate reduced to 49 percent	Top rate reduced to 48 percent Exempt amount increased to $1.5 million	Top Rate reduced to 47 percent	Top rate reduced to 46 percent Exempt amount increased to $2 million	Top rate reduced to 45 percent		Exempt amount increased to $3.5 million	Estate tax repealed	Top rate increased to 60 percent Exempt amount reduced to $1 million

Chart 16–1. MAJOR PROVISIONS OF THE TAX CODE UNDER THE 2001 AND 2003 TAX CUTS—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Small Business Expensing	Deduction increased to $100,000, reduced by amount qualifying property exceeds $400,000, and both amounts inflation-indexed Applies to software			Deduction declines to $25,000, reduced by amount qualifying property exceeds $200,000, and amounts not inflation-indexed Does not apply to software					
Capital Gains	Tax rate on captial gains reduced to 5/15 percent					Tax on captial gains eliminated for taxpayers in 10/15 percent tax brackets	Tax rate on captial gains increased to 10/20 percent		
Dividends	Tax rate on dividends reduced to 5/15 percent					Tax on dividends eliminated for taxpayers in 10/15 percent tax brackets	Dividends taxed at standard income tax rates		
Bonus Depreciation	Bonus depreciation increased to 50 percent of qualified property aquired after 5/5/03		Bonus depreciation expires						
Alternative Minimum Tax	AMT exemption amount increased to $40,250/$58,000 for single/joint filers		AMT exemption amount reduced to $33,750/ $45,000 for single /joint filers						

Accelerate Individual Income Tax Reductions Provided in the 2001 Tax Cut

Accelerate 10-percent individual income tax rate bracket expansion.—The 2001 tax cut created a 10-percent individual income tax bracket, which applied to the first $6,000 of taxable income for single taxpayers and married taxpayers filing separate returns (increasing to $7,000 for taxable years beginning after December 31, 2007 and before January 1, 2011), the first $10,000 of taxable income for heads of household, and the first $12,000 of taxable income for married taxpayers filing a joint return (increasing to $14,000 for taxable years beginning after December 31, 2007 and before January 1, 2011). These amounts were adjusted annually for inflation after December 31, 2008. The 2003 jobs and growth tax cut accelerated the expansions of the 10-percent tax rate bracket scheduled to be effective beginning in taxable year 2008, to be effective in taxable years 2003 and 2004. For taxable years beginning after 2004 and before January 1, 2011, the taxable income levels for the 10-percent individual income tax rate bracket will revert to the levels provided under the 2001 tax cut. The 10-percent bracket will be eliminated for taxable years beginning after December 31, 2010.

Accelerate reduction in individual income tax rates.—Under the 2001 tax cut, the statutory individual income tax rate brackets of 28, 31, 36 and 39.6 percent were temporarily replaced with a rate structure of 25, 28, 33 and 35 percent. The reduced tax rate structure was phased in over a period of six years, with reductions scheduled for 2001, 2002, 2004, and 2006. The new tax rate structure was fully effective for taxable years 2006 through 2010. The 2003 jobs and growth tax cut accelerated the reductions in the statutory individual income tax rate structure scheduled to be effective beginning in taxable years 2004 and 2006, to be effective beginning in taxable year 2003. The statutory individual income tax rate brackets will revert to 28, 31, 36 and 39.6 percent, effective for taxable years beginning after December 31, 2010.

Accelerate increase in standard deduction for married taxpayers filing a joint return.— Under the 2001 tax cut, the standard deduction for married taxpayers filing a joint return, which was 167 percent of the standard deduction for unmarried individuals, was increased to double the standard deduction for single taxpayers over a five-year period. Under the phasein, the standard deduction for married taxpayers filing a joint return increased to 174 percent of the standard deduction for single taxpayers in taxable year 2005, 184 percent in taxable year 2006, 187 percent in taxable year 2007, 190 percent in taxable year 2008, and 200 percent in taxable years 2009 and 2010. The 2003 jobs and growth tax cut accelerated the increase in the standard deduction for married taxpayers filing a joint return to 200 percent of the standard deduction for single taxpayers, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the standard deduction for married taxpayers filing a joint return will revert to the levels provided under the 2001 tax cut. The standard deduction for married taxpayers filing a joint return will decline to 167 percent of the standard deduction for single taxpayers, effective for taxable years beginning after December 31, 2010.

Accelerate expansion of the 15-percent individual income tax rate bracket for married taxpayers filing a joint return.—Under the 2001 tax cut, the maximum taxable income in the 15-percent individual income tax rate bracket for married taxpayers filing a joint return, which was 167 percent of the corresponding amount for an unmarried individual, was increased to twice the corresponding amount for unmarried individuals over a four-year period. Under the phasein, the maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing a joint return increased to 180 percent of the corresponding amount for single taxpayers in taxable year 2005, 187 percent in taxable year 2006, 193 percent in taxable year 2007, and 200 percent in taxable years 2008, 2009 and 2010. The 2003 jobs and growth tax cut accelerated the increase in the size of the 15-percent tax rate bracket for married taxpayers filing a joint return to twice the corresponding tax rate bracket for single taxpayers, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the size of the 15-percent tax rate bracket for married taxpayers filing a joint return will revert to the levels provided under the 2001 tax cut. The maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing a joint return will decline to 167 percent of the corresponding amount for single taxpayers, effective for taxable years beginning after December 31, 2010.

Accelerate increase in child tax credit.—Under the 2001 tax cut, the maximum amount of the tax credit for each qualifying child under the age of 17 increased from $500 to $1,000 over a period of 10 years, as follows: the credit increased to $600 for taxable years 2001 through 2004, $700 for taxable years 2005 through 2008, $800 for taxable year 2009, and $1,000 for taxable year 2010. The 2003 jobs and growth tax cut accelerated the increase in the credit to $1,000 per child, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the credit will revert to the levels provided under the 2001 tax cut. The credit will decline to $500 for taxable years beginning after December 31, 2010.

For 2003, most eligible taxpayers received the benefit of the increase in the credit through an advanced payment of up to $400 per child, issued by the Department of Treasury in the form of a check. The amount of the advanced payment was based on information provided on each taxpayer's 2002 tax return, filed in 2003.

Provide Alternative Minimum Tax (AMT) Relief

Increase AMT exemption amount.—An alternative minimum tax is imposed on individuals to the extent that the tentative minimum tax exceeds the regular tax. An individual's tentative minimum tax generally is equal to the sum of: (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income (taxable income modified to take account of specified preferences and adjustments) in excess of an exemption amount and (2) 28 percent of the remaining alternative minimum taxable income. The exemption amounts, as provided under the 2001 tax cut, were: (1) $49,000 for married taxpayers filing a joint return and surviving spouses for taxable years 2001 through 2004, declining in 2005 to the pre-2001 tax cut level of $45,000; (2) $35,750 for single taxpayers for taxable years 2001 through 2004, returning to $33,750 for taxable years beginning in 2005; and (3) $24,500 for married taxpayers filing a separate return, estates and trusts, for taxable years 2001 through 2004, returning to $22,500 for taxable years beginning in 2005. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's alternative minimum taxable income exceeds: (1) $150,000 for married taxpayers filing a joint return and surviving spouses, (2) $112,500 for single taxpayers, and (3) $75,000 for married taxpayers filing a separate return, estates and trusts. Effective for taxable years 2003 and 2004, the 2003 jobs and growth tax cut increased the alternative minimum tax exemption amount to $58,000 for married taxpayers filing a joint return and surviving spouses, to $40,250 for single taxpayers, and to $29,000 for married taxpayers filing a separate return, estates and trusts. For taxable years beginning after 2004, the exemption amounts will return to the levels prior to the 2001 tax cut.

Provide Growth Incentives for Business

Increase and extend the special depreciation allowance for certain property.—Taypayers are allowed to recover the cost of certain property used in a trade or business or for the production of income through annual depreciation deductions. The amount of the allowable depreciation deduction for a taxable year generally is determined under the modified accelerated cost recovery system, which assigns applicable recovery periods and depreciation methods to different types of property.

The Job Creation and Worker Assistance Act of 2002 (2002 economic stimulus bill) provided an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of the property, for qualifying assets (1) acquired after September 10, 2001 and before September 11, 2004 (but only if no binding written contract for the acquisition of the property was in effect before September 11, 2001) or (2) acquired pursuant to a written binding contract that was entered into after September 10, 2001 and before September 11, 2004. This first-year depreciation deduction was allowed for both regular and alternative minimum tax purposes in the year the property was placed in service. The basis of the property and the remaining allowable depreciation deductions had to be adjusted to reflect the additional first-year depreciation deduction. Property qualifying for the additional first-year depreciation deduction included tangible property with a depreciation recovery period of 20 years or less, certain software, water utility property, and qualified leasehold improvements. To qualify for the special depreciation allowance, the original use of the property must have commenced with the taxpayer after September 10, 2001 (except for certain sale-leaseback property) and the property was required to be placed in service before January 1, 2005 (January 1, 2006 for certain property having longer production periods). The 2003 jobs and growth tax cut extended the final acquisition deadlines for property qualifying for the 30 percent additional first-year depreciation deduction from September 11, 2004 to January 1, 2005. In addition, this Act permitted an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of the property (in lieu of the 30-percent additional deduction) for property acquired after May 5, 2003 and before January 1, 2005 (provided no binding written contract for the acquisition of the property was in effect before May 6, 2003). Qualified property was defined in the same manner as for purposes of the 30-percent additional first-year depreciation deduction, except the original use of the property was required to commence with the taxpayer after May 5, 2003.

Increase expensing for small business.—In lieu of depreciation, a small business taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service during the taxable year. Qualifying property includes certain tangible property that is acquired by purchase for use in the active conduct of a trade or business. The amount that a taxpayer may expense is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $200,000. The deduction is also limited in any taxable year by the amount of taxable income derived from the active conduct by the taxpayer of any trade or business. An election to expense these costs generally is made on the taxpayer's original return for the taxable year to which the election relates, and may be revoked only with the consent of the IRS Commissioner. The 2003 jobs and growth tax cut increased the maximum deduction amount to $100,000, effective for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning in 2003, 2004, and 2005. The amount that a taxpayer may expense is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2006. Additionally, with respect to a taxable year beginning after 2002 and before 2006, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner.

Modify Taxation of Capital Gains and Dividends

Reduce individual income tax rates on net capital gains.—Prior to enactment of the 2003 jobs and growth tax cut, the maximum tax rate on net capital gains (the excess of net long-term gains over net short-term losses) was 20 percent for taxpayers in individual income tax rate brackets exceeding 15 percent and 10 percent for lower income taxpayers. Effective for sales or exchanges of capital assets on or after May 6, 2003 and before January 1, 2009, this Act reduced the maximum tax rate on net capital gains to 15 percent for taxpayers in individual income tax rate brackets above 15 percent and to 5 percent (zero, in 2008) for lower income taxpayers. After December 31, 2008, net capital gains will be taxed at maximum rates of 20 and 10 percent.

Reduce individual income tax rates on dividends.—Prior to enactment of the 2003 jobs and growth tax cut, dividends received by an individual shareholder were taxed as ordinary income, at rates as high as 38.6 percent in 2003. Effective for taxable years beginning after December 31, 2002 and before January 1, 2009, this Act reduced the maximum tax rate on dividends received by an individual shareholder from domestic and qualified foreign corporations to 15 percent for taxpayers in individual income tax rate brackets above 15 percent and to 5 percent (zero, in 2008) for lower income taxpayers. After December 31, 2008, dividends will be taxed as ordinary income.

Modify Estimated Tax Payments by Corporations

Modify the timing of estimated tax payments by corporations.—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15 and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). The 2003 jobs and growth tax cut allowed corporations to delay 25 percent of the estimated payment otherwise due on September 15, 2003 until October 1, 2003.

MEDICARE PRESCRIPTION DRUG, IMPROVEMENT, AND MODERNIZATION ACT OF 2003

President Bush signed this Act, which he referred to as "the greatest advance in health care coverage for America's seniors since the founding of Medicare," on December 8, 2003. In addition to providing prescription drug coverage to more than 40 million seniors and to the disabled, other provisions of this Act increased payments to Medicare providers, provided new preventive health care benefits to seniors, established health care savings accounts, and curtailed the number of employers expected to drop retiree health care coverage. The major provisions of this Act that affect receipts are described below.

Create Health Savings Accounts (HSAs).—Effective January 4, 2004, eligible individuals, their family members and employers are allowed to make tax-free contributions to a Health Savings Account. Eligible individuals are those covered by a high-deductible health plan who cannot be claimed as a dependent on another person's tax return and who are not entitled to benefits under Medicare. A high-deductible plan is one that in 2003 had an annual deductible of at least $1,000 in the case of self-only coverage and $2,000 in the case of family coverage, and a cap on out-of-pocket expenses of $5,000 in the case of self-only coverage and $10,000 in the case of family coverage. The annual deductible and out-of-pocket expense amounts are indexed annually for inflation. Contributions to a HSA made by an eligible individual are deductible and employer contributions made on behalf of an individual (including contributions made through a cafeteria plan) are excluded from gross income and wages for income and employment tax purposes to the extent the contribution would be deductible if made by the employee. The maximum aggregate annual contribution that may be made to a HSA is the lesser of 100 percent of the annual deductible under the high-deductible plan, or the maximum deductible permitted under an Archer Medical Savings Account (MSA) high-deductible health plan, as adjusted for inflation. For 2004, the maximum contribution is $2,600 in the case of a self-only plan and $5,150 in the case of family coverage. Contributions to an Archer MSA reduce the annual contribution limit for HSAs. The annual contribution limits are increased for individuals who have attained age 55 by the end of the taxable year; these "catch-up" contributions are greater than the otherwise applicable contribution limit by the following amounts: $500 in 2004, $600 in 2005, $700 in 2006, $800 in 2007, $900 in 2008, and $1,000 in 2009 and subsequent years. A married couple can make two catch-up contributions as long as both spouses are at least age 55. Distributions from an HSA for qualified medical expenses of the individual and his or her spouse or dependents generally are tax-free. Qualified expenses include prescription and non-prescription drugs, qualified long-term care services and long-term care insurance, COBRA coverage, Medicare expenses (excluding Medigap), and retiree health expenses for individuals age 65 and older. Distributions from an HSA that are not for qualified medical expenses are included in gross income and are subject to an additional 10-percent penalty unless made after death, disability, or the individual attains the age of Medicare eligibility.

Exclude from income Federal subsidy payments to employers who continue prescription drug coverage for retirees.—To encourage employers to continue providing prescription drug benefits to their retirees, this Act provided a subsidy to firms with a retiree health plan certified to be at least the equivalent of the standard Medicare drug plan. The subsidy, which is 28 cents for every dollar between $250 and $5,000 spent on a drug benefit for an employee, is excluded from the gross income of the employer. The exclusion, which applies to the regular tax and to the alternative minimum tax, is effective for taxable years ending after the date of enactment.

MILITARY FAMILY TAX RELIEF ACT OF 2003

This Act, which doubled military death gratuity payments from $6,000 to $12,000 and provided tax reductions to military personnel and their families, was signed by President Bush on November 11, 2003. The major provisions of this Act that affect receipts are described below.

Provide an above-the-line deduction for travel expenses of National Guard and Reserve members.—National Guard and Reserve members are allowed to claim itemized deductions for overnight transportation, meals, and lodging expenses that are incurred and not reimbursed when they travel away from home to attend National Guard and Reserve meetings. Under prior law, such expenses had to be combined with other miscellaneous itemized deductions and were deductible only to the extent that the aggregate of the taxpayer's miscellaneous itemized deductions exceeded two percent of adjusted gross income. This Act provided an above-the-line deduction for the nonreimbursed transportation, meals and lodging expenses of National Guard and Reserve members who must travel more than 100 miles away from home to attend National Guard and Reserve meetings. The deduction, which is effective with respect to expenses paid or incurred in taxable years beginning after December 31, 2002, cannot exceed the general Federal Government per diem rate applicable to the locale in which the expenses are incurred.

Provide special rules for the exclusion of gain on the sale of a principal residence by members of the uniformed services or the Foreign Service.—Under current law, a taxpayer may exclude from tax up to $250,000 ($500,000 for married taxpayers filing a joint return) of the gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or unforeseen circumstances (to the extent provided under regulations) is able to exclude a lesser amount from tax, equal to $250,000/$500,000 times the portion of the two years that the ownership and use requirements are met. This Act modified these rules for members of the uniformed services or Foreign Service, effective for sales or exchanges after May 6, 1997. Under this Act these individuals may elect to suspend the five-year period of current law for a maximum of ten years during certain absences due to service. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period, up to ten years, during which the taxpayer or the taxpayer's spouse was on qualified official extended duty as a member of the uniformed services or in the Foreign Service of the United States. For these purposes qualified official extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. The election may be made with respect to only one property for a suspension period.

Increase exclusion from income for certain death gratuities paid with respect to deceased members of the armed forces.—This Act increased from $6,000 to $12,000, certain death gratuities paid to survivors of members of the armed forces who die while on active duty, inactive duty training, or authorized travel. Survivors of persons who die within 120 days after discharge or release from active duty, inactive duty training, or authorized travel are also paid the death gratuity if the death resulted from an injury or disease incurred or aggravated during the active duty, inactive duty training or authorized travel. Under prior law, only $3,000 of the military death gratuity was excluded from gross income. This Act increased the exclusion from gross income for military death gratuity payments to $12,000, effective with respect to deaths occurring after September 10, 2001.

Provide exclusion from income for amounts received under Department of Defense Homeowners Assistance Program.—The Department of Defense Homeowners Assistance Program (HAP) provides payments to certain employees and members of the armed forces to offset the adverse effects on housing values that result from a military base realignment or closure. Under prior law, amounts received under HAP were included in gross income. This Act generally exempted from gross income amounts received under HAP, up to the reduction in the fair market value of the property. This change was effective for payments made after November 11, 2003.

Modify other tax provisions.—Other changes provided in this Act authorized the expansion of extended tax filing and payment deadlines provided to individuals serving in a combat zone to individuals participating in a contingency operation, clarified the tax treatment of certain dependent care assistance programs provided to members of the uniformed services of the United States, allowed service academy appointments to be considered scholarships for purposes of qualified tuition programs and Coverdell Education Savings Accounts, suspended the tax-exempt status of designated terrorist organizations, and provided tax relief to families of astronauts who lose their lives in the line of duty after December 31, 2002. In addition, for purposes of determining the tax-exempt status of veteran's organizations, this Act expanded membership requirements to include ancestors or lineal descendants of past or present members of the armed forces, or of cadets.

UNITED STATES-CHILE FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Chile Free Trade Agreement (FTA), as signed by the United States and Chile on June 6, 2003. The U.S.-Chile FTA increased market access for American goods and services in Chile and provided U.S. producers and consumers access to lower-cost Chilean goods and services in a manner that was not disruptive to the U.S. economy. It also set the standard in Latin America for progressively opening other countries' economies and pointed the way to a hemisphere united by economic opportunity, freedom, the rule of law, and democracy.

UNITED STATES-SINGAPORE FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Singapore Free Trade Agreement (FTA), as signed by the United States and Singapore on May 6, 2003. The U.S.-Singapore FTA provided tariff-free access to Singapore for all U.S. goods, including textile and agriculture products; opened opportunities for U.S. services businesses; and addressed other barriers to trade. As the first U.S. Free Trade Agreement with an Asian-Pacific country, provisions in this agreement will serve as the foundation for agreements with other countries in the region.

ADMINISTRATION PROPOSALS

The President's policy initiatives include permanent extension of the increased expensing for small businesses and reductions in taxes on capital gains and dividends provided in the 2003 jobs and growth tax cut, as well as extension through 2010 of the accelerated individual income tax reductions provided in that same legislation. They also include permanent extension of the provisions of the 2001 tax cut scheduled to sunset on December 31, 2010, permanent extension of the research and experimentation tax credit, and extension of many other expiring provisions. In addition, the President's initiatives include incentives for charitable giving, strengthening education, investing in health care, protecting the environment, increasing energy production, and promoting energy conservation.

This Budget also includes proposals designed to increase opportunities for saving by simplifying and rationalizing the many tax preferred savings vehicles provided under current law; simplify the tax code, improve tax compliance, and curtail abusive tax avoidance activities; and strengthen the employer-based pension system.

MAKE PERMANENT THE TAX CUTS ENACTED IN 2001 AND 2003

Extend Through 2010 Certain Provisions of the 2003 Jobs and Growth Tax Cut

Extend through 2010 accelerated individual income tax reductions.—The Administration proposes to extend through December 31, 2010, the accelerated increase in the child credit, the accelerated expansion of the 10-percent individual income tax bracket, and the accelerated expansions of the standard deduction and 15-percent individual income tax bracket for married taxpayers filing a joint return, which expire on December 31, 2004.

Extend Permanently Certain Provisions of the 2001 Tax Cut and the 2003 Jobs and Growth Tax Cut

Extend permanently reductions in individual income taxes on capital gains and dividends.—The maximum individual income tax rate on net capital gains and dividends is 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008) for lower income taxpayers. The Administration proposes to extend permanently these reduced rates (15 percent and zero), which are scheduled to expire on December 31, 2008.

Extend permanently increased expensing for small business.—Small businesses taxpayers are allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years 2003, 2004, and 2005. The amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2006. Also, with respect to a taxable year beginning after 2002 and before 2006, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to extend permanently each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning after 2005.

Extend permanently provisions expiring in 2010.—Most of the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 sunset on December 31, 2010. The Administration proposes to extend those provisions permanently.

TAX INCENTIVES

Simplify and Encourage Saving

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional IRAs, nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Account (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $5,000 to an LSA and $5,000 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and, unlike current law, could be made at anytime for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2004 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs could spread the included conversion amount over several years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept new contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Consolidate employer-based savings accounts.—Current law provides multiple types of tax-preferred employer-based savings accounts to encourage saving for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan may not discriminate in favor of highly compensated employees with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan—Employee Retirement Savings Accounts (ERSAs) that would be available to all employers. ERSA non-discrimination rules would be simpler and include a new ERSA non-discrimination safe-harbor. Under one of the safe-harbor options, a plan would satisfy the nondiscrimination rules with respect to employee deferrals and employee contributions if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2004.

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by qualified financial institutions, nonprofit organizations, or Indian tribes (qualified entities). Citizens or legal residents of the United States between the ages of 18 and 60 who cannot be claimed as a dependent on another taxpayer's return, are not students, and who meet certain income limitations would be eligible to establish and contribute to an IDA. A single taxpayer would be eligible to establish and contribute to an IDA if his or her modified AGI in the preceding taxable year did not exceed $20,000 ($30,000 for heads of household, and $40,000 for married taxpayers filing a joint return). These thresholds would be indexed annually for inflation beginning in 2006. Qualified entities that set up and administer IDAs would be required to match, dollar-for-dollar, the first $500 contributed by an eligible individual to an IDA in a taxable year. Qualified entities would be allowed a 100 percent tax credit for up to $500 in annual matching contributions to each IDA, and a $50 tax credit for each IDA maintained at the end of a taxable year with a balance of not less that $100 (excluding the taxable year in which the account was established). Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by qualified entities and the earnings on those contributions would be tax-free. Withdrawals from the parallel account may be made only for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals from the IDA for other than qualified purposes may result in the forfeiture of some or all matching contributions and the earnings on those contributions. The proposal would be effective for contributions made after December 31, 2004 and before January 1, 2012, to the first 900,000 IDA accounts opened before January 1, 2010.

Invest in Health Care

Provide refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan or a public program. Effective for taxable years beginning after December 31, 2004, a new refundable tax credit would be provided for the cost of health insurance purchased by individuals under age 65. The credit would provide a subsidy for a percentage of the health insurance premium, up to a maximum includable premium. The maximum subsidy percentage would be 90 percent for low-income taxpayers and would phase down with income. The maximum credit would be $1,000 for an adult and $500 for a child. The credit would be phased out at $30,000 for single taxpayers and $60,000 for families purchasing a family policy.

Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2006, the tax credit would be available in advance at the time the individual purchases health insurance. The advance credit would reduce the premium paid by the individual to the health insurer, and the health insurer would be reimbursed directly by the Department of Treasury for the amount of the advance credit. Eligibility for an advance credit would be based on an individual's prior year tax return. To qualify for the credit, a health insurance policy would have to include coverage for catastrophic medical expenses. Qualifying insurance could be purchased in the individual market. Qualifying health insurance could also be purchased through private purchasing groups, State-sponsored insurance purchasing pools, and high-risk pools. Such groups may help reduce health insurance costs and increase coverage options for individuals, including older and higher-risk individuals. Individuals would not be allowed to claim the credit and make a contribution to a Health Savings Account (HSA) or Archer MSA for the same taxable year.

Provide an above-the-line deduction for high-deductible insurance premiums.—Current law provides a tax preference for employer-provided health insurance. Current law also provides that individuals may make tax-deductible contributions to Health Savings Accounts (HSAs) if certain criteria are met, including the individual being covered by a high-deductible health insurance plan. Individuals may then make tax-free withdrawals from their HSAs for qualified, health-care related out-of-pocket expenses. Individuals who do not have employer-provided health insurance may also make tax-deductible contributions to HSAs, but the premiums from their high-deductible insurance plan are not tax-deductible. The Administration proposes to allow all individuals an above-the-line deduction for insurance premiums arising from high-deductible health insurance plans if the plan qualifies the individual for an HSA and if the individual does not have employer-provided coverage. This proposal generally eliminates the unequal tax treatment of high-deductible insurance premiums between individuals who have employer-provided health care and those who do not, and further increases the attractiveness of HSAs in general. The deduction would be effective for taxable years beginning after December 31, 2004.

Provide an above-the-line deduction for long-term care insurance premiums.—Current law provides a tax preference for employer-paid long-term care insurance. However, the vast majority of the long-term care insurance market consists of individually purchased policies, for which no tax preference is provided except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. Premiums on qualified long-term care insurance are deductible as a medical expense, subject to annual dollar limitations that increase with age. The Administration proposes to make individually-purchased long-term care insurance more affordable by creating an above-the-line deduction for qualified long-term care insurance premiums. The Secretary of the Treasury would be authorized to require long-term care insurance to meet consumer protection standards for quality coverage. The deduction would be available to taxpayers who individually purchase qualified long-term care insurance and to those who pay at least 50 percent of the cost of employer-provided coverage. The deduction would be effective for taxable years beginning after December 31, 2004 but it would be phased in over four years. The deduction would be subject to current law annual dollar limitations on qualified long-term care insurance premiums.

Provide an additional personal exemption to home caregivers of family members.—Current law provides a tax deduction for certain long-term care expenses. In addition, taxpayers are allowed to claim exemptions for themselves (and their spouses, if married) and dependents who they support. However, neither provision may meet the needs of taxpayers who provide long-term care in their own home for close family members. Effective for taxable years beginning after December 31, 2004, the Administration proposes to provide an additional personal exemption to taxpayers who care for certain qualified family members who reside with the taxpayer in the household maintained by the taxpayer. A taxpayer is considered to maintain a household only if he or she furnishes over half of the annual cost of maintaining the household. Qualified family members would include any individual with long-term care needs who is (1) the spouse of the taxpayer or an ancestor of the taxpayer or the spouse of such an ancestor and (2) a member of the taxpayer's household for the entire year. An individual would be considered to have long-term care needs if he or she were certified by a licensed physician (prior to the filing of a return claiming the exemption) as, for at least 180 consecutive days, unable to perform at least two activities of daily living without substantial assistance from another individual due to a loss of functional capacity; or, alternatively, (1) requiring substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and (2) being unable to perform at least one activity of daily living or being unable to engage in age appropriate activities.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to claim the orphan drug credit for expenses incurred prior to FDA designation if designation occurs before the due date (including extensions) for filing the tax return for the year in which the FDA application was filed. The proposal would be effective for qualified expenses incurred after December 31, 2003.

Clarity the Health Coverage Tax Credit.—The Health Coverage Tax Credit (HCTC) was created under the Trade Adjustment Assistance (TAA) Reform Act of 2002 for the purchase of qualified health insurance. Eligible persons include certain individuals who are receiving benefits under the TAA or the Alternative TAA (ATAA) program and certain individuals between the ages of 55 and 64 who are receiving pension benefits from the Pension Benefit Guaranty Corporation (PBGC). The tax credit is refundable and can be claimed through an advance payment mechanism at the time the insurance is purchased. To clarify the statute and reduce administrative complexity, the Administration proposes the following changes: (1) Modify the definition of "other specified coverage" for "eligible ATAA recipients" to be the same as the definition applied to other eligible individuals; (2) clarify that certain PBGC pension recipients are eligible for the tax credit; (3) allow State-based continuation coverage to qualify without meeting the requirements for State-based qualified coverage; (4) for purposes of the State-based coverage rules, permit Commonwealths of Puerto Rico and Northern Mariana Islands, as well as American Samoa, Guam, and the U.S. Virgin Islands to be deemed as States; and (5) clarify the application of the confidentiality and disclosure rules to the administration of the advance credit.

Provide Incentives for Charitable Giving

Provide charitable contribution deduction for nonitemizers.—Under current law, individual taxpayers who do not itemize their deductions (nonitemizers) are not able to deduct contributions to qualified charitable organizations. The Administration proposes to allow nonitemizers to deduct charitable contributions of cash in addition to claiming the standard deduction, effective for taxable years beginning after December 31, 2003. Nonitemizers would be allowed to deduct cash contributions that exceed $250 ($500 for married taxpayers filing jointly), up to a maximum deduction of $250 ($500 for married taxpayers filing jointly). The deduction floor and limits would be indexed for inflation after 2004. Deductible contributions would be subject to existing rules governing itemized charitable contributions, such as the substantiation requirements.

Permit tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Effective for distributions after date of enactment, the Administration proposes to allow individuals who have attained age 65 to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

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

Under the Administration's proposal, which is designed to encourage contributions of food inventory to charitable organizations, any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value, or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 10 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, state, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer at the time of the contribution or, if not sold at such time, in the recent past. These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2003.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax what would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2003.

Modify tax on unrelated business taxable income of charitable remainder trusts.—A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust. Distributions from a charitable remainder annuity trust or charitable remainder unitrust, which are included in the income of the beneficiary for the year that the amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred, (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred, (3) other income to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred, and (4) corpus (trust principal).

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax; however, such trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus. The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of charitable remainder trusts, in lieu of removing the Federal income tax exemption for any year in which unrelated business taxable income is incurred. This change, which is a more appropriate remedy than loss of tax exemption, is proposed to become effective for taxable years beginning after December 31, 2003, regardless of when the trust was created.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Under current law, each shareholder in an S corporation separately accounts for his or her pro rata share of the S corporation's charitable contributions in determining his or her income tax liability. A shareholder's basis in the stock of the S corporation must be reduced by the amount of his or her pro rata share of the S corporation's charitable contribution. In order to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property and to prevent the recognition of gain on the contributed property on the disposition of the S corporation stock, the Administration proposes to allow a shareholder in an S corporation to increase his or her basis in the stock of an S corporation by an amount equal to the excess of the shareholder's pro rata share of the S corporation's charitable contribution over the stockholder's pro rata share of the adjusted basis of the contributed property. The proposal would be effective for taxable years beginning after December 31, 2003.

Repeal the $150 million limitation on qualified 501(c)(3) bonds.—Current law contains a $150 million limitation on the volume of outstanding, non-hospital, tax-exempt bonds for the benefit of any one 501(c)(3) organization. The limitation was repealed in 1997 for bonds issued after August 5, 1997, at least 95 percent of the net proceeds of which are used to finance capital expenditures incurred after that date. However, the limitation continues to apply to bonds more than five percent of the net proceeds of which finance or refinance working capital expenditures, or capital expenditures incurred on or before August 5, 1997. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the $150 million limitation in its entirety.

Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property.—Tax-exempt, 501(c)(3) organizations generally may utilize tax-exempt financing for charitable purposes. However, existing law contains a special limitation under which 501(c)(3) organizations may not use tax-exempt financing to acquire existing residential rental property for charitable purposes unless the property is rented to low-income tenants or is substantially rehabilitated. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the residential rental property limitation.

Strengthen Education

Extend, increase, and expand the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under recently expired law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses were allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded two percent of AGI. Prior law also allowed certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction), effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2004. Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction qualified for the above-the-line deduction. Expenses claimed as an above-the-line deduction could not be claimed as an itemized deduction. The Administration proposes to extend the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred after December 31, 2003, to increase the deduction to $400, and to expand the deduction to apply to unreimbursed expenditures for certain professional training programs.

Encourage Telecommuting

Exclude from income the value of employer-provided computers, software, and peripherals.—Under current law, the value of computers and related equipment and services provided by an employer to an employee for home use is generally allocated between business and personal use. The business-use portion is excluded from the employee's income whereas the personal-use portion is subject to income and payroll taxes. In order to simplify recordkeeping, improve compliance, and encourage telecommuting, the Administration proposes to allow individuals to exclude from income the value of employer-provided computers and related equipment and services necessary to perform work for the employer at home. The employee would be required to make substantial use of the equipment to perform work for the employer. Substantial business use would include standby use for periods when work from home may be required by the employer, such as during work closures caused by the threat of terrorism, inclement weather, or natural disasters. The proposal would be effective for taxable years beginning after December 31, 2004.

Increase Housing Opportunities

Provide tax credit for developers of affordable single-family housing.—The Administration proposes to provide annual tax credit authority to states (including U.S. possessions) designed to promote the development of affordable single-family housing in low-income urban and rural neighborhoods. Beginning in calendar year 2005, first-year credit authority equal to the amount provided for low-income rental housing tax credits would be made available to each state. That amount is equal to the greater of $2 million or $1.75 per capita (indexed annually for inflation after 2002). State housing agencies would award first-year credits to single-family housing units comprising a project located in a census tract with median income equal to 80 percent or less of area median income. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits, determined on the date of a qualifying sale, could not exceed 50 percent of the cost of constructing a new home or rehabilitating an existing property. The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualified buyer would be eligible to claim credits over a five-year period beginning on the date of sale. Eligible homebuyers would be required to have incomes equal to 80 percent or less of area median income. Certain technical features of the provision would follow similar features of current law with respect to the low-income housing tax credit and mortgage revenue bonds.

Protect the Environment

Extend permanently expensing of brownfields remediation costs.—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2004, to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently for expenditures paid or incurred after December 31, 2003, facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Exclude 50 percent of gains from the sale of property for conservation purposes.—The Administration proposes to create a new incentive for private, voluntary land protection. This incentive is a cost-effective, non-regulatory approach to conservation. Under the proposal, when land (or an interest in land or water) is sold for conservation purposes, only 50 percent of any gain would be included in the seller's income.

This proposal applies to conservation easements and similar sales of partial interests in land, such as development rights and agricultural conservation easements, for conservation purposes. To be eligible for the exclusion, the sale may be either to a government agency or to a qualified conservation organization, and the buyer must supply a letter of intent that the acquisition will serve conservation purposes. In addition, the taxpayer or a member of the taxpayer's family must have owned the property for the three years immediately preceding the sale. Antiabuse provisions will ensure that the conservation purposes continue to be served. The provision would be effective for sales taking place after December 31, 2004 and before January 1, 2008.

Increase Energy Production and Promote Energy Conservation

Extend and modify the tax credit for producing electricity from certain sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity must be sold to an unrelated third party and must be produced during the first 10 years of production at a facility placed in service before January 1, 2004. The Administration proposes to extend the credit for electricity produced from wind and biomass to facilities placed in service before January 1, 2007. In addition, eligible biomass sources would be expanded to include certain biomass from forest-related resources, agricultural sources, and other specified sources. Special rules would apply to biomass facilities placed in service before January 1, 2004. Electricity produced at such facilities from newly eligible sources would be eligible for the credit only from January 1, 2004 through December 31, 2008, and at a rate equal to 60 percent of the generally applicable rate. Electricity produced from newly eligible biomass co-fired in coal plants would also be eligible for the credit only from January 1, 2004 through December 31, 2006, and at a rate equal to 30 percent of the generally applicable rate. The Administration also proposes to modify the rules relating to governmental financing of qualified facilities. There would be no percentage reduction in the credit for governmental financing attributable to tax-exempt bonds. Instead, such financing would reduce the credit only to the extent necessary to offset the value of the tax exemption. The rules relating to leased facilities would also be modified to permit the lessee, rather than the owner, to claim the credit.

Provide tax credit for residential solar energy systems.—Current law provides a 10-percent investment tax credit to businesses for qualifying equipment that uses solar energy to generate electricity; to heat, cool or provide hot water for use in a structure; or to provide solar process heat. A credit currently is not provided for nonbusiness purchases of solar energy equipment. The Administration proposes a new tax credit for individuals who purchase solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) for use in a dwelling unit that the individual uses as a residence, provided the equipment is used exclusively for purposes other than heating swimming pools. The proposed nonrefundable credit would be equal to 15 percent of the cost of the equipment and its installation; each individual taxpayer would be allowed a maximum credit of $2,000 for photovoltaic equipment and $2,000 for solar water heating equipment. The credit would apply to photovoltaic equipment placed in service after December 31, 2003 and before January 1, 2009 and to solar water heating equipment placed in service after December 31, 2003 and before January 1, 2007.

Modify treatment of 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 this limitation.

Also under current law, deductible contributions are not permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. The Administration proposes to permit funding of all decommissioning costs through deductible contributions. Any portion of these additional contributions relating to pre-1984 costs that exceeds the amount previously deducted (other than under the nuclear decommissioning fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs, would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant.

The Administration's proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. These changes in the treatment of nuclear decommissioning funds are proposed to be effective for taxable years beginning after December 31, 2003.

Provide tax credit for purchase of certain hybrid and fuel cell 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 2004. The credit begins to phase down in 2004 and is not available after 2006. A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current, the original use of which commences with the taxpayer, and that is acquired for use by the taxpayer and not for resale. Electric vehicles and hybrid vehicles (those that have more than one source of power on board the vehicle) have the potential to reduce petroleum consumption, air pollution and greenhouse gas emissions. To encourage the purchase of such vehicles, the Administration is proposing the following tax credits: (1) A credit of up to $4,000 would be provided for the purchase of qualified hybrid vehicles after December 31, 2003 and before January 1, 2009. The amount of the credit would depend on the percentage of maximum available power provided by the rechargeable energy storage system and the amount by which the vehicle's fuel economy exceeds the 2000 model year city fuel economy. (2) A credit of up to $8,000 would be provided for the purchase of new qualified fuel cell vehicles after December 31, 2003 and before January 1, 2013. A minimum credit of $4,000 would be provided, which would increase as the vehicle's fuel efficiency exceeded the 2000 model year city fuel economy, reaching a maximum credit of $8,000 if the vehicle achieved at least 300 percent of the 2000 model year city fuel economy.

Provide tax credit for energy produced from landfill gas.—Taxpayers that produce gas from biomass (including landfill methane) are eligible for a tax credit equal to $3 per barrel-of-oil equivalent (the amount of gas that has a British thermal unit content of 5.8 million), adjusted by an inflation adjustment factor for the calendar year in which the sale occurs. To qualify for the credit, the gas must be produced domestically from a facility placed in service by the taxpayer before July 1, 1998, pursuant to a written binding contract in effect before January 1, 1997. In addition, the gas must be sold to an unrelated person before January 1, 2008. The Administration proposes to extend the credit to apply to landfill methane produced from a facility (or portion of a facility) placed in service after December 31, 2003 and before January 1, 2012, and sold (or used to produce electricity that is sold) before January 1, 2012. The credit for fuel produced at landfills subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines would be limited to two-thirds of the otherwise applicable amount beginning on January 1, 2008, if any portion of the facility for producing fuel at the landfill was placed in service before July 1, 1998, and beginning on January 1, 2004, in all other cases.

Provide tax credit for combined heat and power property.—Combined heat and power (CHP) systems are used to produce electricity (and/or mechanical power) and usable thermal energy from a single primary energy source. Depreciation allowances for CHP property vary by asset use and capacity. No income tax credit is provided under current law for investment in CHP property. CHP systems utilize thermal energy that is otherwise wasted in producing electricity by more conventional methods and achieve a greater level of overall energy efficiency, thereby lessening the consumption of primary fossil fuels, lowering total energy costs, and reducing carbon emissions. To encourage increased energy efficiency by accelerating planned investments and inducing additional investments in such systems, the Administration is proposing a 10-percent investment credit for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. Investments in qualified CHP assets that are otherwise assigned cost recovery periods of less than 15 years would be eligible for the credit, provided that the taxpayer elects to treat such property as having a 22-year class life (and thus depreciates the property using a 15-year recovery period). The credit, which would be treated as an energy credit under the investment credit component of the general business credit, and could not be used in conjunction with any other credit for the same equipment, would apply to investments in CHP property placed in service after December 31, 2003 and before January 1, 2009.

Extend excise tax exemption (credit) for ethanol.—Under current law an income tax credit and an excise tax exemption are provided for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol is 52 cents per gallon, but small ethanol producers (those producing less than 30 million gallons of ethanol per year) qualify for a credit of 62 cents per gallon on the first 15 million gallons of ethanol produced in a year. A credit of 60 cents per gallon is allowed for renewable source methanol. As an alternative to the income tax credit, gasohol blenders may claim a gasoline tax exemption of 52 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol that is blended into qualifying gasohol. The rates for the ethanol credit and exemption are each reduced by 1 cent per gallon in 2005. The income tax credit expires on December 31, 2007 and the excise tax exemption expires on September 30, 2007. Neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon. The Administration proposes to extend both the income tax credit and the excise tax exemption through December 31, 2010. The current law rule providing that neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon would be retained.

Permit electric utilities to defer gain from sales of electric transmission property.—Under current law, gain on the sale of business assets is subject to current income tax unless a special rule provides for nonrecognition or deferral of the gain. To encourage restructuring of the electric industry, the Administration proposes to permit electric utilities to defer the gain from sales of electric transmission property (or an ownership interest in an entity providing electric transmission services) to an independent transmission company. For this purpose, an independent transmission company would include any regional transmission organization, independent system operator, or independent transmission company approved by the Federal Energy Regulatory Commission (FERC) and certain other persons that place their transmission facilities under the control of such a FERC-approved transmission provider. (Similar rules would apply in determining whether a sale of facilities subject to the jurisdiction of the Texas Public Utility Commission qualifies for deferral.) A taxpayer electing deferral under the proposal would recognize the gain ratably over the eight-year period beginning with the year of sale. Deferral would be available only to the extent the taxpayer (or an affiliate) reinvests the amount received for the transmission property in other electric or gas utility property. The proposal would apply to sales or other dispositions occurring after the date of enactment and before January 1, 2007.

Modify tax treatment of certain income of electric cooperatives.—Mutual or cooperative electric companies (electric cooperatives) generally are exempt from Federal income tax if at least 85 percent of the cooperative's income consists of amounts collected from members for the sole purpose of meeting losses and expenses (the 85-percent test). Taxable electric cooperatives may exclude from taxable income certain profits rebated to patrons. To encourage participation by electric cooperatives in electric industry restructuring, the Administration proposes that income from the following activities be excluded from the 85-percent test: (1) providing open access transmission service under a tariff filed with FERC (or, if applicable, the Public Utility Commission of Texas) or an independent transmission provider agreement approved or accepted by FERC (or, if applicable, the Public Utility Commission of Texas); (2) providing open access distribution service to end-users served by distribution facilities not owned by the cooperative or any of its members, or to third parties to deliver electric energy generated by a facility not owned or leased by the cooperative or any of its members if the facility is directly connected to distribution facilities owned by the cooperative or any of its members; (3) certain transfers into (and distributions and earnings from) a trust, fund or instrument established to pay nuclear decommissioning costs; and (4) certain voluntary exchanges or involuntary conversions of property related to generating, transmitting, distributing or selling electric energy. The Administration also proposes that income from sales of electric energy to nonmembers be treated as qualifying member income (and, in the case of certain taxable electric cooperatives, excluded from taxable income whether or not profits are rebated to patrons) to the extent such sales do not exceed the cooperative's load losses during a specified ten-year recovery period.

SIMPLIFY THE TAX LAWS FOR FAMILIES

Establish uniform definition of a qualifying child.—The tax code provides assistance to families with children through the dependent exemption, head-of-household filing status, child tax credit, child and dependent care tax credit, and earned income tax credit (EITC). However, because each provision defines an eligible "child" differently, taxpayers must wade through pages of bewildering rules and instructions, resulting in confusion and error. The Administration proposes to harmonize the definition of qualifying child across these five related tax benefits, thereby reducing both compliance and administrative costs. Under the Administration's proposal, a qualifying child must meet the following three tests: (1) Relationship—The child must be the taxpayer's biological or adopted child, stepchild, sibling, or step-sibling, a descendant of one of these individuals, or a foster child. (2) Residence—The child must live with the taxpayer in the same principal home in the United States for more than half of the year. (3) Age—The child must be under age 19, a full-time student if over 18 and under 24, or totally and permanently disabled. Neither the support nor gross income tests of current law would apply to qualifying children who meet these three tests. In addition, taxpayers would no longer be required to meet a household maintenance test when claiming the child and dependent care tax credit. Current law requirements that a child be under age 13 for the dependent care credit and under age 17 for the child tax credit, would be maintained. Taxpayers generally could continue to claim individuals who do not meet the proposed relationship, residency, or age tests as dependents if they meet the requirements under current law, and no other taxpayer claims the same individual. The proposal would be effective for tax years beginning after December 31, 2004.

Simplify adoption tax benefits.—Under current law, for taxable years beginning before January 1, 2011, the following tax benefits are provided to taxpayers who adopt children: (1) a nonrefundable tax credit for qualified expenses incurred in the adoption of a child, up to a certain limit, and (2) the exclusion from gross income of qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program, up to a certain limit. Taxpayers may not claim the credit for expenses that are excluded from gross income. In 2004, the limitation on qualified adoption expenses for both the credit and the exclusion is $10,390. Taxpayers who adopt children with special needs may claim the full $10,390 credit or exclusion even if adoption expenses are less than this amount. Taxpayers may carry forward unused credit amounts for up to five years. When modified adjusted gross income exceeds $155,860 (in 2004), both the credit amount and the amount excluded from gross income are reduced pro-rata over the next $40,000 of modified adjusted gross income. The maximum credit and exclusion and the income at which the phase-out range begins are indexed annually for inflation. For taxable years beginning after December 31, 2010, taxpayers will be able to claim the credit only for actual expenses for the adoption of children with special needs. For these taxpayers the qualified expense limit will be $6,000, the credit will be reduced pro-rata between $75,000 and $115,000 of modified adjusted gross income, and the credit amount and phase-out range will not be indexed annually for inflation. Taxpayers may not exclude employer-provided adoption assistance from gross income for taxable years beginning after December 31, 2010.

To reduce marginal tax rates and simplify computations of tax liabilities, the Administration is proposing to eliminate the income-related phaseout of the adoption tax credit and exclusion. The proposal would be effective for taxable years beginning after December 31, 2004. The phaseout of adoption tax benefits increases complexity for all taxpayers using the adoption tax provisions, including the vast majority who are not affected by the phaseouts; raises marginal tax rates for taxpayers in the phase-out range; and with the higher phase-out income levels under the 2001 tax cut, affects fewer than 10,000 taxpayers. The broader eligibility criteria, larger qualifying expense limitations, and the employer exclusion would apply in taxable years beginning after December 31, 2010 as a result of the Administration's proposal to extend the 2001 tax cut provisions permanently.

Eliminate household maintenance test for head-of-household filing status—Unmarried taxpayers who reside with children may qualify as heads of household or surviving spouses, which entitles them to a more generous standard deduction and rate structure than other unmarried filers. To qualify for the more generous provisions, the taxpayer must provide over half the costs of maintaining the household. The "household maintenance test" imposes a significant record-keeping burden on taxpayers (who must keep receipts for expenditures on food, shelter, utilities, etc.), and it is a difficult test for the IRS to administer. Under the proposal, unmarried taxpayers who live with children or other related dependents could qualify as heads of household even if they do not provide over half the costs of maintaining their home. Similarly, recently widowed taxpayers who live with their children would not have to meet the complicated household maintenance test in order to file as surviving spouses. The proposal would be effective for taxable years beginning after December 31, 2004.

Reduce computational complexity of refundable child tax credit.—Taxpayers with earned income in excess of $10,750 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. About seventy-five percent of additional child tax credit claimants also claim the EITC. However, the two credits have a different definition of earned income and different U.S. residency requirements. In addition, some taxpayers have to perform multiple computations to determine the amount of the additional child tax credit they can claim. First, they must compute the additional child tax credit using a formula based on earned income. Then, if they have three or more children, they may recalculate the credit using a formula based on social security taxes and claim the higher of the two amounts.

Under the proposal, the additional child tax credit would use the same definition of earned income as is used for the EITC. Taxpayers (other than members of the Armed Forces stationed overseas) would be required to reside with a child in the United States to claim the additional child tax credit (as they are currently required to do for the EITC). Taxpayers with three or more children would do only one computation based on earned income to determine the credit amount. The proposal would be effective for taxable years beginning after December 31, 2004.

Simplify EITC eligibility requirements regarding filing status, presence of children, investment income, and work and immigration status.—To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children in their households, investment income, and their work and immigration status in the United States. These rules are confusing, require significant record-keeping, and are costly to administer. Under the proposal, married taxpayers who reside with children could claim the EITC without satisfying a complicated household maintenance test if they live apart from their spouse for the last six months of the year. In addition, certain taxpayers who live with children but do not qualify for the larger child-related EITC could claim the smaller EITC for very low-income childless workers. The proposal also eliminates the investment income test for taxpayers who are otherwise EITC eligible. The proposal would also improve the administration of the EITC with respect to eligibility requirements for undocumented workers. The proposal is effective for taxable years beginning after December 31, 2004.

Simplify the taxation of dependents (including minor children).—Under current law the standard deduction of taxpayers who may be claimed as dependents of another taxpayer is the lesser of (1) the standard deduction for single taxpayers ($4,850 for 2004, indexed annually); or (2) the larger of $800 (for 2004) or the individual's earned income plus $250 (for 2004). In addition, special rules (called the "kiddie tax") apply for minors under age 14 with taxable investment income. Only the first $800 (in 2004) of the child's taxable investment income over the standard deduction is taxed at the child's tax rate. Taxable investment income in excess of $800 is taxed as the marginal income of the parents (or guardian). In certain cases, the parents (or guardian) may elect to include the dependent's income on their own tax return. The proposal would simplify both the standard deduction for all dependents and the "kiddie tax" provisions for dependents under age 14. The standard deduction for dependent filers would be $800 (indexed after 2005) plus the amount of the dependent's earned income, not to exceed the standard deduction for a non-dependent single filer. For dependents under age 14, the first $2,500 (indexed after 2005) of taxable investment income and all earned income would be taxed at the child's own tax rate. Any taxable investment income above $2,500 would be taxed at the highest regular income tax rate (regardless of the parents' tax rate). Any capital gains included in taxable investment income above $2,500 would be taxed at the highest capital gains tax rate generally applicable. The election to include the child's investment income on the parents' tax return would be eliminated. Both proposals wold be effective for tax years beginning after December 31, 2004.

Consolidate rules for lifetime learning credit, Hope credit, and education expense deductions, and simplify other higher education provisions.—Current law allows up to $2,500 of interest on student loans to be deducted. The phase-out range for this provision is $50,000 to $65,000 of modified adjusted gross income (AGI) for single taxpayers ($100,000 to $130,000 for joint returns). Current law also allows up to $4,000 of qualifying higher education expenses to be deducted for single taxpayers whose AGI does not exceed $65,000 ($130,000 for joint returns). Taxpayers with higher AGI may deduct up to $2,000 of qualifying higher education expenses if their AGI does not exceed $80,000 ($160,00 for joint returns). The deduction for higher education expenses expires after 2005. For calendar year 2004, both the Hope credit and lifetime learning credit begin to phase out at $42,000 of modified AGI ($83,00 for joint returns). Taxpayers may claim the HOPE credit for more than one qualifying student. In contrast, the lifetime learning credit is applied on a per-taxpayer rather than a per-student basis.

Under the Administration's proposal the lifetime learning credit would be revised to subsume the deductions for student loan interest and qualified higher education expenses by allowing the credit on a per-student basis, treating up to $2,500 of interest on student loans as a qualified expense, raising the beginning of the phase-out range to $50,000 ($100,000 for joint returns) and reducing the otherwise allowed credits by 5 percent of the extent to which modified AGI exceeds the new AGI thresholds. The temporary, above-the-line deduction for higher education expenses and the deduction for student loan interest would be repealed. The dollar limits of the revised lifetime learning credit and the Hope credit would be indexed. The phase-out rules for the Hope credit would be conformed to those of the revised lifetime learning credit.

The definition of qualified higher education expenses and qualified higher education institution would be made uniform by extending the definitions currently used in connection with Hope and lifetime learning credits and tuition deductions to other provisions of the IRS Code related to higher education. The definition of "special needs services," as referenced under current law with regard to distributions from Coverdell education savings accounts and qualified tuition programs, would be clarified. The exclusion from income for scholarships and fellowships would be clarified by reference to the allowance for books, supplies, and equipment included in an institution's cost of attendance for student aid purposes. The current-law phaseout of the maximum contribution that can be made to a Coverdell education savings account would be repealed.

Allow annual reporting and payment of combined State and Federal unemployment insurance taxes by employers of household employees.—Employers of household employees must separately pay Federal and State unemployment insurance for their employees. Because it is burdensome for employers of household employees to report and pay these taxes separately, the wages of household employees are often improperly reported. The Administration proposes to reduce this burden by requiring that employers of household employees annually report and pay a combined Federal and State unemployment tax to the Federal government. This would also reduce the administrative costs incurred by State unemployment insurance agencies, which are currently very large relative to the taxes collected and are ultimately borne by the Federal government. Unemployment benefits for household employees would continue to be paid by the States and reimbursed by the Federal government.

Simplify taxation of capital gains on collectibles, small business stock, and other assets.—Under current law, special tax rates apply to certain capital gains. Unrecaptured Section 1250 gains, which represent the portion of gain on real property previously deducted as straight-line depreciation, are taxed at ordinary rates up to a maximum rate of 25 percent. Collectibles are taxed at ordinary rates with a maximum rate of 28 percent. Gains from the sale of certain small business stock qualify for a 50-percent exclusion subject to a 28 percent maximum rate, resulting in a maximum effective rate of 14 percent (Section 1202). Subject to certain requirements, gains on small business stock can be deferred if the proceeds of the sale are re-invested in other small business stock (Section 1045). Schedule D and the associated forms and instructions are more complicated than necessary because of these special rates that apply in only a small fraction of cases. The Administration proposal would simplify capital gains tax provisions so as to allow all gains to be taxed at the basic capital gains or ordinary tax rates. Under the proposal, 50 percent of capital gains on collectibles would be taxed as short-term gains and the other 50 percent would be taxed as long-term gains. In addition, 50 percent of unrecaptured Section 1250 gains would be taxed as ordinary income and the other

50 percent would be taxed as long-term gains. The 50 percent exclusion for gain recognized on the sale of certain small business stock under section 1202 and the rollover of gain recognized on the sale of certain small business stock under section 1045 would be repealed. Modifying these three provisions would allow capital gains forms and instructions to be simplified, benefitting all taxpayers with capital gains. These provisions would be effective on the date of enactment.

STRENGTHEN THE EMPLOYER-BASED PENSION SYSTEM

Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans.—Qualified retirement plans consist of defined benefit plans and defined contribution plans. In recent years, many plan sponsors have adopted cash balance and other "hybrid" plans that combine features of defined benefit and defined contribution plans. A cash balance plan is a defined benefit plan that provides for annual "pay credits" to a participant's "hypothetical account" and "interest credits" on the balance in the hypothetical account. Questions have been raised about whether such plans satisfy the rules relating to age discrimination and the calculation of lump sum distributions. The Administration proposes to (1) ensure fairness for older workers in cash balance conversions, (2) protect the defined benefit system by clarifying the status of cash balance plans, and (3) remove the effective ceiling on interest credits in cash balance plans. All changes would be effective prospectively.

Improve the accuracy of pension liability measures.—Current law requires that employers use discount rates based on the interest rate on 30-year Treasury securities when making certain pension calculations. Use now of the 30-year Treasury bond interest rate artificially inflates pension liabilities and adversely affects employers offering defined benefit pension plans and working families who rely on the safe and secure benefits these plans provide. Effective for plan years beginning after December 31, 2003 and before January 1, 2006, the Administration proposes to replace the use of discount rates based on the interest rate on 30-year Treasury securities with a rate based on a composite of long-term corporate bond rates. Effective for plan years beginning after December 31, 2005, the Administration proposes to phase in the permanent use of a spot yield curve of high-grade corporate bonds to measure the value of pension liabilities and lump sums, with full implementation for plan years beginning after December 31, 2007. The yield curve is more accurate than any single rate because it ties pension-funding requirements to the timing of the payout of pension benefits. Additionally, the Administration proposes changes to restrict promises of added benefits by severely underfunded pension plans and to provide better information on pension finances to workers, retirees, and stockholders.

CLOSE LOOPHOLES AND IMPROVE TAX COMPLIANCE

Combat abusive tax avoidance transactions.—Although the vast majority of taxpayers and practitioners do their best to comply with the law, some actively promote or engage in transactions structured to generate tax benefits never intended by Congress. Such abusive transactions harm the public fisc, erode the public's respect for the tax laws, and consume limited IRS resources. The Administration has proposed a number of regulatory and legislative changes designed to significantly enhance the current enforcement regime and curtail the use of abusive tax avoidance transactions. These proposed changes include (1) the modification of the definition of a reportable transaction, (2) the issuance of a coordinated set of disclosure, registration, and investor list maintenance rules, (3) the imposition of new or increased penalties for the failure to disclose and register reportable transactions and for the failure to report an interest in a foreign financial account, (4) the prevention of "income separation" transactions structured to create immediate tax losses or to convert current ordinary income into deferred capital gain, and (5) the denial of foreign tax credits with respect to any foreign withholding taxes if the underlying property was not held for a specified minimum period of time as well as regulatory authority in order to prevent the inappropriate separation of foreign taxes from the related foreign income in cases where taxes are imposed on any person in respect of income of an entity. A number of administrative proposals already have been carried out by the Treasury Department and the IRS.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where (1) the corporation's debt-to-equity ratio exceeds 1.5 to 1.0, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party or paid to an unrelated party but guaranteed by a related party, and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Because of the opportunities available under current law to reduce inappropriately U.S. tax on income earned on U.S. operations through the use of foreign related-party debt, the Administration proposes to tighten the interest disallowance rules of section 163(j) as follows: (1) The current law 1.5 to 1 debt-to-equity safe harbor would be eliminated; (2) the adjusted taxable income threshold for the limitation would be reduced from 50 percent to 25 percent of adjusted taxable income with respect to disqualified interest other than interest paid to unrelated parties on debt that is subject to a related-party guarantee, which generally would remain subject to the current law 50 percent threshold; and (3) the indefinite carryforward for disallowed interest would be limited to ten years and the three-year carryforward of excess limitation would be eliminated.

Modify qualification rules for tax-exempt property-casualty insurance companies.—A property-casualty insurance company with $350,000 or less of annual premiums is exempt from tax. A company with annual premiums that exceed $350,000, but that do not exceed $1,200,000, may elect to be taxed only on its investment income. Premiums of companies that are members of the same controlled group (except for tax-exempt and foreign companies) are aggregated for making these determinations. The Department of Treasury has become aware that certain entities established as insurance companies have limited their premium receipts, claimed tax-exempt status, and are accumulating investment income tax-free. These actions represent a misuse of the tax-exemption and violate the original intent of the exemption, which was to assist small mutual insurers. The Administration proposes that the tax exemption for property-casualty insurance companies apply only to mutual property-casualty insurance companies with no more than $350,000 in annual gross income. In addition, the proposal would provide that tax exemption is available only for a domestic mutual property-casualty insurance company, which is organized within, and subject to regulation within, a single State, and which only writes insurance or reinsurance contracts on risks located within that same State. The proposal would also clarify the rules for determining whether a property-casualty insurance company is an insurance company for U.S. tax purposes, and would grant the Secretary of the Treasury discretion to develop appropriate reporting requirements to assure compliance with these rules. The election that allows a small property-casualty insurer to be taxed only on investment income would remain available to any property-casualty insurance company with annual premiums up to $1,200,000. For purposes of determining eligibility for these provisions, the proposal would aggregate amounts received by members of the same controlled group, including foreign and tax-exempt entities.

Increase penalties for false or fraudulent statements made to promote abusive tax avoidance transactions.—Under current law, a penalty is imposed if a person makes or furnishes a false or fraudulent statement in connection with promotion of an interest in a tax shelter. The amount of the penalty is the lesser of $1,000 or 100 percent of the gross income derived by the person from the organization, participation, or promotion of the tax shelter. This penalty amount is insufficient to deter tax shelter promoters from making false or fraudulent statement regarding the purported benefits of an abusive transaction. The Administration therefore proposes to increase the penalty to 50 percent (or $1,000, if greater) of the income derived by the person making or furnishing the false statement in connection with the promotion of a tax shelter.

Prevent abusive overvaluations on donations of patents and other intellectual property.—Under current law, a taxpayer may claim a deduction for charitable contributions, subject to certain limitations based on the type of taxpayer, the property contributed and the type of donee organization. In the case of noncash contributions, the amount of the deduction generally equals the fair market value of the contributed property on the date of the contribution. The Administration is concerned that some taxpayers are claiming substantially inflated deductions for donations of patents and similar intellectual property to charities. To address these valuation issues, the Administration proposes to allow a taxpayer who contributes a patent or other intellectual property (other than certain copyrights) to charity to deduct up front the lesser of the taxpayer's basis in the donated property or the fair market value of the property. In future years, the taxpayer would be permitted to deduct additional amounts based on the amount of royalties or other revenue, if any, actually received by the donee charity from the donated property. No additional deduction would be permitted after ten years or after the expiration of a patent. The taxpayer would be required to obtain written substantiation from the donee of the amount of revenue derived from the donated property during the year. The proposed changes would be effective for taxable years beginning after December 31, 2003.

Prevent overvaluations and other abuses in charitable donations of used vehicles.—Under current law, a taxpayer may claim a deduction for charitable contributions of tangible personal property subject to certain limitations based on the type of taxpayer, the type of donee organization, and the use of the property by the donee organization. Except for inventory property, the amount of the deduction equals the fair market value of the contributed property if the use of the property by the donee is related to its exempt purpose or function. However, the amount of the deduction is limited to the lesser of the taxpayer's basis in the property (typically cost) or fair market value when the use of the property by the donee is unrelated to the donee's exempt purposes. As a practical matter, taxpayers are generally permitted to deduct the fair market value of donated vehicles, regardless of whether the vehicle is actually used for a charitable purpose or re-sold with the charity receiving some revenue from the sale. A taxpayer who donates a used car to charity and claims a deduction of less that $5,000 is permitted to use established used car pricing guides to determine fair market value, but only if the guide lists a sales price for a car of the same make, model, and year, sold in the same area, and in the same condition as the donated car. The Administration is concerned that the amount of the deduction claimed by taxpayers often exceeds the fair market value of the donated vehicles because taxpayers often use published values for cars in better condition than the donated vehicle. To curtail the problem of excessive donations being claimed for donated vehicles, the Administration proposes to allow a charitable deduction for contributions of vehicles only if the taxpayer obtains a qualified appraisal of the vehicle. The Department of Treasury would be permitted to establish an administrative safe harbor in published guidance. The proposal would not affect the rules governing charitable contributions of inventory property. The proposal would be effective for taxable years beginning after December 31, 2003.

Reform the tax treatment for leasing transactions with tax-indifferent parties.—Certain leasing transactions (often referred to as sale-in/lease-out or SILO transactions) involving tax-indifferent parties (including governments, charities, and foreign entities) do not provide financing related to the construction, purchase or refinancing of productive assets. Rather, they involve the payment of an accommodation fee by a U.S. taxpayer to the tax-indifferent party in exchange for the right of the U.S. taxpayer to claim tax benefits from the purported tax ownership of the property. These arrangements usually result in no change in the tax-indifferent party's use or operation of the property, and are designed to ensure that the U.S. taxpayer bears only limited economic risk. The U.S. taxpayer enjoys substantial current tax deductions, while postponing the recognition of taxable income well into the future. The Administration proposes to limit a taxpayer's annual deductions or losses related to a lease with a tax-indifferent party to the taxable income earned from the transaction for the taxable year. This limitation would apply to all deductions related to the lease. Any disallowed deductions would be carried forward and treated as deductions related to the lease in the next taxable year, subject to the same limitations. When a taxpayer completely disposes of its interest in the leased property, the taxpayer would be allowed to take previously disallowed deductions and losses. The proposal would exclude from these rules certain short-term leases with terms of three or fewer years, qualified asset leases, and other leases subsequently identified in published guidance. The proposal also clarifies that the depreciation recovery period for all depreciable or amortizable property leased to a tax-indifferent entity is the longer of the property's assigned class life or 125 percent of the lease term. For this purpose, the lease term would include service contracts and other arrangements that currently are used to shorten the stated lease term and thus, the asset's cost recovery period.

Ensure foreign subsidiaries of U.S. companies cannot inappropriately avoid U.S. tax on foreign earnings invested in U.S. property through use of the exception for bank deposits.—Under current law, U.S. shareholders of a controlled foreign corporation must include in income their pro rata share of its earnings that are invested in certain U.S. property. Deposits with persons carrying on the banking business are excluded from the definition of U.S. property subject to this rule. Concern has arisen that this exception is being interpreted so as to reach results that are not consistent with the underlying policy. Under the Administration's proposal, the exception for deposits with persons carrying on the banking business would be modified to eliminate this potential for abuse.

Modify tax rules for individuals who give up U.S. citizenship or green card status .—If an individual gives up U.S. citizenship, or terminates long-term U.S. residency, with a principal purpose of avoiding U.S. tax, the individual is subject to an alternative tax regime for 10 years following the individual's loss of citizenship or termination of residency. The Administration proposes to improve compliance with the tax rules applicable to individuals who expatriate by modifying the current-law alternative tax regime as follows: (1) The subjective "principal purpose" test of current law would be replaced with an objective test; (2) individuals who expatriate would continue to be taxed as U.S. citizens or residents until they give notice of the expatriating act or termination of residency; (3) special rules would be provided for individuals subject to the alternative tax regime who are physically present in the U.S. for more than 30 days in a calendar year during the 10-year period following expatriation; (4) certain gifts of stock of closely-held foreign corporations by a former citizen or former long-term resident would be subject to U.S. gift tax; and (5) annual reporting would be required for individuals subject to the alternative tax regime following expatriation.

Expand tax shelter exception for Federal practitioner privelege.—In general, a common law privilege of confidentiality exists for attorney-client communications with respect to legal advice. Communications relating to Federal tax advice between a taxpayer and a Federally authorized tax-practitioner (who may not be an attorney) are protected by a statutory confidentiality privilege to the same extent that the communication would be considered a privileged communication if it were between a taxpayer and an attorney. Written communications relating to corporate tax shelters are not covered by the statutory privilege. The exception to the privilege for communications relating to corporate tax shelters should be expanded to all tax shelters, regardless of whether or not the participant is a corporation. The Administration therefore proposes to modify the Federal tax practitioner privilege by expanding the tax shelter exception to cover written communication relating to any tax shelter.

Extend the statute of limitations for undisclosed reportable transactions.—In general, taxes cannot be assessed or collected unless an assessment is made within three years after a return is filed. If a taxpayer omits an item of gross income totaling more than 25 percent of the amount of gross income shown on the return, the statute of limitations is extended to six years. Extending the statute of limitations for transactions that are not disclosed properly on a return will encourage taxpayers to make the required disclosures and will provide the IRS with the time necessary to examine these transactions. The Administration proposes to extend the statue of limitations for taxpayers who fail to disclose reportable transactions until one year after the earlier of the date on which the taxpayer provides the required disclosures or the date on which the taxpayer's material advisor satisfies certain requirements relating to the maintenance of lists. The statute would be extended only with respect to any underpayment arising from the undisclosed transaction, and the proposal would not shorten any otherwise applicable statute of limitation.

Require increased reporting for noncash charitable contributions.—Under current law, any individual, closely-held corporation, or personal service corporation claiming a charitable contribution deduction for a contribution of property (other than publicly-traded securities) of more than $5,000 ($10,000 in the case of nonpublicly traded stock) must obtain a qualified appraisal for the property contributed. However, C corporations (other than personal service corporations and closely-held corporations) are not required to obtain a qualified appraisal. In order to reduce valuation abuses and assist the IRS in administering the tax laws, the Administration proposes to require all taxpayers to obtain a qualified appraisal for property (other than inventory property and publicly-traded securities) donated to charity if the deduction claimed exceeds $5,000. In addition, if the deduction claimed exceeds $500,000, the taxpayer would be required to provide a copy of the qualified appraisal or an executive summary of the qualified appraisal to the IRS. The proposal would be effective for taxable years beginning after December 31, 2003.

Clarify and simplify qualified tuition programs.—Current law provides special tax treatment for contributions to and distributions from qualified tuition programs under Section 529. The purpose of these programs is to encourage saving for the higher education expenses of designated beneficiaries. However, current law is unclear in certain situations with regard to the transfer tax consequences of changing the designated beneficiary of a qualified tuition program. In addition, current law may afford significant potential for transfer tax abuse through the use of these programs. The Administration's proposal would simplify the tax consequences under these programs, promote the educational purposes for which these programs were intended, and significantly reduce the opportunities for tax abuse.

Under the Administration's proposal, contributions to qualified tuition programs would be treated as completed gifts to the designated beneficiary. There would be no gift tax consequences to a distribution from, or a change in the designated beneficiary of, a qualified tuition program. As long as the funds are used for qualified higher education expenses, the income tax benefits under current law would be available, regardless of the identity of the designated beneficiary. The income portion of distributions not used for qualified higher education expenses would continue to be subject to income tax, as well as a 10 percent penalty, if applicable. The principal portion of any distribution from a qualified tuition program that is not used for higher education expenses would be subject to a new excise tax (payable from the account) once the cumulative amount of these distributions exceeds a stated amount per beneficiary. In addition, the excise tax would not apply to certain distributions made as a result of the beneficiary's death, disability, or receipt of a scholarship. New limitations would restrict designated beneficiaries to individuals under 35 years of age and would prohibit distributions to or for the benefit of any person other than the designated beneficiary of the program. The proposal also includes revised reporting requirements and special rules for trusts or other entities contributing to a qualified tuition program. The proposal would be effective for contributions made to qualified tuition programs after the date of enactment.

TAX ADMINISTRATION, UNEMPLOYMENT INSURANCE, AND OTHER

Improve Tax Administration

Modify the IRS Restructuring and Reform Act of 1998 (RRA98).—The proposed modification to RRA98 is comprised of six parts. The first part modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second part adopts measures to curb frivolous submissions and filings that are intended to impede or delay tax administration. The third part allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The fourth part streamlines jurisdiction over collection due process cases in the Tax Court, thereby simplifying procedures and reducing the cycle time for certain collection due process cases. The fifth part permits taxpayers to enter into installment agreements that do not guarantee full payment of liability over the life of the agreement. It allows the IRS to enter into agreements with taxpayers who desire to resolve their tax obligations but cannot make payments large enough to satisfy their entire liability and for whom an offer in compromise is not a viable alternative. The sixth part eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Treasury Secretary establish standards to determine when an opinion is appropriate.

Initiate IRS cost saving measures.—The Administration has two proposals to improve IRS efficiency and performance from current resources. The first proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to retain a portion of the amount collected before transmitting the balance to the IRS, thereby reducing government transaction costs. The offset amount would be included as part of the 15-percent limit on levies against income and would also be credited against the taxpayer's liability. The second proposal extends the April filing date for electronically filed tax returns to April 30th, provided that any tax due also is paid electronically. This proposal would encourage more taxpayers to file electronically and allow the IRS to process more returns and payments efficiently.

Repeal section 132 of the Revenue Act of 1978 and amend the tax code to authorize the Secretary of the Treasury to issue rules to address inappropriate nonqualified deferred compensation arrangements.—Section 132 currently prohibits the IRS from issuing new regulations on many aspects of nonqualified deferred compensation arrangements, restricting the ability of the IRS to respond effectively to these arrangements. Under the Administration's proposal, that prohibition would be removed and the Treasury Secretary would be given express authority to issue new rules. It is expected that new guidance would address when an individual's access to compensation is considered subject to substantial limitation, the extent to which company assets may be designated as available to meet deferred compensation obligations, and when an arrangement is treated as funded.

Increase continuous levy for certain Federal payments.—Under current law, the IRS is authorized to levy continuously up to 15 percent of specified Federal payments to collect outstanding tax obligations. Many Federal payments, such as salary, retirement, and benefit payments are regularly recurring payments that can be levied continuously until the outstanding tax obligation is satisfied. Other Federal payments, such as those to vendors for goods or services, are not regularly recurring and present fewer opportunities for collection. The Administration therefore proposes to allow the IRS to levy continuously up to 100 percent of Federal payments to vendors.

Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts.—The resource and collection priorities of the IRS do not permit it to pursue continually all outstanding tax liabilities. Many taxpayers are aware of their outstanding tax liabilities, but have failed to pay them. The use of private collection agencies, or PCAs, to support IRS collection efforts would enable the Government to reach these taxpayers to obtain payment while allowing the IRS to focus its own enforcement resources on more complex cases and issues. PCAs would not have any enforcement power, and they would be strictly prohibited from threatening enforcement action or violating any taxpayer confidentiality protection or other taxpayer rights. The IRS would be required to monitor closely PCA activities and performance, including the protection of taxpayer rights. PCAs would be compensated out of the revenue collected through their activities, although compensation would be based on quality of service, taxpayer satisfaction, and case resolution, in addition to collection results.

Strengthen Financial Integrity of Unemployment Insurance

Strengthen the financial integrity of the unemployment insurance system by reducing tax avoidance and improper benefit payments.—Under current law, State unemployment insurance (UI) taxes are deposited into the Federal Unemployment Trust Fund and used by States to pay unemployment benefits. In order to receive full credit against Federal unemployment taxes, Federal law requires that employers' State tax rates be based in part on the unemployment experience of each employer. In general, the more unemployment benefits paid to former employees, the higher the tax rate of the employer. This feature of State tax law is commonly known as "experience rating." The Administration has a three-pronged proposal to strengthen the financial integrity of the UI system, including: Curtailing tax avoidance by certain unscrupulous employers who successfully manipulate their "experience rating;" reducing UI benefit overpayments; and improving collection of past overpayments. The proposal would require States to amend their UI tax laws to deter schemes to manipulate experience rates through such means as transfers of businesses to shell companies. In addition, the proposal would help reduce UI benefit overpayments by providing State UI agencies with access to information from the National Directory of New Hires for the quick detection of individuals who illegally collect unemployment benefits after returning to work. Finally, the proposal would help States collect more delinquent UI benefit overpayments through offsets of individuals' Federal income tax refunds. Many States already do this through their own State income tax system. These efforts to strengthen the financial integrity of the UI system will also help keep State UI taxes down and improve the solvency of State trust funds.

Other Proposals

Increase Indian gaming activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, the Commission has been prohibited from collecting more than $8 million in annual fees from gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

REAUTHORIZE FUNDING FOR THE HIGHWAY TRUST FUND

Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund.—Under current law, an 18.4-cents-per-gallon excise tax is imposed on gasoline. In general, 18.3 cents per gallon of the gasoline excise tax is deposited in the Highway Trust Fund and 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank (LUST) Trust Fund. In the case of gasohol, which is taxed at a reduced rate, 2.5 cents per gallon is retained in the General Fund of the Treasury, 0.1 cent per gallon is deposited in the LUST Trust Fund, and the balance of the reduced rate is deposited in the Highway Trust Fund. The Administration believes that it is appropriate that the entire amount of the excise tax on gasohol (except for the 0.1 cent per gallon deposited in the LUST Trust Fund) be deposited in the Highway Trust Fund. Effective for collections after September 30, 2003, the Administration proposes to transfer the 2.5 cents per gallon of the gasohol excise tax that is currently retained in the General Fund of the Treasury to the Highway Trust Fund.

Impose additional registration requirements on the transfer of tax-exempt fuel by pipeline, vessel, or barge.—Fuel tax evasion results in a substantial amount of lost revenue to the Highway Trust Fund. To prevent or reduce evasion of highway fuel taxes and to improve their collection, the Administration proposes the following changes, effective November 1, 2004: (1) To qualify for the fuel tax exemption provided to bulk transfers of taxable fuel to registered terminals or refineries, the fuel would have to be transferred by registered pipeline, vessel, or barge; (2) proof of registration would be required to be displayed on any vessel or barge used to transport taxable fuel; and (3) new penalties would be imposed for failure to comply with registration and display of proof of registration requirements. The penalty for failure to register would be $1,000 per day; the penalty for failure to display proof of registration would be $500 per day.

Repeal installment method for payment of heavy highway vehicle use tax.—The Administration proposes to repeal the current law provision that allows owners of heavy highway vehicles to pay the highway use tax in quarterly installments. Effective July 1, 2004, owners would be required to pay the annual tax in full with their returns. Installment payments have provided an opportunity for tax evasion by allowing owners to register vehicles for the entire tax year after payment of only the first installment of the annual tax.

Allow tax-exempt financing for private highway projects and rail-truck transfer facilities.—Interest on bonds issued by state and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of certain tax-exempt private activity bonds that state and local governments may issue in each calendar year is limited by state-wide volume limits. The Administration proposes to provide authority to issue an aggregate of $15 billion of tax-exempt private activity bonds beginning in 2004 for the development of highway facilities and surface freight transfer facilities. Highway facilities eligible for financing would consist of any surface transportation project eligible for Federal assistance under Title 13 of the United States Code, or any project for an international bridge or tunnel for which an international entity authorized under Federal or State law is responsible. Surface freight transfer facilities would consist of facilities for the transfer of freight from truck to rail or rail to truck, including any temporary storage facilities directly related to those transfers. The Secretary of Transportation would allocate the $15 billion, which would not be subject to the aggregate annual state private activity bond volume limit, among competing projects.

EXTEND EXPIRING PROVISIONS

Extend minimum tax relief for individuals.—A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax for taxable years beginning before January 1, 2004. The Administration is concerned that the AMT may limit the benefit of personal tax credits and impose financial and compliance burdens on taxpayers who have few, if any, tax preference items and who were not the originally intended subjects of the AMT. The Administration proposes to extend minimum tax relief for nonrefundable personal credits for two years, to apply to taxable years 2004 and 2005. The proposed extension does not apply to the child credit, the new saver credit, the earned income credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the 2001 tax cut. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

A temporary provision of current law increased the AMT exemption amounts to $40,250 for single taxpayers, $58,000 for married taxpayers filing a joint return and surviving spouses, and $29,000 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2004, the AMT exemption amounts will decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts. The Administration proposes to extend the temporary, higher exemption amounts through taxable year 2005.

The design of the AMT causes it increasingly to extend to middle-income taxpayers. The AMT's original focus, however, was on high-income taxpayers who have arranged their affairs to eliminate most or all Federal income taxes. Although temporary changes have and will continue to address this issue for the near term, long-term change is needed. The Treasury Department has been directed to study the AMT with the goal of producing a long-term solution.

Extend permanently the research and experimentation (R&E) tax credit.—The Administration proposes to extend permanently the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which are scheduled to expire on June 30, 2004.

In addition, the Administration is concerned that features of the R&E credit may limit its effectiveness in encouraging taxpayers to invest in R&E. Consequently, the Treasury Department has been directed to study how the credit can be restructured to make it more effective. The Administration will work closely with the Congress to develop and enact reforms to rationalize the R&E credit and to improve its incentive effect.

Repeal the disallowance of certain deductions of mutual life insurance companies.—Life insurance companies may generally deduct policyholder dividends, while dividends to stockholders are not deductible. Section 809 of the Internal Revenue Code attempts to identify amounts returned by mutual life insurance companies to holders of participating policies in their role as owners of the company, and generally disallows a deduction for mutual company policyholder dividends (or otherwise increases taxable income by reducing the amount of end-of-year reserves) in an amount equal to the amount identified under section 809. Section 809 has been criticized as being theoretically unsound, overly complex, inaccurate in its measurement of income, unfair, and increasingly irrelevant. The 2002 economic stimulus bill suspended the operation of section 809 for three years, 2001 through 2003. The Administration proposes to repeal section 809.

Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.—Under present law, the work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit is available for a qualified individual who begins work before January 1, 2004.

Under present law, the welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 percent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This credit is available for qualified individuals who begin work before January 1, 2004.

The Administration proposes to simplify employment incentives by combining the credits into one credit and making the rules for computing the combined credit simpler. The credits would be combined by creating a new welfare-to-work targeted group under the work opportunity tax credit. The minimum employment periods and credit rates for the first year of employment under the present work opportunity tax credit would apply to welfare-to-work employees. The maximum amount of eligible wages would continue to be $10,000 for welfare-to-work employees and $6,000 for other targeted groups. In addition, the second year 50-percent credit currently available under the welfare-to-work credit would continue to be available for welfare-to-work employees under the modified work opportunity tax credit. Qualified wages would be limited to cash wages. The work opportunity tax credit would also be simplified by eliminating the need to determine family income for qualifying ex-felons (one of the present targeted groups). The modified work opportunity tax credit would apply retroactively (provided specified filing deadlines are met) to individuals who begin work after December 31, 2003 and before January 1, 2006.

Extend the District of Columbia (DC) Enterprise Zone.—The DC Enterprise Zone includes the DC Enterprise Community and District of Columbia census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) A wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who reside within the District of Columbia; (2) $35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Zone, or within any District of Columbia census tract with a poverty rate of at least 10 percent. The DC Zone incentives apply for the period from January 1, 1998 through December 31, 2003. The Administration proposes to extend the DC Zone incentives for two years, making the incentives applicable through December 31, 2005.

Extend the first-time homebuyer credit for the District of Columbia.—A one-time, nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2003. The Administration proposes to extend the credit for two years, making the credit available with respect to purchases after December 31, 2003 and before January 1, 2006.

Extend authority to issue Qualified Zone Academy Bonds.—Current law 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 have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2003. In addition, unused authority arising in 1998 and 1999 can be carried forward for up to three years and unused authority arising in 2000 through 2003 can be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2004 and 2005; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided augmented deductions, not subject to this limitation, for certain contributions. Under current law, an augmented deduction is provided for contributions of computer technology and equipment to public libraries and to U.S. schools for educational purposes in grades K-12. The Administration proposes to extend the deduction, which expires with respect to donations made after December 31, 2003, to apply to donations made before January 1, 2006.

Allow net operating losses to offset 100 percent of alternative minimum taxable income.—Under current law (and under law in effect prior to 2001) net operating loss (NOL) deductions cannot reduce a taxpayer's alternative minimum taxable income (AMTI) by more than 90 percent. Under the 2002 economic stimulus bill, this limitation was temporarily waived. The Administration's proposal would extend this waiver through 2005. NOL carrybacks arising in taxable years ending in 2003, 2004, and 2005, or carryforwards to these years, would offset up to 100 percent of a taxpayer's AMTI.

Extent permanently IRS user fees.—The Administration proposes to extend permanently IRS authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. Under current law, these fees are scheduled to expire effective with requests made after December 31, 2004.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—Current law permits disclosure of tax return information relating to terrorism in two situations. The first is when an executive of a Federal law enforcement or intelligence agency has reason to believe that the return information is relevant to a terrorist incident, threat or activity and submits a written request. The second is when the IRS wishes to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The Administration proposes to extend this disclosure authority, which expired on December 31, 2003, through December 31, 2004.

Extend abandoned mine reclamation fees.—Collections from abandoned mine reclamation fees are allocated to States and Tribes for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on September 30, 2004. Abandoned land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees at a reduced rate. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

Extend authority to issue Liberty Zone Bonds.—The 2002 economic stimulus bill provided authority to issue an aggregate of $8 billion of tax-exempt private activity bonds during calendar years 2002, 2003, and 2004 for the acquisition, construction, reconstruction, and renovation of nonresidential real property, residential rental property, and public utility property in the New York City Liberty Zone. Authority to issue these bonds, which are not subject to the aggregate annual State private activity bond volume limit, is proposed to be extended through calendar year 2009.

Extend excise tax on coal at current rates.—Excise taxes levied on coal mined and sold for use in the United States are deposited in the Black Lung Disability Trust Fund. Amounts deposited in the Fund are used to cover the cost of program administration and compensation, medical, and survivor benefits to eligible miners and their survivors, when mine employment terminated prior to 1970 or when no mine operator can be assigned liability. Current tax rates on coal sold by a producer are $1.10 per ton of coal from underground mines and $.55 per ton of coal from surface mines; however, these rates may not exceed 4.4 percent of the price at which the coal is sold. Effective for coal sold after December 31, 2013, the tax rates on coal from underground mines and surface mines will decline to $.50 per ton and $.25 per ton, respectively, and will be capped at 2 percent of the price at which the coal is sold. The Administration proposes to repeal the reduction in these tax rates effective for sales after December 31, 2013, and keep current rates in effect until the Black Lung Disability Trust Fund debt is repaid.

PROMOTE TRADE

Implement free trade agreements with Morocco, Australia, and Central American countries.—Free trade agreements are expected to be completed with Morocco, Australia, and Central American countries in 2004, with ten-year implementation to begin in fiscal year 2005. These agreements will benefit U.S. producers and consumers, as well as strengthen the economies of Morocco, Australia, and Central America.

RESPOND TO FOREIGN SALES CORPORATION/EXTRATERRITORIAL INCOME DECISIONS

World Trade Organization (WTO) panels have ruled that the extraterritorial income (ETI) exclusion provisions and the foreign sales corporation (FSC) provisions of the Internal Revenue Code constitute prohibited export subsidies under the WTO rules. To comply with the WTO ruling and honor the United States' WTO obligations, the current-law ETI provisions must be repealed. At the same time, meaningful changes to our tax law are required to preserve the competitiveness of U.S. businesses operating in the global marketplace. Thus, the Administration believes the necessary repeal of the ETI provisions must be coupled with other tax law changes that promote the competitiveness of American manufacturers and other job-creating sectors of the U.S. economy. Tax law changes that would provide a benefit to these contributors to the U.S. economy include corporate tax rate reduction, alternative minimum tax reform, extension of net operating loss carryback rules, expansion and permanence of the research credit, improvements in depreciation rules, business tax simplification, and rationalization of the international tax rules. The Administration intends to work closely with the Congress on prompt enactment of legislation that brings our tax law into compliance with WTO rules and makes changes to the tax law to enhance the competitiveness of American businesses and the workers they employ. The Administration believes this legislation should achieve these objectives on as close to a budget neutral basis as possible.

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Make Permanent The Tax Cuts Enacted in 2001 and 2003 (assumed in the baseline):								
Extend through 2010 certain provisions of the 2003 jobs and growth tax cut:								
Child tax credit [1]	....	–2,166	–8,930	–9,023	–9,067	–8,325	–37,511	–42,079
Marriage penalty relief	....	–5,318	–6,634	–3,883	–1,850	–423	–18,108	–18,108
10–percent individual income tax rate bracket	....	–4,005	–5,981	–6,435	–4,036	–2,956	–23,413	–27,343
Total extend through 2010 certain provisions of the 2003 jobs and growth tax cut	....	–11,489	–21,545	–19,341	–14,953	–11,704	–79,032	–87,530
Extend permanently certain provisions of the 2001 tax cut and the 2003 jobs and growth tax cut:								
Dividends tax rate structure	....	498	486	485	642	–17,272	–15,161	–81,280
Capital gains tax rate structure	....	....	....	....	–5,268	–7,366	–12,634	–49,970
Expensing for small business	....	226	–3,336	–5,711	–4,102	–3,205	–16,128	–24,798
Marginal individual income tax rate reductions	....	....	....	....	....	....	....	–395,269
Child tax credit [2]	....	....	....	....	....	....	....	–72,786
Marriage penalty relief [3]	....	....	....	....	....	....	....	–32,426
Education incentives	....	–11	–16	–22	–24	–37	–110	–6,758
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	....	–1,000	–1,609	–1,732	–1,977	–2,244	–8,562	–180,111
Modifications of pension plans	....	....	....	....	....	....	....	–1,804
Other incentives for families and children	....	....	....	....	....	....	....	–3,531
Total extend permanently certain provisions of the 2001 tax cut and the 2003 jobs and growth tax cut	....	–287	–4,475	–6,980	–10,729	–30,124	–52,595	–848,733
Total make permanent the tax cuts enacted in 2001 and 2003	....	–11,776	–26,020	–26,321	–25,682	–41,828	–131,627	–936,263
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	....	3,949	8,192	5,488	2,798	685	21,112	5,558
Consolidate employer-based savings accounts	....	–214	–318	–337	–358	–380	–1,607	–11,763
Establish Individual Development Accounts (IDAs)	....	–134	–286	–326	–300	–255	–1,301	–1,380

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Total simplify and encourage saving	....	3,601	7,588	4,825	2,140	50	18,204	–7,585
Invest in health care:								
Provide refundable tax credit for the purchase of health insurance [4]	....	–24	–1,417	–1,059	–854	–632	–3,986	–4,700
Provide an above-the-line deduction for high-deductible insurance premiums	....	–173	–1,764	–2,014	–2,292	–2,501	–8,744	–24,775
Provide an above-the-line deduction for long-term care insurance premiums	....	–68	–489	–805	–1,572	–2,435	–5,369	–21,428
Provide an additional personal exemption to home caregivers of family members	....	–71	–460	–398	–398	–415	–1,742	–3,759
Allow the orphan drug tax credit for certain pre-designation expenses	....	....	....	....	....	....	–1	–2
Clarify the Health Coverage Tax Credit [5]	....	....	....	....	....	....	....	....
Total invest in health care	....	–336	–4,130	–4,276	–5,116	–5,983	–19,841	–54,662
Provide incentives for charitable giving:								
Provide charitable contribution deduction for nonitemizers	....	–1,248	–1,103	–1,111	–1,144	–1,173	–5,779	–12,036
Permit tax-free withdrawals from IRAs for charitable contributions	–68	–450	–341	–327	–330	–329	–1,777	–3,498
Expand and increase the enhanced charitable deduction for contributions of food inventory	....	–42	–87	–96	–106	–116	–447	–1,224
Reform excise tax based on investment income of private foundations	....	–133	–83	–84	–86	–90	–476	–1,009
Modify tax on unrelated business taxable income of charitable remainder trusts	....	–8	–5	–6	–6	–6	–31	–68
Modify basis adjustment to stock of S corporations contributing appreciated property	....	–21	–13	–15	–18	–21	–88	–239
Repeal the $150 million limitation on qualified 501(c)(3) bonds	....	–8	–10	–11	–10	–10	–49	–94
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	....	–5	–6	–12	–18	–25	–66	–299
Total provide incentives for charitable giving	–68	–1,915	–1,648	–1,662	–1,718	–1,770	–8,713	–18,467
Strengthen education:								
Extend, increase, and expand the above-the-line deduction for qualified out-of-pocket classroom expenses	–23	–229	–240	–249	–260	–263	–1,241	–2,611
Encourage telecommuting:								
Exclude from income the value of employer-provided computers, software, and peripherals	....	–27	–45	–43	–48	–55	–218	–668
Increase housing opportunities:								
Provide tax credit for developers of affordable single-family housing	....	–7	–81	–327	–776	–1,352	–2,543	–16,409
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	–178	–243	–212	–201	–191	–181	–1,028	–1,858
Exclude 50 percent of gains from the sale of property for conservation purposes	....	–45	–88	–101	–58	....	–292	–292
Total protect the environment	–178	–288	–300	–302	–249	–181	–1,320	–2,150
Increase energy production and promote energy conservation:								
Extend and modify the tax credit for producing electricity from certain sources	....	–401	–337	–305	–278	–139	–1,460	–2,175
Provide tax credit for residential solar energy systems	....	–12	–11	–17	–23	–10	–73	–73
Modify treatment of nuclear decommissioning funds	....	–193	–147	–154	–162	–169	–825	–1,767
Provide tax credit for purchase of certain hybrid and fuel cell vehicles	....	–79	–223	–376	–556	–542	–1,776	–2,211
Provide tax credit for energy produced from landfill gas	....	–34	–67	–91	–104	–117	–413	–737
Provide tax credit for combined heat and power property	....	–154	–107	–64	–62	–13	–400	–349
Extend excise tax exemption (credit) for ethanol [5]	....	....	....	....	....	....	....	....
Permit electric utilities to defer gain from sales of electric transmission property	–11	–475	–615	–532	–227	100	–1,749	361
Modify tax treatment of certain income of electric cooperatives	....	–14	–20	–21	–22	–23	–100	–235
Total increase energy production and promote energy conservation	–11	–1,362	–1,527	–1,560	–1,434	–913	–6,796	–7,186
Total tax incentives	–280	–563	–383	–3,594	–7,461	–10,467	–22,468	–109,738

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Simplify the Tax Laws for Families:								
Establish uniform definition of a qualifying child [6]	....	–38	–34	–29	–20	–9	–130	–142
Simplify adoption tax benefits	....	–4	–39	–40	–42	–43	–168	–411
Eliminate household maintenance test for head-of-household filing status	....	–123	–297	–284	–285	–281	–1,270	–2,555
Reduce computational complexity of refundable child tax credit [7]	....	....	....	....	....	....	....	21
Simplify EITC eligibility requirements regarding filing status, presence of children, investment income, and work and immigration status [8]	....	64	–36	–35	–32	–33	–72	–272
Simplify the taxation of dependents	....	–11	–25	–20	–25	–43	–124	–498
Consolidate rules for lifetime learning credit, Hope credit, and education expense deductions, and simplify other higher education provisions	....	–19	–94	–311	–294	–282	–1,000	–2,558
Allow annual reporting and payment of combined State and Federal unemployment insurance taxes by employers of household employees	....	–20	–1	–1	–1	–1	–24	–30
Simplify taxation of capital gains on collectibles, small business stock, and other assets	....	–4	5	11	–1	–17	–6	–35
Total simplify the tax laws for families	....	–155	–521	–709	–700	–709	–2,794	–6,480
Strengthen the Employer-Based Pension System:								
Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans	....	....	....	....	....	....	....	2,373
Improve the accuracy of pension liability measures	8,537	12,297	7,340	3,042	–1,586	–5,467	15,626	–15,869
Total strengthen the employer-based pension system	8,537	12,297	7,340	3,042	–1,586	–5,467	15,626	–13,496
Close Loopholes and Improve Tax Compliance:								
Combat abusive tax avoidance transactions	....	46	63	85	113	128	435	1,071
Limit related party interest deductions	....	–51	93	146	203	265	656	3,116
Modify qualification rules for tax-exempt property-casualty insurance companies	....	67	114	116	119	121	537	1,184
Prevent abusive overvaluations on donations of patents and other intellectual property	....	432	270	273	277	287	1,539	3,207
Prevent overvaluations and other abuses in charitable donations of used vehicles	....	158	102	105	108	112	585	1,197
Reform the treatment for leasing transactions with tax-indifferent parties	340	1,591	2,712	3,285	3,565	3,766	14,919	33,385
Ensure foreign subsidiaries of U.S. companies cannot inappropriately avoid U.S. tax on foreign earnings invested in U.S. property through use of the exception for bank deposits	....	24	21	22	22	23	112	234
Modify tax rules for individuals who give up U.S. citizenship or green card status	1	23	20	22	24	25	114	272
Require increased reporting for noncash charitable contributions	....	49	31	32	33	34	179	367
Clarify and simplify qualified tuition programs	....	7	12	13	13	17	62	194
Total close loopholes and improve tax compliance	341	2,346	3,438	4,099	4,477	4,778	19,138	44,227
Tax Administration, Unemployment Insurance, and Other:								
Improve tax administration:								
Implement IRS administrative reforms	....	52	47	46	47	49	241	505
Increase continuous levy for certain Federal payments	....	10	18	19	20	20	87	202
Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts	....	....	47	151	190	153	541	1,531
Total improve tax administration	....	62	112	216	257	222	869	2,238
Strengthen financial integrity of unemployment insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing tax avoidance and improper benefit payments [9]	....	....	–2	108	142	120	368	–216
Other proposals:								
Increase Indian gaming activity fees	....	....	4	4	5	5	18	43
Total tax administration, unemployment insurance, and other	....	62	114	328	404	347	1,255	2,065

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Reauthorize Funding for the Highway Trust Fund:								
Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund [9]	....	....	648	666	681	699	2,694	6,443
Impose additional registration requirements on the transfer of tax-exempt fuel by pipeline, vessel, or barge [9]	....	76	93	96	91	87	443	747
Repeal installment method for payment of heavy highway vehicle use tax [9]	407	30	31	32	31	32	156	341
Allow tax-exempt financing for private highway projects and rail-truck transfer facilities	....	–20	–49	–77	–94	–97	–337	–619
Total reauthorize funding for the Highway Trust Fund	407	86	723	717	709	721	2,956	6,912
Expiring Provisions:								
Minimum tax relief for individuals	–86	–9,383	–13,881	....	....	....	–23,264	–23,264
Research & Experimentation (R&E) tax credit	–672	–3,610	–5,187	–6,291	–7,129	–7,775	–29,992	–78,351
Repeal the disallowance of certain deductions of mutual life insurance companies	....	–85	–51	–48	–45	–43	–272	–471
Combined work opportunity/welfare-to-work tax credit	–12	–187	–268	–162	–86	–46	–749	–768
DC tax incentives	–47	–97	–54	–7	–9	–24	–191	–363
Authority to issue Qualified Zone Academy Bonds	–2	–9	–15	–22	–28	–30	–104	–254
Deduction for corporate donations of computer technology	....	–180	–46	....	....	....	–226	–226
Net operating loss offset of 100 percent of alternative minimum taxable income	–1,326	–755	–101	203	154	129	–370	82
IRS user fees	....	32	44	45	46	47	214	464
Disclosure of tax return information related to terrorist activity [5]	....	....	....	....	....	....	....	....
Abandoned mine reclamation fees	....	239	245	252	256	262	1,254	2,550
Authority to issue Liberty Zone Bonds	....	–8	–27	–45	–62	–79	–221	–616
Excise tax on coal [9]	....	....	....	....	....	....	....	180
Total extend other expiring provisions	–2,145	–14,043	–19,341	–6,075	–6,903	–7,559	–53,921	–101,037
Promote Trade:								
Implement free trade agreements with Morocco, Australia, and Central American countries [9]	....	–389	–583	–675	–749	–831	–3,227	–8,305
Total budget proposals [10]	6,860	–12,135	–35,233	–29,188	–37,491	–61,015	–175,062	–1,122,115

* $500,000 or less.

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $4,265 million for 2006, $4,131 million for 2007, $4,003 million for 2008, $3,936 million for 2009, $16,335 million for 2005–2009 and $18,906 million for 2005–2014.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $28,903 million for 2005–2014.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $5,676 million for 2005–2014.

[4] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $82 million for 2005, $3,760 million for 2006, $5,041 million for 2007, $6,388 million for 2008, $7,133 million for 2009, $22,404 million for 2005–2009 and $65,355 million for 2005–2014.

[5] Policy proposal with a receipt effect of zero.

[6] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $36 million for 2006, $36 million for 2007, $36 million for 2008, $37 million for 2009, $145 million for 2005–2009 and $333 million for 2005–2014.

[7] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$181 million for 2006, –$183 million for 2007, –$185 million for 2008, –$187 million for 2009, –$736 million for 2005–2009 and –$1,701 million for 2005–2014.

[8] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$440 million for 2005, $131 million for 2006, $130 million for 2007, $119 million for 2008, $134 million for 2009, $74 million for 2005–2009 and $643 million for 2005–2014.

[9] Net of income offsets.

[10] Includes proposals assumed in the baseline.

Table 16–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2003 Actual	Estimate 2004	2005	2006	2007	2008	2009
Individual income taxes (federal funds):							
Existing law	793,699	765,770	892,318	992,132	1,073,730	1,161,925	1,259,118
Proposed Legislation	....	–371	–18,481	–35,680	–24,444	–28,575	–49,244
Total individual income taxes	**793,699**	**765,399**	**873,837**	**956,452**	**1,049,286**	**1,133,350**	**1,209,874**
Corporation income taxes:							
Federal funds:							
Existing law	131,877	162,051	221,930	248,159	254,285	259,375	265,722
Proposed Legislation	....	6,690	8,266	1,854	–3,243	–7,262	–10,041
Total Federal funds corporation income taxes	131,877	168,741	230,196	250,013	251,042	252,113	255,681
Trust funds:							
Hazardous substance superfund	–99	....	....	....	....	....	....
Total corporation income taxes	**131,778**	**168,741**	**230,196**	**250,013**	**251,042**	**252,113**	**255,681**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	447,806	456,513	491,627	515,586	543,900	570,695	597,465
Disability insurance (Off-budget)	76,036	77,491	83,474	87,551	92,361	96,910	101,457
Hospital insurance	147,186	150,540	165,173	173,748	183,790	193,294	202,831
Railroad retirement:							
Social Security equivalent account	1,620	1,658	1,680	1,705	1,738	1,771	1,794
Rail pension and supplemental annuity	2,333	2,227	2,116	2,127	2,165	2,202	2,240
Total employment and general retirement	674,981	688,429	744,070	780,717	823,954	864,872	905,787
On-budget	151,139	154,425	168,969	177,580	187,693	197,267	206,865
Off-budget	523,842	534,004	575,101	603,137	636,261	667,605	698,922
Unemployment insurance:							
Deposits by States [1]	26,702	32,418	38,146	40,970	41,912	42,557	43,197
Proposed Legislation	....	....	–21	–33	103	143	114
Federal unemployment receipts [1]	6,520	6,679	6,988	7,581	7,972	6,523	6,473
Proposed Legislation	....	....	1	30	31	33	34
Railroad unemployment receipts [1]	144	130	103	109	125	126	111
Total unemployment insurance	33,366	39,227	45,217	48,657	50,143	49,382	49,929
Other retirement:							
Federal employees' retirement—employee share	4,578	4,690	4,619	4,591	4,553	4,509	4,406
Non-Federal employees retirement [2]	53	46	42	39	36	33	30
Total other retirement	4,631	4,736	4,661	4,630	4,589	4,542	4,436
Total social insurance and retirement receipts	**712,978**	**732,392**	**793,948**	**834,004**	**878,686**	**918,796**	**960,152**
On-budget	189,136	198,388	218,847	230,867	242,425	251,191	261,230
Off-budget	523,842	534,004	575,101	603,137	636,261	667,605	698,922
Excise taxes:							
Federal funds:							
Alcohol taxes	7,893	8,051	8,170	8,270	8,358	8,471	8,597
Proposed Legislation	....	–58	–79	–21	....	....	....
Tobacco taxes	7,934	7,990	7,907	7,850	7,793	7,719	7,635
Transportation fuels tax	920	1,004	1,058	310	318	325	331
Proposed Legislation	....	–701	–750	....	....	....	....
Telephone and teletype services	5,788	6,319	6,798	7,183	7,596	8,040	8,509
Other Federal fund excise taxes	1,269	1,484	1,528	1,563	1,599	1,635	1,689
Proposed Legislation	....	58	–54	–62	–84	–86	–90
Total Federal fund excise taxes	23,804	24,147	24,578	25,093	25,580	26,104	26,671
Trust funds:							
Highway	33,726	34,270	35,680	36,920	37,869	38,763	39,669

Table 16–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2003 Actual	Estimate 2004	2005	2006	2007	2008	2009
Proposed Legislation	....	1,242	887	1,015	1,031	1,039	1,040
Airport and airway	8,684	9,751	10,677	11,332	11,944	12,595	13,304
Aquatic resources	392	415	428	440	454	469	482
Black lung disability insurance	506	542	540	552	572	594	611
Inland waterway	90	94	95	96	96	97	98
Vaccine injury compensation	138	127	128	130	130	132	133
Leaking underground storage tank	184	188	197	202	208	211	217
Proposed Legislation	....	....	....	1	1	....	....
Total trust funds excise taxes	43,720	46,629	48,632	50,688	52,305	53,900	55,554
Total excise taxes	**67,524**	**70,776**	**73,210**	**75,781**	**77,885**	**80,004**	**82,225**
Estate and gift taxes:							
Federal funds	21,959	23,909	23,097	25,710	23,474	24,261	25,640
Proposed Legislation	....	....	–1,655	–1,853	–1,984	–2,090	–2,034
Total estate and gift taxes	**21,959**	**23,909**	**21,442**	**23,857**	**21,490**	**22,171**	**23,606**
Customs duties:							
Federal funds	19,039	20,831	21,320	23,774	25,614	27,150	29,596
Proposed Legislation	....	885	–179	–426	–538	–627	–724
Trust funds	823	879	954	1,035	1,107	1,123	1,148
Total customs duties	**19,862**	**22,595**	**22,095**	**24,383**	**26,183**	**27,646**	**30,020**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	93	98	101	100	101	103	105
Proposed Legislation	....	....	....	4	4	5	5
United Mine Workers of America combined benefit fund	190	153	143	136	128	124	123
Deposit of earnings, Federal Reserve System	21,878	22,880	25,262	29,779	34,646	39,672	43,080
Defense cooperation	9	7	7	7	8	8	8
Confiscated Assets	1,917	....	....	....	....	....	....
Fees for permits and regulatory and judicial services	7,707	8,724	8,374	8,449	8,639	8,612	8,796
Proposed Legislation	....	....	271	289	297	302	309
Fines, penalties, and forfeitures	2,850	3,398	2,850	2,875	2,898	2,920	2,942
Proposed Legislation	....	–885	–341	–351	–362	–373	–384
Gifts and contributions	211	204	184	196	180	186	187
Refunds and recoveries	–313	–298	–306	–308	–316	–324	–332
Total miscellaneous receipts	**34,542**	**34,281**	**36,545**	**41,176**	**46,223**	**51,235**	**54,839**
Adjustment for revenue uncertainty [4]	....	**–20,000**	**–15,000**	....	....	....	....
Total budget receipts	**1,782,342**	**1,798,093**	**2,036,273**	**2,205,666**	**2,350,795**	**2,485,315**	**2,616,397**
On-budget	1,258,500	1,264,089	1,461,172	1,602,529	1,714,534	1,817,710	1,917,475
Off-budget	523,842	534,004	575,101	603,137	636,261	667,605	698,922
MEMORANDUM							
Federal funds	1,025,170	1,018,566	1,195,990	1,319,965	1,420,122	1,513,425	1,601,537
Trust funds	467,557	501,441	550,348	615,937	650,879	681,480	714,622
Interfund transactions	–234,227	–255,918	–285,166	–333,373	–356,467	–377,195	–398,684
Total on-budget	**1,258,500**	**1,264,089**	**1,461,172**	**1,602,529**	**1,714,534**	**1,817,710**	**1,917,475**
Off-budget (trust funds)	**523,842**	**534,004**	**575,101**	**603,137**	**636,261**	**667,605**	**698,922**
Total	**1,782,342**	**1,798,093**	**2,036,273**	**2,205,666**	**2,350,795**	**2,485,315**	**2,616,397**

[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 adminstrative 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.

[4] These amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.